2009 Kindred Healthcare, Inc 10K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)
☑ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009
OR

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

Commission File Number: 001-14057

KINDRED HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**61-1323993** **(I.R.S. Employer Identification Number)**
680 South Fourth Street **Louisville, Kentucky** **(Address of principal executive offices)**	**40202-2412** **(Zip Code)**

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value $0.25 per share	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment of this Annual Report on Form 10-K. ☐

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

Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer ☐ Smaller reporting company ☐

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

The aggregate market value of the shares of the registrant held by non-affiliates of the registrant, based on the closing price of such stock on the New York Stock Exchange on June 30, 2009, was approximately $471,000,000. For purposes of the foregoing calculation only, all directors and executive officers of the registrant have been deemed affiliates.

As of January 31, 2010, there were 39,111,208 shares of the registrant's common stock, $0.25 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 18, 2010 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

Item 1. *Business*

GENERAL

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing and rehabilitation centers and a contract rehabilitation services business across the United States. At December 31, 2009, our hospital division operated 83 long-term acute care ("LTAC") hospitals (6,580 licensed beds) in 24 states. Our health services division operated 222 nursing and rehabilitation centers (27,523 licensed beds) in 27 states. We also operated a contract rehabilitation services business that provides rehabilitative services primarily in long-term care settings. All references in this Annual Report on Form 10-K to "Kindred," "Company," "we," "us," or "our" mean Kindred Healthcare, Inc. and, unless the context otherwise requires, our consolidated subsidiaries.

All financial and statistical information presented in this Annual Report on Form 10-K reflects the continuing operations of our businesses for all periods presented unless otherwise indicated.

Spin-Off Transaction. On July 31, 2007, we completed the spin-off of our former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. Immediately after the Spin-off Transaction, our stockholders and the stockholders of AmerisourceBergen each held approximately 50% of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from our balance sheet effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in our operating results. In accordance with the authoritative guidance for accounting for the impairment or disposal of long-lived assets, the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in our historical continuing operations.

In addition to the pharmacy services contracts noted above, we also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters.

Commonwealth Transaction. In February 2006, we acquired the operations of the LTAC hospitals, nursing centers and assisted living facilities operated by Commonwealth Communities Holdings LLC and certain of its affiliates for a total purchase price of $124 million in cash (the "Commonwealth Transaction").

The Commonwealth Transaction included five freestanding LTAC hospitals and one hospital-in-hospital with a total of 421 licensed hospital beds. Three of these hospitals also operate co-located sub-acute units and skilled nursing units with a total of 168 licensed beds. In addition, we acquired the operations of nine nursing and rehabilitation centers containing 1,316 licensed beds and four assisted living facilities with a total of 215 licensed beds. In the transaction, we also acquired the right to develop 95 additional licensed hospital beds in Massachusetts. In September 2008, we closed one of the freestanding LTAC hospitals acquired in the Commonwealth Transaction and relinquished the related licensed beds to the Commonwealth of Massachusetts. See "– Discontinued Operations."

Spin-off from Ventas. On May 1, 1998, Ventas, Inc. ("Ventas") completed the spin-off of its healthcare operations to its stockholders through the distribution of our former common stock. Ventas retained ownership of substantially all of its real property and leases a portion of such real property to us. In anticipation of the spin-off from Ventas, we were incorporated on March 27, 1998 as a Delaware corporation. For accounting purposes, the consolidated historical financial statements of Ventas became our historical financial statements following the spin-off.

Risk Factors. This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). See "Item 1A – Risk Factors."

Discontinued Operations

In recent years, we have completed several transactions related to the divestiture of unprofitable hospitals and nursing centers.

In June 2009, we purchased for resale six under-performing nursing centers (the "Nursing Centers") previously leased from Ventas for $55.7 million (the "2009 Facility Acquisitions"). In addition, we paid Ventas a lease termination fee of $2.3 million. The Nursing Centers were included in our Master Lease Agreements (as defined) with Ventas and we do not have the ability to terminate a lease of an individual facility under the Master Lease Agreements. The aggregate annual rent for the Nursing Centers was approximately $6 million for the year ended December 31, 2008. The Nursing Centers, which contained 777 licensed beds, generated pretax losses of $0.5 million, $2.5 million and $5.5 million for 2009, 2008 and 2007, respectively. We recorded a pretax loss of $39.5 million ($24.3 million net of income taxes) during 2009 related to these divestitures. We disposed of five of the Nursing Centers in 2009 for $26.2 million and intend to dispose of the remaining Nursing Center as soon as practicable.

In September 2008, we purchased for resale a LTAC hospital for $22.3 million that was previously leased. We recorded a pretax loss of $36.9 million ($22.7 million net of income taxes) in 2008 resulting from the losses related to the purchase, closure and planned divestiture of the hospital, including the impairment of a certificate of need intangible asset ($15.2 million), the impairment of property and equipment ($17.3 million) and other costs ($4.4 million).

In September 2008, we also announced our intention to dispose of another LTAC hospital and its related operations. We recorded a pretax loss of $7.4 million ($4.6 million net of income taxes) during 2008 related to the impairment of the hospital's building and equipment.

These two hospitals generated pretax losses of $3.3 million in 2009 and $8.0 million in each of 2008 and 2007.

We also discontinued the operations of a hospital in 2008 after terminating the hospital operating lease and ceasing operations.

In June 2007, we purchased for resale 21 nursing centers and one LTAC hospital (collectively, the "Ventas Facilities") previously leased from Ventas for $171.5 million (the "2007 Facility Acquisitions"). In addition, we paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax income of approximately $3 million in 2008 and a pretax loss of approximately $4 million in 2007. During 2008 and 2007, we sold the Ventas Facilities for approximately $95 million. We recorded a pretax gain of $10.5 million ($6.5 million net of income taxes) during 2008 and a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to the sale of the Ventas Facilities.

In January 2007, we acquired from HCP, Inc., formerly known as Health Care Property Investors, Inc. ("HCP"), the real estate related to 11 unprofitable leased nursing centers operated by us for resale in exchange for the real estate related to three hospitals previously owned by us (the "HCP Transaction"). As part of the HCP Transaction, we continue to operate these hospitals under a long-term lease arrangement with HCP. In addition, we paid HCP a one-time cash payment of approximately $36 million. We also amended our existing master lease with HCP to (1) terminate the current annual rent of $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022. The 11 unprofitable nursing centers, which contained 1,754 licensed beds, were sold in 2007 and generated a pretax loss of approximately $4 million for 2007. In addition, we terminated a nursing center lease with another landlord during 2007. We recorded a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2009 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

HEALTHCARE OPERATIONS

We are organized into three operating divisions: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing and rehabilitation centers. The rehabilitation division primarily provides rehabilitation services primarily in long-term care settings. We believe that the independent focus of each division on the unique aspects of its business enhances its ability to attract patients, residents and non-affiliated customers, improve the quality of its operations and achieve operating efficiencies.

Congress and the White House Administration are currently considering healthcare reform bills, which would initiate significant reforms to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors. The House of Representatives has passed a healthcare reform bill entitled "The Affordable Healthcare for America Act" and the Senate has passed a healthcare reform bill entitled "The Patient Protection and Affordable Care Act." At this time, we cannot predict if or when one of these bills or similar legislation may be passed and submitted to the President.

The healthcare reforms contained in these bills would impact each of our businesses in some manner. Due to the unsettled nature of the current healthcare reform bills, the substantial regulatory changes that would need to be implemented by the Centers for Medicare and Medicaid Services ("CMS") and others, and the numerous processes required to implement these reforms, we cannot predict which healthcare reforms will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on our business.

Several of the proposed reforms are very significant and could ultimately change the nature of our services, the methods of payment for our services and the underlying regulatory environment. The proposed reforms could include modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care and the imposition of enrollment limitations on new providers. In addition, a primary goal of healthcare reform is to reduce costs which could include reductions in the reimbursement paid to us and other healthcare providers. Moreover, healthcare reform could negatively impact insurance companies, other third party payors, our customers, as well as other healthcare providers, which may in turn negatively impact our

business. As such, these healthcare reforms or other similar healthcare reforms, if adopted, could have a material adverse effect on our business, financial position, results of operations and liquidity.

HOSPITAL DIVISION

Our hospital division provides long-term acute care services to medically complex patients through the operation of a national network of 83 hospitals with 6,580 licensed beds located in 24 states as of December 31, 2009. We operate the largest network of LTAC hospitals in the United States based upon fiscal 2009 revenues of approximately $1.9 billion (before eliminations). As a result of our commitment to the LTAC hospital business, we have developed a comprehensive program of care for medically complex patients that allows us to deliver high quality care in a cost-effective manner.

A number of the hospital division's hospitals also provide skilled nursing, sub-acute and outpatient services. Outpatient services may include diagnostic services, rehabilitation therapy, CT scanning, one-day surgery and laboratory.

In our hospitals, we treat medically complex patients, including the critically ill, suffering from multiple organ system failures, most commonly of the cardiovascular, pulmonary, kidney, gastro-intestinal and cutaneous (skin) systems. In particular, we have a core competency in treating patients with cardio-pulmonary disorders, skin and wound conditions, and life-threatening infections. Prior to being admitted to our hospitals, many of our patients have undergone a major surgical procedure or developed a neurological disorder following head and spinal cord injury, cerebrovascular incident or metabolic instability. Our expertise lies in the ability to simultaneously deliver comprehensive and coordinated medical interventions directed at all affected organ systems, while maintaining a patient-centered, integrated care plan. Medically complex patients are characteristically dependent on technology for continued life support, including mechanical ventilation, total parenteral nutrition, respiratory or cardiac monitors and kidney dialysis machines. During 2009, the average length of stay for patients in our hospitals was approximately 31 days.

Our hospital division patients generally have conditions that require a high level of monitoring and specialized care, yet may not need the services of a traditional intensive care unit. These patients are not clinically appropriate for admission to other post-acute settings because their severe medical conditions are periodically or chronically unstable. By providing a range of services required for the care of medically complex patients, we believe that our LTAC hospitals provide our patients with high quality, cost-effective care.

Our LTAC hospitals employ a comprehensive program of care for their patients that draws upon the talents of interdisciplinary teams, including physician specialists. The teams evaluate patients upon admission to determine treatment programs. Our hospital division has developed specialized treatment programs focused on the needs of medically complex patients. In addition to traditional medical services, most of our patients receive individualized treatment plans in rehabilitation, skin integrity management and clinical pharmacology. Where appropriate, the treatment programs may involve the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

Hospital Division Strategy

Our goal is to be the leading operator of LTAC hospitals in terms of both quality of care and operating efficiency. Our strategies for achieving this goal include:

Maintaining High Quality of Care. The hospital division differentiates its hospitals through its ability to care for medically complex patients in a high quality, cost-effective setting. We are committed to maintaining and improving the quality of our patient care by dedicating appropriate resources at each facility and continuing

to refine our clinical initiatives and objectives. We continue to take steps to improve our quality indicators and maintain the quality of care at our hospitals, including:

- attracting and retaining high quality professional staff within each market. The hospital division believes that its future success will depend in part upon its continued ability to hire and retain qualified healthcare personnel and to promote leadership and development training,
- maintaining an integrated quality assurance and improvement program, administered by our chief medical officer and senior vice president of clinical operations, which encompasses utilization review, quality improvement, infection control and risk management,
- promoting best practices through our hospitals and standardizing products and services to promote better care,
- expanding our service excellence programs to further embed a culture of caring in each of our hospitals,
- maintaining clinical outcomes programs, which include concurrent reviews of all of our patient population against quality screenings, outcomes reporting and patient and family satisfaction surveys,
- maintaining a program whereby our hospitals are reviewed by internal quality auditors for compliance with standards of The Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals (the "Joint Commission"),
- engaging quality councils at the divisional, regional, district and hospital levels to analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division,
- incorporating the clinical advice of our chief medical officer, medical advisory board and other physicians into our operational procedures, and
- implementing an integrated risk management plan to improve quality and expand existing patient safety initiatives.

Improving Operating Efficiency. The hospital division is continually focused on improving operating efficiency and controlling costs while maintaining quality patient care. Our hospital division seeks to improve operating efficiencies and control costs by standardizing key operating procedures and optimizing the skill mix of its staff based upon the clinical needs of each hospital's patients. The initiatives we have undertaken to control our costs and improve efficiency include:

- managing labor costs by adjusting staffing to patient acuity and fluctuations in patient census,
- increasing the standardization of operating processes, procedures and equipment,
- improving physician participation in resource consumption, medical record documentation and intensity of service management,
- managing pharmacy costs through the use of a medication control program and evaluating medical utilization through our pharmacy and therapeutic committees in each hospital,
- centralizing administrative functions such as accounting, payroll, legal, reimbursement, compliance, tax and information systems, and
- utilizing management information technology to aid in financial and clinical reporting as well as billing and collections.

Growing Through Business Development and Acquisitions. Our growth strategy is focused on the development and expansion of our services:

- Freestanding Hospitals – At December 31, 2009, we operated 67 freestanding hospitals (5,888 licensed beds). During 2009, we opened one hospital with 60 licensed hospital beds. During 2008 and 2007, we opened five new freestanding hospitals and one replacement hospital which added a total of 331 licensed hospital beds and 39 licensed sub-acute beds. The maturation of these hospitals is a key component of our growth strategy. We have two new freestanding hospitals under development which will add 100 licensed hospital beds to our capacity. Pursuant to the Medicare, Medicaid and SCHIP Extension Act of 2007 (the "SCHIP Extension Act"), a three-year moratorium, beginning December 29, 2007, has been imposed on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development. We believe both of the freestanding hospitals under development are exempt from the three-year moratorium established by the SCHIP Extension Act. We also have two replacement hospitals under development.
- Sub-Acute Development – We are well positioned to develop sub-acute units in several of our hospitals to broaden our scope of services, promote higher quality care and take advantage of unused capacity. We operate seven sub-acute units with 409 licensed beds and we have five hospital-based sub-acute units with approximately 150 licensed beds currently under development.
- Cluster Market Development – We are increasingly focused on the opportunities available to us in markets where we operate multiple hospitals or in which we have affiliated nursing and rehabilitation centers. These cluster markets present opportunities for our hospitals and nursing and rehabilitation centers to share centralized business office operations and collaborate on their sales and marketing and managed care strategies. These cluster markets also allow us to better coordinate and manage the continuum of care for each of our patients as well as implement physician services strategies. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.
- Growing Through Selective Acquisitions – We seek growth opportunities through strategic acquisitions in selected target markets, particularly where an acquisition may assist us in scaling our operations more rapidly and efficiently than internal growth.
- Hospital-in-Hospital – We have contracts with non-Kindred short-term acute care and other hospitals to operate LTAC hospitals with a host hospital ("HIH"). Under these arrangements, we lease space and purchase certain ancillary services from the host hospital and provide it with the option to discharge a portion of its clinically appropriate patients into the care of our hospital. These HIHs also receive patients from general short-term acute care hospitals in addition to the host hospital. At December 31, 2009, we operated 16 HIHs with 692 licensed beds. We currently have a 50-bed HIH under development which we believe is exempt from the three-year moratorium established by the SCHIP Extension Act.

Expanding Program Development. We are a leading provider of long-term acute care to patients with pulmonary dysfunction. In addition, we have developed and continue to expand other inpatient and outpatient service areas such as wound care, post-surgical care, acute rehabilitation, pain management, as well as new intensive care units, where we believe opportunities exist to position our hospitals as centers of excellence in given markets. We continue to broaden our expertise beyond pulmonary services and to leverage our leadership position in pulmonary care to expand our market strength to other clinical services. We also continue to expand our sub-acute programs in selected markets.

Increasing Patient Volume, Particularly Commercial Patients. We continue to expand our sales and marketing function to grow same-store admissions and to take advantage of available capacity. We generally receive higher reimbursement rates from commercial insurers as a group than from the Medicare and Medicaid

programs. As a result, we work to expand relationships with insurers and to enhance their understanding of our services in order to increase commercial patient volume. Each of our hospitals employs specialized staff to focus on patient admissions and the patient referral process. We have enhanced our sales and marketing function and implemented new technologies to increase the speed of referrals and admissions.

Improving Relationships with Referring Providers. Substantially all of the acute and medically complex patients admitted to our hospitals are transferred to us by other healthcare providers such as general short-term acute care hospitals, intensive care units, managed care programs, physicians, nursing centers and home care settings. Accordingly, we are focused on maintaining strong relationships with these providers as well as developing more comprehensive relationships with physician groups. In order to maintain these relationships, we employ clinical liaisons that are responsible for coordinating admissions and assessing the nature of services necessary for the proper care of the patient. The clinical liaisons also are responsible for educating healthcare professionals at the referral sources about the unique nature of the services provided by our LTAC hospitals.

Selected Hospital Division Operating Data

The following table sets forth certain operating and financial data for the hospital division (dollars in thousands, except statistics):

	Year ended December 31,		
	2009	2008	2007
Revenues	$ 1,932,892	$ 1,837,322	$ 1,727,419
Operating income	$ 363,811	$ 345,367	$ 365,068
Hospitals in operation at end of period	83	82	81
Licensed beds at end of period	6,580	6,482	6,358
Admissions	45,019	43,936	41,330
Patient days	1,381,350	1,395,049	1,328,050
Average length of stay	30.7	31.8	32.1
Revenues per admission	$ 42,935	$ 41,818	$ 41,796
Revenues per patient day	$ 1,399	$ 1,317	$ 1,301
Medicare case mix index (discharged patients only)	1.21	1.15	1.11
Average daily census	3,785	3,812	3,638
Occupancy %	64.7	64.8	64.6
Annualized employee turnover %	22.1	25.2	26.1
Assets at end of period	$ 867,332	$ 847,394	$ 846,429
Capital expenditures:			
Routine	$ 26,716	$ 35,932	$ 35,646
Development	42,371	33,285	59,438

The term "operating income" is defined as earnings before interest, income taxes, depreciation, amortization, rent and corporate overhead. A reconciliation of "operating income" to our consolidated results of operations is included in note 7 of the notes to consolidated financial statements. The term "licensed beds" refers to the maximum number of beds permitted in a facility under its license regardless of whether the beds are actually available for patient care. "Patient days" refers to the total number of days of patient care provided for the periods indicated. "Average length of stay" is computed by dividing each facility's patient days by the number of admissions in the respective period. "Medicare case mix index" is the sum of the individual patient diagnostic related group weights for the period divided by the sum of the discharges for the same period. "Average daily census" is computed by dividing each facility's patient days by the number of calendar days in the respective period. "Occupancy %" is computed by dividing average daily census by the number of operational licensed beds, adjusted for the length of time each facility was in operation during each respective period. "Annualized employee turnover %" is calculated by dividing full-time and part-time terminations by the active employee count at the beginning of the year. Routine capital expenditures include expenditures at existing

facilities that generally do not result in the expansion of services. Development capital expenditures include expenditures for the development of new facilities or the expansion of services at existing facilities.

Sources of Hospital Revenues

The hospital division receives payment for its services from third party payors, including government reimbursement programs such as Medicare and Medicaid and non-government sources such as Medicare Advantage, commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. Patients covered by non-government payors generally are more profitable to the hospital division than those covered by the Medicare and Medicaid programs. The following table sets forth the approximate percentages of our hospital admissions, patient days and revenues derived from the payor sources indicated:

Year ended December 31,	Medicare			Medicaid			Medicare Advantage (a)			Commercial insurance and other		
	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues
2009	64%	56%	55%	9%	15%	10%	9%	10%	10%	18%	19%	25%
2008	66	58	55	10	15	10	8	8	9	16	19	26
2007	68	60	58	10	15	10	4	4	4	18	21	28

(a) Data not available prior to April 1, 2007.

For the year ended December 31, 2009, revenues of the hospital division totaled approximately $1.9 billion or 42% of our total revenues (before eliminations). For more information regarding the reimbursement for our hospital services, see "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

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Hospital Facilities

The following table lists by state the number of hospitals and related licensed beds we operated as of December 31, 2009:

State	Licensed beds	Number of facilities: Owned by us	Leased from Ventas (2)	Leased from other parties	Total
Arizona	217	–	2	2	4
California	823	4	5	1	10
Colorado	68	–	1	–	1
Florida (1)	745	2	6	2	10
Georgia (1)	72	–	–	1	1
Illinois (1)	545	–	4	1	5
Indiana	119	1	1	–	2
Kentucky (1)	414	–	1	1	2
Louisiana	168	–	1	–	1
Massachusetts (1)	676	1	2	4	7
Missouri (1)	265	–	2	1	3
Nevada	238	1	1	1	3
New Jersey (1)	117	–	–	3	3
New Mexico	61	–	1	–	1
North Carolina (1)	124	–	1	–	1
Ohio	250	–	–	3	3
Oklahoma	93	–	1	1	2
Pennsylvania	393	2	2	3	7
South Carolina (1)	59	–	–	1	1
Tennessee (1)	109	–	1	1	2
Texas	822	2	6	3	11
Virginia (1)	60	–	–	1	1
Washington (1)	80	1	–	–	1
Wisconsin	62	–	–	1	1
Totals	6,580	14	38	31	83

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."

(2) See "– Master Lease Agreements."

Quality Assessment and Improvement

The hospital division maintains a clinical outcomes and customer service program which includes a review of its patient population measured against utilization and quality standards, clinical outcomes data collection and patient/family, employee and physician satisfaction surveys. In addition, our hospitals have integrated quality assurance and improvement programs administered by a director of quality management, which encompass quality improvement, infection control and risk management. The objective of these programs is to ensure that patients are managed appropriately in our hospitals and that quality healthcare is provided in a cost-effective manner.

The hospital division has implemented a program whereby its hospitals are reviewed by internal quality auditors for compliance with standards of the Joint Commission. The purposes of this internal review process are to (1) ensure ongoing compliance with industry recognized standards for hospitals, (2) assist management in analyzing each hospital's operations and (3) provide consulting and educational programs for each hospital to identify opportunities to improve patient care.

Hospital Division Management and Operations

Each of our hospitals has a fully credentialed, multi-specialty medical staff to meet the needs of the medically complex, long-term acute patient. Our hospitals offer a broad range of physician services including pulmonology, internal medicine, infectious diseases, neurology, nephrology, cardiology, radiology and pathology. In addition, our hospitals have a multi-disciplinary team of healthcare professionals including a professional nursing staff trained to care for long-term acute patients, respiratory, physical, occupational and speech therapists, pharmacists, registered dietitians and social workers, to address the needs of medically complex patients.

Each hospital utilizes a pre-admission assessment system to evaluate clinical needs and other information in determining the appropriateness of each potential patient admission. After admission, each patient's case is reviewed by the hospital's interdisciplinary team to determine a care plan. Typically, and where appropriate, the care plan involves the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

A hospital chief executive officer or administrator supervises and is responsible for the day-to-day operations at each of our hospitals. Each hospital or network of hospitals also employs a chief financial officer who monitors the financial matters of the hospital or network. Within selected markets having a significant concentration of hospitals, administrative functions such as billing and collections may be shared to improve efficiency. In addition, each hospital or network of hospitals employs a chief clinical officer to oversee the clinical operations and a director of quality management to oversee our quality assurance programs. We provide centralized services in the areas of information systems design and development, training, reimbursement expertise, legal advice, tax, technical accounting support, purchasing and facilities management to each of our hospitals. We believe that this centralization improves efficiency, promotes the standardization of certain processes and allows hospital staff to focus more attention on patient care.

A division president and a chief financial officer manage the hospital division. The operations of the hospitals are divided into an east region, a central region and a west region, each headed by a senior officer of the division who reports to the division president. The clinical issues and quality concerns of the hospital division are managed by the division's chief medical officer and senior vice president of clinical operations.

Hospital Division Competition

In each geographic market that we serve, there are generally several competitors that provide similar services to those provided by our hospital division. In addition, several of the markets in which the hospital division operates have other LTAC hospitals that provide services comparable to those offered by our hospitals. Certain competing hospitals are operated by not-for-profit, non-taxpaying or governmental agencies, which can finance capital expenditures on a tax-exempt basis and receive funds and charitable contributions unavailable to our hospital division.

Competition for patients covered by non-government reimbursement sources is intense. The primary competitive factors in the LTAC hospital business include quality of services, charges for services and responsiveness to the needs of patients, families, payors and physicians. Other companies have entered the LTAC market with licensed hospitals that compete with our hospitals. The competitive position of any hospital also is affected by the ability of its management to negotiate contracts with purchasers of group healthcare services, including managed care companies, preferred provider organizations and health maintenance organizations. Such organizations attempt to obtain discounts from established hospital charges. The importance to a hospital's competitive position of obtaining contracts with preferred provider organizations, health maintenance organizations and other organizations that finance healthcare varies from market to market, depending on the number and market strength of such organizations.

HEALTH SERVICES DIVISION

Our health services division provides quality, cost-effective care through the operation of a national network of 222 nursing and rehabilitation centers (27,523 licensed beds) located in 27 states. We are the largest publicly held operator of nursing and rehabilitation centers in the United States based upon our fiscal 2009 revenues of approximately $2.2 billion (before eliminations). Through our nursing and rehabilitation centers, we provide short stay patients and long stay residents with a full range of medical, nursing, rehabilitative, pharmacy and routine services, including daily dietary, social and recreational services.

Consistent with industry trends, patients and residents admitted to our nursing and rehabilitation centers arrive with greater medical complexity and require a more extensive and costly level of care. This is particularly true with our Medicare population for whom the average length of stay in 2009 was 35 days. To appropriately care for a higher acuity short stay patient population and a more frail and unstable long stay resident population, we are taking steps to improve the delivery of the clinical and hospitality services offered to our patients and residents by adjusting the level of clinical and hospitality staffing, assisting physician oversight through the selective use of nurse practitioners, enhancing nursing skills via ongoing education and improving clinical case management through the employment of clinical case managers.

We have developed transitional care units at approximately half of our nursing and rehabilitation centers. These discrete units within our nursing and rehabilitation centers typically consist of 20 to 50 beds offering skilled nursing services and a range of rehabilitation services including physical, occupational and speech therapy to patients recovering from a variety of surgical procedures such as joint replacements, amputation, bariatric procedures, wound closure/ repair procedures as well as medical conditions such as stroke, and cardiac and respiratory ailments. Several of our nursing and rehabilitation centers have clinical teams focused primarily upon a short stay patient population arriving for recovery, recuperation and rehabilitation resulting in a transitional care patient population that comprises a majority of the patients in the nursing and rehabilitation center. We refer to these types of nursing and rehabilitation centers as transitional care centers since this higher level of care encompasses all of the center.

At a number of our nursing and rehabilitation centers, we offer specialized programs for residents with Alzheimer's disease and other dementias through our Reflections units. We have developed specific certification criteria for these units. These are discrete units operated by teams of professionals that are dedicated to addressing the unique problems experienced by residents with Alzheimer's disease or other dementias. We believe that we are a leading provider of nursing care to residents with Alzheimer's disease and dementia based upon the specialization and size of our program.

We also monitor and enhance the quality of care and customer service at our nursing and rehabilitation centers through the use of performance improvement committees as well as family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Physician medical directors serve on these committees and advise on healthcare policies and practices. We regularly conduct surveys of residents and their families, and these surveys are reviewed by our performance improvement committees at each center to promote quality care and customer service.

Substantially all of our nursing and rehabilitation centers are certified to provide services under the Medicare and Medicaid programs. Our nursing and rehabilitation centers have been certified because the quality of our services, accommodations, equipment, safety, personnel, physical environment and policies and procedures meet or exceed the standards of certification set by those programs.

Health Services Division Strategy

Our goal is to become the provider of choice in the markets we serve, which we believe will allow us to increase our patient census and enhance our payor mix. We are employing several initiatives to improve the quality of our services and to address the needs of a more acute patient population. The principal elements of our health services division strategy are:

Providing Quality, Clinical-Based Services. The health services division is focused on qualitative and quantitative clinical performance indicators with the goal of providing quality care under the cost containment objectives imposed by government and private payors. In an effort to continually improve the quality of our services and enhance our ability to care for complex and higher acuity residents, we pursue initiatives to:

- improve recruitment, retention, management development, succession planning and employee satisfaction,
- expand the involvement of our medical directors, engage the services of more primary care and specialty physicians and increase the use of nurse practitioners,
- expand our therapy services, wound care, complex medical care and palliative care programs to improve our ability to care for a more acute patient population,
- improve our processes to monitor and promote our patient care objectives and align financial incentives with quality care and customer service goals,
- increase the number of our transitional care and sub-acute units to treat patients with rehabilitation and complex medical needs,
- develop medical advisory boards at select transitional care centers to enhance our clinical programming and review case studies to improve care,
- improve our Reflections units to care for residents with Alzheimer's disease and other dementias,
- maximize quality outcomes by implementing the collaborative advice and recommendations of the chief medical officer, senior nursing staff and rehabilitation therapists, and
- implement recommendations of our performance improvement committees established at the division, regional and district levels that analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division.

Enhancing Sales and Marketing Programs. We conduct our nursing center marketing efforts, which focus on the quality of care provided at our nursing and rehabilitation centers, at the local market level through our nursing center executive directors, clinical liaisons, admissions coordinators and/or other center-based sales and marketing personnel. The marketing efforts of our nursing and rehabilitation center personnel are supplemented by strategies provided by our divisional, regional and district marketing staffs. We also continue to refocus our marketing efforts to address the difference between the needs of short-term rehabilitation patients and those seeking long-term care. To better promote our services we are:

- concentrating our sales and marketing resources toward our transitional care, sub-acute and Alzheimer's units,
- working to improve our relationships with existing local referral sources and identifying and developing new referral sources and promoting our value proposition,
- expanding the number of clinical liaisons and admission coordinators, particularly at the nursing center level, and implementing community outreach programs,
- focusing on improving the recruiting, training and retention of sales and marketing personnel and improving accountability,

- reconfiguring our admission and discharge procedures to address a higher volume of short-term admissions, and
- increasingly focusing on the opportunities available to us in markets where we operate multiple nursing and rehabilitation centers or in which we have affiliated hospitals. These cluster markets present opportunities for our nursing and rehabilitation centers and hospitals to share centralized business office operations and collaborate on their sales and marketing and managed care strategies. These cluster markets also allow us to better coordinate and manage the continuum of care for each of our patients and residents as well as implement physician services strategies. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.

Increasing Operating Efficiency. The health services division continually seeks to improve operating efficiency with a view to maintaining high quality care. We believe that operating efficiency is critical to maintaining our position as a leading provider of nursing center services in the United States. To improve operating efficiency we strive to:

- increase our average patient occupancy levels, which leverages higher revenues over the fixed costs associated with operating our nursing and rehabilitation centers,
- manage our labor costs by improving nurse and other staff retention, maintaining competitive labor rates and reducing reliance on overtime compensation and temporary nursing agency services,
- centralize administrative functions such as accounting, payroll, legal, reimbursement, compliance and information systems,
- enhance our quality assurance, risk management and liability claims defense initiatives to address professional liability and workers compensation costs,
- enhance monitoring of our ancillary expenses, such as rehabilitation and pharmacy costs, that grow in an environment of higher admissions and higher acuity patients, and
- continue to upgrade our management information systems to provide financial and clinical reporting, and improve billing and collections.

Nursing Center Development. The health services division continually seeks ways to improve its existing portfolio. We have:

- repositioned our portfolio by divesting 29 underperforming nursing and rehabilitation centers with approximately 3,600 licensed beds in the last three years, including the underperforming nursing and rehabilitation centers acquired as part of the 2009 Facility Acquisitions and 2007 Facility Acquisitions,
- continued to seek additional growth opportunities through strategic acquisitions in selected target markets, particularly where an acquisition may assist us in scaling our operations more rapidly and efficiently than internal growth, and
- expanded our transitional care centers and transitional care units to address the needs of more Medicare and managed care short term patients.

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Selected Health Services Division Operating Data

The following table sets forth certain operating and financial data for the health services division (dollars in thousands, except statistics):

	Year ended December 31,		
	2009	2008	2007
Revenues	$ 2,150,342	$ 2,093,297	$ 1,958,322
Operating income	$ 305,590	$ 321,814	$ 294,625
Nursing centers in operation at end of period:			
Owned or leased	218	218	218
Managed	4	4	4
Licensed beds at end of period:			
Owned or leased	27,038	27,252	27,809
Managed	485	485	485
Patient days (a)	8,810,288	8,921,598	8,840,517
Revenues per patient day (a)	$ 244	$ 235	$ 221
Average daily census (a)	24,138	24,376	24,221
Admissions (a)	72,801	69,986	65,772
Occupancy % (a)	89.0	89.1	87.8
Medicare average length of stay (a,b)	35.4	35.5	35.6
Annualized employee turnover %	38.9	48.9	55.9
Assets at end of period	$ 566,592	$ 574,710	$ 550,525
Capital expenditures:			
Routine	$ 39,663	$ 44,627	$ 41,252
Development	5,687	5,466	5,688

(a) Excludes managed facilities.
(b) Computed by dividing total Medicare discharge patient days by total Medicare discharges.

Sources of Nursing Center Revenues

Nursing center revenues are derived principally from the Medicare and Medicaid programs and from private and other payors. Consistent with the nursing center industry, changes in the mix of the patient and resident population among these three categories significantly affect the profitability of our nursing center operations. Although higher acuity patients generally produce the most revenue per patient day, profitability with respect to higher acuity patients is impacted by the costs associated with the higher level of nursing care and other services generally required. In addition, these patients usually have a significantly shorter length of stay.

The following table sets forth the approximate percentages of nursing center patient days and revenues derived from the payor sources indicated:

	Medicare		Medicaid		Medicare Advantage (a)		Private and other	
Year ended December 31,	Patient days	Revenues	Patient days	Revenues	Patient days	Revenues	Patient days	Revenues
2009	17%	34%	61%	42%	4%	6%	18%	18%
2008	17	34	61	43	3	5	19	18
2007	17	35	63	44			20	21

(a) Data not available prior to January 1, 2008.

For the year ended December 31, 2009, revenues of the health services division totaled approximately $2.2 billion or 47% of our total revenues (before eliminations). For more information regarding the reimbursement for our nursing center services, see "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

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Nursing Center Facilities

The following table lists by state the number of nursing centers and related licensed beds we operated as of December 31, 2009:

		Number of facilities				
State	Licensed beds	Owned by us	Leased from Ventas (2)	Leased from other parties	Managed	Total
Alabama (1)	474	–	2	1	–	3
Arizona	562	–	3	1	–	4
California	2,437	4	6	11	–	21
Colorado	464	–	4	–	–	4
Connecticut (1)	522	–	5	–	–	5
Georgia (1)	537	–	4	–	–	4
Idaho	695	1	7	–	–	8
Indiana	3,625	10	13	1	–	24
Kentucky (1)	1,575	2	10	1	–	13
Maine (1)	756	–	8	–	–	8
Massachusetts (1)	4,844	–	26	12	3	41
Missouri (1)	240	–	–	2	–	2
Montana (1)	276	–	2	–	–	2
Nevada	174	–	2	–	–	2
New Hampshire (1)	512	–	3	–	–	3
North Carolina (1)	2,135	–	16	3	–	19
Ohio (1)	1,812	2	9	2	–	13
Oregon (1)	205	–	2	–	–	2
Pennsylvania	103	–	1	–	–	1
Rhode Island (1)	201	–	2	–	–	2
Tennessee (1)	1,065	–	3	5	–	8
Utah	411	–	4	–	–	4
Vermont (1)	310	–	1	–	1	2
Virginia (1)	629	–	4	–	–	4
Washington (1)	659	–	7	–	–	7
Wisconsin (1)	1,922	–	11	1	–	12
Wyoming	378	–	4	–	–	4
Totals	27,523	19	159	40	4	222

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."

(2) See "– Master Lease Agreements."

Health Services Division Management and Operations

Each of our nursing and rehabilitation centers is managed by a state-licensed executive director who is supported by other professional personnel, including a director of nursing, nursing assistants, licensed practical nurses, staff development coordinator, activities director, social services director, clinical liaisons, admissions coordinator and business office manager. The directors of nursing are state-licensed nurses who supervise our nursing staffs that include registered nurses, licensed practical nurses and nursing assistants. Staff size and composition vary depending on the size and occupancy of each nursing and rehabilitation center, the types of services provided and the acuity level of the patients and residents. The nursing and rehabilitation centers contract with physicians who provide medical director services and serve on performance improvement committees. We provide our centers with centralized information systems, federal and state reimbursement

expertise, state licensing and certification maintenance, as well as legal, finance, accounting, purchasing and facilities management support. The centralization of these services improves operating efficiencies, promotes the standardization of certain processes and permits our healthcare staff to focus on the delivery of quality care.

Our health services division is managed by a division president and a chief financial officer. Our nursing center operations are divided into three geographic regions, each of which is headed by an operational senior vice president. These three operational senior vice presidents report to the division president. The clinical issues and quality concerns of the health services division are overseen by two physicians, the division's chief medical officer and a divisional medical director as well as a senior vice president of clinical and nursing operations with assistance from our regional and district teams. The sales and marketing efforts for the division are led by our vice president of sales and marketing with assistance from our regional and district teams. Divisional, regional and/or district staff also support the health services division in the areas of nursing, dietary services, federal and state reimbursement, human resources management, maintenance and financial services.

Quality Assessment and Improvement

Quality of care is monitored and enhanced by our clinical operations personnel as well as our performance improvement committees and family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Additionally, physician medical directors serve on these committees and advise on healthcare policies and practices. Regional and district nursing professionals visit our nursing and rehabilitation centers periodically to review practices and recommend improvements where necessary in the level of care provided and to ensure compliance with requirements under applicable Medicare and Medicaid regulations. Surveys of residents' families are conducted on a regular basis and provide an opportunity for families to rate various aspects of our service and the physical condition of our nursing and rehabilitation centers. These surveys are reviewed by performance improvement committees at each nursing and rehabilitation center to promote and improve resident care.

The health services division provides training programs for nursing center executive directors, business office and other department managers, nurses and nursing assistants. These programs are designed to maintain high levels of quality patient and resident care, with an orientation towards regulatory compliance.

Substantially all of our nursing and rehabilitation centers are certified to provide services under the Medicare and Medicaid programs. A nursing center's qualification to participate in such programs depends upon many factors, such as accommodations, equipment, clinical services, safety, personnel, physical environment and adequacy of policies and procedures.

Health Services Division Competition

Our nursing and rehabilitation centers compete with other nursing centers and similar long-term care facilities primarily on the basis of quality of care, reputation, location and physical appearance and, in the case of private payment residents, the charges for our services. Our nursing and rehabilitation centers also compete on a local and regional basis with other nursing centers as well as with facilities providing similar services, including hospitals, extended care centers, assisted living facilities, home health agencies and similar institutions. Some competitors may operate newer facilities and may provide services that we do not offer. Our competitors include government-owned, religious organization-owned, secular not-for-profit and for-profit institutions. Many of these competitors have greater financial and other resources than we do. Although there is limited, if any, price competition with respect to Medicare and Medicaid residents (since revenues received for services provided to these residents are based generally on fixed rates), there is substantial price competition for private payment residents.

REHABILITATION DIVISION

Our rehabilitation division provides rehabilitative services including physical and occupational therapies and speech pathology services, to residents and patients of nursing centers, acute and long-term acute care hospitals, outpatient clinics, home health agencies, assisted living facilities, school districts and hospice providers. We provide rehabilitative services to 478 nursing centers, 89 hospitals and 55 other locations in 41 states under the name "People*first* Rehabilitation." Approximately 61% of the rehabilitation division's revenues in 2009 were generated from therapy services contracts with our hospitals and nursing centers.

Our rehabilitation division employs approximately 8,100 therapists and had revenues of approximately $475 million (before eliminations) in 2009. We are organized into six geographic regions.

Our rehabilitation division provides specialized rehabilitation programs designed to meet the individual needs of the residents and patients we serve. Our specialized care programs address complex medical needs, such as wound care, pain management, cognitive retraining, in addition to neurologic, orthopedic, cardiac and pulmonary recovery.

People*first* Rehabilitation provides clinical education and programming which is developed and supported by our clinical experts. These programs are implemented in an effort to ensure clinical practices that support the provision of quality rehabilitation services in accordance with applicable standards of care.

People*first* Rehabilitation recruits and retains qualified professionals with the clinical expertise to provide quality patient care and measurable rehabilitation outcomes. People*first* Rehabilitation also provides regulatory expertise and compliance support that benefits our clients and their residents and patients.

Rehabilitation Division Strategy

Our goals are to be the leading rehabilitation services provider and employer of choice in the markets we serve and to increase our market share and name recognition through contract growth. Our strategies for achieving these goals include:

Improving Quality Care and Customer Satisfaction. Our rehabilitation division is committed to providing effective and efficient care to the residents and patients to whom we provide rehabilitation services. We have implemented the following measures in an effort to improve the operations of our customers with the goal of enhancing the quality of care provided to their residents and patients:

- we have specialized rehabilitation programs to promote quality care. Such programs focus on residents and patients with Alzheimer's disease and other forms of dementia, pain management and medically complex, orthopedic and neurological rehabilitation needs;
- we promote the competencies of our therapists by providing extensive training and implementing a best practices approach to the provision of rehabilitation services;
- we take an integrated approach to delivering our services as a key member of our customer's interdisciplinary care team and work to enhance our customer's quality care objectives;
- we have developed a proprietary nationwide rehabilitation information system that allows us to access management and clinical reports which provide quality assurance measures, identify industry trends, track patient outcomes and streamline invoicing; and
- we have implemented the use of technological enhancements, such as handheld devices for capturing information related to the provision of rehabilitation services. These devices increase the efficiency of our therapists and support compliance with the regulations which govern documentation of rehabilitation services.

Effective Recruiting and Retention of Qualified Therapists. The healthcare industry is facing a significant shortage of qualified therapists. In an effort to provide quality care to the patients and residents to whom we provide rehabilitation services, we continuously strive to recruit and retain qualified therapists. We offer competitive incentive and recognition programs for our therapists and have increased our recruiting infrastructure to reduce open positions, decrease contract labor and improve productivity. We also promote continuing education opportunities to enhance the personal knowledge and growth of our therapists and encourage our therapists' participation in nurturing a culture of quality and customer service.

Increasing Operating Efficiency. We seek to improve our operating efficiency by increasing the productivity of our therapists and other rehabilitation staff. We have developed standard division-wide labor productivity tools to monitor and better manage therapist productivity as well as our staffing models. In an effort to enable our therapists to focus their attention on providing quality rehabilitation services to patients and residents, we have implemented the use of technological enhancements and clinical protocols that promote best practices.

Growing Through Business Development and External Contract Sales. Our growth strategy is focused on the enhancement of rehabilitation programs for the customers we serve and the expansion of our business in strategic markets. These markets include locations in which we already have a significant presence, where demand may exist for our services, or where we wish to expand the provision of our services. Our efforts will continue to target customers in both the acute and post-acute care settings. In order to increase market share, our initiatives include demonstrating our value proposition to customers in the areas of clinical excellence and programming, staff recruitment and retention, regulatory and reimbursement support, census development and committed customer service. In addition, we continue to promote a greater awareness of the services we provide by enhancing sales and marketing strategies and through the use of our People*first* website.

Growth Through Selective Acquisitions. We seek growth opportunities through strategic acquisitions in selected target markets, particularly where an acquisition may assist us in scaling our operations more rapidly and efficiently than internal growth.

Capital Investments. We are expanding our operational and capital programs to refurbish and expand gym space, upgrade equipment and enhance our brand image in several of the sub-acute units, transitional care centers and transitional care units in which we provide services.

Selected Rehabilitation Division Operating Data

The following table sets forth certain operating and financial data for the rehabilitation division (dollars in thousands):

	Year ended December 31,		
	2009	2008	2007
Revenues:			
Company-operated	$ 288,265	$ 268,663	$ 239,740
Non-affiliated	186,773	158,657	112,657
	$ 475,038	$ 427,320	$ 352,397
Operating income	$ 50,592	$ 38,071	$ 34,526
Number of customer contracts:			
Company-operated	306	310	326
Non-affiliated	316	345	318
Revenue per site	$ 730,345	$ 651,895	$ 582,207
Therapist productivity %	84.2	81.4	79.4
Annualized employee turnover %	12.8	13.3	15.6
Assets at end of period	$ 53,856	$ 45,733	$ 30,751
Routine capital expenditures	$ 1,043	$ 1,162	$ 2,037

"Therapist productivity %" is computed by dividing labor minutes related to patient care by total labor minutes for the period.

Sources of Rehabilitation Division Revenues

The rehabilitation division receives payment for the rehabilitation services it provides to residents and patients of the customers that we serve. The payments are based upon negotiated patient per diem rates, negotiated per minute rates, or a negotiated fee schedule based upon the types of services rendered. For the year ended December 31, 2009, revenues of the rehabilitation division totaled approximately $475 million or 11% of our total revenues (before eliminations). As a provider of services to healthcare providers, trends and developments in healthcare reimbursement will impact our revenues and growth. Changes in the reimbursement provided by Medicare or Medicaid to our customers can impact the demand and pricing for our services. For more information regarding the reimbursement for our rehabilitation services, see "– Governmental Regulation – Rehabilitation Division – Overview of Rehabilitation Division Revenues," "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement," and "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

Geographic Coverage

The following table lists by state the number of hospitals, nursing centers and other rehabilitation customer contracts we serviced as of December 31, 2009:

State	Hospitals		Nursing centers		Other	Total	
	Company operated	Non-affiliated	Company operated	Non-affiliated	Non-affiliated	Company operated	Non-affiliated
Alabama	–	–	3	–	–	3	–
Arizona	4	–	4	3	2	8	5
California	11	–	21	3	–	32	3
Colorado	1	–	4	6	2	5	8
Connecticut	–	–	6	8	–	6	8
Delaware	–	–	–	1	–	–	1
Florida	10	–	–	4	4	10	8
Georgia	1	–	4	1	–	5	1
Idaho	–	–	8	2	6	8	8
Illinois	5	–	–	20	4	5	24
Indiana	2	–	24	4	13	26	17
Iowa	–	–	–	1	–	–	1
Kentucky	2	–	13	17	4	15	21
Louisiana	1	–	–	–	–	1	–
Maine	–	–	8	4	–	8	4
Maryland	–	–	–	15	–	–	15
Massachusetts	7	–	42	8	–	49	8
Michigan	–	1	–	–	–	–	1
Minnesota	–	–	–	2	–	–	2
Missouri	3	–	2	1	–	5	1
Montana	–	–	2	–	2	2	2
Nebraska	–	–	–	1	–	–	1
Nevada	3	–	2	3	1	5	4
New Hampshire	–	–	3	–	–	3	–
New Jersey	2	–	–	–	–	2	–
New Mexico	1	1	–	–	–	1	1
North Carolina	1	–	19	43	2	20	45
Ohio	3	–	13	20	7	16	27
Oklahoma	2	–	–	–	–	2	–
Oregon	–	–	2	1	–	2	1
Pennsylvania	7	1	1	9	–	8	10
Rhode Island	–	–	2	4	–	2	4
South Carolina	1	–	–	–	–	1	–
Tennessee	1	–	8	6	–	9	6
Texas	11	4	–	11	5	11	20
Utah	–	–	4	1	–	4	1
Vermont	–	–	2	3	–	2	3
Virginia	1	–	4	30	–	5	30
Washington	1	–	7	10	3	8	13
Wisconsin	1	–	12	12	–	13	12
Wyoming	–	–	4	–	–	4	–
Totals	82	7	224	254	55	306	316

Sales and Marketing

The rehabilitation division's sales and marketing strategy focuses on the outsourcing needs of long-term care facilities and hospitals by emphasizing the broad range of rehabilitation programs, clinical expertise, and competitive pricing that we can provide. The rehabilitation division's new business efforts are led by the vice president of business development and six directors of business development in geographically defined regions.

Rehabilitation Division Management and Operations

We have four nursing center and two hospital regions organized predominantly by the geographic location of our customers. Each of our rehabilitation programs has an on-site manager that reports to an area rehabilitation director. The area director is responsible for the overall management of eight to 12 on-site managers. The area directors report to their respective division vice president of rehabilitation operations.

We provide our program staff with centralized information systems, federal and state reimbursement expertise, professional licensing support, as well as legal, finance, accounting and purchasing support. The centralization of these services improves operating efficiencies, promotes the standardization of certain processes and permits program staff to focus on the delivery of quality, medically necessary rehabilitation services.

A division president and a chief financial officer manage our rehabilitation division. Our operations are divided between the nursing center line of business and hospital line of business and each is headed by an officer of the division who reports to the division president. A senior vice president of clinical operations manages the clinical education of our therapists and our quality care initiatives.

Rehabilitation Division Competition

In the geographic markets that we serve, there are national, regional and local rehabilitation services providers that offer rehabilitation services comparable to ours. A number of our competitors may have greater financial and other resources than us, may be more established in the markets in which we compete and may be willing to provide services at lower prices. In addition, a number of long-term care facilities and hospitals may elect not to outsource rehabilitation services thereby reducing our potential customer base. While there are several large rehabilitation providers, the market generally is highly fragmented and is primarily comprised of smaller independent providers.

We believe our rehabilitation division generally competes on its reputation for providing quality rehabilitation services, qualified therapists and competitive pricing.

GOVERNMENTAL REGULATION

Congress and the White House Administration are currently considering healthcare reform bills, which would initiate significant reforms to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors. The House of Representatives has passed a healthcare reform bill entitled "The Affordable Healthcare for America Act" and the Senate has passed a healthcare reform bill entitled "The Patient Protection and Affordable Care Act." At this time, we cannot predict if or when one of these bills or similar legislation may be passed and submitted to the President.

The healthcare reforms contained in these bills would impact each of our businesses in some manner. Due to the unsettled nature of the current healthcare reform bills, the substantial regulatory changes that would need to be implemented by CMS and others, and the numerous processes required to implement these reforms, we cannot predict which healthcare reforms will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on our business.

Several of the proposed reforms are very significant and could ultimately change the nature of our services, the methods of payment for our services and the underlying regulatory environment. The proposed reforms could include modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care and the imposition of enrollment limitations on new providers. In addition, a primary goal of healthcare reform is to reduce costs which could include reductions in the reimbursement paid to us and other healthcare providers. Moreover, healthcare reform could negatively impact insurance companies, other third party payors, our customers, as well as other healthcare providers, which may in turn negatively impact our business. As such, these healthcare reforms or other similar healthcare reforms, if adopted, could have a material adverse effect on our business, financial position, results of operations and liquidity.

Medicare and Medicaid

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over and certain disabled persons. Medicaid is a medical assistance program administered by each state pursuant to which healthcare benefits are available to certain indigent or disabled patients. Within the Medicare and Medicaid statutory framework, there are substantial areas subject to administrative rulings, interpretations and discretion that may affect payments made under Medicare and Medicaid. A substantial portion of our revenues are derived from patients covered by the Medicare and Medicaid programs. See " Hospital Division – Sources of Hospital Revenues," " Health Services Division – Sources of Nursing Center Revenues" and "Rehabilitation Division – Sources of Rehabilitation Division Revenues."

We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. In addition, we cannot assure you that the facilities operated by us, or the provision of goods and services offered by us, will meet the requirements for participation in such programs. In addition, there are continuing efforts to reform governmental healthcare programs that could result in major changes in the healthcare delivery and reimbursement system on a national and state level and we cannot assure you that healthcare reform, future healthcare legislation or other changes in the administration or interpretation of governmental healthcare programs will not have a material adverse effect on our business, financial position, results of operations and liquidity. See "Item 1A – Risk Factors – Risk Factors Relating to Reimbursement and Regulation of Our Business – Changes in the reimbursement rates or methods or timing of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins."

Federal, State and Local Regulation

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities, allowable costs, services and prices for services, facility staffing requirements, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other governmental programs. Sanctions for violating these anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations,

including enhanced medical necessity review of LTAC hospital cases pursuant to the SCHIP Extension Act and audits under the CMS Recovery Audit Contractor ("RAC") program which was made permanent and required to be expanded pursuant to the Tax Relief and Health Care Act of 2006. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bars on Medicare and Medicaid payments for new admissions and civil monetary penalties. These enforcement policies, along with the costs incurred to respond to and defend reviews, audits and investigations, could have a material adverse effect on our business, financial position, results of operations and liquidity. We vigorously contest such sanctions where appropriate; however, these cases can involve significant legal expense and consume our resources.

Section 1877 of the Social Security Act, commonly known as "Stark I," provides that a physician who has a financial relationship with a clinical laboratory generally is prohibited from referring patients to that laboratory. The Omnibus Budget Reconciliation Act of 1993 contains provisions, commonly known as "Stark II," amending Section 1877 to expand greatly the scope of Stark I. Effective January 1995, Stark II broadened the referral limitations of Stark I to include, among other designated health services, inpatient and outpatient hospital services. Under Stark I and Stark II, a "financial relationship" is defined as an ownership interest or a compensation arrangement. If such a financial relationship exists, the entity generally is prohibited from claiming payment for services under the Medicare or Medicaid programs. Compensation arrangements generally are exempted from Stark I and Stark II if, among other things, the compensation to be paid is set in advance, does not exceed fair market value and is not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties. The U.S. Department of Health and Human Services has issued regulations that describe some of the conduct and business relationships permissible under the anti-kickback amendments. The fact that a given business arrangement does not fall within one of these safe harbors does not render the arrangement per se illegal. Business arrangements of healthcare service providers that fail to satisfy the applicable criteria, however, risk increased scrutiny and possible sanctions by enforcement authorities. These laws and regulations, however, are complex, and there is limited judicial or regulatory interpretation. We believe that business practices of providers and financial relationships between providers have become subject to increased scrutiny as healthcare reform efforts continue on the federal and state levels. Many states have adopted or are considering similar legislative proposals, some of which extend beyond the Medicaid program, to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of the source of payment for the care. While we do not believe our arrangements are in violation of these prohibitions, we cannot assure you that governmental officials charged with the responsibility for enforcing the provisions of these prohibitions will not assert that one or more of our arrangements are in violation of the provisions of such laws and regulations.

The Balanced Budget Act of 1997 (the "Balanced Budget Act") also includes a number of anti-fraud and abuse provisions. The Balanced Budget Act contains additional civil monetary penalties for violations of the anti-kickback amendments discussed above and imposes an affirmative duty on healthcare providers to ensure that they do not employ or contract with persons excluded from the Medicare program. The Balanced Budget Act also provides a minimum ten-year period for exclusion from participation in federal healthcare programs for persons or entities convicted of a prior healthcare offense.

Various states in which we operate hospitals and nursing and rehabilitation centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals, including nurses, certified nurse's assistants, therapists and other staff. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through

Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

The International Classification of Diseases ("ICD") is a classification system for diseases and signs, symptoms, abnormal findings, complaints, social circumstances and external causes of injury or diseases, promulgated by the World Health Organization. The U.S. Department of Health and Human Services has mandated that healthcare payors and providers and their vendors must convert from the current ICD-9 coding system to the materially different ICD-10 coding system by October 1, 2013. ICD-10 is the first major change in diagnosis and procedure coding in three decades.

HIPAA. The federal Health Insurance Portability and Accountability Act of 1996, commonly known as "HIPAA," among other requirements, broadened the scope of existing fraud and abuse laws and mandated the adoption of administrative simplification regulations aimed at standardizing transaction formats and billing codes for documenting medical services, dealing with claims submissions and protecting the privacy and security of individually identifiable health information. HIPAA regulations that standardize transactions and code sets require standard formatting for healthcare providers, like us, that submit claims electronically.

The HIPAA privacy regulations apply to "protected health information," which is defined generally as individually identifiable health information transmitted or maintained in any form or medium, excluding certain types of records such as education records. The privacy regulations seek to limit the use and disclosure of most paper and oral communications, as well as those in electronic form, regarding an individual's past, present or future physical or mental health or condition, or relating to the provision of healthcare to the individual or payment for that healthcare, if the individual can or may be identified by such information. HIPAA provides for the imposition of civil and/or criminal penalties if protected health information is improperly disclosed.

HIPAA's security regulations require us to ensure the confidentiality, integrity, and availability of all electronically protected health information that we create, receive, maintain or transmit. We must protect against reasonably anticipated threats or hazards to the security of such information and the unauthorized use or disclosure of such information. The HIPAA unique health identifier standards require us to obtain and use national provider identifiers.

The Health Information Technology for Economic and Clinical Health Act, known as "HITECH," was passed in 2009 and instituted new HIPAA requirements regarding providing individuals with notification of breaches of their unsecured protected health information. HITECH also imposed new requirements on HIPAA business associates and strengthened HIPAA enforcement provisions, including civil monetary penalty amounts.

We believe we are in substantial compliance with the HIPAA regulations. Sanctions for failing to comply with HIPAA health information practices provisions include sanctions and civil and criminal penalties. We cannot assure you that potential non-compliance by us with HIPAA regulations will not have a material adverse effect on our business, financial position, results of operations and liquidity.

Certificates of Need and State Licensing. Certificate of need, or CON, regulations control the development and expansion of healthcare services and facilities in certain states. Certain states also require regulatory approval prior to certain changes in ownership of a hospital or nursing center. Certain states that do not have CON programs may have other laws or regulations that limit or restrict the development or expansion of healthcare facilities. We operate hospitals in 12 states and nursing and rehabilitation centers in 18 states that require state approval for the expansion of our facilities and services under CON programs. To the extent that CONs or other similar approvals are required for expansion of the operations of our hospitals or nursing and rehabilitation centers, either through facility acquisitions, expansion or provision of new services or other changes, such expansion could be affected adversely by the failure or inability to obtain the necessary approvals, changes in the standards applicable to such approvals or possible delays and expenses associated with obtaining such approvals.

We are required to obtain state licenses to operate each of our hospitals and nursing and rehabilitation centers and to ensure their participation in government programs. Once a hospital or nursing and rehabilitation center becomes licensed and operational, it must continue to comply with federal, state and local licensing requirements in addition to local building and life-safety codes. All of our hospitals and nursing and rehabilitation centers have the necessary licenses. Failure of our hospitals and nursing and rehabilitation centers to satisfy applicable licensure and certification requirements could have a material adverse effect on our business, financial position, results of operations and liquidity.

Hospital Division

General Regulations. The hospital division is subject to various federal and state regulations. In order to receive Medicare reimbursement, each hospital must meet the applicable conditions of participation set forth by the U.S. Department of Health and Human Services relating to the type of hospital, its equipment, personnel and standard of medical care, as well as comply with state and local laws and regulations. We have developed a management system to facilitate our compliance with these various standards and requirements. Among other things, each hospital employs a person who is responsible for leading an ongoing quality assessment and improvement program. Hospitals undergo periodic on-site Medicare certification surveys, which generally are limited in frequency if the hospital is accredited by the Joint Commission. As of December 31, 2009, 82 hospitals operated by the hospital division were certified as Medicare LTAC providers and one hospital has a pending certification as a Medicare short-term acute care provider. In addition, 70 hospitals also were certified by their respective state Medicaid programs. Loss of certification could affect adversely a hospital's ability to receive payments from the Medicare and Medicaid programs.

As noted above, the hospital division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed above. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Accreditation by the Joint Commission. Hospitals may receive accreditation from the Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals. Generally, hospitals and certain other healthcare facilities are required to have been in operation at least four months in order to be eligible for accreditation by the Joint Commission. After conducting on-site surveys, the Joint Commission awards accreditation for up to three years to hospitals found to be in substantial compliance with Joint Commission standards. Accredited hospitals also are periodically resurveyed, at the option of the Joint Commission, upon a major change in facilities or organization and after merger or consolidation. As of December 31, 2009, all of the hospitals operated by the hospital division were accredited by the Joint Commission or were in the process of seeking accreditation. The hospital division intends to seek and obtain Joint Commission accreditation for any additional facilities it may operate in the future.

Peer Review. Federal regulations provide that admission to and utilization of hospitals by Medicare and Medicaid patients must be reviewed by peer review organizations or quality improvement organizations in order to ensure efficient utilization of hospitals and services. A quality improvement organization may conduct such review either prospectively or retroactively and may, as appropriate, recommend denial of payments for services provided to a patient. The review is subject to administrative and judicial appeals. Each of the hospitals operated by our hospital division employs a clinical professional to administer the hospital's integrated quality assurance and improvement program. Denials by third party utilization review organizations historically have not had a material adverse effect on the hospital division's operating results.

Overview of Hospital Division Reimbursement

Medicare Reimbursement of Short-term Acute Care Hospitals – Medicare reimburses general short-term acute care hospitals under a prospective payment system ("IPPS"). Under IPPS, Medicare inpatient costs are reimbursed based upon a fixed payment amount per discharge using medical severity diagnostic related groups ("MS-DRGs"). The MS-DRG payment under IPPS is based upon the national average cost of treating a Medicare patient's condition. Although the average length of stay varies for each MS-DRG, we believe that the average stay for all Medicare patients subject to IPPS is approximately six days. An additional outlier payment is made for patients with higher treatment costs but these payments are designed only to cover marginal costs. Hospitals that are certified by Medicare as LTAC hospitals are excluded from the IPPS.

Medicare Reimbursement of Long-term Acute Care Hospitals – Since October 2002, the Medicare payment system for LTAC hospitals has been based upon the Long-Term Acute Care Prospective Payment System ("LTAC PPS"), a prospective payment system specifically for LTAC hospitals. LTAC PPS maintains LTAC hospitals as a distinct provider type, separate from short-term acute care hospitals. Only providers certified as LTAC hospitals may be paid under this system. To maintain certification under LTAC PPS, the average length of stay of fee for service Medicare patients must be at least 25 days.

CMS has, for a number of years, considered the development of facility and patient certification criteria for LTAC hospitals, potentially as an alternative to the current payment system under LTAC-PPS. In 2004, the Medicare Payment Advisory Commission ("MedPAC") recommended to Congress the adoption by CMS of new facility staffing and services criteria and patient clinical characteristics and treatment requirements for LTAC hospitals in order to ensure that only appropriate patients are admitted to these facilities. MedPAC is an independent federal body that advises Congress on issues affecting the Medicare program. Since the MedPAC recommendation, CMS has initiated studies to examine such recommendations and those studies are ongoing. Implementation of additional criteria that may limit the population of patients eligible for our hospital services or change the basis on which we are paid could have a material adverse effect on our business, financial position, results of operations and liquidity.

On August 1, 2007, CMS issued final regulations regarding Medicare hospital inpatient payments to short-term acute care hospitals as well as certain provisions affecting LTAC hospitals. These regulations adopt a new system for LTAC hospitals for classifying patients into diagnostic categories called Medicare Severity Diagnosis Related Groups or more specifically, for LTAC hospitals, "MS-LTC-DRGs." LTAC PPS is based upon discharged-based MS-LTC-DRGs similar to the system used to pay short-term acute care hospitals. This new MS-LTC-DRG system replaced the previous diagnostic related group system for LTAC hospitals and became effective for discharges occurring on or after October 1, 2007. The MS-LTC-DRG system created additional severity-adjusted categories for most diagnoses.

While the clinical system which groups procedures and diagnoses is identical to the prospective payment system for short-term acute care hospitals, LTAC PPS utilizes different rates and formulas. Three types of payments are used in this system: (a) short-stay outlier payment, which provides for patients whose length of stay is less than 5/6th of the geometric mean length of stay for that MS-LTC-DRG, based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) a blend of an amount comparable to what would otherwise be paid under IPPS computed as a per diem, capped at the full IPPS MS-DRG comparable payment amount and a per diem based upon the average payment for that MS-LTC-DRG under LTAC PPS; (b) MS-LTC-DRG fixed payment which provides a single payment for all patients with a given MS-LTC-DRG, regardless of length of stay, cost of care or place of discharge; and (c) high cost outlier that will provide a partial coverage of costs for patients whose cost of care far exceeds the MS-LTC-DRG reimbursement. For patients in the high cost outlier category, Medicare will reimburse 80% of the costs incurred above the MS-LTC-DRG reimbursement plus a fixed cost outlier threshold per discharge.

On July 31, 2008, CMS issued final regulations regarding the re-weighting of MS-LTC-DRGs for discharges occurring on or after October 1, 2008. CMS announced that this update was made in a budget neutral manner, and that estimated aggregate LTAC Medicare payments would be unaffected by these regulations. Based upon our experience under these final regulations, it appears that the re-weighting increased payments for the care of higher acuity patients.

On May 29, 2009, CMS issued an interim final rule that revised the October 1, 2008 payment weights. Effective June 3, 2009, CMS reduced MS-LTC-DRG payment weights by 3.9%, resulting in approximately a 0.9% reduction of the estimated total LTAC PPS payments in the federal fiscal year ending September 30, 2009. No retroactive adjustments to payments were made. On July 31, 2009, CMS finalized this interim rule.

For discharges occurring on or after July 1, 2007 and before December 29, 2007, certain short-stay outlier cases having a length of stay less than or equal to a predetermined IPPS threshold were reimbursed based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) an amount comparable to what would otherwise be paid under IPPS. These very short-stay payment provisions were suspended for three years beginning with discharges on or after December 29, 2007, pursuant to the SCHIP Extension Act.

LTAC PPS provides for an adjustment for differences in area wages resulting from salary and benefit variations. There also are additional rules for payment for patients who are transferred from a LTAC hospital to another healthcare setting and are subsequently re-admitted to the LTAC hospital. The LTAC PPS payment rates also are subject to annual adjustments.

Medicare regulations require that when two or more hospital facilities share the same provider number and are considered to be a single hospital, the "remote" or "satellite" facility must meet certain criteria with respect to the "main" facility. These criteria relate largely to demonstrating a high level of integration between the two facilities. If the criteria are not met, each facility would need to meet all Medicare requirements independently, including, for example, the minimum average length of patient stay for LTAC hospital qualification. It is advantageous for certain satellite facilities that may not independently be able to meet these Medicare requirements to maintain provider-based status so that they will be reimbursed at the higher rate for LTAC hospitals under Medicare. If CMS determines that facilities claiming to be provider-based and being reimbursed accordingly do not meet the integration requirements of the regulations, CMS may recover the amount of any excess reimbursements based upon that claimed status. We have several hospitals in which multiple facilities share a Medicare provider number, and the failure of any one or more of them to meet the provider-based status regulations could materially and adversely affect our business, financial position, results of operations and liquidity.

We cannot predict the ultimate long-term impact of LTAC PPS. This payment system is subject to significant change. Slight variations in patient acuity or length of stay could significantly change Medicare revenues generated under LTAC PPS. In addition, our hospitals may not be able to appropriately adjust their operating costs to changes in patient acuity and length of stay or to changes in reimbursement rates. In addition, we cannot assure you that LTAC PPS will not have a material adverse effect on revenues from non-government third party payors. Various factors, including a reduction in average length of stay, have negatively impacted revenues from non-government third party payors in recent years.

SCHIP Extension Act.

The SCHIP Extension Act became law on December 29, 2007. This legislation provides for, among other things:

(1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria;

(2) enhanced medical necessity review of LTAC hospital cases;

(3) a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development;

(4) a three-year moratorium on an increase in the number of licensed beds at a LTAC hospital or satellite facility, subject to exceptions for states where there is only one other LTAC hospital and upon request following the closure or decrease in the number of licensed beds at a LTAC hospital within the state;

(5) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS;

(6) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 1, 2007;

(7) a three-year moratorium on the application of the so-called "25 Percent Rule" to freestanding LTAC hospitals;

(8) a three-year period during which LTAC hospitals that are co-located with another hospital may admit up to 50% of their patients from their co-located hospital and still be paid according to LTAC PPS;

(9) a three-year period during which LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS; and

(10) the elimination of the July 1, 2007 market basket increase in the standard federal payment rate of 0.71%, effective for discharges occurring on or after April 1, 2008.

The three year moratorium beginning on December 29, 2007 on the establishment and classification of new LTAC hospitals, LTAC satellite facilities and LTAC beds in existing LTAC hospitals or satellite hospitals does not apply to LTAC hospitals that, before December 29, 2007, (1) began the qualifying period for payment under LTAC PPS, (2) had a written agreement with an unrelated party for the construction, renovation, lease or demolition for a LTAC hospital and had expended at least 10% of the estimated cost of the project or $2,500,000, or (3) had obtained an approved certificate of need. The moratorium also does not apply to an increase in beds in an existing hospital or satellite facility if the LTAC hospital is located in a state where there is only one other LTAC hospital and the LTAC hospital requests an increase in beds following the closure or the decrease in the number of beds of the other LTAC hospital.

Recent Medicare Rate Adjustments.

On July 31, 2009, CMS issued final regulations regarding Medicare reimbursement for LTAC hospitals for the fiscal year beginning October 1, 2009. These final regulations include a recalibration of the MS-LTC-DRG payment weights as well as updates to the payment rates. CMS indicated that these changes will result in a 3.3% increase to average Medicare payments to LTAC hospitals. The 2.7% annualized reduction that resulted from a recalibration of MS-LTC-DRG payment weights on June 3, 2009 is incorporated into the final October 1, 2009 payment weights.

On May 2, 2008, CMS issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the "2008 Final Rule") that became effective for discharges occurring on or after July 1, 2008. The 2008 Final Rule projected an overall increase in payments to all Medicare certified LTAC hospitals of approximately 2.5%. Included in the 2008 Final Rule were (1) an increase to the standard federal payment rate of 2.7% (as compared to the adjusted federal rate for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.1%; (3) an increase in the high cost outlier threshold per discharge to $22,960; and (4) an extension of the rate year cycle for one year to September 30, 2009, in order to be consistent thereafter with the federal fiscal year that begins October 1 of each year.

On May 1, 2007, CMS issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the "2007 Final Rule") that became effective for discharges occurring on or after July 1, 2007. The 2007 Final

Rule was amended on June 29, 2007 by revising the high cost outlier threshold. The 2007 Final Rule projected an overall decrease in payments to all Medicare certified LTAC hospitals of approximately 1.2%. Included in the 2007 Final Rule were (1) an increase to the standard federal payment rate of 0.71% (which was eliminated for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) revisions to payment methodologies impacting short-stay outliers, which reduce payments by 0.9% (currently subject to a three-year moratorium pursuant to the SCHIP Extension Act); (3) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.5%; (4) an increase in the high cost outlier threshold per discharge to $20,707, resulting in projected reductions of 0.4%; and (5) an extension of the policy known as the "25 Percent Rule" to all LTAC hospitals (as discussed in more detail below), with a three-year phase-in, which CMS projected would not result in payment reductions for the first year of implementation (also currently subject to a three-year moratorium pursuant to the SCHIP Extension Act).

The 25 Percent Rule and Other Rules Impacting Reimbursement to HIHs.

CMS has regulations governing payments to LTAC hospitals that are co-located with another hospital, such as a HIH. The rules generally limit Medicare payments to the HIH if the Medicare admissions to the HIH from its co-located hospital exceed 25% of the total Medicare discharges for the HIH's cost reporting period, the so-called "25 Percent Rule." There are limited exceptions for admissions from rural, urban single and MSA Dominant hospitals. Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non co-located hospital, are eligible for the full payment under LTAC PPS. If the HIH's admissions from the co-located hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of (1) the amount payable under LTAC PPS or (2) the amount payable under IPPS. At December 31, 2009, we operated 16 HIHs with 692 licensed beds.

In the 2007 Final Rule, the "25 Percent Rule" was expanded to all LTAC hospitals, regardless of whether they are co-located with another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon IPPS rates. Under the 2007 Final Rule, the 25% threshold was to be phased in over three years. Hospitals having fiscal years beginning on or after July 1, 2007 and before July 1, 2008, including most of our hospitals, had their admission cap initially established at the lesser of 75% of Medicare referrals or the actual percentage of Medicare referrals received from a primary referral source for that hospital in the base year of 2005. For most of our hospitals, this initial first year cap began on September 1, 2007. Beginning on September 1, 2008, the cap would have been reduced to the lesser of 50% of Medicare referrals or the actual percentage of Medicare referrals for that hospital in the 2005 base year. The fully phased-in cap of 25% would have applied to most of our hospitals after September 1, 2009.

As set forth above, the SCHIP Extension Act has placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals. In addition, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals may admit up to 50% of their patients from their co-located hospital and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS. The three-year moratorium of the "25 Percent Rule" threshold payment adjustment for freestanding hospitals and grandfathered HIHs will expire for cost reporting periods beginning on or after July 1, 2010. The expansion of the admission limit to 50% for non-grandfathered, LTAC hospitals from their co-located hospital will expire for cost reports beginning on or after October 1, 2010, the same time at which the 75% limit for MSA Dominant hospitals will expire.

Medicaid Reimbursement of Long-term Acute Care Hospitals – The Medicaid program is designed to provide medical assistance to individuals unable to afford care. Medicaid payments are made under a number of different systems, which include cost-based reimbursement, prospective payment systems or programs that

negotiate payment levels with individual hospitals. Medicaid programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by state agencies and certain government funding limitations, all of which may increase or decrease the level of payments to our hospitals.

Non-government and Medicare Advantage Payment – The hospital division seeks to maximize the number of non-government payment patients admitted to its hospitals, including those covered under commercial insurance and managed care health plans. Non-government payment patients typically have financial resources (including insurance coverages) to pay for their services and do not rely on government programs for support. It is important to our business to establish relationships with commercial insurers, managed care health plans and other private payors and to maintain our reputation with such payors as a provider of quality patient care. We negotiate contracts with purchasers of group healthcare services, including private employers, commercial insurers and managed care companies. Some payor organizations attempt to obtain discounts from established charges. We focus on demonstrating to these payors how our services can provide them and their customers with the most viable pricing arrangements in circumstances where they may otherwise be faced with funding treatment at higher rates at other healthcare providers. The importance of obtaining contracts with commercial insurers, managed care health plans and other private payors varies among markets, depending on such factors as the number of commercial payors and their relative market strength. Failure to obtain contracts with certain commercial insurers and managed care health plans or reductions in payments for our services provided to individuals covered by commercial insurance could have a material adverse effect on our business, financial position, results of operations and liquidity.

Health Services Division

General Regulations. The development and operation of nursing and rehabilitation centers and the provision of healthcare services are subject to federal, state and local laws relating to the adequacy of medical care, equipment, personnel, operating policies, fire prevention, rate-setting and compliance with building codes and environmental laws. Nursing and rehabilitation centers are subject to periodic inspection by governmental and other authorities to ensure continued compliance with various standards, continued licensing under state law, certification under the Medicare and Medicaid programs and continued participation in the Veterans Administration program. The failure to obtain, maintain or renew any required regulatory approvals or licenses could adversely affect nursing center operations including their financial results.

As noted above, the health services division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

In certain circumstances, federal law mandates that conviction for certain abusive or fraudulent behavior with respect to one nursing center may subject other facilities under common control or ownership to disqualification from participation in the Medicare and Medicaid programs. In addition, some regulations provide that all nursing and rehabilitation centers under common control or ownership within a state are subject to being delicensed if any one or more of such facilities are delicensed.

Licensure and Requirements for Participation. The nursing and rehabilitation centers operated and managed by the health services division are licensed either on an annual or bi-annual basis and generally are certified annually for participation in Medicare and Medicaid programs through various regulatory agencies that

determine compliance with federal, state and local laws. These legal requirements relate to compliance with the laws and regulations governing the operation of nursing and rehabilitation centers including the quality of nursing care, the qualifications of the administrative and nursing personnel, and the adequacy of the physical plant and equipment. Federal regulations determine the survey process for nursing and rehabilitation centers that is followed by state survey agencies. The state survey agencies recommend to CMS the imposition of federal sanctions and impose state sanctions on facilities for noncompliance with certain requirements. Available sanctions include, but are not limited to, imposition of civil monetary penalties, temporary suspension of payment for new admissions, appointment of a temporary manager, suspension of payment for eligible patients and suspension or decertification from participation in the Medicare and Medicaid programs.

We believe that substantially all of our nursing and rehabilitation centers are in substantial compliance with applicable Medicare and Medicaid requirements of participation. In the ordinary course of business, however, our nursing and rehabilitation centers periodically receive statements of deficiencies from regulatory agencies. In response, the nursing and rehabilitation centers implement plans of correction to address the alleged deficiencies. In most instances, the regulatory agency accepts the nursing center's plan of correction and places the nursing center back into compliance with regulatory requirements. In some cases, the regulatory agency may take a number of adverse actions against the nursing center, including the imposition of fines, temporary suspension of admission of new residents to the nursing center, decertification from participation in the Medicaid and/or Medicare programs and, in extreme circumstances, revocation of the nursing center's license.

Overview of Health Services Division Reimbursement

Medicare – The Medicare Part A program provides reimbursement for extended care services furnished to Medicare beneficiaries who are admitted to nursing and rehabilitation centers after at least a three-day stay in an acute care hospital. Covered services include supervised nursing care, room and board, social services, physical, speech and occupational therapies, pharmaceuticals, supplies and other necessary services provided by nursing and rehabilitation centers. Medicare payments to our nursing and rehabilitation centers are based upon certain resource utilization grouping ("RUG") payment rates developed by CMS that provide various levels of reimbursement based upon patient acuity.

The Balanced Budget Act established a Medicare prospective payment system ("PPS") for nursing centers for cost reporting periods beginning on or after July 1, 1998. The payments received under PPS cover substantially all services for Medicare residents including all ancillary services, such as respiratory therapy, physical therapy, occupational therapy, speech therapy and certain covered pharmaceuticals.

Medicare Part B provides reimbursement for certain physician services, limited drug coverage and other outpatient services, such as therapy and other services, outside of a Medicare Part A covered patient stay. Since 2006, federal legislation has provided for an annual Medicare Part B outpatient therapy cap. In succeeding years, CMS subsequently increased the amount of the therapy cap. Legislation also was passed that required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. Legislation has annually extended the Medicare Part B outpatient therapy cap. Most recently, the Medicare Improvements for Patients and Providers Act of 2008, enacted on July 15, 2008, extended the therapy cap exception process from July 1, 2008 to December 31, 2009. The therapy cap exception process expired on December 31, 2009 and the current therapy cap for 2010 is $1,860.

On January 1, 2006, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("Medicare Part D") implemented a major expansion of the Medicare program through the introduction of a prescription drug benefit. Under Medicare Part D, dual eligible patients have their outpatient prescription drug costs covered by this new Medicare benefit, subject to certain limitations. Most of our nursing center patients whose drug costs were previously covered by state Medicaid programs are dual eligible patients who qualify for the Medicare drug benefit. Accordingly, Medicaid is no longer a primary payor for the pharmacy services provided to these residents.

Recent Medicare Rate Adjustments

On July 31, 2009, CMS issued final regulations regarding Medicare reimbursement for nursing centers for the fiscal year beginning October 1, 2009. Included in these regulations are (1) a market basket increase to the federal payment rates of 2.2%, (2) updates to the wage indexes which adjust the federal payment, and (3) a reduction in the RUG indexes attributed to a CMS forecast error in a prior year, resulting in a 3.3% reduction in payments. CMS estimated that these changes will result in a net decrease in Medicare payments to nursing and rehabilitation centers of 1.1%.

In addition, for the fiscal year beginning October 1, 2010, CMS will increase the number of RUG categories for nursing centers from 53 to 66 (i.e. RUGs IV) and amend the criteria, including the provision of therapy services, currently used to classify patients into these categories. CMS has indicated that these changes will be enacted in a budget neutral manner. While we are unable to estimate the impact of these changes, the operating results of our contract rehabilitation services business may be adversely affected.

On July 31, 2008, CMS issued final regulations regarding Medicare reimbursement for nursing centers for the fiscal year beginning October 1, 2008. These regulations included, among other things, a market basket increase to the federal payment rates of 3.4% and updates to the wage indexes which adjusted the federal payment. CMS estimates that the overall impact of these proposed changes will be a net increase in payments of 3.4%.

Medicaid – Medicaid is a state-administered program financed by state funds and matching federal funds. The program provides for medical assistance to the indigent and certain other eligible persons. Although administered under broad federal regulations, states are given flexibility to construct programs and payment methods consistent with their individual goals. Accordingly, these programs differ in many respects from state to state.

The health services division provides to eligible individuals Medicaid-covered services consisting of nursing care, room and board and social services. In addition, states may at their option cover other services such as physical, occupational and speech therapies and pharmaceuticals. Medicaid programs also are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by the state agencies and certain government funding limitations, all of which may materially increase or decrease the level of program payments to nursing and rehabilitation centers operated by the health services division. We believe that the payments under many of these programs may not be sufficient on an overall basis to cover the costs of serving certain patients participating in these programs. In addition, the recent downturn in the United States economy has accentuated budgetary pressures impacting state fiscal budgets, thereby further reducing Medicaid payments to our nursing and rehabilitation centers from current levels.

There continue to be legislative and regulatory proposals that would impose further limitations on government and private payments to providers of healthcare services. The Balanced Budget Act eased existing impediments on the ability of states to reduce their Medicaid reimbursement levels. Many states are considering or have enacted measures that are designed to reduce their Medicaid expenditures and to make certain changes to private healthcare insurance. As states face budgetary issues, we anticipate further pressure on Medicaid rates that could negatively impact payments to our nursing and rehabilitation centers.

In addition, some states seek to increase the levels of funding contributed by the federal government to their Medicaid programs through a mechanism known as a provider tax. Under these programs, states levy a tax on healthcare providers, which increases the amount of state revenue available to expend on the Medicaid program. This increase in program revenues increases the payment made by the federal government to the state in the form of matching funds. Consequently, the state then has more funds available to support Medicaid rates for providers of Medicaid covered services. However, states may not necessarily use these funds to increase payments to nursing center providers. Provider tax plans are subject to approval by the federal government and were included as a provision in the Tax Relief and Health Care Act of 2006, codifying the maximum Medicaid provider tax rate

at 5.5% through fiscal year 2011. Although these plans have been approved in the past, we cannot assure you that such plans will be approved by the federal government in the future.

Non-government and Medicare Advantage Payment – The health services division seeks to maximize the number of non-government payment residents admitted to our nursing and rehabilitation centers, including those covered under private insurance and managed care health plans. Non-government payment residents typically have financial resources (including insurance coverages) to pay for their services and do not rely on government programs for support. It is important to our business to establish relationships with commercial insurers, managed care health plans and other private payors and to maintain our reputation with such payors as a provider of quality patient and resident care. We negotiate contracts with purchasers of group healthcare services, including private employers, commercial insurers and managed care companies. Some payor organizations attempt to obtain discounts from established charges. We focus on demonstrating to these payors how our services can provide them and their customers with the most viable pricing arrangements in circumstances where they may otherwise be faced with funding treatment at higher rates at other healthcare providers. The importance of obtaining contracts with commercial insurers, managed care health plans and other private payors varies among markets, depending on such factors as the number of commercial payors and their relative market strength. Failure to obtain contracts with certain commercial insurers and managed care health plans or reductions in payments for our services provided to individuals covered by commercial insurance could have a material adverse effect on our business, financial position, results of operations and liquidity.

Rehabilitation Division

General Regulations. The rehabilitation division is subject to various federal and state regulations. Therapists and other healthcare professionals that we employ are required to be individually licensed or certified pursuant to applicable state and federal laws. We have processes in place in an effort to ensure that our therapists and other healthcare professionals are licensed or certified in accordance with applicable federal and state laws. In addition, we require our therapists and other employees to participate in continuing education programs. The failure of a therapist or other healthcare professional to obtain, maintain or renew required licenses or certifications could adversely affect a client's and our operations, including negatively impacting our financial results.

As noted above, the rehabilitation division is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-fraud and anti-kickback laws discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers. Some states also prohibit for-profit corporations from providing rehabilitation services through therapists who are directly employed by the corporation or otherwise providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of eligibility to contract with long-term care facilities, hospitals and other providers participating in Medicare, Medicaid and other federal healthcare programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Overview of Rehabilitation Division Revenues

The rehabilitation division receives payment for the services it provides to patients and residents of the nursing centers, acute and long-term acute care hospitals, outpatient clinics, home health agencies, assisted living facilities, school districts and hospice providers that we serve. The payments are based upon negotiated patient per diem rates, negotiated per minute rates or a fee schedule based upon the type of service rendered.

As noted above, various federal and state laws and regulations govern reimbursement to long-term care facilities, hospitals and other healthcare providers participating in Medicare, Medicaid and other federal

healthcare programs. Though these laws and regulations are generally not applicable to our rehabilitation division, they are applicable to our customers. If our customers fail to comply with these laws and regulations they could be subject to possible sanctions, including loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties, which could materially and adversely affect our business, financial position, results of operations and liquidity. In addition, there continue to be legislative and regulatory proposals to contain healthcare costs by imposing further limitations on government and private payments to providers of healthcare services.

Since 2006, federal legislation has provided for an annual Medicare Part B outpatient therapy cap. In succeeding years, CMS subsequently increased the therapy cap. Legislation also was passed that required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. Legislation has annually extended the Medicare Part B outpatient therapy cap. Most recently, the Medicare Improvements for Patients and Providers Act of 2008, enacted on July 15, 2008, extended the therapy cap exception process from July 1, 2008 to December 31, 2009. The therapy cap exception process expired on December 31, 2009 and the current therapy cap for 2010 is $1,860.

In addition, for the fiscal year beginning October 1, 2010, CMS will increase the number of RUG categories for nursing centers from 53 to 66 (i.e. RUGs IV) and amend the criteria, including the provision of therapy services, currently used to classify patients into these categories. CMS has indicated that these changes will be enacted in a budget neutral manner. While we are unable to estimate the impact of these changes, the operating results of our contract rehabilitation services business may be adversely affected.

Reductions in the reimbursement provided to our customers by Medicare or Medicaid could negatively impact the demand and price for our services and could have a material adverse effect on our rehabilitation revenues and growth prospects.

MASTER LEASE AGREEMENTS

At December 31, 2009, we leased from Ventas and its affiliates 38 LTAC hospitals and 159 nursing centers under four master lease agreements (as amended, the "Master Lease Agreements"). Under the Master Lease Agreements, Ventas has a right to sever properties from the existing leases in order to create additional leases, a device adopted to facilitate its financing flexibility. In such circumstances, our aggregate lease obligations remain unchanged.

On April 30, 2009, we entered into agreements with Ventas to renew the leases for 86 nursing centers and 22 LTAC hospitals (collectively, the "2010 Renewal Facilities") for an additional five years. The initial lease term for the 2010 Renewal Facilities was set to expire in April 2010.

In addition, we completed the 2009 Facility Acquisitions for $55.7 million in June 2009 and paid Ventas a lease termination fee of $2.3 million.

The following summary description of the Master Lease Agreements is qualified in its entirety by reference to the Master Lease Agreements as filed with the Securities and Exchange Commission (the "SEC").

Term and Renewals

Each Master Lease Agreement includes land, buildings, structures and other improvements on the land, easements and similar appurtenances to the land and improvements, and permanently affixed equipment, machinery and other fixtures relating to the operation of the leased properties. There are several bundles of leased properties under each Master Lease Agreement, with each bundle containing approximately five to 20 leased properties.

Under the Master Lease Agreements, the base term for 28 nursing center and eight LTAC hospital leases (which are contained in four renewal bundles) is scheduled to expire in April 2013 (the "2013 Lease Renewals").

At our option, the 2013 Lease Renewals may be extended for one five-year renewal term beyond the base term at the then existing rental rate plus the then existing escalation amount per annum. If we elect to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed.

The base terms for 45 nursing centers and eight LTAC hospitals as well as the 2010 Renewal Facilities were initially set to expire in April 2008 and 2010, respectively, but were each renewed for additional five-year terms. We may further extend the term of these leases for two additional five-year renewal terms beyond the first renewal term at the greater of (1) the then existing rental rate plus the then existing escalation amount per annum or (2) the then fair market value rental rate. The fair market value rental rate is determined through an appraisal procedure set forth in the Master Lease Agreements. The then fair market value rental rate may be materially higher than the existing rental rate. In such a situation we may be forced to either not exercise the renewal or pay the higher rental rate, either of which could have a material adverse effect on our business, financial position, results of operations and liquidity. If we elect to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed.

The following chart sets forth the remaining lease renewals under the Master Lease Agreements:

			Facility renewals		
Expiration date	Renewal date		Nursing centers	Hospitals	Renewal bundles
April 30, 2013	November 1, 2011 –	April 29, 2012	28	8	4
April 30, 2013	November 1, 2011 –	April 29, 2012	45	8	7
April 30, 2015	November 1, 2013 –	April 29, 2014	86	22	11

We may not extend the Master Lease Agreements beyond the base term or any previously exercised renewal term if, at the time we seek such extension and at the time such extension takes effect, (1) an event of default has occurred and is continuing or (2) a Medicare/Medicaid event of default (as described below) and/or a licensed bed event of default (as described below) has occurred and is continuing with respect to three or more leased properties subject to a particular Master Lease Agreement. The base term and renewal term of each Master Lease Agreement are subject to termination upon default by us (subject to certain exceptions) and certain other conditions described in the Master Lease Agreements.

Rental Amounts and Escalators

Each Master Lease Agreement is commonly known as a triple-net lease or an absolute-net lease. Accordingly, in addition to rent, we are required to pay the following: (1) all insurance required in connection with the leased properties and the business conducted on the leased properties, (2) certain taxes levied on or with respect to the leased properties (other than taxes on the income of Ventas) and (3) all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties.

Under the Master Lease Agreements, the annual aggregate base rent owed by us currently approximates $242 million. We paid rents to Ventas (including amounts classified as discontinued operations) approximating $243 million for the year ended December 31, 2009, $239 million for the year ended December 31, 2008 and $238 million for the year ended December 31, 2007.

Each Master Lease Agreement provides for rent escalations each May 1 if the patient revenues for the leased properties meet certain criteria as measured using the preceding calendar year revenues as compared to the base period. All annual rent escalators are payable in cash. In connection with the exercise of the rent reset by Ventas in 2006, the rent escalations were modified. The contingent annual rent escalator is 2.7% for Master Lease Agreements Nos. 1, 3 and 4. The contingent annual rent escalator for Master Lease Agreement No. 2 is based

upon the Consumer Price Index with a floor of 2.25% and a ceiling of 4%. In 2009, the contingent annual rent escalator for Master Lease Agreement No. 2 was 2.25%.

Use of the Leased Property

The Master Lease Agreements require that we utilize the leased properties solely for the provision of healthcare services and related uses and as Ventas may otherwise consent. We are responsible for maintaining or causing to be maintained all licenses, certificates and permits necessary for the leased properties to comply with various healthcare and other regulations. We also are obligated to operate continuously each leased property as a provider of healthcare services.

Events of Default

Under each Master Lease Agreement, an "Event of Default" will be deemed to occur if, among other things:

- we fail to pay rent or other amounts within five days after notice,
- we fail to comply with covenants, which failure continues for 30 days or, so long as diligent efforts to cure such failure are being made, such longer period (not over 180 days) as is necessary to cure such failure,
- certain bankruptcy or insolvency events occur, including filing a petition of bankruptcy or a petition for reorganization under the bankruptcy code,
- an event of default arises from our failure to pay principal or interest on any indebtedness exceeding $50 million,
- the maturity of any indebtedness exceeding $50 million is accelerated,
- we cease to operate any leased property as a provider of healthcare services for a period of 30 days,
- a default occurs under any guaranty of any lease or the indemnity agreements with Ventas,
- we or our subtenant lose any required healthcare license, permit or approval or fail to comply with any legal requirements as determined by a final unappealable determination,
- we fail to maintain insurance,
- we create or allow to remain certain liens,
- we breach any material representation or warranty,
- a reduction occurs in the number of licensed beds in a facility, generally in excess of 10% (or less than 10% if we have voluntarily "banked" licensed beds) of the number of licensed beds in the applicable facility on the commencement date (a "licensed bed event of default"),
- Medicare or Medicaid certification with respect to a participating facility is revoked and re-certification does not occur for 120 days (plus an additional 60 days in certain circumstances) (a "Medicare/Medicaid event of default"),
- we become subject to regulatory sanctions as determined by a final unappealable determination and fail to cure such regulatory sanctions within the specified cure period for any facility,
- we fail to cure a breach of any permitted encumbrance within the applicable cure period and, as a result, a real property interest or other beneficial property right of Ventas is at material risk of being terminated, or
- we fail to cure the breach of any of the obligations of Ventas as lessee under any existing ground lease within the applicable cure period and, if such breach is a non-monetary, non-material breach, such existing ground lease is at material risk of being terminated.

Remedies for an Event of Default

Except as noted below, upon an Event of Default under one of the Master Lease Agreements, Ventas may, at its option, exercise the following remedies:

(1) after not less than ten days notice to us, terminate the Master Lease Agreement to which such Event of Default relates, repossess any leased property, relet any leased property to a third party and require that we pay to Ventas, as liquidated damages, the net present value of the rent for the balance of the term, discounted at the prime rate,

(2) without terminating the Master Lease Agreement to which such Event of Default relates, repossess the leased property and relet the leased property with us remaining liable under such Master Lease Agreement for all obligations to be performed by us thereunder, including the difference, if any, between the rent under such Master Lease Agreement and the rent payable as a result of the reletting of the leased property, and

(3) seek any and all other rights and remedies available under law or in equity.

In addition to the remedies noted above, under the Master Lease Agreements, in the case of a facility-specific event of default, Ventas may terminate a Master Lease Agreement as to the leased property to which the Event of Default relates, and may, but need not, terminate the entire Master Lease Agreement. Each of the Master Lease Agreements includes special rules relative to Medicare/Medicaid events of default and a licensed bed event of default. In the event a Medicare/Medicaid event of default and/or a licensed bed event of default occurs and is continuing (a) with respect to not more than two properties at the same time under a Master Lease Agreement that covers 41 or more properties and (b) with respect to not more than one property at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, Ventas may not exercise termination or dispossession remedies against any property other than the property or properties to which the event of default relates. Thus, in the event Medicare/Medicaid events of default and licensed bed events of default would occur and be continuing (a) with respect to one property under a Master Lease Agreement that covers less than 20 properties, (b) with respect to two or more properties at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, or (c) with respect to three or more properties at the same time under a Master Lease Agreement that covers 41 or more properties, then Ventas would be entitled to exercise all rights and remedies available to it under the Master Lease Agreements.

Assignment and Subletting

Except as noted below, the Master Lease Agreements provide that we may not assign, sublease or otherwise transfer any leased property or any portion of a leased property as a whole (or in substantial part), including by virtue of a change of control, without the consent of Ventas, which may not be unreasonably withheld if the proposed assignee (1) is a creditworthy entity with sufficient financial stability to satisfy its obligations under the related Master Lease Agreement, (2) has not less than four years experience in operating healthcare facilities for the purpose of the applicable facility's primary intended use, (3) has a favorable business and operational reputation and character, and (4) has all licenses, permits, approvals and authorizations to operate the facility and agrees to comply with the use restrictions in the related Master Lease Agreement. The obligation of Ventas to consent to a subletting or assignment is subject to the reasonable approval rights of any mortgagee and/or the lenders under its credit agreement. We may sublease up to 20% of each leased property for restaurants, gift shops and other stores or services customarily found in hospitals or nursing centers without the consent of Ventas, subject, however, to there being no material alteration in the character of the leased property or in the nature of the business conducted on such leased property.

In addition, each Master Lease Agreement allows us to assign or sublease (a) without the consent of Ventas, 10% of the nursing center facilities in each Master Lease Agreement and (b) with Ventas's consent (which consent will not be unreasonably withheld, delayed or conditioned), two hospitals in each Master Lease

Agreement, if either (i) the applicable regulatory authorities have threatened to revoke our Medicaid or Medicare certification or an authorization necessary to operate such leased property or (ii) we cannot profitably operate such leased property. Any such proposed assignee/sublessee must satisfy the requirements listed above and it must have all licenses, permits, approvals and other authorizations required to operate the leased properties in accordance with the applicable permitted use. With respect to any assignment or sublease made under this provision, Ventas agrees to execute a nondisturbance and attornment agreement with such proposed assignee or subtenant. Upon any assignment or subletting, we will not be released from our obligations under the applicable Master Lease Agreement.

Subject to certain exclusions, we must pay to Ventas 80% of any consideration received by us on account of an assignment and 80% (50% in the case of existing subleases) of sublease rent payments (approximately equal to revenue net of specified allowed expenses attributable to a sublease, and specifically defined in the Master Lease Agreements), provided that Ventas's right to such payments will be subordinate to that of our lenders.

Ventas will have the right to approve the purchaser at a foreclosure of one or more of our leasehold mortgages by our lenders. Such approval will not be unreasonably withheld so long as such purchaser is creditworthy, reputable and has four years experience in operating healthcare facilities. Any dispute regarding whether Ventas has unreasonably withheld its consent to such purchaser will be subject to expedited arbitration.

ADDITIONAL INFORMATION

Employees

As of December 31, 2009, we had approximately 39,500 full-time and 14,600 part-time and per diem employees. We had approximately 2,800 unionized employees at 29 of our facilities as of December 31, 2009.

The market for qualified nurses, therapists and other healthcare professionals is highly competitive. We, like other healthcare providers, have experienced difficulties in attracting and retaining qualified personnel such as nurses, certified nurse's assistants, nurse's aides, therapists and other providers of healthcare services. Our hospitals and nursing and rehabilitation centers are particularly dependent on nurses for patient care. Our rehabilitation division continues to seek qualified therapists to fill open positions. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract personnel. We expect to continue to experience increases in our labor costs primarily due to higher wages and greater benefits required to attract and retain qualified healthcare personnel. Salaries, wages and benefits were approximately 58% of our consolidated revenues for the year ended December 31, 2009. Our ability to manage labor costs will significantly affect our future operating results.

Professional and General Liability Insurance

Our healthcare operations are primarily insured for professional and general liability risks by our wholly owned limited purpose insurance subsidiary, Cornerstone Insurance Company ("Cornerstone"). Cornerstone insures initial losses up to specified coverage levels per occurrence. On a per claim basis, coverages for losses in excess of those insured by Cornerstone are maintained through unaffiliated commercial insurance carriers. Cornerstone insures all claims in all states up to a per occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk.

We believe that our insurance is adequate in amount and coverage. There can be no assurance that in the future such insurance will be available at a reasonable price or that we will be able to maintain adequate levels of professional and general liability insurance coverage.

Where You Can Find More Information

We file annual, quarterly and special reports, proxy statements and other information with the SEC under the Exchange Act.

You also may read or obtain copies of this information in person or by mail from the SEC's Public Reference Room, 100 F Street, NE, Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our filings with the SEC also are available to the public on the SEC website at *http://www.sec.gov*, which contains reports, proxy and information statements and other information. You also may inspect reports, proxy statements and other information about us at the office of the NASD, Inc. at 1735 K Street, N.W., Washington, D.C. 20006.

Our filings with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments thereto, are available free of charge on our website, through a link to the SEC's website, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Our website is *www.kindredhealthcare.com*. Information made available on our website is not a part of this document.

Item 1A. ***Risk Factors***

Certain statements made in this Annual Report on Form 10-K and the documents we incorporate by reference in this Annual Report on Form 10-K include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements regarding our 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 you must recognize that actual results may differ materially from our expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based upon management's current expectations and include known and unknown risks, uncertainties and other factors, many of which we are unable to predict or control, that may cause our 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 our filings with the SEC. Factors that may affect our plans or results include, without limitation:

- the potential impact of healthcare reform, which would initiate significant reforms to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors. Healthcare reform would impact each of our businesses in some manner. Due to the unsettled nature of the current healthcare reform bills, the substantial regulatory changes that would need to be implemented by CMS and others, and the numerous processes required to implement these reforms, we cannot predict which healthcare initiatives will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on our business, financial position, results of operations and liquidity,
- changes in the reimbursement rates or the methods or timing of payment from third party payors, including the Medicare and Medicaid programs, changes arising from and related to LTAC PPS, including potential changes in the Medicare payment rules, Medicare Part D and changes in Medicare and Medicaid reimbursements for our nursing centers, and the expiration of the Medicare Part B therapy cap exception process,

- the effects of additional legislative changes and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry,
- the impact of the SCHIP Extension Act, including the ability of our hospitals to adjust to potential LTAC certification, medical necessity reviews and the three-year moratorium on future hospital development that expires December 29, 2010,
- the impact of the expiration of several moratoriums under the SCHIP Extension Act which could impact the short stay rules, the budget neutrality adjustment as well as implement the "25 Percent Rule," which could limit certain patient admissions,
- failure of our facilities to meet applicable licensure and certification requirements,
- the further consolidation and cost containment efforts of managed care organizations and other third party payors,
- our ability to meet our rental and debt service obligations,
- our ability to operate pursuant to the terms of our debt obligations and the Master Lease Agreements,
- the condition of the financial markets, including volatility and weakness in the equity, capital and credit markets, which could limit the availability and terms of debt and equity financing sources to fund the requirements of our businesses, or which could negatively impact our investment portfolio,
- national and regional economic, financial, business and political conditions, including their effect on the availability and cost of labor, credit, materials and other services,
- our ability to control costs, particularly labor and employee benefit costs,
- increased operating costs due to shortages in qualified nurses, therapists and other healthcare personnel,
- our ability to attract and retain key executives and other healthcare personnel,
- the increase in the costs of defending and insuring against alleged professional liability claims and our ability to predict the estimated costs related to such claims, including the impact of differences in actuarial assumptions and estimates compared to eventual outcomes,
- our ability to successfully reduce (by divestiture of operations or otherwise) our exposure to professional liability claims,
- our ability to successfully pursue our development activities, including through acquisitions, and successfully integrate new operations, including the realization of anticipated revenues, economies of scale, cost savings and productivity gains associated with such operations,
- our ability to successfully dispose of unprofitable facilities,
- events or circumstances which could result in impairment of an asset or other charges,
- changes in generally accepted accounting principles or practices, and
- our ability to maintain an effective system of internal control over financial reporting.

Many of these factors are beyond our control. We caution you that any forward-looking statements made by us are not guarantees of future performance. We disclaim 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.

You should consider carefully all the risks described below, together with all of the information included in this Annual Report on Form 10-K, in evaluating our Company and our common stock. To facilitate your consideration of all of the risks described below, these risks are organized under headings and subheadings for

your convenience. If any of the risks described in this Annual Report on Form 10-K were to occur, it could have a material adverse effect on our business, financial position, results of operations, liquidity and stock price.

Risk Factors Relating to Reimbursement and Regulation of Our Business

Healthcare reform would initiate significant reforms to the United States healthcare system.

Congress and the White House Administration are currently considering healthcare reform bills, which would initiate significant reforms to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors. The House of Representatives has passed a healthcare reform bill entitled "The Affordable Healthcare for America Act" and the Senate has passed a healthcare reform bill entitled "The Patient Protection and Affordable Care Act." At this time, we cannot predict if or when one of these bills or similar legislation may be passed and submitted to the President.

The healthcare reforms contained in these bills would impact each of our businesses in some manner. Due to the unsettled nature of the current healthcare reform bills, the substantial regulatory changes that would need to be implemented by CMS and others, and the numerous processes required to implement these reforms, we cannot predict which healthcare reforms will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on our business.

Several of the proposed reforms are very significant and could ultimately change the nature of our services, the methods of payment for our services and the underlying regulatory environment. The proposed reforms could include modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care and the imposition of enrollment limitations on new providers. In addition, a primary goal of healthcare reform is to reduce costs, which could include reductions in the reimbursement paid to us and other healthcare providers. Moreover, healthcare reform could negatively impact insurance companies, other third party payors, our customers, as well as other healthcare providers, which may in turn negatively impact our business. As such, these healthcare reforms or other similar healthcare reforms, if adopted, could have a material adverse effect on our business, financial position, results of operations and liquidity.

Changes in the reimbursement rates or methods or timing of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins.

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for substantially all of our revenues. For the year ended December 31, 2009, we derived approximately 64% of our total revenues (before eliminations) from the Medicare and Medicaid programs and the balance from other third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Item 1 – Business."

There are continuing efforts to reform governmental healthcare programs that could result in major changes in the healthcare delivery and reimbursement system on a national and state level, including changes directly impacting the government and private reimbursement systems for our LTAC hospitals, our nursing and rehabilitation centers as well as our rehabilitation operations. Reforms or other changes to the payment systems, including modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care or the imposition of enrollment limitations on new providers, may be proposed or could be adopted by Congress or CMS in the future.

Moreover, weak economic conditions also could adversely affect the budgets of individual states and of the federal government. This could result in attempts to reduce or eliminate payments for federal and state healthcare programs, including Medicare and Medicaid, and could result in an increase in taxes and assessments on our

activities. In addition, private third party payors are continuing their efforts to control healthcare costs through direct contracts with healthcare providers, increased utilization review and greater enrollment in managed care programs and preferred provider organizations. These private payors increasingly are demanding discounted fee structures and are requesting that healthcare providers assume more financial risk.

Though we cannot predict what, if any, reform proposals will be adopted, healthcare reform and regulations may have a material adverse effect on our business, financial position, results of operations and liquidity through, among other things, decreasing funds available for our services or increased operating costs. We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. Future changes in third party payor reimbursement rates or methods, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues. Our operating margins may continue to be under pressure because of deterioration in pricing flexibility, changes in payor mix, changes in length of stay and growth in operating expenses in excess of increases in payments by third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients or commercial payors is limited. These results could have a material adverse effect on our business, financial position, results of operations and liquidity.

Future cost containment initiatives undertaken by third party payors may limit our revenues and profitability.

Initiatives undertaken by major insurers and managed care companies to contain healthcare costs or to respond to healthcare reform could affect the profitability of our services. These payors attempt to control healthcare costs by contracting with providers of healthcare to obtain services on a discounted basis. We believe that this trend may continue or intensify and may limit reimbursements for healthcare services. If insurers or managed care companies from whom we receive substantial payments reduce the amounts they pay for services, our profit margins may decline, or we may lose patients if we choose not to renew our contracts with these insurers at lower rates. These results could have a material adverse effect on our business, financial position, results of operations and liquidity.

Further consolidation of managed care organizations and other third party payors may adversely affect our profits.

Managed care organizations and other third party payors have continued to consolidate in order to enhance their ability to influence the delivery of healthcare services. Consequently, the healthcare needs of a large percentage of the United States population are increasingly served by a smaller number of managed care organizations. These organizations generally enter into service agreements with a limited number of providers for needed services. In addition, third party payors, including managed care payors, increasingly are demanding discounted fee structures. To the extent that these organizations terminate us as a preferred provider, engage our competitors as a preferred or exclusive provider or demand discounted fee structures, our business, financial position, results of operations and liquidity could be materially and adversely affected.

We conduct business in a heavily regulated industry, and changes in regulations, the enforcement thereof or violations of regulations may result in increased costs or sanctions that reduce our revenues and profitability.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense.

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities,

allowable costs, services and prices for services, facility staffing requirements, qualifications and licensure of staff, environmental and occupational health and safety, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other governmental programs. Sanctions for violating the anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid. See "Item 1 – Business – Governmental Regulation."

Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, audits, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bans on Medicare and Medicaid payments for new admissions and civil monetary penalties. RAC audits and other audits evaluating the medical necessity of services provided are expected to further intensify the regulatory environment surrounding the healthcare industry as third party firms engaged by CMS commence extensive reviews of claims data and medical and other records to identify improper payments to healthcare providers under the Medicare program. If we fail to comply with the extensive laws and regulations applicable to our businesses, we could become ineligible to receive government program reimbursement, suffer civil or criminal penalties or be required to make significant changes to our operations. In addition, we could be forced to expend considerable resources responding to investigations, audits or other enforcement actions under these laws or regulations. Furthermore, should we lose the licenses for one or more of our facilities as a result of regulatory action or otherwise, we could be in default under our Master Lease Agreements and our revolving credit facility. Failure of our staff to satisfy applicable licensure requirements or of our hospitals and nursing centers to satisfy applicable licensure and certification requirements could have a material adverse effect on our business, financial position, results of operations and liquidity.

We are unable to predict the future course of federal, state and local regulation or legislation, including Medicare and Medicaid statutes and regulations, or the intensity of federal and state enforcement actions. Changes in the regulatory framework, including those associated with healthcare reform, and sanctions from various enforcement actions could have a material adverse effect on our business, financial position, results of operations and liquidity.

We face periodic reviews, audits and investigations under our contracts with federal and state government agencies and other payors, and these audits could have adverse findings that may negatively impact our business.

As a result of our participation in the Medicare and Medicaid programs, we are subject to various governmental reviews, audits and investigations to verify our compliance with these programs and applicable laws and regulations. We also are subject to audits under various government programs, including the RAC program, in which third party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments to healthcare providers under the Medicare program. Private pay sources also reserve the right to conduct audits. Our costs to respond to and defend reviews, audits and investigations may be significant and could have a material adverse effect on our business, financial position, results of operations and liquidity. Moreover, an adverse review, audit or investigation could result in:

- required refunding or retroactive adjustment of amounts we have been paid pursuant to the Medicare or Medicaid programs or from other payors;
- state or federal agencies imposing fines, penalties and other sanctions on us;
- loss of our right to participate in the Medicare or Medicaid programs or one or more third party payor networks; or
- damage to our reputation in various markets.

These results could have a material adverse effect on our business, financial position, results of operations and liquidity.

If our LTAC hospitals fail to maintain their certification as long-term acute care hospitals, our profitability would decline.

If our LTAC hospitals, satellite LTAC facilities or HIHs fail to meet or maintain conditions for participation in the Medicare program and the standards for certification as LTAC hospitals, such as average minimum length of patient stay, they will receive payments under the prospective payment system applicable to general acute care hospitals rather than payment under the system applicable to LTAC hospitals. Payments at rates applicable to general acute care hospitals would result in our LTAC hospitals receiving less Medicare reimbursement than they currently receive for their patient services and our profitability would decline. In addition, implementation of additional LTAC hospital certification criteria and medical necessity reviews may limit the population of patients eligible for our services or change the basis upon which we are paid, which could have a material adverse effect on our business, financial position, results of operations and liquidity.

Implementation of additional patient or facility criteria for LTAC hospitals that limit the population of patients eligible for our hospital services or change the basis upon which we are paid could adversely affect our revenues and profitability.

CMS has, for a number of years, considered the development of facility and patient certification criteria for LTAC hospitals, potentially as an alternative to the current payment system under LTAC PPS. In 2004, MedPAC recommended to Congress the adoption by CMS of new facility staffing and services criteria and patient clinical characteristics and treatment requirements for LTAC hospitals in order to ensure that only appropriate patients are admitted to these facilities. Since the MedPAC recommendation, CMS has initiated studies to examine such recommendations and those studies are ongoing. Implementation of additional criteria that may limit the population of patients eligible for our hospital services or change the basis upon which we are paid could have a material adverse effect on our business, financial position, results of operations and liquidity.

The temporary moratorium on the Medicare certification of new LTAC hospitals and beds in existing LTAC hospitals will limit our ability to increase LTAC hospital bed capacity, expand into new areas or increase services in existing areas we serve.

The SCHIP Extension Act imposed a three-year moratorium beginning on December 29, 2007 on the establishment and classification of new LTAC hospitals, LTAC satellite facilities and LTAC beds in existing LTAC hospitals or satellite hospitals. The moratorium does not apply to LTAC hospitals that, before December 29, 2007, (1) began the qualifying period for payment under LTAC PPS, (2) had a written agreement with an unrelated party for the construction, renovation, lease or demolition for a LTAC hospital and had expended at least 10% of the estimated cost of the project or $2,500,000 or (3) had obtained an approved certificate of need. The moratorium also does not apply to an increase in beds in an existing hospital or satellite facility if the LTAC hospital is located in a state where there is only one other LTAC hospital and the LTAC hospital requests an increase in beds following the closure or the decrease in the number of beds of the other LTAC hospital. This moratorium may adversely affect our ability to increase LTAC bed capacity, expand into new areas or increase bed capacity in existing markets we serve.

Expiration of the moratorium imposed on certain federal regulations otherwise applicable to LTAC hospitals, including HIHs and satellite hospitals, will have an adverse effect on our future revenues and profitability.

The SCHIP Extension Act, among other things, placed a three-year moratorium on (1) the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS, and (2) the very short stay outlier payment reductions to LTAC hospitals. This three-year moratorium expires on December 29,

2010. The expiration of this moratorium could have a material adverse effect on our business, financial position, results of operations and liquidity.

CMS has regulations governing payments to LTAC hospitals that are co-located with another hospital, such as a HIH. The rules generally limit Medicare payments to the HIH if the Medicare admissions to the HIH from its co-located hospital exceed 25% of the total Medicare discharges for the HIH's cost reporting period. There are limited exceptions for admissions from rural, urban single and MSA Dominant hospitals. Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non co-located hospital, are eligible for the full payment under LTAC PPS. If the HIH's admissions from the co-located hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of (1) the amount payable under LTAC PPS or (2) the amount payable under IPPS.

In 2007 CMS expanded the "25 Percent Rule" to all LTAC hospitals, regardless of whether they are co-located with another hospital. Under this 2007 final rule, all LTAC hospitals were to be paid LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon IPPS rates.

Under the 2007 final rule, the 25% threshold was to be phased in over three years. Hospitals having fiscal years beginning on or after July 1, 2007 and before July 1, 2008, including most of our hospitals, had their admission cap initially established at the lesser of 75% of Medicare referrals or the actual percentage of Medicare referrals received from a primary referral source for that hospital in the base year of 2005. For most of our hospitals, this initial first year cap began on September 1, 2007. Beginning on September 1, 2008, the cap would have been reduced to the lesser of 50% of Medicare referrals or the actual percentage of Medicare referrals for that hospital in the 2005 base year. The fully phased-in cap of 25% would have applied to most of our hospitals after September 1, 2009.

The SCHIP Extension Act placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals. In addition, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals may admit up to 50% of their patients from their co-located hospital and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS. The three-year moratorium of the "25 Percent Rule" threshold payment adjustment for freestanding hospitals and grandfathered HIHs will expire for cost reporting periods beginning on or after July 1, 2010. The expansion of the admission limit to 50% for non-grandfathered LTAC hospitals from their co-located hospital will expire for cost reports beginning on or after October 1, 2010, the same time at which the 75% limit for MSA Dominant hospitals will expire.

Since these rules are complex and are based on the volume of Medicare admissions and the source of those admissions, we cannot predict with any certainty the impact on our future revenues or operations from these regulations. If the "25 Percent Rule" is applied as currently written, it could have a material adverse effect on our business, financial position, results of operations and liquidity when the moratorium expires.

Healthcare reform and other regulations could adversely affect the liquidity of our customers, which could have an adverse effect on their ability to make timely payments to us for our products and services.

Healthcare reform and other regulations that limit or restrict Medicare and Medicaid payments to our customers could adversely impact the liquidity of our customers, resulting in their inability to pay us, or to timely pay us, for our products and services. In addition, if our customers fail to comply with applicable laws and regulations they could be subject to possible sanctions, including loss of licensure or eligibility to participate in

reimbursement programs as well as civil and criminal penalties. These developments could have a material adverse effect on our business, financial position, results of operations and liquidity.

Risks Factors Relating to Our Capital and Liquidity

We may not be able to meet our substantial rent and debt service requirements.

A substantial portion of our cash flows from operations is dedicated to the payment of rents related to our leased properties as well as principal and interest obligations on our outstanding indebtedness, including our revolving credit facility. Subject to certain restrictions, we also have the ability to incur substantial additional borrowings under our revolving credit facility. Our existing revolving credit facility expires in July 2012. If we are unable to generate sufficient funds to meet our obligations or our revolving credit facility otherwise becomes due and payable, we may be required to refinance, restructure or otherwise amend some or all of such obligations, sell assets or raise additional cash through the sale of our equity. We cannot assure you that we would be able to obtain such refinancing on terms as favorable as our current financing or that such restructuring activities, sales of assets or issuances of equity can be accomplished or, if accomplished, would raise sufficient funds to meet these obligations. In addition, our Master Lease Agreements and/or our revolving credit facility:

- require us to dedicate a substantial portion of our cash flow to payments on our rent and interest obligations, thereby reducing the availability of cash flow to fund working capital, capital expenditures and other general corporate activities,
- require us to pledge as collateral substantially all of our assets,
- require us to maintain a certain defined fixed payment ratio at a specified level, thereby reducing our financial flexibility,
- require us to limit the amount of capital expenditures we can incur in any fiscal year and also limits the aggregate amount we can expend on acquisitions, and
- require us to operate continuously each leased property despite its level of profitability and otherwise restrict our operational flexibility.

These provisions:

- could have a material adverse effect on our ability to withstand competitive pressures or adverse economic conditions (including adverse regulatory changes),
- could adversely affect our ability to make material acquisitions, obtain future financing or take advantage of business opportunities that may arise, and
- could increase our vulnerability to a downturn in general economic conditions or in our business.

Our failure to pay rent or otherwise comply with the provisions of any of our Master Lease Agreements could materially adversely affect our business, financial position, results of operations and liquidity.

We lease 38 of our hospitals and 159 of our nursing centers from Ventas under our Master Lease Agreements. Our failure to pay the rent or otherwise comply with the provisions of any of our Master Lease Agreements would result in an "Event of Default" under such Master Lease Agreement and also would result in a default under our revolving credit facility. Upon an Event of Default, remedies available to Ventas include, without limitation, terminating such Master Lease Agreement, repossessing and reletting the leased properties and requiring us to remain liable for all obligations under such Master Lease Agreement, including the difference between the rent under such Master Lease Agreement and the rent payable as a result of reletting the leased properties, or requiring us to pay the net present value of the rent due for the balance of the term of such Master Lease Agreement. The exercise of such remedies would have a material adverse effect on our business, financial position, results of operations and liquidity.

For additional information on the Master Lease Agreements, see "Item 1 – Business – Master Lease Agreements."

The condition of the financial markets, including volatility and weakness in the equity, capital and credit markets, could limit the availability and terms of debt and equity financing sources to fund the capital and liquidity requirements of our businesses.

Financial markets experienced significant disruptions in 2009 and 2008. These disruptions have impacted liquidity in the debt markets, making financing terms for borrowers less attractive and, in certain cases, significantly reducing the availability of certain types of debt financing. Despite the recent instability within the financial markets nationally and globally, we have not experienced any individual lender limitations to extend credit under our revolving credit facility. However, the obligations of each of the lending institutions in our revolving credit facility are separate and the availability of future borrowings under our revolving credit facility could be impacted by further volatility and disruptions in the financial credit markets or other events. While the term of our revolving credit facility expires in July 2012, we cannot assure you that a prolonged downturn in the credit markets or other circumstances will not impact our ability to access our revolving credit facility or to refinance the revolving credit facility. Our inability to access our revolving credit facility or refinance the revolving credit facility would have a material adverse effect on our business, financial position, results of operations and liquidity.

Interest rates under our revolving credit facility are based, at our option, upon (a) the London Interbank Offered Rate ("LIBOR") plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. Higher interest rates could have a material adverse effect on our business, financial position, results of operations and liquidity. Moreover, current market conditions and our level of leverage make it likely that we would not be able to refinance or amend our existing revolving credit facility without experiencing higher interest rates and additional covenant restrictions.

Our revolving credit facility is collateralized by substantially all of our assets including certain owned real property and is guaranteed by substantially all of our subsidiaries. The terms of our revolving credit facility include one financial covenant and certain other provisions that limit acquisitions and annual capital expenditures. We were in compliance with the terms of our revolving credit facility at December 31, 2009. However, a downturn in operating earnings or events beyond our control could impair our ability to comply with the financial covenants contained within our revolving credit facility. If we anticipated a potential financial or other covenant violation, however, we would seek relief from our lenders, which likely would include some cost to us, and such relief may not be on terms as favorable as those in our existing revolving credit facility. Under these circumstances, there is also the potential that our lenders would not grant relief to us. A default due to the violation of a financial or other covenant contained within our revolving credit facility or the occurrence of an "Event of Default" under the Master Lease Agreements could require us to immediately repay all amounts then outstanding under the revolving credit facility.

Our inability to access external sources of financing when our revolving credit facility terminates could have a material adverse effect on our business, financial position, results of operations and liquidity.

Prior to the termination of our revolving credit facility, we will need to enter into a new revolving credit facility to continue to operate our business. There can be no assurance that we will be successful in our effort to enter into a new revolving credit facility in the future. Many lenders have been adversely impacted by recent events in the United States and international financial markets and, as a result, have ceased certain lending practices or reduced the amount of lending they have made available to borrowers. While we expect there to be alternatives available to us to enter into a new revolving credit facility, we cannot assure you that any of these alternatives will be successfully implemented.

We depend on our revolving credit facility to meet our cash requirements to operate our business. If we repay our revolving credit facility upon its termination and are unable to enter into a new revolving credit facility on terms acceptable to us, or at all, we may be forced to reduce our operations and may not be able to respond to changing business conditions or competitive pressures. As a result, our business, financial position, results of operations and liquidity could be adversely affected.

Our inability to refinance our revolving credit facility prior to its scheduled termination or maturity could cause an event of default under our Master Lease Agreements because we may not otherwise have cash available to make required rental payments. We cannot assure you that we will be able to refinance indebtedness under our revolving credit facility on terms acceptable to us, if at all. If an event of default were to occur under our revolving credit facility, our lenders would be entitled to take various actions, including all actions permitted to be taken by a secured creditor. These results would have a material adverse effect on our business, financial position, results of operations and liquidity.

We may have future capital needs and any future issuances of equity securities may dilute the value of our common stock.

Though we anticipate that the cash amounts generated internally, together with amounts available under our revolving credit facility, will be sufficient to implement our business plan for the foreseeable future, we may need additional capital if a substantial acquisition or other growth opportunity becomes available or if unexpected events occur or opportunities arise. We cannot assure you that additional capital will be available, or available on terms favorable to us. If capital is not available, we may not be able to fund internal or external business expansion or respond to competitive pressures or other market conditions. If available, we may obtain additional capital through the public or private sale of debt or equity securities. However, our ability to access the public debt or equity capital markets, on terms favorable to us or at all, may be limited by further disruptions in these markets or other events. If we sell equity securities, the transaction could be dilutive to our existing shareholders. Furthermore, these securities could have rights, preferences and privileges more favorable than those of our common stock. If we incur additional debt, our leverage would increase and could have a material adverse effect on our business, financial position, results of operations and liquidity.

Disruptions in the financial markets could negatively impact our investment portfolio.

The recent financial market disruptions have impacted the value of equity investments, bonds and other securities. We regularly hold cash in depository and money market accounts. If the financial institutions holding or managing these accounts fail or experience other disruptions, we could lose a portion or all of our cash which could have a material adverse effect on our business, financial position, results of operations and liquidity.

In addition, we hold a substantial investment portfolio in our limited purpose insurance subsidiary. Investments held in our limited purpose insurance subsidiary consist principally of cash and cash equivalents, asset backed securities, corporate bonds, U.S. Treasury notes, equities and commercial paper that are held to satisfy the payment of claims and expenses related to professional liability and workers compensation risks. Our investment policy governing insurance subsidiary investments precludes the investment portfolio managers from selling any security at a loss without prior authorization from us. The investment managers also limit the exposure to any one issue, issuer or type of investment. We intend, and have the ability, to hold insurance subsidiary investments for a long duration without the necessity of selling securities to fund the underwriting needs of our insurance subsidiary. This ability to hold securities should allow sufficient time for recovery of temporary declines in the market value of equity securities and the par value of debt securities as of their stated maturity date. We cannot assure you, however, that we will recover declines in the market value of our investments. There is a continuing risk that declines in fair value may occur and additional material realized losses from sales or other-than-temporary impairments may be recorded in the future. Furthermore, we cannot assure you that declines in the market value of our investments will not require us to further capitalize our limited purpose insurance subsidiary or otherwise have a material adverse effect on our business, financial position, results of operations and liquidity.

Our stock price is volatile and fluctuations in our operating results, quarterly earnings and other factors may result in declines in the price of our common stock.

Equity markets are prone to, and in the last few years have experienced, extreme price and volume fluctuations. Recent volatility has had a significant impact on the market price of securities issued by many

companies, including us and other companies in the healthcare industry. If we are unable to operate our businesses as profitably as we have in the past or as our stockholders expect us to in the future, the market price of our common stock will likely decline as stockholders could sell shares of our common stock when it becomes apparent that the market expectations may not be realized. In addition to our operating results, many economic and other factors beyond our control could have an adverse effect on the price of our common stock, including:

- general economic conditions;
- quarterly variations in operating results;
- changes in financial estimates and recommendations by securities analysts;
- operating and stock price performance of other companies that investors may deem comparable;
- press releases or negative publicity relating to our competitors or us or relating to trends in healthcare;
- regulatory changes and adverse outcomes from litigation and government or regulatory investigations;
- sales of stock by insiders;
- changes in our credit ratings;
- natural disasters, terrorist attacks and pandemics; and
- limitations on our ability to repurchase our common stock.

Market volatility and declines in the price of our common stock could have a material adverse effect on our ability to obtain capital or complete acquisitions through the public or private sale or issuance of our equity securities.

In addition, security holders often institute class action litigation following periods of volatility in the price of a company's securities. If the market value of our common stock experiences adverse fluctuations and we become a party to this type of litigation, regardless of the outcome, we could incur substantial legal costs and our management's attention could be diverted from the operation of our business, causing our business to decline.

Risk Factors Relating to Our Operations

We could experience significant increases to our operating costs due to shortages of qualified nurses, therapists and other healthcare professionals or union activity.

The market for qualified nurses, therapists and other healthcare professionals is highly competitive. We, like other healthcare providers, have experienced difficulties in attracting and retaining qualified personnel such as nurses, certified nurse's assistants, nurse's aides, therapists and other providers of healthcare services. Our hospitals and nursing and rehabilitation centers are particularly dependent on nurses for patient care. Our rehabilitation division continues to seek qualified therapists to fill open positions. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract personnel.

In addition, healthcare providers are continuing to see an increase in the amount of union activity across the country. At December 31, 2009, approximately 2,800 of the employees at 29 of our facilities were unionized. Though we cannot predict the degree to which we will be affected by future union activity, there are continuing legislative proposals that could result in increased union activity. We could experience an increase in labor and other costs from such union activity.

Various states in which we operate hospitals and nursing and rehabilitation centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation

of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

We expect to continue to experience increases in our labor costs primarily due to higher wages and greater benefits required to attract and retain qualified healthcare personnel. Salaries, wages and benefits were approximately 58% of our consolidated revenues for the year ended December 31, 2009. Our ability to manage labor costs will significantly affect our future operating results.

If we lose our key management personnel, we may not be able to successfully manage our business and achieve our objectives.

Our future success depends in large part upon the leadership and performance of our executive management team and key employees and our ability to retain and motivate these individuals. Competition for these individuals is intense and there can be no assurance that we will retain our key officers and employees or that we can attract or retain other highly qualified individuals in the future. If we lose the services of one or more of our key officers or employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives and we may not be able to replace them with similarly qualified personnel. If we lose key personnel, we may be unable to replace them with personnel of comparable experience, reputation in the industry or skills. The loss of any of our key officers or employees could have a material adverse effect on our business, financial position, results of operations and liquidity.

If we fail to attract patients and residents and compete effectively with other healthcare providers or if our referral sources fail to view us as an attractive long-term healthcare provider, our revenues and profitability may decline.

The long-term healthcare services industry is highly competitive. Our hospitals face competition from healthcare providers that provide services comparable to those offered by our hospitals. Many competing hospitals are larger and more established than our hospitals. We may experience increased competition from existing hospitals as well as hospitals converted, in whole or in part, to specialized care facilities. Our nursing and rehabilitation centers compete on a local and regional basis with other nursing centers and other long-term healthcare providers. Some of our competitors operate newer facilities and may offer services not provided by us or are operated by entities having greater financial and other resources than us. Our rehabilitation division competes with national, regional and local rehabilitation service providers within our markets. Several of these competitors may have greater financial and other resources than us, may be more established in the markets in which we compete and may be willing to provide services at lower prices. We cannot assure you that increased competition in the future will not adversely affect our business, financial position, results of operations and liquidity.

In addition, we rely significantly on appropriate referrals from physicians, hospitals and other healthcare providers in the communities in which we deliver our services to attract appropriate patients and residents. Our referral sources are not obligated to refer business to us and may refer business to other healthcare providers. We believe many of our referral sources refer patients and residents to us as a result of the quality of our patient services and our efforts to establish and build a relationship with them. If any of our facilities fail to achieve or maintain a reputation for providing high quality care, or are perceived to provide a lower quality of care than comparable facilities within the same geographic area, or customers of our rehabilitation therapy services perceive that they could receive higher quality services from other providers, our ability to attract and retain patients and customers could be adversely affected. We believe that the perception of our quality of care by

potential residents or patients or their families seeking our services is influenced by a variety of factors, including physician and other healthcare professional referrals, community information and referral services, newspapers and other print and electronic media, results of patient surveys, recommendations from family and friends, and published quality care statistics compiled by CMS or other industry data. If we lose, or fail to maintain, existing relationships with our referral resources, fail to develop new relationships or if we are perceived by our referral sources for any reason as not providing high quality patient care, our patient volumes and the quality of our patient mix could suffer and our revenue and profitability could decline.

Significant legal actions could subject us to increased operating costs and substantial uninsured liabilities, which could materially and adversely affect our business, financial position, results of operations and liquidity.

We incur significant costs for professional liability claims, particularly in our nursing center and hospital operations. In addition to large compensatory claims, plaintiffs' attorneys increasingly are seeking significant punitive damages and attorney's fees. Furthermore, there are continuing efforts to limit the ability of healthcare providers to utilize arbitration as a process to resolve professional liability claims. As a result of these factors, our professional liability costs are significant and can be unpredictable.

We insure a substantial portion of our professional liability risks primarily through our limited purpose insurance subsidiary. Provisions for loss for our professional liability risks are based upon management's best available information including actuarially determined estimates. 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 liabilities 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. Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between our estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. Differences between the ultimate claims costs and our historical provisions for loss and actuarial assumptions and estimates could have a material adverse effect on our business, financial position, results of operations and liquidity.

Our limited purpose insurance subsidiary insures initial losses up to specified coverage levels per occurrence and in the aggregate. On a per claim basis, coverages for losses in excess of those insured by the limited purpose insurance subsidiary are maintained through unaffiliated commercial insurance carriers. Our limited purpose insurance subsidiary insures all claims in all states up to a per occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk. We maintain professional and general liability insurance in amounts and coverage that management believes are sufficient for our operations. However, our insurance may not cover all claims against us or the full extent of our liability nor continue to be available at a reasonable cost. Moreover, the cost of insurance coverage maintained with unaffiliated commercial insurance carriers is costly and may continue to increase. If we are unable to maintain adequate insurance coverage or are required to pay punitive damages that are uninsured, we may be exposed to substantial liabilities.

In our rehabilitation division contracts, we generally indemnify our customers from claim denials associated with our services. From time to time, we may be subject to indemnification obligations under these contracts.

We also are subject to lawsuits under the federal False Claims Act and comparable state laws for submitting fraudulent bills for services to the Medicare and Medicaid programs. These lawsuits, which may be initiated by whistleblowers, can involve significant monetary damages, fines, attorney fees and the award of bounties to private plaintiffs who successfully bring these suits and to the government programs.

We have limited operational and strategic flexibility since we lease a substantial number of our facilities.

We lease a substantial number of our facilities from Ventas and other third parties. Under our leases, we generally are required to operate continuously our leased properties as a provider of healthcare services. In addition, these leases generally limit or restrict our ability to assign the lease to another party. Our failure to comply with these lease provisions would result in an event of default under the leases and subject us to material damages, including potential defaults under our revolving credit facility. Given these restrictions, we may be forced to continue operating unprofitable facilities to avoid defaults under our leases. See "Item 1 – Business – Master Lease Agreements."

Possible changes in the acuity of residents and patients as well as payor mix and payment methodologies may significantly affect our profitability.

The sources and amount of our revenues are determined by a number of factors, including the occupancy rates of our facilities, length of stay, the payor mix of residents and patients, rates of reimbursement among payors and patient acuity. Changes in patient acuity as well as payor mix among private pay, Medicare and Medicaid can significantly affect our profitability. In particular, any significant decrease in our population of high acuity residents and patients or any significant increase in our Medicaid population could have a material adverse effect on our business, financial position, results of operations and liquidity, especially if state Medicaid programs continue to limit, or more aggressively seek limits on, reimbursement rates.

We may be unable to reduce costs to offset completely any decreases in our revenues.

Reduced levels of occupancy in our facilities and reductions in reimbursements from Medicare, Medicaid or other payors would adversely impact our revenues and liquidity. We may be unable to put in place corresponding reductions in costs in response to declines in census or other revenue shortfalls. The inability to timely adjust our operations to address a decrease in our revenues could have a material adverse effect on our business, financial position, results of operations and liquidity.

We are exposed to the credit risk of our payors which in the future may cause us to make larger allowances for doubtful accounts or incur bad debt write-offs.

Due to weak economic conditions or other factors, commercial payors and customers may default on their payments to us and individual patients may default on co-payments and deductibles for which they are responsible under the terms of either commercial insurance programs or Medicare. Although we review the credit risk of our commercial payors and customers regularly, such risks may arise from events or circumstances that are difficult to anticipate or control, such as a general economic downturn. If our payors default on their payments to us in the future, we may have to record higher provisions for allowances for doubtful accounts or incur bad debt write-offs, both of which could have a material adverse effect on our business, financial position, results of operations and liquidity.

Delays in collection of our accounts receivable could adversely affect our business, financial position, results of operations and liquidity.

Prompt billing and collection are important factors in our liquidity. Billing and collection of our accounts receivable are subject to the complex regulations that govern Medicare and Medicaid reimbursement and rules imposed by non-government payors. Our inability, or the inability of our customers, to bill and collect on a timely basis pursuant to these regulations and rules could subject us to payment delays that could negatively impact our business, financial position, results of operations and liquidity. In addition, we may experience delays in reimbursement as a result of the failure to receive prompt approvals related to change of ownership applications for acquired or other facilities or from delays caused by our or other third parties' information system failures.

If we are found to have violated laws protecting the confidentiality of patient health information, we could be subject to civil or criminal penalties, which could increase our liabilities and harm our reputation or our business.

There are a number of federal and state laws protecting the confidentiality of certain patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the privacy rules under HIPAA protect medical records and other personal health information by limiting their use and disclosure, giving individuals the right to access, amend and seek accounting of their own health information and limiting most use and disclosures of health information to the minimum amount reasonably necessary to accomplish the intended purpose. If we are found to be in violation of the privacy or security rules under HIPAA or other federal or state laws protecting the confidentiality of patient health information, we could be subject to sanctions and civil or criminal penalties, which could increase our liabilities, harm our reputation and have a material adverse effect on our business, financial position, results of operations and liquidity.

Acquisitions, investments and strategic alliances that we have made or may make in the future may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.

We intend to selectively pursue strategic acquisitions of, investments in, and strategic alliances with LTAC hospitals, nursing centers, rehabilitation operations and other related healthcare operations, particularly where an acquisition may assist us in scaling our operations more rapidly and efficiently than internal growth. Acquisitions may involve significant cash expenditures, debt incurrence, additional operating losses, amortization of certain intangible assets of acquired companies, dilutive issuances of equity securities and expenses that could have a material adverse effect on our business, financial position, results of operations and liquidity. Acquisitions, investments and strategic alliances involve numerous risks, including:

- limitations on our ability to identify acquisitions that meet our target criteria and limitations on our ability to complete such acquisitions on reasonable terms and valuations,
- limitations on our ability to access equity or capital to fund acquisitions, including difficulty in obtaining financing for acquisitions at a reasonable cost, or that such financing will not contain restrictive covenants that limit our operating flexibility or ability to access additional capital when needed,
- entry into markets or businesses in which we may have limited or no experience,
- difficulties integrating acquired operations, personnel and information systems, and in realizing projected efficiencies and cost savings, particularly in the case of significant acquisitions,
- diversion of management's time from existing operations,
- potential loss of key employees or customers of acquired companies,
- inaccurate assessment of assets and liabilities and exposure to undisclosed or unforeseen liabilities of acquired companies, including liabilities for failure to comply with healthcare laws,
- inability to operate acquired facilities profitably or succeed in achieving improvements in their financial performance, and
- impairment of acquired goodwill and intangible assets.

We continue to seek acquisitions and other strategic opportunities for each of our businesses that may negatively impact our business, financial position, results of operations and liquidity.

We continue to seek acquisitions and other strategic opportunities for each of our businesses, particularly where an acquisition may assist us in scaling our operations more rapidly and efficiently than internal growth. Accordingly, we are often engaged in evaluating potential transactions and other strategic alternatives, some of which may be significant in size, and we engage in preliminary discussions that may result in one or more

transactions. Although there is uncertainty that any of our discussions will result in definitive agreements or the timing of announcement or completion of any transaction, our business, short-term and long-term financial position, results of operations and liquidity may be impacted if we announce or complete any such transaction or if we incur substantial costs or other losses in connection with such transaction, whether or not it is completed. Moreover, although we intend to enter into transactions that enhance long-term shareholder value, our ability to achieve this objective would be subject to integration risks, the ability to retain and attract key personnel, the ability to realize synergies and other risks, all of which would be more material with transactions of significant size.

In addition to acquisitions, we also may pursue strategic opportunities involving the construction of new hospitals or nursing centers. The construction of new facilities involves numerous risks, including construction delays, cost over-runs, and the satisfaction of zoning and other regulatory requirements. We may be unable to operate newly constructed facilities profitably and such facilities may involve significant cash expenditures, debt incurrence, additional operating losses, and expenses that could have a material adverse effect on our business, financial position, results of operations and liquidity.

We depend on the proper functioning and availability of our information systems.

We are dependent on the proper functioning and availability of our information systems. Though we have taken steps to protect the safety and security of our information systems and the data maintained within those systems, there can be no assurance that our safety and security measures and disaster recovery plan will prevent damage or interruption of our systems and operations and we may be vulnerable to losses associated with the improper functioning, security breach or unavailability of our information systems. Failure to maintain proper functioning and available information systems could have a material adverse effect on our business, financial position, results of operations and liquidity.

In addition, certain software programs supporting our business and information systems are licensed to us by independent software developers. Our inability, or the inability of these developers, to continue to maintain and upgrade our information systems and software programs could disrupt or reduce the efficiency of our operations. In addition, costs and potential problems and interruptions associated with the implementation of new or upgraded systems and technology or with maintenance or adequate support of existing systems also could disrupt or reduce the efficiency of our operations and could have a material adverse effect on our business, financial position, results of operations and liquidity.

Terrorist attacks, pandemics or natural disasters could negatively impact our business, financial position, results of operations and liquidity.

Terrorist attacks, pandemics, or acts of nature, such as floods, fires, hurricanes, tornadoes or earthquakes, may cause damage or disruption to us, our employees and our facilities, which could have an adverse impact on our residents and patients. In order to provide care for our residents and patients, we are dependent upon consistent and reliable delivery of food, pharmaceuticals, power and other products to our facilities and the availability of employees to provide services at our facilities. If the delivery of goods or the ability of employees to reach our facilities were interrupted due to a natural disaster, pandemic or a terrorist attack, it could have a significant negative impact on our business. Furthermore, the impact, or impending threat, of a natural disaster has in the past and may in the future require that we evacuate one or more facilities, which would be costly and would involve substantial risks to our operations and potentially to our residents and patients. The impact of natural disasters, pandemics and terrorist attacks is inherently uncertain. Such events could severely damage or destroy one or more of our facilities, harm our business, reputation and financial performance or otherwise have a material adverse effect on our business, financial position, results of operations and liquidity.

Climate change poses both regulatory and physical risks that could adversely impact our business, financial position, results of operations and liquidity.

Climate change could have a potential economic impact on us and climate change mitigation programs and regulations could increase our costs. Energy costs could be higher as a result of climate change regulations. Our costs could increase if utility companies pass on their costs, such as those associated with carbon taxes, emission cap and trade programs, or renewable portfolio standards. In addition, climate change may increase the frequency or intensity of natural disasters. As such, we cannot assure you that climate change will not adversely impact our business, financial position, results of operations and liquidity.

Certain events or circumstances could result in the impairment of our assets or other charges, including, without limitation, impairments of goodwill and identifiable intangible assets that result in material charges to earnings.

We regularly review the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. On an ongoing basis, we also evaluate, based upon the fair value of our reporting units, whether the carrying value of our goodwill is impaired. If circumstances suggest that the recorded amounts of any of these assets cannot be recovered based upon estimated future cash flows, the carrying values of such assets are reduced to fair value. If the carrying value of any of these assets is impaired, we may incur a material charge to earnings.

Although we have determined that there was no goodwill or other indefinite lived intangible asset impairments as of December 31, 2009, adverse changes in the operating environment and related key assumptions used to determine the fair value of our reporting units and indefinite lived intangible assets or continued declines in the value of our common stock may result in future impairment charges for a portion or all of these assets. Moreover, the value of our goodwill and other indefinite lived assets could be negatively impacted by potential healthcare reforms. An impairment charge could have a material adverse effect on our business, financial position and results of operations.

The inability or failure of management in the future to conclude that we maintain effective internal control over financial reporting, or the inability of our independent registered public accounting firm to issue a report of our internal control over financial reporting, could have a material adverse effect on our business, financial position, results of operations and liquidity.

Under the Sarbanes-Oxley Act of 2002, our management is required to report in our Annual Report on Form 10-K on the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm also is required to audit the effectiveness of our internal control over financial reporting. Significant resources are required to establish that we are in full compliance with the financial reporting controls and procedures. If we fail to have, or management or our independent registered public accounting firm is unable to conclude that we maintain, effective internal controls and procedures for financial reporting, we could be unable to provide timely and reliable financial information which could have a material adverse effect on our business, financial position, results of operations and liquidity.

Different interpretations of accounting principles or changes in generally accepted accounting principles could have a material adverse effect on our business, financial position, results of operations and liquidity.

Generally accepted accounting principles are complex, continually evolving and changing and may be subject to varied interpretation by third parties, including the SEC. Such varied interpretations could result from differing views related to specific facts and circumstances. Differences in interpretation of generally accepted accounting principles or changes in generally accepted accounting principles could have a material adverse effect on our business, financial position, results of operations and liquidity.

Risk Factors Relating to the KPS Spin-Off

If the Spin-off Transaction does not qualify as a tax-free transaction, tax could be imposed on us and our shareholders.

As a condition to closing the Spin-off Transaction in 2007, we received a private letter ruling from the Internal Revenue Service (the "IRS") that the spin-off of KPS and the subsequent merger of KPS and distribution of PharMerica common stock qualified for tax-free treatment to holders of our common stock (except with respect to cash received in lieu of a fractional share) and, generally, to us.

Though the IRS ruling has been received, the ruling does not address all of the issues that are relevant to determining whether the Spin-off Transaction will qualify for tax-free treatment because the IRS will not rule on certain issues. As a condition to closing, we received an opinion of counsel that the Spin-off Transaction generally qualifies for tax-free treatment to us and our shareholders. The opinion of counsel is intended to address certain of those matters that the ruling does not. The IRS ruling and opinion of counsel do not address, however, state, local or foreign tax consequences of the Spin-off Transaction, merger and distribution of PharMerica common stock.

The IRS ruling and the opinion of counsel relied on representations, assumptions and undertakings made by us and PharMerica (and its subsidiaries), including representations and undertakings from PharMerica regarding the conduct of its business and other matters after the closing of the Spin-off Transaction. If such representations, assumptions or undertakings are incorrect, neither the IRS ruling nor the opinion of counsel would be valid. In addition, current law generally creates a presumption that the spin-off of KPS in the Spin-off Transaction would be taxable to us, but not to our shareholders, if PharMerica or its shareholders were to engage in certain transactions that result in a change in ownership of its stock during the four-year period beginning two years before the Spin-off Transaction, unless it is established that the Spin-off Transaction and such transactions were not part of a plan or series of related transactions to effect a change in ownership of the stock of PharMerica.

Furthermore, notwithstanding the IRS private letter ruling and the opinion of counsel, the IRS could determine that the Spin-off Transaction should be treated as a taxable transaction to us and our shareholders if it determines that any of the representations, assumptions or undertakings that were included in the request for the private letter ruling are false or have been violated or if it disagrees with the conclusions in the opinion of counsel that are not covered by the IRS ruling. If the spin-off of KPS in the Spin-off Transaction fails to qualify for tax-free treatment, the deemed receipt of shares of KPS will be treated as a taxable distribution to our shareholders. In addition, events occurring after the distribution of common stock of PharMerica could cause us to recognize a gain on the spin-off of KPS.

We may be required to satisfy certain indemnification obligations to PharMerica or may not be able to collect on indemnification rights from PharMerica.

Under the terms of the Spin-off Transaction, we indemnified PharMerica, and PharMerica indemnified us, for certain damages, liabilities and expenses resulting from a breach by the other of certain covenants contained in a master transaction agreement and other agreements entered into as part of the Spin-off Transaction.

These indemnification obligations could be significant and we cannot presently determine the amount, if any, of indemnification obligations for which we may be liable or for which we may seek payment. Our ability to satisfy these obligations will depend upon our future financial performance and other factors. Similarly, the ability of PharMerica to satisfy any such obligations to us will depend on its future financial performance and other factors. We cannot assure you that we will have the ability to satisfy any obligations to PharMerica or that PharMerica will have the ability to satisfy any obligations to us.

Item 1B. ***Unresolved Staff Comments***

Not applicable.

Item 2. ***Properties***

For information concerning the hospitals and nursing centers operated by us, see "Item 1 – Business – Hospital Division – Hospital Facilities," "Item 1 – Business – Health Services Division – Nursing Center Facilities," and "Item 1 – Business – Master Lease Agreements." We believe that our facilities are adequate for our future needs in such locations.

Our corporate headquarters is located in a 287,000 square foot building in Louisville, Kentucky.

We are subject to various federal, state and local laws and regulations governing the use, discharge and disposal of hazardous materials, including medical waste products. Compliance with these laws and regulations is not expected to have a material adverse effect on us. It is possible, however, that environmental issues may arise in the future which we cannot predict.

Item 3. ***Legal Proceedings***

We are a party to various legal actions (some of which are not insured), and regulatory and other government investigations in the ordinary course of our business. We cannot predict the ultimate outcome of pending litigation and regulatory and other government investigations. These legal actions and investigations could potentially subject us to sanctions, damages, recoupments, fines and other penalties. The U.S. Department of Justice, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to our businesses in the future which may, either individually or in the aggregate, have a material adverse effect on our business, financial position, results of operations and liquidity. See "Item 1A – Risk Factors – Risk Factors Relating to Our Operations – Significant legal actions could subject us to increased operating costs and substantial uninsured liabilities, which could materially and adversely affect our business, financial position, results of operations and liquidity."

Item 4. ***Submission of Matters to a Vote of Security Holders***

Not applicable.

PART II

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

MARKET PRICE FOR COMMON STOCK AND DIVIDEND HISTORY

Our common stock is quoted on the New York Stock Exchange (the "NYSE") under the ticker symbol "KND." The prices in the table below, for the calendar quarters indicated, represent the high and low sale prices for our common stock as reported on the NYSE.

	Sales price of common stock			
2009		**High**		**Low**
First quarter	$	18.57	$	11.51
Second quarter	$	17.83	$	10.70
Third quarter	$	17.27	$	11.83
Fourth quarter	$	20.00	$	13.80
2008		**High**		**Low**
First quarter	$	28.74	$	20.25
Second quarter	$	32.34	$	21.34
Third quarter	$	33.25	$	25.80
Fourth quarter	$	28.30	$	8.12

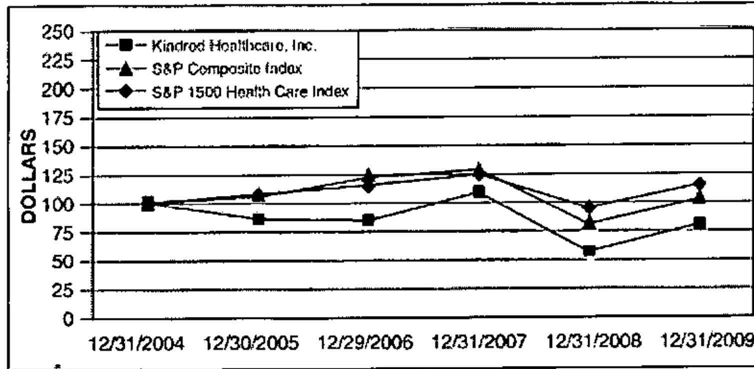
Our revolving credit facility contains covenants that limit, among other things, our ability to pay dividends. Any determination to pay dividends in the future will be dependent upon our results of operations, financial position, contractual restrictions, restrictions imposed by applicable laws and other factors deemed relevant by our Board of Directors. We have not paid, and do not anticipate that we will pay in the foreseeable future, any cash dividends on our common stock. Accordingly, investors must rely on sales of their common stock after price appreciation which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

As of January 31, 2010, there were 473 holders of record of our common stock.

See "Part III – Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for disclosures regarding our equity compensation plans.

PERFORMANCE GRAPH

The following graph summarizes the cumulative total return to shareholders of our common stock from December 31, 2004 to December 31, 2009, compared to the cumulative total return on the Standard & Poor's 500 Stock Index (the "S&P Composite Index") and the Standard & Poor's 1500 Health Care Index (the "S&P 1500 Health Care Index"). The graph assumes an investment of $100 in each of our common stock, the S&P Composite Index, and the S&P 1500 Health Care Index on December 31, 2004, and also assumes the reinvestment of all cash dividends. In accordance with SEC rules, the July 31, 2007 distribution of the KPS shares to our shareholders in connection with the Spin-off Transaction is treated for purposes of the following graph as a special stock dividend in calculating shareholder return and prior period prices have been adjusted accordingly.



	12/31/04	12/30/05	12/29/06	12/31/07	12/31/08	12/31/09
Kindred Healthcare, Inc.	$ 100.00	$ 86.01	$ 84.31	$ 108.19	$ 56.39	$ 79.95
S&P Composite Index	100.00	104.91	121.48	128.16	80.74	102.11
S&P 1500 Health Care Index	100.00	107.49	114.98	124.20	94.68	114.34

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Item 6. *Selected Financial Data*

KINDRED HEALTHCARE, INC.
SELECTED FINANCIAL DATA
(In thousands, except per share amounts)

	Year ended December 31,				
	2009	2008	2007	2006	2005
Statement of Operations Data:					
Revenues	$ 4,270,007	$ 4,093,864	$ 4,128,649	$ 4,041,786	$ 3,655,681
Salaries, wages and benefits	2,483,086	2,374,163	2,325,417	2,185,316	1,942,385
Supplies	333,056	317,149	542,986	669,023	556,054
Rent	348,248	338,673	337,769	289,080	244,787
Other operating expenses	886,205	854,383	730,965	650,045	583,841
Other income	(11,512)	(17,407)	(7,701)	-	-
Depreciation and amortization	125,730	120,022	118,574	115,057	95,518
Interest expense	7,880	15,373	17,044	13,920	8,095
Investment income	(4,413)	(7,096)	(16,105)	(14,488)	(11,025)
	4,168,280	3,995,260	4,048,949	3,907,953	3,419,655
Income from continuing operations before reorganization items and income taxes	101,727	98,604	79,700	133,833	236,026
Reorganization items	-	-	-	-	(1,639)
Income from continuing operations before income taxes	101,727	98,604	79,700	133,833	237,665
Provision for income taxes	39,115	38,144	36,567	52,739	94,959
Income from continuing operations	62,612	60,460	43,133	81,094	142,706
Discontinued operations, net of income taxes:					
Income (loss) from operations	931	(3,399)	(12,982)	(2,351)	3,584
Loss on divestiture of operations	(23,432)	(20,776)	(77,021)	(32)	(1,381)
Net income (loss)	$ 40,111	$ 36,285	$ (46,870)	$ 78,711	$ 144,909
Earnings (loss) per common share:					
Basic:					
Income from continuing operations	$ 1.61	$ 1.56	$ 1.09	$ 2.02	$ 3.73
Discontinued operations:					
Income (loss) from operations	0.02	(0.09)	(0.33)	(0.06)	0.09
Loss on divestiture of operations	(0.60)	(0.53)	(1.94)	-	(0.03)
Net income (loss)	$ 1.03	$ 0.94	$ (1.18)	$ 1.96	$ 3.79
Diluted:					
Income from continuing operations	$ 1.60	$ 1.54	$ 1.06	$ 1.95	$ 3.12
Discontinued operations:					
Income (loss) from operations	0.02	(0.09)	(0.32)	(0.06)	0.08
Loss on divestiture of operations	(0.60)	(0.53)	(1.90)	-	(0.03)
Net income (loss)	$ 1.02	$ 0.92	$ (1.16)	$ 1.89	$ 3.17
Shares used in computing earnings (loss) per common share:					
Basic	38,339	37,830	38,791	39,108	37,328
Diluted	38,502	38,397	39,558	40,677	44,803
Financial Position:					
Working capital	$ 241,032	$ 403,917	$ 294,878	$ 295,389	$ 208,873
Total assets	2,022,224	2,181,761	2,079,552	2,016,127	1,760,561
Long-term debt	147,647	349,433	275,814	130,090	26,323
Stockholders' equity	966,594	914,975	862,124	995,578	870,536

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

You should read the following discussion together with the selected financial data in Item 6 and our consolidated financial statements and the notes thereto included in this Annual Report on Form 10-K. All financial and operating data presented in Items 6 and 7 reflects the continuing operations of our business for all periods presented unless otherwise indicated.

Overview

We are a healthcare services company that through our subsidiaries operates hospitals, nursing and rehabilitation centers and a contract rehabilitation services business across the United States. At December 31, 2009, our hospital division operated 83 LTAC hospitals with 6,580 licensed beds in 24 states. Our health services division operated 222 nursing and rehabilitation centers with 27,523 licensed beds in 27 states. We also operated a contract rehabilitation services business that provides rehabilitative services primarily in long-term care settings.

On July 31, 2007, we completed the Spin-off Transaction. See "Item 1 – Business – General – Spin-off Transaction" and note 2 of the notes to consolidated financial statements.

In recent years, we have completed several strategic divestitures to improve our future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2009 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

The operating results of acquired businesses have been included in our accompanying consolidated financial statements from the respective acquisition dates.

Critical Accounting Policies

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates and judgments that affect the reported amounts and related disclosures of commitments and contingencies. We rely on historical experience and on various other assumptions that we believe to be reasonable under the circumstances to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

We believe the following critical accounting policies, among others, affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

We have agreements with third party payors that provide for payments to each of our operating divisions. These payment arrangements may be based upon prospective rates, reimbursable costs, established charges, discounted charges or per diem payments. Net patient service revenue is recorded at the estimated net realizable amounts from Medicare, Medicaid, Medicare Advantage, other third party payors and individual patients for services rendered. Retroactive adjustments that are likely to result from future examinations by third party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods based upon new information or final settlements.

We recorded income of approximately $8 million in 2008 related to the favorable settlement of a prior year nursing center Medicaid cost report dispute. Favorable settlements of prior year hospital Medicare cost reports aggregated $3 million in 2007.

During 2007, we also recorded a pretax credit of approximately $3 million to reflect a change in estimate for hospital Medicare accounts receivable and a pretax credit of approximately $4 million to adjust certain nursing center Medicaid revenues.

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

	Year ended December 31,		
	2009	2008	2007
Medicare	$ 1,811,181	$ 1,741,256	$ 1,851,183
Medicaid	1,086,447	1,075,464	1,067,741
Medicare Advantage	321,437	263,699	72,548
Other	1,339,207	1,277,520	1,452,777
	4,558,272	4,357,939	4,444,249
Eliminations:			
Rehabilitation	(288,265)	(264,075)	(232,802)
Pharmacy	–	–	(82,798)
	(288,265)	(264,075)	(315,600)
	$ 4,270,007	$ 4,093,864	$ 4,128,649

Collectibility of accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, we consider a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of the change.

The provision for doubtful accounts totaled $29 million for 2009, $31 million for 2008 and $25 million for 2007. During 2007, we recorded a $6 million charge for doubtful accounts related to accounts receivable acquired in a hospital acquisition in a prior year.

Allowances for insurance risks

We insure a substantial portion of our professional liability risks and workers compensation risks through our limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including actuarially determined estimates.

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 liabilities 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.

Provisions for loss for professional liability risks retained by our limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 2% for the

2009 policy year, 3% for the 2008 policy year and 5% for all prior policy years. The discount rates are based upon the risk free interest rate for the respective year. Amounts equal to the discounted loss provision are funded annually. We do 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. The allowance for professional liability risks aggregated $242 million at December 31, 2009 and $243 million at December 31, 2008. If we did not discount any of the allowances for professional liability risks, these balances would have approximated $247 million at December 31, 2009 and $252 million at December 31, 2008.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $34 million in 2009, $39 million in 2008 and $37 million in 2007 from our limited purpose insurance subsidiary in accordance with applicable regulations. These distributions had no impact on earnings and the proceeds were used primarily to repay borrowings under our revolving credit facility.

Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between our estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. For example, a 1% variance in the allowance for professional liability risks at December 31, 2009 would impact our operating income by approximately $2 million.

The provision for professional liability risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $48 million for 2009, $33 million for 2008 and $35 million for 2007. Changes in estimates for prior year professional liability costs reduced professional liability costs by approximately $27 million, $38 million and $35 million in 2009, 2008 and 2007, respectively.

With respect to our discontinued operations, we recorded favorable pretax adjustments of $11 million in 2009 and $10 million in 2008, and a pretax charge aggregating $2 million in 2007 resulting from changes in estimates for professional liability reserves related to prior years.

Provisions for loss for workers compensation risks retained by our limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually. The allowance for workers compensation risks aggregated $82 million at December 31, 2009 and $83 million at December 31, 2008. The provision for workers compensation risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $36 million for 2009, $30 million for 2008 and $37 million for 2007.

See notes 4 and 9 of the notes to consolidated financial statements.

Accounting for income taxes

The provision for income taxes is based upon our annual reported income or loss for each respective accounting period. We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. We also recognize as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

In 2007, we paid approximately $3 million of employer payroll taxes related to a settlement reached with the IRS for all disputed federal income tax issues for fiscal 2000 and 2001.

Our effective income tax rate was 38.5% in 2009, 38.7% in 2008 and 45.9% in 2007. We recorded favorable income tax adjustments related to the resolution of state income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million in each of 2009, 2008 and 2007. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction.

We adopted the provisions of the authoritative guidance related to the uncertainty in income taxes on January 1, 2007. The adoption did not have a material impact on our business, financial position, results of operations or liquidity.

There are significant uncertainties with respect to capital loss carryforwards that could affect materially the realization of certain deferred tax assets. Accordingly, we have recognized deferred tax assets to the extent it is more likely than not they will be realized and a valuation allowance is provided for deferred tax assets to the extent that it is uncertain that the deferred tax asset will be realized. We recognized net deferred tax assets totaling $154 million at December 31, 2009 and $159 million at December 31, 2008.

We identified deferred income tax assets for state income tax NOLs of $38 million and $34 million at December 31, 2009 and 2008, respectively, and a corresponding deferred income tax valuation allowance of $34 million at December 31, 2009 and 2008 for that portion of the net deferred income tax assets that were not realizable.

After our emergence from bankruptcy in 2001, the realization of pre-reorganization deferred tax assets and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of approximately $1 million in 2008 and $3 million in 2007 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability. Following the adoption of the revised provisions for accounting for business combinations on January 1, 2009, future adjustments to pre-emergence unrecognized income tax benefits will be recorded to earnings.

We are 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. While we believe our tax positions are appropriate, we cannot assure you that the various authorities engaged in the examination of our income tax returns will not challenge our positions.

We record accrued interest and penalties associated with uncertain tax positions as income tax expense in the consolidated statement of operations. Accrued interest related to uncertain tax provisions totaled $0.1 million as of December 31, 2009 and $0.8 million as of December 31, 2008.

To the extent the unrecognized income tax benefits become realized or the related accrued interest is no longer necessary, our provision for income taxes would be favorably impacted. The amount, if recognized, that would favorably impact our results of operations approximates $6 million.

The federal statute of limitations remains open for tax years 2006 through 2008. We are currently under IRS examination for fiscal years 2008 and 2007. See note 8 of the notes to consolidated financial statements.

State jurisdictions generally have statutes of limitations for tax returns ranging from three to five years. The state impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification to the states. We currently have various state income tax returns under examination.

During 2010, the statute of limitations associated with certain state income tax filing positions will expire and may decrease the amount of unrecognized income tax benefits. A reduction in our income tax liability of approximately $2 million to $3 million for unrecognized income tax benefits is reasonably possible and may favorably impact our financial position and results of operations.

Valuation of long-lived assets and goodwill

We regularly review the carrying value of certain long-lived assets and identifiable finite lived intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest that the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

In assessing the carrying values of long-lived assets, we estimate 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 facility 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 our ability to renew the lease or divest a particular property), we define the group of facilities under a master lease agreement 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 are aggregated for purposes of evaluating the carrying values of long-lived assets.

Our other intangible assets with finite lives are amortized in accordance with the authoritative guidance for goodwill and other intangible assets using the straight-line method over their estimated useful lives ranging from one to ten years.

In accordance with the authoritative guidance for goodwill and other intangible assets, we are required to perform an impairment test for goodwill and indefinite lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. Also, during 2009 and the fourth quarter of 2008, the market value of our common stock was below our book equity value. Management believes that the difference between our market equity value and our book equity value during 2009 was generally attributable to uncertainty in the equity markets related to proposed federal healthcare reform legislation and Medicare revenue reductions announced by CMS during the year. The decline in 2008 was generally attributable to our announcement of weaker than expected third quarter operating results (particularly in our hospital division) and the related reduction in our earnings outlook in the fourth quarter of 2008 and fiscal 2009 as compared to investor expectations. In addition, the weak global economic conditions that negatively impacted the condition of the debt and equity markets in 2008 may have contributed to the decline in the market value of our common stock. The difference between the book equity value and the market value of our common stock during 2009 and the fourth quarter of 2008 was a potential indication that the carrying value of our goodwill may have been impaired but was not viewed as a triggering event.

We perform our annual goodwill impairment test at the end of each fiscal year for each of our reporting units. A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. When the components within our operating segments have similar economic characteristics, we aggregate the components of our operating segments into one reporting unit. Accordingly, we have determined

that our reporting units are hospitals, health services, rehabilitation services and hospice. The carrying value of goodwill for each of our reporting units at December 31, 2009 and 2008 were as follows (in thousands):

	December 31,	
	2009	2008
Hospitals	$ 68,577	$ 68,577
Health services	889	639
Rehabilitation services	3,363	1,863
Hospice	8,394	1,165
	$ 81,223	$ 72,244

The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. If the carrying value of the reporting unit is greater than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. Based upon the results of the step one impairment test for goodwill and the impairment test of indefinite lived intangible assets in each of the last three years, no impairment charges were recorded in connection with our annual impairment tests.

Since quoted market prices for our reporting units are not available, we applied judgment in determining the fair value of these reporting units for purposes of performing the goodwill impairment test. We relied on widely accepted valuation techniques, including equally weighted discounted cash flow and market multiple analyses approaches, which capture both the future income potential of the reporting unit and the market behaviors and actions of market participants in the industry that includes the reporting unit. These types of analyses require us to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management's best estimates of economic and market conditions over the projected period for each reporting unit including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. The market multiple analysis estimates fair value by applying cash flow multiples to the reporting unit's operating results. The multiples are derived from comparable publicly traded companies with similar operating and investment characteristics to the reporting units.

Our analysis indicated that the estimated fair value of each reporting unit exceeded its book equity value. Our conclusions were supported by both quantitative and qualitative factors, including the estimate of an implied control premium for acquisitions in our industry, our fourth quarter operating results that exceeded investment analyst expectations and consideration of our updated business expectations at December 31, 2009 and 2008. We do not believe that any of our reporting units were at risk for failing the step one impairment test at December 31, 2009.

The fair values of our indefinite lived intangible assets, primarily hospital certificates of need, are estimated using an excess earnings method, a form of discounted cash flows, which is based upon the concept that net after-tax cash flows provide a return supporting all of the assets of a business enterprise. The carrying value of the our certificates of need at December 31, 2009 was $62 million. The fair values of our indefinite lived intangible assets are derived from projections at a facility level which include management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. At December 31, 2009, the fair value of our certificates of need intangible assets exceeded its carrying value. We do not believe that any of our certificates of need were at risk for failing the impairment test at December 31, 2009.

Although we have determined that there was no goodwill or other indefinite lived intangible asset impairments as of December 31, 2009, adverse changes in the operating environment and related key assumptions used to determine the fair value of our reporting units and indefinite lived intangible assets or declines in the value of our common stock may result in future impairment charges for a portion or all of these assets. Specifically, if the rate of growth of government and commercial revenues earned by our reporting units were to be less than projected or if proposed healthcare reforms were to negatively impact our business, an impairment charge for a portion or all of the assets may be required. An impairment charge could have a material adverse effect on our business, financial position and results of operations, but would not be expected to have an impact on our cash flows or liquidity.

Recently Issued Accounting Requirements

In January 2010, the Financial Accounting Standards Board (the "FASB") issued authoritative guidance related to fair value measurements and disclosures. The provisions of the guidance require new disclosures related to transfers in and out of Levels 1 and 2 (as described in note 17 of the notes to consolidated financial statements). The provisions also require a reconciliation of the activity in Level 3 (as described in note 17 of the notes to consolidated financial statements) recurring fair value measurements. Existing disclosures also were expanded to include Level 2 fair value measurement valuation techniques and inputs. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2009, except for the disclosures for Level 3 activity which is effective for fiscal years beginning after December 15, 2010. The adoption of the guidance is not expected to have a material impact on our business, financial position, results of operations or liquidity.

In August 2009, the FASB issued authoritative guidance related to fair value measurements and disclosures. The provisions of this guidance clarify how an entity should measure liabilities at fair value. The guidance is effective for all interim and annual reporting periods beginning after August 26, 2009. The adoption of the guidance did not have a material impact on our business, financial position, results of operations or liquidity.

In June 2009, the FASB issued revised authoritative guidance related to the consolidation criteria for variable interest entities ("VIE"). The guidance, among other things, requires a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE; requires continuous assessments of whether an enterprise is the primary beneficiary of a VIE; enhances disclosures regarding an enterprise's involvement with a VIE; and amends certain guidance for determining whether an entity is a VIE. Under the guidance, a VIE must be consolidated if the enterprise has both (a) the power to direct the activities of the VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. The guidance will be effective as of the beginning of an enterprise's first fiscal year beginning after November 15, 2009, and for interim periods within that first period, with earlier adoption prohibited. We are currently evaluating the effect of this authoritative guidance on our consolidated financial statements.

In June 2009, the FASB issued authoritative guidance for establishment of the FASB Codification, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The FASB Codification is the sole source of authoritative accounting principles recognized by the FASB. The guidance is effective for all financial statements issued for interim and annual reporting periods ending after September 15, 2009. The application of this guidance (or the FASB Codification) did not have an impact on our business, financial position, results of operations or liquidity.

In May 2009, the FASB issued authoritative guidance which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new provisions provide guidance related to the disclosure date through which an entity has evaluated subsequent events and whether such date represents the date the financial statements were

issued or were available to be issued. In February 2010, the FASB issued an amendment, effective February 24, 2010, to remove the requirement for a filer to disclose a date in its financial statements. The adoption of the guidance did not have an impact on our business, financial position, results of operations or liquidity.

In April 2009, the FASB issued additional authoritative guidance related to fair value measurements and the recognition of other-than-temporary impairments of financial instruments. The new provisions provide guidance to determine whether the market for a security is inactive and whether transactions in inactive markets are distressed and clarify the recognition and measurement of other-than-temporary impairments of debt and equity securities. Authoritative guidance also was issued for interim disclosures regarding fair value of financial instruments, which requires an entity to provide disclosures about the fair value of financial instruments in both interim and annual financial statements. The guidance is effective for all interim and annual reporting periods beginning after June 15, 2009. The adoption of the guidance did not have a material impact on our business, financial position, results of operations or liquidity.

On January 1, 2009, we adopted the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities, which requires that unvested restricted stock that entitles the holder to receive nonforfeitable dividends before vesting be included as a participating security in the basic and diluted earnings per common share calculation pursuant to the two-class method. The adoption of the guidance has been applied retrospectively in the accompanying consolidated financial statements and did not have a material impact on our earnings per common share calculations.

In December 2007, the FASB revised the authoritative guidance for business combinations, which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at the acquisition date and expensing acquisition and restructuring costs. The guidance is applied prospectively and is effective for business combinations which occur during fiscal years beginning after December 15, 2008. Our adoption of the guidance on January 1, 2009 did not have a material impact on our business, financial position, results of operations or liquidity at December 31, 2009 or for the year ended December 31, 2009. However, any future business combinations may significantly impact our financial position and results of operations when compared to acquisitions accounted for under the previous guidance and may result in generally lower earnings due to the expensing of acquisition and restructuring costs.

In April 2009, the FASB issued authoritative guidance for accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies, which will amend the provisions related to the initial recognition and measurement, subsequent measurement and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance is effective for all business combinations which occur during fiscal years beginning after December 15, 2008. Our adoption of the guidance retroactive to January 1, 2009 did not have a material impact on our business, financial position, results of operations or liquidity.

Impact of Medicare and Medicaid Reimbursement

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for a substantial portion of our revenues. For the year ended December 31, 2009, we derived approximately 64% of our total revenues (before eliminations) from the Medicare and Medicaid programs and the balance from other third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers.

The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Part I – Item 1 – Business – Governmental Regulation" for an overview of the reimbursement systems impacting our businesses and "Part I – Item 1A – Risk Factors."

Results of Operations – Continuing Operations

For the years ended December 31, 2009, 2008 and 2007

A summary of our operating data follows (dollars in thousands, except statistics):

	Year ended December 31,		
	2009	2008	2007
Revenues:			
Hospital division	$ 1,932,892	$ 1,837,322	$ 1,727,419
Health services division	2,150,342	2,093,297	1,958,322
Rehabilitation division	475,038	427,320	352,397
Pharmacy division	–	–	406,111
	4,558,272	4,357,939	4,444,249
Eliminations:			
Rehabilitation	(288,265)	(264,075)	(232,802)
Pharmacy	–	–	(82,798)
	(288,265)	(264,075)	(315,600)
	$ 4,270,007	$ 4,093,864	$ 4,128,649
Income from continuing operations:			
Operating income (loss):			
Hospital division	$ 363,811	$ 345,367	$ 365,068
Health services division	305,590	321,814	294,625
Rehabilitation division	50,592	38,071	34,526
Pharmacy division	–	–	17,557
Corporate:			
Overhead	(134,636)	(133,019)	(167,717)
Insurance subsidiary	(6,185)	(6,657)	(7,077)
	(140,821)	(139,676)	(174,794)
Operating income	579,172	565,576	536,982
Rent	(348,248)	(338,673)	(337,769)
Depreciation and amortization	(125,730)	(120,022)	(118,574)
Interest, net	(3,467)	(8,277)	(939)
Income from continuing operations before income taxes	101,727	98,604	79,700
Provision for income taxes	39,115	38,144	36,567
	$ 62,612	$ 60,460	$ 43,133

A summary of our consolidating statement of operations follows (in thousands):

	Year ended December 31, 2009					
	Hospital division	Health services division	Rehabilitation division	Corporate	Eliminations	Consolidated
Revenues	$1,932,892	$2,150,342	$ 475,038	$ –	$ (288,265)	$4,270,007
Salaries, wages and benefits	875,788	1,102,975	402,986	101,337	–	2,483,086
Supplies	221,529	108,038	2,827	664	(2)	333,056
Rent	147,494	194,835	5,778	141	–	348,248
Other operating expenses	471,764	633,739	18,633	50,332	(288,263)	886,205
Other income	–	–	–	(11,512)	–	(11,512)
Depreciation and amortization	51,932	48,631	2,291	22,876	–	125,730
Interest expense	2	130	1	7,747	–	7,880
Investment income	(7)	(111)	(8)	(4,287)	–	(4,413)
	1,768,502	2,088,237	432,508	167,298	(288,265)	4,168,280
Income from continuing operations before income taxes	$ 164,390	$ 62,105	$ 42,530	$(167,298)	$ –	101,727
Provision for income taxes						39,115
Income from continuing operations						$ 62,612
Capital expenditures, excluding acquisitions (including discontinued operations):						
Routine	$ 26,716	$ 39,663	$ 1,043	$ 30,128	$ –	$ 97,550
Development	42,371	5,687	–	–	–	48,058
	$ 69,087	$ 45,350	$ 1,043	$ 30,128	$ –	$ 145,608

Consolidating statement of operations (in thousands) (Continued):

	Year ended December 31, 2008					
	Hospital division	Health services division	Rehabilitation division	Corporate	Eliminations	Consolidated
Revenues	$1,837,322	$2,093,297	$ 427,320	$ –	$ (264,075)	$4,093,864
Salaries, wages and benefits	842,018	1,068,648	371,248	92,249	–	2,374,163
Supplies	210,962	103,626	1,744	821	(4)	317,149
Rent	146,316	186,612	5,555	190	–	338,673
Other operating expenses	438,975	599,209	16,257	64,013	(264,071)	854,383
Other income	–	–	–	(17,407)	–	(17,407)
Depreciation and amortization	48,150	48,645	1,965	21,262	–	120,022
Interest expense	326	133	–	14,914	–	15,373
Investment income	(43)	(160)	(48)	(6,845)	–	(7,096)
	1,686,704	2,006,713	396,721	169,197	(264,075)	3,995,260
Income from continuing operations before income taxes	$ 150,618	$ 86,584	$ 30,599	$(169,197)	$ –	98,604
Provision for income taxes						38,144
Income from continuing operations						$ 60,460
Capital expenditures, excluding acquisitions (including discontinued operations):						
Routine	$ 35,932	$ 44,627	$ 1,162	$ 28,205	$ –	$ 109,926
Development	33,285	5,466	–	–	–	38,751
	$ 69,217	$ 50,093	$ 1,162	$ 28,205	$ –	$ 148,677

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Consolidating statement of operations (in thousands) (Continued):

	Year ended December 31, 2007						
	Hospital division	Health services division	Rehabilitation division	Pharmacy division	Corporate	Eliminations	Consolidated
Revenues	$1,727,419	$1,958,322	$ 352,397	$ 406,111	$ –	$ (315,600)	$4,128,649
Salaries, wages and benefits	771,768	1,017,799	305,282	107,202	123,594	(228)	2,325,417
Supplies	190,481	97,480	1,260	253,659	690	(584)	542,986
Rent	139,875	188,599	4,641	4,325	329	–	337,769
Other operating expenses	400,102	548,418	11,329	27,693	58,211	(314,788)	730,965
Other income	–	–	–	–	(7,701)	–	(7,701)
Depreciation and amortization	40,958	48,815	1,176	6,510	21,115	–	118,574
Interest expense	168	124	–	–	16,752	–	17,044
Investment income	(474)	(836)	–	(11)	(14,784)	–	(16,105)
	1,542,878	1,900,399	323,688	399,378	198,206	(315,600)	4,048,949
Income from continuing operations before income taxes	$ 184,541	$ 57,923	$ 28,709	$ 6,733	$(198,206)	$ –	79,700
Provision for income taxes							36,567
Income from continuing operations							$ 43,133
Capital expenditures, excluding acquisitions (including discontinued operations):							
Routine	$ 35,646	$ 41,252	$ 2,037	$ 4,115	$ 38,312	$ –	$ 121,362
Development	59,438	5,688	–	–	–	–	65,126
	$ 95,084	$ 46,940	$ 2,037	$ 4,115	$ 38,312	$ –	$ 186,488

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Operating data:

	Year ended December 31,		
	2009	2008	2007
Hospital data:			
End of period data:			
Number of hospitals	83	82	81
Number of licensed beds	6,580	6,482	6,358
Revenue mix %:			
Medicare	55	55	58
Medicaid	10	10	10
Medicare Advantage (a)	10	9	4
Commercial insurance and other	25	26	28
Admissions:			
Medicare	28,696	29,028	28,140
Medicaid	4,254	4,233	4,204
Medicare Advantage	4,030	3,587	1,681
Commercial insurance and other	8,039	7,088	7,305
	45,019	43,936	41,330
Admissions mix %:			
Medicare	64	66	68
Medicaid	9	10	10
Medicare Advantage	9	8	4
Commercial insurance and other	18	16	18
Patient days:			
Medicare	779,359	806,427	793,497
Medicaid	202,290	208,423	203,192
Medicare Advantage	132,262	117,945	55,033
Commercial insurance and other	267,439	262,254	276,328
	1,381,350	1,395,049	1,328,050
Average length of stay:			
Medicare	27.2	27.8	28.2
Medicaid	47.6	49.2	48.3
Medicare Advantage	32.8	32.9	32.7
Commercial insurance and other	33.3	37.0	37.8
Weighted average	30.7	31.8	32.1
Revenues per admission:			
Medicare	$ 37,436	$ 35,127	$ 35,489
Medicaid	44,465	43,816	42,439
Medicare Advantage	47,141	45,148	43,157
Commercial insurance and other	59,647	66,345	65,406
Weighted average	42,935	41,818	41,796
Revenues per patient day:			
Medicare	$ 1,378	$ 1,264	$ 1,259
Medicaid	935	890	878
Medicare Advantage	1,436	1,373	1,318
Commercial insurance and other	1,793	1,793	1,729
Weighted average	1,399	1,317	1,301
Medicare case mix index (discharged patients only)	1.21	1.15	1.11
Average daily census	3,785	3,812	3,638
Occupancy %	64.7	64.8	64.6
Annualized employee turnover %	22.1	25.2	26.1

(a) Data not available prior to April 1, 2007.

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Operating data (Continued):

	Year ended December 31,		
	2009	2008	2007
Nursing center data:			
End of period data:			
Number of nursing centers:			
Owned or leased	218	218	218
Managed	4	4	4
	222	222	222
Number of licensed beds:			
Owned or leased	27,038	27,252	27,809
Managed	485	485	485
	27,523	27,737	28,294
Revenue mix %:			
Medicare	34	34	35
Medicaid	42	43	44
Medicare Advantage (a)	6	5	
Private and other	18	18	21
Patient days (b):			
Medicare	1,463,445	1,523,090	1,520,831
Medicaid	5,375,605	5,466,653	5,534,048
Medicare Advantage	333,775	272,517	
Private and other	1,637,463	1,659,338	1,785,638
	8,810,288	8,921,598	8,840,517
Patient day mix %:			
Medicare	17	17	17
Medicaid	61	61	63
Medicare Advantage	4	3	
Private and other	18	19	20
Revenues per patient day:			
Medicare Part A	$ 461	$ 437	$ 411
Total Medicare (including Part B)	503	474	447
Medicaid	167	163	155
Medicare Advantage	394	373	
Private and other	235	229	235
Weighted average	244	235	221
Average daily census	24,138	24,376	24,221
Admissions (b)	72,801	69,986	65,772
Occupancy %	89.0	89.1	87.8
Medicare average length of stay	35.4	35.5	35.6
Annualized employee turnover %	38.9	48.9	55.9
Rehabilitation data:			
Revenue mix %:			
Company-operated	61	63	68
Non-affiliated	39	37	32
Sites of service (at end of period)	622	655	644
Revenue per site	$ 730,345	$ 651,895	$ 582,207
Therapist productivity %	84.2	81.4	79.4
Annualized employee turnover %	12.8	13.3	15.6

(a) Data not available prior to 2008.

(b) Excludes managed facilities.

The Year in Review

Fiscal 2009 was a year of solid operational and financial performance despite a number of reimbursement and other external challenges. Our financial results further reinforce and support our fundamental management philosophy: If we take care of our people and focus on quality and customer service, our business results will follow.

Financial highlights of the year included:

- revenue gains in each of our three operating divisions: Hospitals – 5%, Health Services – 3% and People*first* Rehabilitation – 11%. Overall revenues of $4.3 billion were 4% ahead of last year;
- volume growth continued to be a major operational focus for each of our divisions, with hospital admissions rising 2%, nursing center admissions growing 4% and rehabilitation therapy minutes increasing 8% compared to fiscal 2008;
- consolidated operating income rose 2% to $579 million in 2009 despite significant Medicare and Medicaid reimbursement reductions that negatively impacted our revenues by approximately $23 million during the year;
- income from continuing operations totaled $63 million, up 4% over 2008;
- diluted earnings per share rose 4% to $1.60 in 2009 compared to $1.54 last year;
- operating cash flows rose 36% to $234 million, the highest level in three years;
- routine capital expenditures declined 11% to $98 million in 2009, while development capital expenditures grew 24% to $48 million;
- all routine and development capital expenditures in both 2009 and 2008 were financed through internal sources;
- our accounts receivable days outstanding declined 2% in 2009, while our revolving credit borrowings, net of excess cash, declined nearly $80 million; and
- the remaining unused capacity under our revolving credit facility totaled $353 million at the end of the year, providing significant financial flexibility to pursue other growth opportunities.

Our hospital division reported solid admissions growth in 2009 with particularly strong growth in non-government admissions. We continued to make progress in educating our referral sources on the value of our hospital services from both a clinical and financial perspective. In addition, we are expanding our service lines to further promote the value of our hospitals, diversify our patient population and take advantage of unused hospital capacity. For example, at December 31, 2009, we operated seven hospital-based sub-acute units comprising 409 licensed beds and have plans to add another five hospital-based sub-acute units in key markets over the next two years. Despite a mid-year Medicare rate cut, we managed to increase our hospital operating income by 5% to $364 million in 2009 primarily as a result of growth in non-government admissions and operational improvements in certain newer facilities.

In our health services division, we have made the necessary investments in leadership, clinical resources and information systems to bring a higher level of operational consistency and stability to this business. Despite strong admissions growth, our 2009 operating results reflected a more difficult government reimbursement environment with respect to both the Medicare and Medicaid programs. As a result, our health services division operating income declined 5% to $305 million in 2009. Nevertheless, we continued to enhance our asset base through the continued development of our transitional care centers and units in selected markets that contain the physical plant, clinical programs and professional staff necessary to attract higher acuity patients who require more extensive services including rehabilitation therapy.

People*first* Rehabilitation reported an outstanding year in 2009, with improvements in several of the operational and financial measures we use to manage our business. Strong growth in average revenues per site of service, improved therapist productivity and a renewed commitment to differentiate our brand in the markets we serve resulted in 33% growth in People*first* operating income to $51 million in 2009. In addition, growth in People*first* operating income contributed significantly to the consolidated net income growth we reported for the year.

We also have made great progress over the past few years in the recruitment, retention and development of our people. Our investments in employee orientation, continuing clinical education, leadership development and employee recognition programs have helped to make Kindred an employer of choice in many of our local markets. Our employee turnover percentages, a leading indicator in our business, improved significantly in 2009 in each of our three operating divisions.

Our commitment to our employees is the key driver in our ongoing efforts to improve clinical quality and customer service in each market we serve. During 2009, we continued to measure our progress in such critical areas as ventilator pneumonia rates and blood stream infection rates as well as improvements in functional outcomes of rehabilitation therapy patients discharged from our care. We also monitor our nursing center standard survey results against our peer companies and competitors in our local markets to identify ways to improve our clinical operations and enhance our services.

We continued to pursue our organic development and external growth strategies in our key markets. In the near term, we are developing five new hospitals, five hospital-based sub-acute units and 20 to 30 additional transitional care centers and units in selected nursing centers that will provide additional growth in each of our operating divisions. For 2010, we expect that our routine and development capital expenditures will range from $185 million to $200 million, a significant portion of which will be financed through internal sources.

Our focus on the quality of care provided to our patients and residents, our commitment to taking care of our employees and our efforts to effectively use and preserve our capital resources have positioned us as a leading provider of post-acute services. We are in a position to effectively respond to a challenging economic, political and regulatory environment in order to deliver high quality care to our patients and residents, produce a valuable work experience for our employees and provide profitability to our shareholders.

Hospital division

Revenues increased 5% in 2009 to $1.9 billion and 6% in 2008 to $1.8 billion. During each of the past two years, revenue growth was primarily a result of increases in admissions, ongoing development of new hospitals and reimbursement rate increases associated with higher average patient acuity levels.

Aggregate admissions increased 2% in 2009 and 6% in 2008. On a same-facility basis, aggregate admissions rose 3% in 2009 and 4% in 2008, while non-government same-facility admissions increased 14% and 15%, respectively.

Hospital operating margins (operating income as a percentage of revenues) were essentially unchanged in 2009 as compared to 2008. The decline in 2008 was primarily due to growth in wage and benefit costs and growth in ancillary costs, which exceeded overall revenue growth. Hospital wage and benefit costs increased 4% to $876 million in 2009 and increased 9% to $842 million in 2008 compared to $772 million in 2007. Average hourly wage rates grew 2% in 2009 and 4% in 2008. Employee benefit costs increased 7% in 2009 and 9% in 2008, primarily as a result of increased employee health insurance costs.

Professional liability costs were $21 million in 2009, $11 million in 2008 and $12 million in 2007. The increase in professional liability costs in 2009 resulted primarily from greater levels of prior year favorable adjustments recorded in 2008 and 2007 resulting from changes in estimates.

Health services division

Revenues increased 3% in 2009 to $2.2 billion and 7% in 2008 to $2.1 billion. Revenue growth in each of the past two years was primarily attributable to reimbursement rate increases that reflected both inflationary adjustments and higher patient case mix due to increased acuity for the patients served. Revenues for 2008 included pretax income of approximately $8 million related to the favorable settlement of a prior year nursing center Medicaid cost report dispute.

On a same-facility basis, nursing center admissions increased 3% in 2009 and 5% in 2008 compared to prior periods. On a same-facility basis, aggregate patient days declined 1% in 2009 and were relatively unchanged in 2008 compared to prior periods. Same-facility Medicare patient days declined 4% in 2009 and 1% in 2008. Same-facility non-government patient days increased 2% in 2009 and 6% in 2008.

Nursing center operating margins declined in 2009 as growth in labor, ancillary services costs and professional liability costs exceeded revenue growth. Nursing center operating margins in 2008 improved primarily due to same-facility growth in managed care volumes, the favorable impact of acquired nursing centers and reductions in professional liability costs. Nursing center wage and benefit costs increased 3% to $1.1 billion in 2009 and increased 5% to $1.1 billion in 2008 compared to $1.0 billion in 2007. Average hourly wage rates increased 2% in 2009 and 4% in 2008. Employee benefit costs increased 8% in 2009 and 5% in 2008, primarily as a result of increased employee health insurance costs.

Professional liability costs were $26 million in 2009, $21 million in 2008 and $22 million in 2007. The increase in professional liability costs in 2009 resulted primarily from greater levels of prior year favorable adjustments recorded in 2008 and 2007 resulting from changes in estimates.

Rehabilitation division

Revenues increased 11% to $475 million in 2009 and 21% to $427 million in 2008. The increase in revenues in both periods was primarily attributable to growth in the volume of services provided to existing customers and, in 2008, growth in the number of contracts. Revenues derived from non-affiliated customers aggregated $187 million in 2009, $158 million in 2008 and $112 million in 2007.

Operating margins in 2009 increased primarily due to improvements in therapist productivity levels and the volume of services provided to existing customers. Despite growth in volumes and revenues in 2008, operating margins declined in 2008 primarily due to wage pressures and start-up costs associated with external customer growth.

Pharmacy division

The Spin-off Transaction was completed on July 31, 2007. As a result, our consolidated operating results for 2007 included the results of our former pharmacy division for seven months. For accounting purposes, our former pharmacy division was not treated as a discontinued operation in our historical consolidated financial statements. See note 2 of the notes to consolidated financial statements.

Corporate overhead

Operating income for our operating divisions excludes allocations of corporate overhead. These costs aggregated $135 million in 2009, $133 million in 2008 and $168 million in 2007. As a percentage of consolidated revenues, corporate overhead totaled 3.2% in 2009, 3.2% in 2008 and 4.1% in 2007. Corporate overhead in 2007 included $22 million of costs associated with the Spin-off Transaction.

We recorded approximately $11 million, $17 million and $8 million in other income in 2009, 2008 and 2007, respectively, related to the information systems and transition services agreements with PharMerica.

Corporate expenses included the operating losses from our limited purpose insurance subsidiary of $6 million in 2009 and $7 million in each of 2008 and 2007.

Capital costs

Rent expense increased 3% to $348 million in 2009 and was relatively unchanged at $339 million in 2008. The increase in rent expense in 2009 resulted primarily from contractual inflation and contingent rent increases. Rent expense in 2008 was favorably impacted by the purchase of 13 previously leased facilities in 2008 and 2007 and the elimination of pharmacy division rents in connection with the Spin-off Transaction.

Depreciation and amortization expense increased to $126 million in 2009 from $120 million in 2008 and $118 million in 2007. The increase in both years was primarily a result of our ongoing capital expenditure program and hospital development projects.

Interest expense aggregated $8 million in 2009 compared to $15 million in 2008 and $17 million in 2007. The decrease in 2009 and 2008 was primarily attributable to lower interest rates and lower borrowing levels under our revolving credit facility compared to the previous year.

Investment income related primarily to our insurance subsidiary investments totaled $5 million in 2009 compared to $7 million in 2008 and $16 million in 2007. Investment income was negatively impacted in 2009 and 2008 by declining investment yields and by pretax other-than-temporary impairments of investments of approximately $0.4 million and $2 million, respectively, held in our insurance subsidiary investment portfolio.

Income taxes

The provision for income taxes is based upon our annual reported income or loss for each respective accounting period and includes the effect of certain non-taxable and non-deductible items. Our effective income tax rate was 38.5% in 2009, 38.7% in 2008 and 45.9% in 2007. We recorded favorable income tax adjustments related to the resolution of state income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million in each of 2009, 2008 and 2007. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction.

Consolidated results

Income from continuing operations before income taxes increased 3% to $102 million in 2009 from $99 million in 2008 and increased 24% in 2008 from $80 million in 2007. Income from continuing operations increased 4% to $63 million in 2009 from $60 million in 2008 and increased 40% in 2008 from $43 million in 2007.

Results of Operations – Discontinued Operations

Income from discontinued operations aggregated $1 million in 2009 compared to a loss from discontinued operations of $3 million in 2008 and $13 million in 2007. Discontinued operations included a favorable pretax adjustment of $11 million ($7 million net of income taxes) in 2009, a favorable pretax adjustment of $10 million ($6 million net of income taxes) in 2008 and a pretax charge of approximately $2 million ($1 million net of income taxes) in 2007 resulting from changes in estimates for professional liability reserves related to prior years.

We recorded a pretax loss on divestiture of operations of $39 million ($24 million net of income taxes) during 2009 related to the planned divestiture of the Nursing Centers. We recorded a pretax loss on divestiture of operations of $44 million ($27 million net of income taxes) during 2008 related to the planned divestiture of two

LTAC hospitals. We recorded a pretax gain on divestiture of operations of $10 million ($6 million net of income taxes) during 2008 and a pretax loss on divestiture of operations of $113 million ($69 million net of income taxes) during 2007 related to the sale of the Ventas Facilities. During 2007, we also recorded a pretax loss on divestiture of operations related to the HCP Transaction of $13 million ($8 million net of income taxes).

See notes 3, 4 and 9 of the notes to consolidated financial statements.

Liquidity

Operating cash flows and capital expenditures

Cash flows provided by operations (including discontinued operations) aggregated $234 million for 2009, $172 million for 2008 and $160 million for 2007. During each year we maintained sufficient liquidity to fund our ongoing capital expenditure program and finance our ongoing development expenditures as well as our acquisition and strategic divestiture activities.

Our operating cash flows in 2009 and 2008 increased primarily as a result of improved accounts receivable collections and lower income tax payments. Federal income tax refunds totaled $7 million in 2009, while federal income tax payments totaled $6 million in 2008 and $17 million in 2007.

Cash and cash equivalents totaled $16 million at December 31, 2009 compared to $141 million at December 31, 2008. Our long-term debt, comprised principally of borrowings under our revolving credit facility, aggregated $148 million at December 31, 2009 compared to $350 million at December 31, 2008. Based upon our existing cash levels, expected operating cash flows and the availability of borrowings under our revolving credit facility ($353 million at December 31, 2009), we believe that we have the necessary financial resources to satisfy our expected short-term and long-term liquidity needs.

Revolving credit facility and financing activities

Under the terms of our revolving credit facility, the aggregate amount of the credit may be increased from $500 million to $600 million at our option subject to lender approval and certain other conditions. If we elect to expand the available credit, the existing lenders are likely to demand new terms, including increases in the effective interest rate. The term of our revolving credit facility expires in July 2012. See "Item 1A – Risk Factors – Risk Factors Relating to Our Capital and Liquidity."

Interest rates under our revolving credit facility are based, at our option, upon (a) LIBOR plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. Our revolving credit facility is collateralized by substantially all of our assets including certain owned real property and is guaranteed by substantially all of our subsidiaries. The terms of our revolving credit facility include a certain defined fixed payment ratio covenant and covenants which limit acquisitions and annual capital expenditures. We were in compliance with the terms of our revolving credit facility at December 31, 2009.

Despite the recent instability within the financial markets both nationally and globally, we have not experienced any individual lender limitations to extend credit under our revolving credit facility. However, the obligations of each of the lending institutions in our revolving credit facility are separate and the availability of future borrowings under our revolving credit facility could be impacted by further volatility and disruptions in the financial credit markets or other events, including the bankruptcy of a lending institution.

In April 2009, we provided Ventas with notices to renew the Master Lease Agreements for an additional five years for the 2010 Renewal Facilities. The initial lease term for the 2010 Renewal Facilities was scheduled to expire in April 2010. Our option to renew the leases on the 2010 Renewal Facilities would have expired on April 30, 2009. No additional rent or other consideration was paid in connection with these renewals. The effectiveness of the renewals is contingent upon there being no events of default under the Master Lease Agreements in April 2010.

In May 2008, we received a cash distribution of $7 million related to the sale of land by a partnership. We have a noncontrolling ownership interest in the partnership that is accounted for under the equity method of accounting. No gain or loss was recognized on the land sale.

In April 2008, we repaid a capital lease obligation of approximately $16 million in connection with the exercise of a purchase option under a hospital lease agreement.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $34 million in 2009, $39 million in 2008 and $37 million in 2007 from our limited purpose insurance subsidiary in accordance with applicable regulations. These distributions had no impact on earnings and the proceeds were used primarily to repay borrowings under our revolving credit facility.

Strategic divestitures

In June 2009, we purchased the Nursing Centers from Ventas for approximately $56 million. In addition, we paid Ventas a lease termination fee of approximately $2 million. The Nursing Centers were included in our Master Lease Agreements with Ventas and we do not have the ability to terminate a lease of an individual facility under the Master Lease Agreements. The aggregate annual rent for the Nursing Centers was approximately $6 million for the year ended December 31, 2008. The Nursing Centers, which contained 777 licensed beds, generated pretax losses of approximately $0.5 million, $3 million and $6 million for 2009, 2008 and 2007, respectively. We disposed of five of the Nursing Centers in 2009 for approximately $26 million. We recorded a pretax loss of approximately $39 million ($24 million net of income taxes) during 2009 related to these divestitures. We intend to dispose of the remaining Nursing Center as soon as practicable. The fair value of the remaining Nursing Center is classified as Level 3 in the fair value hierarchy.

In September 2008, we purchased for resale a LTAC hospital for $22 million that was previously leased and announced our intention to dispose of another LTAC hospital and its related operations. We expect to dispose of these two hospitals as soon as practicable.

Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. We used these proceeds to reduce outstanding borrowings under our revolving credit facility.

In June 2007, we paid approximately $176 million to purchase the Ventas Facilities with borrowings under our revolving credit facility. During 2008 and 2007, we sold the Ventas Facilities for approximately $95 million. See note 3 of the notes to consolidated financial statements.

In January 2007, we paid $37 million as part of the consideration to complete the HCP Transaction. We also divested the 11 nursing centers acquired in the HCP Transaction during 2007 and received proceeds of $78 million, which were used to repay borrowings under our revolving credit facility.

Equity transactions

In August 2007, our Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, we expended $50 million to purchase approximately 2.6 million shares of our common stock. We financed these repurchases from both internally generated funds and borrowings under our revolving credit facility. The authorization expired during 2008 and we did not purchase any common stock in 2009 or 2008.

Debt and lease obligations

Future payments of principal and interest due under long-term debt agreements and lease obligations as of December 31, 2009 follows (in thousands):

	Payments due by period					
			Non-cancelable operating leases			
Year	Revolving credit facility (a)	Other long-term debt	Ventas (b)	Other	Subtotal	Total
2010	$ 3,607	$ 128	$ 243,984	$ 68,328	$ 312,312	$ 316,047
2011	3,607	128	250,325	64,977	315,302	319,037
2012	148,976	127	255,474	57,657	313,131	462,234
2013	–	127	178,915	57,226	236,141	236,268
2014	–	127	141,519	54,958	196,477	196,604
Thereafter	–	266	47,399	215,465	262,864	263,130
	$ 156,190	$ 903	$ 1,117,616	$ 518,611	$ 1,636,227	$ 1,793,320

(a) Revolving credit facility interest is based upon the weighted average interest rate of 2.4% as of December 31, 2009.

(b) See "Part I – Business – Master Lease Agreements – Rental Amounts and Escalators."

As previously discussed, we adopted the provisions for accounting for the uncertainty of income taxes on January 1, 2007. As of December 31, 2009, we had approximately $8 million of total gross unrecognized tax benefits and $0.1 million of accrued interest related to uncertain tax positions. Because future cash outflows related to these unrecognized tax benefits are uncertain, they are excluded from the table above.

Capital Resources

Excluding acquisitions, routine capital expenditures totaled $98 million in 2009, $110 million in 2008 and $121 million in 2007. Hospital development capital expenditures totaled $42 million in 2009, $33 million in 2008 and $59 million in 2007. Nursing center development capital expenditures totaled $6 million in each of 2009, 2008 and 2007. Excluding acquisitions, we anticipate that routine capital expenditures in 2010 will approximate $115 million to $120 million, hospital development capital expenditures should approximate $45 million to $50 million and nursing center development capital expenditures on transitional care centers and units should approximate $25 million to $30 million. We believe that our capital expenditure program is adequate to improve and equip existing facilities. Capital expenditures in each of the last three years were financed primarily through internally generated funds. At December 31, 2009, the estimated cost to complete and equip construction in progress approximated $36 million.

In January 2010, we acquired the real estate of two previously leased hospitals and two previously leased nursing centers for approximately $31 million in cash and approximately $2 million in unamortized prepaid rent. Annual rents associated with these four facilities approximated $3 million. These transactions were financed through borrowings under our revolving credit facility.

In July 2009, we acquired a hospice business for $8 million. In March 2009, we also acquired the real estate of a previously leased hospital for approximately $16 million in cash and approximately $2 million in unamortized prepaid rent. Annual rents associated with this facility approximated $2 million.

During 2008, we acquired the real estate of four previously leased nursing centers for approximately $24 million. Annual rents associated with the four nursing centers approximated $3 million. These transactions were financed through borrowings under our revolving credit facility.

During 2007, we acquired the real estate of eight previously leased nursing centers and one previously leased hospital for approximately $113 million. Annual rents associated with these facilities approximated $10 million. In July 2007, we acquired a combined nursing center and assisted living facility for approximately $20 million. These transactions were financed through borrowings under our revolving credit facility.

In February 2007, we entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8 million.

At December 31, 2009, the remaining permitted acquisition amount under our revolving credit facility aggregated $216 million.

Other Information

Effects of inflation and changing prices

We derive a substantial portion of our revenues from the Medicare and Medicaid programs. Congress and certain state legislatures have enacted or may enact additional significant cost containment measures limiting our ability to recover our cost increases through increased pricing of our healthcare services. Medicare revenues in LTAC hospitals and nursing centers are subject to fixed payments under the Medicare prospective payment systems.

Medicaid reimbursement rates in many states in which we operate nursing centers also are based upon fixed payment systems. Generally, these rates are adjusted annually for inflation. However, these adjustments may not reflect the actual increase in the costs of providing healthcare services.

Congress and the White House Administration are currently considering healthcare reform bills, which would initiate significant reforms to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors. The House of Representatives has passed a healthcare reform bill entitled "The Affordable Healthcare for America Act" and the Senate has passed a healthcare reform bill entitled "The Patient Protection and Affordable Care Act." At this time, we cannot predict if or when one of these bills or similar legislation may be passed and submitted to the President.

The healthcare reforms contained in these bills would impact each of our businesses in some manner. Due to the unsettled nature of the current healthcare reform bills, the substantial regulatory changes that would need to be implemented by CMS and others, and the numerous processes required to implement these reforms, we cannot predict which healthcare reforms will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on our business.

Several of the proposed reforms are very significant and could ultimately change the nature of our services, the methods of payment for our services and the underlying regulatory environment. The proposed reforms could include modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care and the imposition of enrollment limitations on new providers. In addition, a primary goal of healthcare reform is to reduce costs which could include reductions in the reimbursement paid to us and other healthcare providers. Moreover, healthcare reform could negatively impact insurance companies, other third party payors, our customers, as well as other healthcare providers, which may in turn negatively impact our business. As such, these healthcare reforms or other similar healthcare reforms, if adopted, could have a material adverse effect on our business, financial position, results of operations and liquidity.

We believe that our operating margins may continue to be under pressure as the growth in operating expenses, particularly professional liability, labor and employee benefits costs, exceeds payment increases from third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients is limited.

See "Part I – Item 1 – Business – Governmental Regulation" for a detailed discussion of Medicare and Medicaid reimbursement regulations. Also see "Part I – Item 1A – Risk Factors."

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The following discussion of our exposure to market risk contains "forward-looking statements" that involve risks and uncertainties. Given the unpredictability of interest rates as well as other factors, actual results could differ materially from those projected in such forward-looking information.

Our exposure to market risk relates to changes in the prime rate, federal funds rate and LIBOR which affect the interest paid on certain borrowings.

The following table provides information about our financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted average interest rates by expected maturity date.

Interest Rate Sensitivity
Principal (Notional) Amount by Expected Maturity
Average Interest Rate
(Dollars in thousands)

	Expected maturities							Fair value
	2010	2011	2012	2013	2014	Thereafter	Total	12/31/09
Liabilities:								
Long-term debt, including amounts due within one year:								
Fixed rate	$ 86	$ 91	$ 96	$ 102	$ 109	$ 249	$ 733	$ 724(a)
Average interest rate	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%		
Variable rate (b)	$ –	$ –	$ 147,000	$ –	$ –	$ –	$ 147,000	$ 147,000

(a) Calculated based upon the net present value of future principal and interest payments using a discount rate of 6%.

(b) Interest on borrowings under our revolving credit facility is payable, at our option, at (1) LIBOR plus an applicable margin ranging from 1.25% to 2.00% or (2) the applicable margin ranging from 0.25% to 1.00% plus the higher of the prime rate or 0.5% over the federal funds rate. The applicable margin is based upon our average daily excess availability as defined in our revolving credit facility.

Item 8. ***Financial Statements and Supplementary Data***

The information required by this Item 8 is included in appendix pages F-2 through F-43 of this Annual Report on Form 10-K.

Item 9. ***Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

Not applicable.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting

We have carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2009, the disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2009, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based upon our assessment and those criteria, management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2009.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, who also audited our consolidated financial statements included in this Annual Report on Form 10-K, as stated in their report which appears in our consolidated financial statements.

Item 9B. ***Other Information***

Not applicable.

PART III

Item 10. *Directors, Executive Officers and Corporate Governance*

EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names, ages (as of January 1, 2010) and present and past positions of our current executive officers:

Name	Age	Position
Paul J. Diaz	48	President and Chief Executive Officer
Frank J. Battafarano	59	Chief Operating Officer
Richard A. Lechleiter	51	Executive Vice President and Chief Financial Officer
Lane M. Bowen	59	Executive Vice President and President, Health Services Division
Benjamin A. Breier	38	Executive Vice President and President, Hospital Division
Richard E. Chapman	61	Executive Vice President and Chief Administrative and Information Officer
Christopher M. Bird	45	President, People*first* Rehabilitation Division
William M. Altman	50	Senior Vice President, Strategy and Public Policy
Joseph L. Landenwich	45	Senior Vice President of Corporate Legal Affairs and Corporate Secretary
Gregory C. Miller	40	Senior Vice President, Corporate Development and Financial Planning
M. Suzanne Riedman	58	Senior Vice President and General Counsel

Paul J. Diaz has served as one of our directors since May 2002, as our Chief Executive Officer since January 1, 2004 and as our President since January 2002. Mr. Diaz served as our Chief Operating Officer from January 2002 to December 31, 2003.

Frank J. Battafarano has served as our Chief Operating Officer since March 2008. He served as our Executive Vice President from February 2005 to March 2008 and as President, Hospital Division from November 1998 to March 2008.

Richard A. Lechleiter, a certified public accountant, has served as our Executive Vice President and Chief Financial Officer since February 2005. He served as Senior Vice President and Chief Financial Officer from February 2002 to February 2005.

Lane M. Bowen has served as our Executive Vice President since February 2005 and as President, Health Services Division since October 2002.

Benjamin A. Breier has served as our Executive Vice President and President, Hospital Division since March 2008. He served as President, People*first* Rehabilitation division from August 2005 to March 2008. Prior to joining us, Mr. Breier served as Senior Vice President, Operations for Concentra, Inc., a leading provider of workers compensation and occupational health services, from December 2003 to August 2005.

Richard E. Chapman has served as our Executive Vice President and Chief Administrative and Information Officer since February 2005. He served as Chief Administrative and Information Officer and Senior Vice President from January 2001 to February 2005.

Christopher M. Bird has served as our President, People*first* Rehabilitation division since April 2008. Prior to joining us, Mr. Bird served as Vice President, Operations and Business Development, Outpatient Services Division with Tenet Healthcare Corp., which owns and operates acute care hospitals and related ancillary healthcare businesses, from May 2006 to April 2008. Mr. Bird served as Division Vice President, Western Division, with DaVita, Inc., a provider of dialysis services for patients suffering from chronic kidney failure, from December 2001 to April 2006.

William M. Altman, an attorney, has served as our Senior Vice President, Strategy and Public Policy since January 1, 2008. He served as Senior Vice President, Compliance and Government Programs from April 2002 to December 2007.

Joseph L. Landenwich, an attorney and certified public accountant, has served as our Senior Vice President of Corporate Legal Affairs and Corporate Secretary since December 2003. Mr. Landenwich served as Vice President of Corporate Legal Affairs and Corporate Secretary from November 1999 to December 2003.

Gregory C. Miller has served as our Senior Vice President, Corporate Development and Financial Planning since January 2005. He served as our Vice President, Corporate Development and Financial Planning from January 2004 to January 2005.

M. Suzanne Riedman, an attorney, has served as our Senior Vice President and General Counsel since August 1999. She served as our Vice President and Associate General Counsel from April 1998 to August 1999.

From 1996 to July 1998, Mr. Diaz served in various executive capacities with Mariner Health Group, Inc. ("Mariner Health"), a long-term healthcare provider, most recently as Executive Vice President and Chief Operating Officer. On July 31, 1998, Paragon Health Network, Inc., the predecessor to Mariner Post-Acute Networks, Inc. ("Mariner Post-Acute") acquired Mariner Health. Mariner Post-Acute and substantially all of its subsidiaries, including Mariner Health, filed voluntary petitions under the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware on January 18, 2000.

As a result of decreased Medicare and Medicaid reimbursement rates introduced by the Balanced Budget Act and other issues associated with our Company, we were unable to meet our then existing financial obligations, including rent payable to the Company's largest landlord, Ventas, and debt service obligations under our then existing indebtedness. Accordingly, on September 13, 1999, we filed voluntary petitions for protection under the Bankruptcy Code. On March 1, 2001, the Bankruptcy Court approved our Fourth Amended Joint Plan of Reorganization. From the date of our bankruptcy filing until we emerged from bankruptcy on April 20, 2001, we operated our businesses as a debtor-in-possession subject to the jurisdiction of the Bankruptcy Court. Messrs. Battafarano, Chapman and Lechleiter and Ms. Riedman were each executive officers of the Company at the time of our bankruptcy filing.

The information required by this Item, other than the information set forth above under "Executive Officers of the Registrant," is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 11. *Executive Compensation*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 14. ***Principal Accounting Fees and Services***

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a)(1) and (a)(2) Index to Consolidated Financial Statements and Financial Statement Schedules:

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(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

(a)(3) Index to Exhibits:

Exhibit number	Description of document
2.1	Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code. Exhibit 2.1 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.2	Order Confirming the Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code, as entered by the United States Bankruptcy Court for the District of Delaware on March 16, 2001. Exhibit 2.2 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.3	Purchase and Sale Agreement by and among those entities listed on Schedule P thereto as buying entities, those entities listed on Schedule P thereto as selling entities and Jeffrey A. Goldshine, Douglas B. Noble, and Mary Catherine Rumsey, and solely for purposes of Article III thereof and the Guaranty, Kindred Healthcare Operating, Inc., dated as of October 24, 2005. Exhibit 2.1 to the Company's Current Report on Form 8-K dated October 24, 2005 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.4*	Master Transaction Agreement, dated as of October 25, 2006, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.5	Amendment No. 1 To Master Transaction Agreement, dated as of June 4, 2007, among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 4, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.6*	Amendment No. 2 To Master Transaction Agreement, dated as of July 31, 2007, among AmerisourceBergen Corporation, PharMerica Long-Term Care, Inc. (formerly named PharMerica, Inc.), Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., PharMerica Corporation (formerly named Safari Holding Corporation), Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 2.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.1	Amended and Restated Certificate of Incorporation of the Company. Exhibit 4.1 to the Company's Registration Statement on Form S-3 filed August 31, 2001 (Comm. File No. 333-68838) is hereby incorporated by reference.
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation. Exhibit 3.1 to the Company's Form 10-Q for the quarterly period ended March 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.3	Amended and Restated Bylaws of the Company. Exhibit 3.1 to the Company's Current Report on Form 8-K dated March 20, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
4.1	Articles IV, IX, X and XII of the Restated Certificate of Incorporation of the Company is included in Exhibit 3.1.

Exhibit number	Description of document
10.1	Second Amended and Restated Credit Agreement dated as of July 18, 2007 among the Company, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, J.P. Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, Citicorp USA, Inc., as Syndication Agent, and General Electric Capital Corporation, The CIT Group/Business Credit, Inc. and Wells Fargo Foothill, as Co-Documentation Agents. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.2	Tax Allocation Agreement dated as of April 30, 1998 by and between Vencor, Inc. and Ventas, Inc. Exhibit 10.9 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.3	Agreement of Indemnity-Third Party Leases dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.4	Agreement of Indemnity-Third Party Contracts dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.12 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.5	Form of Indemnification Agreement between the Company and certain of its officers and employees. Exhibit 10.31 to the Ventas, Inc. Form 10-K for the year ended December 31, 1995 (Comm. File No. 1-10989) is hereby incorporated by reference.
10.6	Form of Indemnification Agreement between the Company and each member of its Board of Directors. Exhibit 10.21 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.7**	Kindred Deferred Compensation Plan, Third Amendment and Restatement effective as of January 1, 2009. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.8	Tax Refund Escrow Agreement and First Amendment to the Tax Allocation Agreement made and entered into as of the 20th of April 2001 by and between the Company and each of its subsidiaries and Ventas, Inc., Ventas Realty Limited Partnership and Ventas LP Realty, L.L.C. Exhibit 10.31 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.9**	Vencor, Inc. Supplemental Executive Retirement Plan dated January 1, 1998, as amended. Exhibit 10.27 to the Company's Registration Statement on Form S-4 (Reg. No. 333-57953) is hereby incorporated by reference.
10.10**	Amendment No. Two to Supplemental Executive Retirement Plan dated as of January 15, 1999. Exhibit 10.48 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.11**	Amendment No. Three to Supplemental Executive Retirement Plan dated as of December 31, 1999. Exhibit 10.49 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.12**	Amendment No. 4 to Supplemental Executive Retirement Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended March 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.13**	Amendment No. 5 to Supplemental Executive Retirement Plan. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended September 30, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.14**	Amendment No. 6 to Supplemental Executive Retirement Plan. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.15**	Amended and Restated Kindred Healthcare, Inc. Long-Term Incentive Plan. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended March 31, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.16**	Amended and Restated Kindred Healthcare, Inc. Short-Term Incentive Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.17**	Agreement dated as of March 20, 2009 by and between Kindred Healthcare, Inc. and Edward L. Kuntz. Exhibit 10.1 to the Company's Current Report on Form 8-K dated March 20, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.18**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.3 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.19**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 13, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.20**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard E. Chapman. Exhibit 10.21 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.21**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Richard E. Chapman.
10.22**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Frank J. Battafarano. Exhibit 10.7 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.23**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Frank J. Battafarano. Exhibit 10.3 to the Company's Current Report on Form 8-K dated November 13, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.24**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and M. Suzanne Riedman. Exhibit 10.25 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.25**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and M. Suzanne Riedman.
10.26**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.5 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.27**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.2 to the Company's Current Report on Form 8-K dated November 13, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.28**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and William M. Altman. Exhibit 10.29 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.29**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and William M. Altman.
10.30**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.9 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.31**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.4 to the Company's Current Report on Form 8-K dated November 13, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.32**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Joseph L. Landenwich. Exhibit 10.33 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.33**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Joseph L. Landenwich.
10.34**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier. Exhibit 10.35 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.35**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier.
10.36**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller. Exhibit 10.37 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.37**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller.
10.38**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Christopher M. Bird. Exhibit 10.39 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.39**	Change-in-Control Severance Agreement dated as of November 13, 2009 by and between Kindred Healthcare Operating, Inc. and Christopher M. Bird.
10.40	Second Amended and Restated Master Lease Agreement No. 1 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.41	Amendment to Memorandum of Lease and Specific Property Lease Amendment dated as of June 8, 2007 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.47 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.42	Amendment to Master Lease and Memorandum of Lease dated as of January 16, 2009 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended March 31, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.43	Amendment to Memorandum of Lease and Specific Property Lease Amendment dated as of October 14, 2009 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant.
10.44	Second Amended and Restated Master Lease Agreement No. 2 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.45	Second Amended and Restated Master Lease Agreement No. 3 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.46	Amendment to Memorandum of Lease and Specific Property Lease Amendment dated as of January 9, 2009 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.2 to the Company's Form 10-Q for the quarterly period ended March 31, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.47	Second Amended and Restated Master Lease Agreement No. 4 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.48	Amendment to Master Lease and Memorandum of Lease dated as of August 7, 2007 by and among Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.51 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.49	Renewal Notice to Lessor dated April 30, 2009 regarding the Second Amended and Restated Master Lease Agreements Nos. 1-4 between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended June 30, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.50	Master Lease among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated May 16, 2001. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.51	First Amendment to Master Lease dated effective August 1, 2001 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.53 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.52	Second Amendment to Master Lease dated as of November 18, 2003 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.54 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.53	Third Amendment to Master Lease dated and effective as of June 30, 2004 by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.55 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.54	Fourth Amendment to Master Lease by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated February 28, 2006. Exhibit 10.71 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.55	Fifth Amendment to Master Lease by and among Health Care Property Investors, Inc., Health Care Property Partners, and Texas HCP Holding, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C., Kindred Nursing Centers Limited Partnership, Kindred Hospitals Limited Partnership and Transitional Hospitals Corporation of Wisconsin, Inc., collectively, as Lessee, dated January 31, 2007. Exhibit 10.72 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.56	Sixth Amendment to Master Lease by and among HCP, Inc. f/k/a Health Care Property Investors, Inc., Health Care Property Investors, Inc., Health Care Property Partners, and Texas HCP Holding, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C., Kindred Nursing Centers Limited Partnership and Transitional Hospitals Corporation of Wisconsin, Inc., collectively, as Lessee, dated December 8, 2008. Exhibit 10.53 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.57	Master Lease Agreement dated as of February 28, 2006 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended March 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.58	First Amendment to Master Lease Agreement dated as of June 20, 2007 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant. Exhibit 10.59 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.59	Agreement and Plan of Reorganization between the Company and Ventas, Inc. Exhibit 10.1 to the Company's Form 10, as amended, dated April 27, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.60**	The Company's 2000 Stock Option Plan. Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.61**	The Company's Restricted Share Plan. Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.62**	Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 22, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.63**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.64 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.64**	Form of Kindred Healthcare, Inc. Incentive Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.65 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.65**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.66 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.66**	Form of Kindred Healthcare, Inc. Stock Bonus Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended March 31, 2009 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.67**	Form of Kindred Healthcare, Inc. Performance Unit Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.68 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.68**	Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.69 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.69**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.70 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.70**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.71 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.71**	Form of Amendment No. 1 to Non-Discretionary Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.72 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.72**	Form of Amendment No. 1 to Discretionary Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.73 to the Company's Form 10-K for the year ended December 31, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.73	Tax Matters Agreement, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Pharmacy Services, Inc. and Safari Holding Corporation, in each case on behalf of itself and its Affiliates. Exhibit 10.2 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.74	Other Debt Instruments – Copies of debt instruments for which the related debt is less than 10% of total assets will be furnished to the SEC upon request.
21	List of Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
31	Rule 13a-14(a)/15d-14(a) Certifications.
32	Section 1350 Certifications.

* The Company will furnish supplementally to the SEC upon request a copy of any omitted exhibit or annex.

** Compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(b) of this Annual Report on Form 10-K.

(b) Exhibits.

The response to this portion of Item 15 is submitted as a separate section of this Annual Report on Form 10-K.

(c) Financial Statement Schedules.

The response to this portion of Item 15 is included in appendix page F-43 of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 26, 2010

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Joel Ackerman **Joel Ackerman**	Director	February 26, 2010
/s/ Ann C. Berzin **Ann C. Berzin**	Director	February 26, 2010
/s/ Jonathan D. Blum **Jonathan D. Blum**	Director	February 26, 2010
/s/ Thomas P. Cooper, M.D. **Thomas P. Cooper, M.D.**	Director	February 26, 2010
/s/ Isaac Kaufman **Isaac Kaufman**	Director	February 26, 2010
/s/ Frederick J. Kleisner **Frederick J. Kleisner**	Director	February 26, 2010
/s/ Eddy J. Rogers, Jr. **Eddy J. Rogers, Jr.**	Director	February 26, 2010
/s/ Phyllis R. Yale **Phyllis R. Yale**	Director	February 26, 2010
/s/ Edward L. Kuntz **Edward L. Kuntz**	Chairman of the Board	February 26, 2010
/s/ Paul J. Diaz **Paul J. Diaz**	President and Chief Executive Officer (Principal Executive Officer)	February 26, 2010
/s/ Richard A. Lechleiter **Richard A. Lechleiter**	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 26, 2010
/s/ John J. Lucchese **John J. Lucchese**	Senior Vice President and Corporate Controller (Principal Accounting Officer)	February 26, 2010

KINDRED HEALTHCARE, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

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(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of Kindred Healthcare, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Kindred Healthcare, Inc. and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

Louisville, Kentucky
February 26, 2010

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year ended December 31,		
	2009	2008	2007
Revenues	$ 4,270,007	$ 4,093,864	$ 4,128,649
Salaries, wages and benefits	2,483,086	2,374,163	2,325,417
Supplies	333,056	317,149	542,986
Rent	348,248	338,673	337,769
Other operating expenses	886,205	854,383	730,965
Other income	(11,512)	(17,407)	(7,701)
Depreciation and amortization	125,730	120,022	118,574
Interest expense	7,880	15,373	17,044
Investment income	(4,413)	(7,096)	(16,105)
	4,168,280	3,995,260	4,048,949
Income from continuing operations before income taxes	101,727	98,604	79,700
Provision for income taxes	39,115	38,144	36,567
Income from continuing operations	62,612	60,460	43,133
Discontinued operations, net of income taxes:			
Income (loss) from operations	931	(3,399)	(12,982)
Loss on divestiture of operations	(23,432)	(20,776)	(77,021)
Net income (loss)	$ 40,111	$ 36,285	$ (46,870)
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	$ 1.61	$ 1.56	$ 1.09
Discontinued operations:			
Income (loss) from operations	0.02	(0.09)	(0.33)
Loss on divestiture of operations	(0.60)	(0.53)	(1.94)
Net income (loss)	$ 1.03	$ 0.94	$ (1.18)
Diluted:			
Income from continuing operations	$ 1.60	$ 1.54	$ 1.06
Discontinued operations:			
Income (loss) from operations	0.02	(0.09)	(0.32)
Loss on divestiture of operations	(0.60)	(0.53)	(1.90)
Net income (loss)	$ 1.02	$ 0.92	$ (1.16)
Shares used in computing earnings (loss) per common share:			
Basic	38,339	37,830	38,791
Diluted	38,502	38,397	39,558

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED BALANCE SHEET
(In thousands, except per share amounts)

	December 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,303	$ 140,795
Cash–restricted	5,820	5,104
Insurance subsidiary investments	106,834	123,535
Accounts receivable less allowance for loss of $20,156 – 2009 and $27,548 – 2008	610,959	611,032
Inventories	22,303	22,325
Deferred tax assets	42,791	58,296
Income taxes	17,447	47,257
Other	21,194	20,843
	843,651	1,029,187
Property and equipment, at cost:		
Land	47,912	46,388
Buildings	787,803	702,178
Equipment	613,344	572,682
Construction in progress	66,641	71,388
	1,515,700	1,392,636
Accumulated depreciation	(765,602)	(656,676)
	750,098	735,960
Goodwill	81,223	72,244
Intangible assets less accumulated amortization of $2,647 – 2009 and $1,817 – 2008	64,491	64,367
Assets held for sale	8,806	7,786
Insurance subsidiary investments	100,223	122,058
Deferred tax assets	110,930	100,751
Other	62,802	49,408
	$ 2,022,224	$ 2,181,761
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 161,066	$ 178,246
Salaries, wages and other compensation	287,772	281,542
Due to third party payors	28,261	33,122
Professional liability risks	47,076	55,447
Other accrued liabilities	78,358	76,832
Long-term debt due within one year	86	81
	602,619	625,270
Long-term debt	147,647	349,433
Professional liability risks	195,126	187,804
Deferred credits and other liabilities	110,238	104,279
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.25 par value; authorized 1,000 shares; none issued and outstanding	–	–
Common stock, $0.25 par value; authorized 175,000 shares; issued 39,104 shares – 2009 and 38,909 shares – 2008	9,776	9,727
Capital in excess of par value	820,407	812,141
Accumulated other comprehensive loss	(423)	(3,619)
Retained earnings	136,834	96,726
	966,594	914,975
	$ 2,022,224	$ 2,181,761

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)

	Shares of common stock	Par value common stock	Capital in excess of par value	Accumulated other comprehensive income/(loss)	Retained earnings	Total
Balances, December 31, 2006	39,978	$ 9,994	$ 793,054	$ 1,246	$ 191,284	$995,578
Comprehensive loss:						
Net loss					(46,870)	(46,870)
Net unrealized investment gains, net of income taxes				349		349
Other				(345)		(345)
Comprehensive loss						(46,866)
Grant of non-vested restricted stock	437	109	(109)			–
Issuance of common stock in connection with employee benefit plans	597	150	10,457		(142)	10,465
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(114)	(28)	(2,564)		(293)	(2,885)
Spin-off Transaction (as defined)					(80,220)	(80,220)
Repurchase of common stock, at cost	(2,559)	(640)	(46,520)		(2,837)	(49,997)
Stock-based compensation amortization			31,222			31,222
Pre-emergence income tax liability adjustment			2,950			2,950
Income tax benefit in connection with the issuance of common stock under employee benefit plans			1,877			1,877
Balances, December 31, 2007	38,339	9,585	790,367	1,250	60,922	862,124
Comprehensive income:						
Net income					36,285	36,285
Net unrealized investment losses, net of income taxes				(3,044)		(3,044)
Other				(1,825)		(1,825)
Comprehensive income						31,416
Grant of non-vested restricted stock	166	41	(41)			–
Issuance of common stock in connection with employee benefit plans	504	126	9,016		(277)	8,865
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(100)	(25)	(2,326)		(53)	(2,404)
Stock-based compensation amortization			12,637			12,637
Pre-emergence income tax liability adjustment			1,385			1,385
Income tax benefit in connection with the issuance of common stock under employee benefit plans			1,103			1,103
Other					(151)	(151)
Balances, December 31, 2008	38,909	9,727	812,141	(3,619)	96,726	914,975
Comprehensive income:						
Net income					40,111	40,111
Net unrealized investment gains, net of income taxes				1,230		1,230
Other				1,966		1,966
Comprehensive income						43,307
Grant of non-vested restricted stock	196	49	(49)			–
Issuance of common stock in connection with employee benefit plans	104	26	931			957
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(105)	(26)	(1,512)		(3)	(1,541)
Stock-based compensation amortization			9,905			9,905
Income tax provision in connection with the issuance of common stock under employee benefit plans			(1,009)			(1,009)
Balances, December 31, 2009	39,104	$ 9,776	$ 820,407	$ (423)	$ 136,834	$966,594

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year ended December 31,		
	2009	2008	2007
Cash flows from operating activities:			
Net income (loss)	$ 40,111	$ 36,285	$ (46,870)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	126,404	122,265	124,280
Amortization of stock-based compensation costs	9,905	12,637	31,222
Provision for doubtful accounts	29,320	32,336	30,093
Deferred income taxes	10,876	20,793	(9,148)
Loss on divestiture of discontinued operations	23,432	20,776	77,021
Other	(1,186)	1,029	(4,022)
Change in operating assets and liabilities:			
Accounts receivable	(29,247)	(46,610)	(97,292)
Inventories and other assets	(17,386)	(11,489)	18,123
Accounts payable	(4,088)	(13,953)	6,631
Income taxes	35,009	9,052	11,477
Due to third party payors	(6,369)	(8,309)	14,196
Other accrued liabilities	16,939	(2,527)	3,934
Net cash provided by operating activities	233,720	172,285	159,645
Cash flows from investing activities:			
Routine capital expenditures	(97,550)	(109,926)	(121,362)
Development capital expenditures	(48,058)	(38,751)	(65,126)
Acquisitions	(83,432)	(48,824)	(351,097)
Sale of assets	25,967	27,984	148,490
Purchase of insurance subsidiary investments	(103,477)	(121,693)	(142,897)
Sale of insurance subsidiary investments	122,410	119,810	151,725
Net change in insurance subsidiary cash and cash equivalents	22,005	31,064	(6,246)
Net change in other investments	2,002	7,002	1,514
Other	3,538	2,568	4,982
Net cash used in investing activities	(156,595)	(130,766)	(380,017)
Cash flows from financing activities:			
Proceeds from borrowings under revolving credit	1,214,400	1,498,000	1,746,600
Repayment of borrowings under revolving credit	(1,416,100)	(1,424,300)	(1,600,800)
Repayment of capital lease obligation	–	(16,268)	–
Payment of deferred financing costs	(855)	(508)	(3,059)
Proceeds from borrowing related to Spin-off Transaction	–	–	125,000
Issuance of common stock	957	8,865	10,465
Repurchase of common stock	–	–	(49,997)
Other	(19)	610	4,183
Net cash provided by (used in) financing activities	(201,617)	66,399	232,392
Change in cash and cash equivalents	(124,492)	107,918	12,020
Cash and cash equivalents at beginning of period	140,795	32,877	20,857
Cash and cash equivalents at end of period	$ 16,303	$ 140,795	$ 32,877
Supplemental information:			
Interest payments	$ 6,122	$ 14,661	$ 15,961
Income tax payments (refunds)	(4,480)	7,590	23,402
Rental payments to Ventas, Inc.	243,011	239,367	237,860

See accompanying notes.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ACCOUNTING POLICIES

Reporting entity

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing and rehabilitation centers and a contract rehabilitation services business across the United States (collectively, "Kindred" or the "Company").

Basis of presentation

The consolidated financial statements include all subsidiaries. All intercompany transactions have been eliminated. Investments in affiliates in which the Company has a 50% or less interest are accounted for by either the equity or cost method.

On July 31, 2007, the Company completed the spin-off of its former institutional pharmacy business. See Note 2.

In recent years, the Company has completed several transactions related to the divestiture of unprofitable hospitals and nursing centers. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2009 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See Notes 3 and 4.

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

Recently issued accounting requirements

In January 2010, the Financial Accounting Standards Board (the "FASB") issued authoritative guidance related to fair value measurements and disclosures. The provisions of the guidance require new disclosures related to transfers in and out of Levels 1 and 2 (as described in Note 17). The provisions also require a reconciliation of the activity in Level 3 (as described in Note 17) recurring fair value measurements. Existing disclosures also were expanded to include Level 2 fair value measurement valuation techniques and inputs. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2009, except for the disclosures for Level 3 activity which is effective for fiscal years beginning after December 15, 2010. The adoption of the guidance is not expected to have a material impact on the Company's business, financial position, results of operations or liquidity.

In August 2009, the FASB issued authoritative guidance related to fair value measurements and disclosures. The provisions of this guidance clarify how an entity should measure liabilities at fair value. The guidance is effective for all interim and annual reporting periods beginning after August 26, 2009. The adoption of the guidance did not have a material impact on the Company's business, financial position, results of operations or liquidity.

In June 2009, the FASB issued revised authoritative guidance related to the consolidation criteria for variable interest entities ("VIE"). The guidance, among other things, requires a qualitative rather than a quantitative analysis to determine the primary beneficiary of a VIE; requires continuous assessments of whether an enterprise is the primary beneficiary of a VIE; enhances disclosures regarding an enterprise's involvement

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Recently issued accounting requirements (Continued)

with a VIE; and amends certain guidance for determining whether an entity is a VIE. Under the guidance, a VIE must be consolidated if the enterprise has both (a) the power to direct the activities of the VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE. The guidance will be effective as of the beginning of an enterprise's first fiscal year beginning after November 15, 2009, and for interim periods within that first period, with earlier adoption prohibited. The Company is currently evaluating the effect of this authoritative guidance on its consolidated financial statements.

In June 2009, the FASB issued authoritative guidance for establishment of the FASB Codification, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The FASB Codification is the sole source of authoritative accounting principles recognized by the FASB. The guidance is effective for all financial statements issued for interim and annual reporting periods ending after September 15, 2009. The application of this guidance (or the FASB Codification) did not have an impact on the Company's business, financial position, results of operations or liquidity.

In May 2009, the FASB issued authoritative guidance which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new provisions provide guidance related to the disclosure date through which an entity has evaluated subsequent events and whether such date represents the date the financial statements were issued or were available to be issued. In February 2010, the FASB issued an amendment, effective February 24, 2010, to remove the requirement for a filer to disclose a date in its financial statements. The adoption of the guidance did not have an impact on the Company's business, financial position, results of operations or liquidity.

In April 2009, the FASB issued additional authoritative guidance related to fair value measurements and the recognition of other-than-temporary impairments of financial instruments. The new provisions provide guidance to determine whether the market for a security is inactive and whether transactions in inactive markets are distressed and clarify the recognition and measurement of other-than-temporary impairments of debt and equity securities. Authoritative guidance also was issued for interim disclosures regarding fair value of financial instruments, which requires an entity to provide disclosures about the fair value of financial instruments in both interim and annual financial statements. The guidance is effective for all interim and annual reporting periods beginning after June 15, 2009. The adoption of the guidance did not have a material impact on the Company's business, financial position, results of operations or liquidity.

On January 1, 2009, the Company adopted the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities, which requires that unvested restricted stock that entitles the holder to receive nonforfeitable dividends before vesting be included as a participating security in the basic and diluted earnings per common share calculation pursuant to the two-class method. The adoption of the guidance has been applied retrospectively in the accompanying consolidated financial statements and did not have a material impact on the Company's earnings per common share calculations.

In December 2007, the FASB revised the authoritative guidance for business combinations, which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at the acquisition date and expensing acquisition and restructuring costs. The guidance is applied prospectively and is effective for business combinations which occur during fiscal years

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Recently issued accounting requirements (Continued)

beginning after December 15, 2008. The Company's adoption of the guidance on January 1, 2009 did not have a material impact on the Company's business, financial position, results of operations or liquidity at December 31, 2009 or for the year ended December 31, 2009. However, any future business combinations may significantly impact the Company's financial position and results of operations when compared to acquisitions accounted for under the previous guidance and may result in generally lower earnings due to the expensing of acquisition and restructuring costs.

In April 2009, the FASB issued authoritative guidance for accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies, which will amend the provisions related to the initial recognition and measurement, subsequent measurement and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance is effective for all business combinations which occur during fiscal years beginning after December 15, 2008. The Company's adoption of the guidance retroactive to January 1, 2009 did not have a material impact on the Company's business, financial position, results of operations or liquidity.

Reclassifications

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

The Company has revised the classification of $73.4 million of investments held at December 31, 2008 from current insurance subsidiary investments to non-current insurance subsidiary investments to conform with the current year presentation. While these investments were to mature within one year, this change was made because these investments are restricted for purposes of paying the long-term obligations of the Company's limited purpose insurance subsidiary and are not available for general working capital requirements. The reclassification had no impact on total assets, total liabilities, stockholders' equity, net income or cash flows for the year ended December 31, 2008.

The Company reclassified $10.8 million and $3.7 million of book overdrafts for the years ended December 31, 2008 and 2007, respectively, from net cash used in financing activities to net cash used in operating activities in the accompanying consolidated statement of cash flows to conform with the current year presentation. The reclassifications had no impact on the Company's financial position or results of operations.

Revenues

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

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Revenues (Continued)

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

	Year ended December 31,		
	2009	2008	2007
Medicare	$ 1,811,181	$ 1,741,256	$ 1,851,183
Medicaid	1,086,447	1,075,464	1,067,741
Medicare Advantage	321,437	263,699	72,548
Other	1,339,207	1,277,520	1,452,777
	4,558,272	4,357,939	4,444,249
Eliminations:			
Rehabilitation	(288,265)	(264,075)	(232,802)
Pharmacy	–	–	(82,798)
	(288,265)	(264,075)	(315,600)
	$ 4,270,007	$ 4,093,864	$ 4,128,649

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less when purchased.

Insurance subsidiary investments

The Company maintains investments 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. The fair value of publicly traded debt and equity securities and money market funds are based upon quoted market prices or observable inputs such as interest rates using either a market or income valuation approach. Since the Company's insurance subsidiary investments are restricted for a limited purpose, they are classified in the accompanying consolidated balance sheet based upon the expected current and long-term cash requirements of the limited purpose insurance subsidiary.

The Company follows the authoritative guidance related to the meaning of other-than-temporary impairment and its application to certain investments to assess whether the Company's investments with unrealized loss positions are other-than-temporarily impaired. Unrealized gains and losses, net of deferred income taxes, are reported as a component of accumulated other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary are determined using the specific identification method and are reported in the Company's statement of operations. See Note 10.

Accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Accounts receivable (Continued)

In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of change.

The provision for doubtful accounts totaled $28.7 million for 2009, $30.8 million for 2008 and $25.1 million for 2007. During 2007, the Company recorded a $5.9 million charge for doubtful accounts related to accounts receivable acquired in a hospital acquisition in a prior year.

Due to third party payors

The Company's hospitals and nursing centers are required to submit cost reports at least annually to various state and federal agencies administering the respective reimbursement programs. In many instances, interim cash payments to the Company are only an estimate of the amount due for services provided. Any overpayment to the Company arising from the completion of a cost report is recorded as a liability.

Inventories

Inventories consist primarily of pharmaceutical and medical supplies and are stated at the lower of cost (first-in, first-out) or market.

Property and equipment

Property and equipment is carried at cost less accumulated depreciation. Depreciation expense, computed by the straight-line method, was $124.8 million for 2009, $119.1 million for 2008 and $114.1 million for 2007. Depreciation rates for buildings range generally from 20 to 45 years. Leasehold improvements are depreciated over their estimated useful lives or the remaining lease term, whichever is shorter. Estimated useful lives of equipment vary from five to 15 years. Depreciation expense is not recorded for property and equipment classified as held for sale.

Interest costs incurred during the construction of the Company's development projects are capitalized. Capitalized interest for the years ended December 31, 2009, 2008 and 2007 was $2.2 million, $2.9 million and $2.6 million, respectively. Repairs and maintenance are expensed as incurred.

The Company separates capital expenditures into two categories, routine and development, in the accompanying consolidated statement of cash flows. Purchases of routine property and equipment include expenditures at existing facilities that generally do not result in the expansion of services. Development capital expenditures include expenditures for the development of new facilities or the expansion of services at existing facilities.

Long-lived assets

The Company regularly reviews the carrying value of certain long-lived assets and identifiable finite lived intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Long-lived assets (Continued)

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 facility 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 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 are aggregated for purposes of evaluating the carrying values of long-lived assets.

Goodwill and other intangible assets

Intangible assets are comprised primarily of goodwill, certificates of need, Medicare certifications and non-compete agreements primarily originating from business combinations accounted for as purchase transactions.

A summary of goodwill by reporting unit follows (in thousands):

	Hospital division	Health services division	Rehabilitation division	Hospice	Total
Balances, December 31, 2007	$ 67,598	$ 639	$ 863	$ –	$ 69,100
Acquisitions	–	–	–	1,165	1,165
Other	979	–	1,000	–	1,979
Balances, December 31, 2008	68,577	639	1,863	1,165	72,244
Acquisitions	–	–	–	6,917	6,917
Other	–	250	1,500	312	2,062
Balances, December 31, 2009	$ 68,577	$ 889	$ 3,363	$ 8,394	$ 81,223

In accordance with the authoritative guidance for goodwill and other intangible assets, the Company is required to perform an impairment test for goodwill and indefinite lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired.

The Company performs its annual goodwill impairment test at the end of each fiscal year for each of its reporting units. A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. When the components within the Company's operating segments have similar economic characteristics, the Company aggregates the components of its operating segments into one reporting unit. Accordingly, the Company has determined that its reporting units are hospitals, health services, rehabilitation services and hospice.

The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. If the carrying value of the reporting unit is greater than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. Based upon the results of the step one impairment test for goodwill and the impairment test of indefinite lived intangible assets in each of the last three years, no impairment charges were recorded in connection with the Company's annual impairment tests.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

Since quoted market prices for the Company's reporting units are not available, the Company applied judgment in determining the fair value of these reporting units for purposes of performing the goodwill impairment test. The Company relied on widely accepted valuation techniques, including equally weighted discounted cash flow and market multiple analyses approaches, which capture both the future income potential of the reporting unit and the market behaviors and actions of market participants in the industry that includes the reporting unit. These types of analyses require the Company to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management's best estimates of economic and market conditions over the projected period for each reporting unit including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. The market multiple analysis estimates fair value by applying cash flow multiples to the reporting unit's operating results. The multiples are derived from comparable publicly traded companies with similar operating and investment characteristics to the reporting units.

The Company's analysis indicated that the estimated fair value of each reporting unit exceeded its book equity value. The Company's conclusions were supported by both quantitative and qualitative factors, including the estimate of an implied control premium for acquisitions in the Company's industry, the Company's fourth quarter operating results that exceeded investment analyst expectations and consideration of the Company's updated business expectations at December 31, 2009 and 2008.

The fair values of the Company's indefinite lived intangible assets, primarily hospital certificates of need, are estimated using an excess earnings method, a form of discounted cash flows, which is based upon the concept that net after-tax cash flows provide a return supporting all of the assets of a business enterprise. The carrying value of the Company's certificates of need at December 31, 2009 was $61.9 million. The fair values of the Company's indefinite lived intangible assets are derived from projections at a facility level which include management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. At December 31, 2009, the fair value of the Company's hospital certificates of need intangible assets exceeded its carrying value.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

The Company's other intangible assets include both finite and indefinite lived intangible assets. The Company's other intangible assets with finite lives are amortized under the authoritative provisions for goodwill and other intangible assets using the straight-line method over their estimated useful lives ranging from one to ten years. A summary of intangible assets at December 31 follows (in thousands):

	2009				2008			
	Cost	Accumulated amortization	Carrying value	Weighted average life	Cost	Accumulated amortization	Carrying value	Weighted average life
Current:								
Employment contracts	$ 186	$ (182)	$ 4	1 year	$ 141	$ (58)	$ 83	1 year
Non-current:								
Certificates of need (indefinite life)	61,856	–	61,856		61,856	–	61,856	
Medicare certifications (indefinite life)	919	–	919		450	–	450	
Customer relationship assets	1,044	(558)	486	4 years	1,044	(310)	734	4 years
Non-compete agreements	2,994	(2,076)	918	5 years	2,834	(1,507)	1,327	5 years
Trade name	325	(13)	312	10 years	–	–	–	
	67,138	(2,647)	64,491		66,184	(1,817)	64,367	
	$ 67,324	$ (2,829)	$ 64,495		$ 66,325	$ (1,875)	$ 64,450	

During 2008, a certificate of need intangible asset totaling $15.2 million was determined to be fully impaired when the Company closed a long-term acute care ("LTAC") hospital. See Note 3.

Amortization expense computed by the straight-line method totaled $0.9 million for both 2009 and 2008, and $4.5 million for 2007. Amortization expense for intangible assets transferred to PharMerica (as defined in Note 2) in connection with the Spin-off Transaction (as defined in Note 2) totaled $2.4 million for 2007.

Estimated annual amortization expense for intangible assets at December 31, 2009 will approximate $0.9 million, $0.4 million, $0.2 million, $0.1 million and $0.1 million for the years 2010, 2011, 2012, 2013 and 2014, respectively.

Insurance risks

Provisions for loss for professional liability risks and workers compensation risks are based upon management's best available information including actuarially determined estimates. The provisions for loss related to professional liability risks retained by the Company's wholly owned limited purpose insurance subsidiary are discounted based upon actuarial estimates of claim payment patterns. Provisions for loss related to workers compensation risks retained by the Company's limited purpose insurance subsidiary are not discounted. To the extent that expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited. See Notes 4 and 9.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Earnings (loss) per common share

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of stock options and performance-based restricted shares. On January 1, 2009, the Company adopted the provisions of the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities for purposes of calculating earnings (loss) per common share. See Note 6.

Stock option accounting

The Company recognizes compensation expense in its consolidated financial statements using a Black-Scholes option valuation model for non-vested stock options. See Note 14.

Other information

The Company has performed an evaluation of subsequent events through the date on which the financial statements were issued.

NOTE 2 – SPIN-OFF TRANSACTION

On July 31, 2007, the Company completed the spin-off of its former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to the Company. Immediately after the Spin-off Transaction, the stockholders of the Company and of AmerisourceBergen each held approximately 50% of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from the balance sheet of the Company effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in the operating results of the Company. In accordance with the authoritative guidance for accounting for the impairment or disposal of long-lived assets, the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in the historical continuing operations of the Company. See Note 7.

In addition to the pharmacy services contracts noted above, the Company also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters. The Company recorded $11.5 million, $17.4 million and $7.7 million in other income in 2009, 2008 and 2007, respectively, related to the information systems and transition services agreements.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2 – SPIN-OFF TRANSACTION (Continued)

A summary of the net assets of KPS which were transferred to PharMerica in the Spin-off Transaction follows (in thousands):

Assets:				
Current assets	$	140,934		
Property and equipment, net		24,008		
Goodwill		45,819		
Intangible assets, net		35,655		
Other long-term assets		19,370	$	265,786
Liabilities:				
Current liabilities	$	56,024		
Long-term debt		125,000		
Other long-term liabilities		4,542		185,566
Net assets transferred in 2007				80,220
Deferred income tax assets transferred in 2008				151
Total net assets transferred through 2008			$	80,371

The net assets transferred by the Company were recorded as a reduction to retained earnings.

NOTE 3 – DIVESTITURES

In recent years, the Company has completed certain strategic divestitures to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. See Note 4.

2009 divestitures

In June 2009, the Company purchased for resale six under-performing nursing centers (the "Nursing Centers") previously leased from Ventas, Inc. ("Ventas") for $55.7 million. In addition, the Company paid Ventas a lease termination fee of $2.3 million. The Nursing Centers were included in the Company's Master Lease Agreements (as defined in Note 11) with Ventas and the Company does not have the ability to terminate a lease of an individual facility under the Master Lease Agreements. The aggregate annual rent for the Nursing Centers was approximately $6 million for the year ended December 31, 2008. The Nursing Centers, which contained 777 licensed beds, generated pretax losses of $0.5 million, $2.5 million and $5.5 million for 2009, 2008 and 2007, respectively. The Company recorded a pretax loss of $39.5 million ($24.3 million net of income taxes) for the year ended December 31, 2009 related to these divestitures. The Company disposed of five of the Nursing Centers in 2009 for $26.2 million and intends to dispose of the remaining Nursing Center as soon as practicable.

2008 divestitures

In September 2008, the Company purchased for resale a LTAC hospital for $22.3 million that was previously leased. The Company recorded a pretax loss of $36.9 million ($22.7 million net of income taxes) in 2008 resulting from the losses related to the purchase, closure and planned divestiture of the hospital, including the impairment of a certificate of need intangible asset ($15.2 million), the impairment of property and equipment ($17.3 million) and other costs ($4.4 million).

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 – DIVESTITURES (Continued)

2008 divestitures (Continued)

In September 2008, the Company also announced its intention to dispose of another LTAC hospital and its related operations. The Company recorded a pretax loss of $7.4 million ($4.6 million net of income taxes) during 2008 related to the impairment of the hospital's building and equipment.

These two hospitals generated pretax losses of $3.3 million in 2009 and $8.0 million in each of 2008 and 2007.

The Company also discontinued the operations of a hospital in 2008 after terminating the hospital operating lease and ceasing operations.

2007 divestitures

In June 2007, the Company purchased for resale 21 nursing centers and one LTAC hospital (collectively, the "Ventas Facilities") previously leased from Ventas for $171.5 million. In addition, the Company paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax income of approximately $3 million in 2008 and a pretax loss of approximately $4 million in 2007. During 2008 and 2007, the Company sold the Ventas Facilities for approximately $95 million. The Company recorded a pretax gain of $10.5 million ($6.5 million net of income taxes) during 2008 and a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to the sale of the Ventas Facilities.

In January 2007, the Company acquired from HCP, Inc., formerly known as Health Care Property Investors, Inc. ("HCP"), the real estate related to 11 unprofitable leased nursing centers operated by the Company for resale in exchange for the real estate related to three hospitals previously owned by the Company (the "HCP Transaction"). As part of the HCP Transaction, the Company continues to operate these hospitals under a long-term lease arrangement with HCP. In addition, the Company paid HCP a one-time cash payment of approximately $36 million. The Company also amended its existing master lease with HCP to (1) terminate the current annual rent of $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022. The 11 unprofitable nursing centers, which contained 1,754 licensed beds, were sold in 2007 and generated a pretax loss of approximately $4 million for 2007. In addition, the Company terminated a nursing center lease with another landlord during 2007. The Company recorded a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

Assets not sold at December 31, 2009 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See Note 4.

NOTE 4 – DISCONTINUED OPERATIONS

In accordance with the authoritative guidance for the impairment or disposal of long-lived assets, the divestiture of unprofitable businesses discussed in Notes 1 and 3 have been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the losses or impairments related to these divestitures have been classified as discontinued operations, net of income taxes, in the accompanying consolidated statement of operations. At December 31, 2009, the Company held for sale two hospitals and one nursing center.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

Discontinued operations included favorable pretax adjustments of $11.1 million ($6.8 million net of income taxes) in 2009 and $9.7 million ($6.0 million net of income taxes) in 2008, and a pretax charge of $1.5 million ($0.9 million net of income taxes) in 2007 resulting from changes in estimates for professional liability reserves related to prior years.

A summary of discontinued operations follows (in thousands):

	Year ended December 31,		
	2009	2008	2007
Revenues	$ 56,249	$ 104,698	$ 259,227
Salaries, wages and benefits	33,945	63,567	151,389
Supplies	3,426	7,802	17,976
Rent	3,572	9,161	16,039
Other operating expenses	13,122	27,462	89,274
Depreciation	674	2,243	5,706
Interest expense	9	2	6
Investment income	(12)	(13)	(55)
	54,736	110,224	280,335
Income (loss) from operations before income taxes	1,513	(5,526)	(21,108)
Provision (benefit) for income tax	582	(2,127)	(8,126)
Income (loss) from operations	931	(3,399)	(12,982)
Loss on divestiture of operations, net of income taxes	(23,432)	(20,776)	(77,021)
	$ (22,501)	$ (24,175)	$ (90,003)

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	Year ended December 31,		
	2009	2008	2007
Revenues:			
Hospital division	$ 4,850	$ 33,687	$ 59,726
Health services division	51,399	71,011	199,501
	$ 56,249	$ 104,698	$ 259,227
Operating income (loss):			
Hospital division	$ (2,759)	$ (5,470)	$ (334)
Health services division	8,515	11,337	922
	$ 5,756	$ 5,867	$ 588
Rent:			
Hospital division	$ 208	$ 2,858	$ 4,388
Health services division	3,364	6,303	11,651
	$ 3,572	$ 9,161	$ 16,039
Depreciation:			
Hospital division	$ –	$ 852	$ 1,544
Health services division	674	1,391	4,162
	$ 674	$ 2,243	$ 5,706

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

	December 31,	
	2009	2008
Long-term assets:		
Property and equipment, net	$ 8,723	$ 7,730
Other	83	56
	8,806	7,786
Current liabilities (included in other accrued liabilities)	(422)	(111)
	$ 8,384	$ 7,675

NOTE 5 – ACQUISITIONS

The following is a summary of the Company's significant acquisition activities. The operating results of the acquired businesses have been included in the accompanying consolidated financial statements of the Company from the respective acquisition dates. The purchase price of the acquired businesses and acquired leased facilities resulted from negotiations with each of the sellers that were based upon both the historical and expected future cash flows of the respective businesses and real estate values. Substantially all of these acquisitions were financed through borrowings under the Company's revolving credit facility.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – ACQUISITIONS (Continued)

2009 acquisitions

During 2009, the Company acquired a hospice business for $8.0 million, which included $6.9 million of goodwill, $0.9 million of intangible assets and $0.2 million of equipment. The Company also acquired the real estate of a previously leased hospital for $15.6 million in cash and $1.6 million in unamortized prepaid rent. Annual rents associated with this facility approximated $2 million.

2008 acquisitions

During 2008, the Company acquired the real estate of four previously leased nursing centers for $23.9 million. Annual rents associated with these facilities approximated $2.6 million.

2007 acquisitions

During 2007, the Company acquired the real estate of eight previously leased nursing centers and one previously leased hospital for $112.5 million. Annual rents associated with these facilities approximated $9.6 million. The Company also acquired a combined nursing center and assisted living facility for $20.3 million. Goodwill and identifiable intangible assets recorded in connection with the acquisition aggregated $1.1 million.

In addition, the Company entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8.1 million.

Unaudited pro formas related to acquired new businesses have not been presented because the acquisitions are not material, either individually or in the aggregate, to the Company's consolidated financial statements.

NOTE 6 – EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of stock options and performance-based restricted shares. On January 1, 2009, the Company adopted 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 (loss) per common share calculation pursuant to the two-class method.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 – EARNINGS (LOSS) PER SHARE (Continued)

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

	Year ended December 31,					
	2009		2008		2007	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
Earnings (loss):						
Income from continuing operations:						
As reported in Statement of Operations	$ 62,612	$ 62,612	$ 60,460	$ 60,460	$ 43,133	$ 43,133
Allocation to participating unvested restricted stockholders	(1,094)	(1,090)	(1,374)	(1,355)	(1,029)	(1,010)
Available to common stockholders	$ 61,518	$ 61,522	$ 59,086	$ 59,105	$ 42,104	$ 42,123
Discontinued operations, net of income taxes:						
Income (loss) from operations:						
As reported in Statement of Operations	$ 931	$ 931	$ (3,399)	$ (3,399)	$(12,982)	$(12,982)
Allocation to participating unvested restricted stockholders	(16)	(16)	77	76	310	304
Available to common stockholders	$ 915	$ 915	$ (3,322)	$ (3,323)	$(12,672)	$(12,678)
Loss on divestiture of operations:						
As reported in Statement of Operations	$(23,432)	$(23,432)	$(20,776)	$(20,776)	$(77,021)	$(77,021)
Allocation to participating unvested restricted stockholders	409	408	472	466	1,837	1,803
Available to common stockholders	$(23,023)	$(23,024)	$(20,304)	$(20,310)	$(75,184)	$(75,218)
Net income (loss):						
As reported in Statement of Operations	$ 40,111	$ 40,111	$ 36,285	$ 36,285	$(46,870)	$(46,870)
Allocation to participating unvested restricted stockholders	(701)	(698)	(825)	(813)	1,118	1,097
Available to common stockholders	$ 39,410	$ 39,413	$ 35,460	$ 35,472	$(45,752)	$(45,773)
Shares used in the computation:						
Weighted average shares outstanding – basic computation	38,339	38,339	37,830	37,830	38,791	38,791
Dilutive effect of employee stock options		128		567		767
Dilutive effect of performance-based restricted shares		35		–		–
Adjusted weighted average shares outstanding – diluted computation		38,502		38,397		39,558
Earnings (loss) per common share:						
Income from continuing operations	$ 1.61	$ 1.60	$ 1.56	$ 1.54	$ 1.09	$ 1.06
Discontinued operations:						
Income (loss) from operations	0.02	0.02	(0.09)	(0.09)	(0.33)	(0.32)
Loss on divestiture of operations	(0.60)	(0.60)	(0.53)	(0.53)	(1.94)	(1.90)
Net income (loss)	$ 1.03	$ 1.02	$ 0.94	$ 0.92	$ (1.18)	$ (1.16)
Number of antidilutive stock options excluded from shares used in the diluted earnings (loss) per common share computation		2,986		1,310		149

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – BUSINESS SEGMENT DATA

At December 31, 2009, the Company operated three business segments: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing and rehabilitation centers. The rehabilitation division provides rehabilitation services primarily in long-term care settings. For segment purposes, the Company defines operating income as earnings before interest, income taxes, depreciation, amortization and rent. Operating income reported for each of the Company's business segments excludes the allocation of corporate overhead. The accounting policies of each of the segments are the same and are described in Note 1.

Beginning January 1, 2008, certain incentive compensation costs were charged to the operating divisions that had previously been classified as corporate overhead. These charges approximated $5.5 million for the hospital division, $5.4 million for the health services division and $1.0 million for the rehabilitation division for the year ended December 31, 2009 and $5.1 million for the hospital division, $4.3 million for the health services division and $1.2 million for the rehabilitation division for the year ended December 31, 2008. Segment operating results for prior periods were not restated to reflect this reclassification.

The Spin-off Transaction was completed on July 31, 2007. As a result, the Company's consolidated operating results for 2007 included the results of the Company's former pharmacy division for seven months. For accounting purposes, the Company's former pharmacy division was not treated as a discontinued operation in the Company's historical consolidated financial statements. See Note 2.

The Company identifies its segments in accordance with the aggregation provisions of the authoritative guidance for segment reporting. This information is consistent with information used by the Company in managing its businesses and aggregates businesses with similar economic characteristics. The Company includes operating data for its hospice business in the rehabilitation division.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – BUSINESS SEGMENT DATA (Continued)

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

	Year ended December 31,		
	2009	2008	2007
Revenues:			
Hospital division	$ 1,932,892	$ 1,837,322	$ 1,727,419
Health services division	2,150,342	2,093,297	1,958,322
Rehabilitation division	475,038	427,320	352,397
Pharmacy division	–	–	406,111
	4,558,272	4,357,939	4,444,249
Eliminations:			
Rehabilitation	(288,265)	(264,075)	(232,802)
Pharmacy	–	–	(82,798)
	(288,265)	(264,075)	(315,600)
	$ 4,270,007	$ 4,093,864	$ 4,128,649
Income from continuing operations:			
Operating income (loss):			
Hospital division	$ 363,811	$ 345,367	$ 365,068
Health services division	305,590	321,814	294,625
Rehabilitation division	50,592	38,071	34,526
Pharmacy division	–	–	17,557
Corporate:			
Overhead	(134,636)	(133,019)	(167,717)
Insurance subsidiary	(6,185)	(6,657)	(7,077)
	(140,821)	(139,676)	(174,794)
Operating income	579,172	565,576	536,982
Rent	(348,248)	(338,673)	(337,769)
Depreciation and amortization	(125,730)	(120,022)	(118,574)
Interest, net	(3,467)	(8,277)	(939)
Income before income taxes	101,727	98,604	79,700
Provision for income taxes	39,115	38,144	36,567
	$ 62,612	$ 60,460	$ 43,133

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – BUSINESS SEGMENT DATA (Continued)

	Year ended December 31,		
	2009	2008	2007
Rent:			
Hospital division	$ 147,494	$ 146,316	$ 139,875
Health services division	194,835	186,612	188,599
Rehabilitation division	5,778	5,555	4,641
Pharmacy division	–	–	4,325
Corporate	141	190	329
	$ 348,248	$ 338,673	$ 337,769
Depreciation and amortization:			
Hospital division	$ 51,932	$ 48,150	$ 40,958
Health services division	48,631	48,645	48,815
Rehabilitation division	2,291	1,965	1,176
Pharmacy division	–	–	6,510
Corporate	22,876	21,262	21,115
	$ 125,730	$ 120,022	$ 118,574
Capital expenditures, excluding acquisitions (including discontinued operations):			
Hospital division:			
Routine	$ 26,716	$ 35,932	$ 35,646
Development	42,371	33,285	59,438
	69,087	69,217	95,084
Health services division:			
Routine	39,663	44,627	41,252
Development	5,687	5,466	5,688
	45,350	50,093	46,940
Rehabilitation division	1,043	1,162	2,037
Pharmacy division	–	–	4,115
Corporate:			
Information systems	28,441	26,363	24,431
Other	1,687	1,842	13,881
	$ 145,608	$ 148,677	$ 186,488
Assets at end of period:			
Hospital division	$ 867,332	$ 847,394	
Health services division	566,592	574,710	
Rehabilitation division	53,856	45,733	
Corporate	534,444	713,924	
	$ 2,022,224	$ 2,181,761	
Goodwill:			
Hospital division	$ 68,577	$ 68,577	
Health services division	889	639	
Rehabilitation division	11,757	3,028	
	$ 81,223	$ 72,244	

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES

The provision for income taxes is based upon the Company's annual reported income or loss for each respective accounting period. The Company recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Company also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

Provision for income taxes consists of the following (in thousands):

	Year ended December 31,		
	2009	2008	2007
Current:			
Federal	$ 23,246	$ 21,218	$ 37,870
State	4,227	3,769	6,158
	27,473	24,987	44,028
Deferred	11,642	13,157	(7,461)
	$ 39,115	$ 38,144	$ 36,567

Reconciliation of federal statutory tax expense to the provision for income taxes follows (in thousands):

	Year ended December 31,		
	2009	2008	2007
Income tax expense at federal rate	$ 35,605	$ 34,511	$ 27,894
State income tax expense, net of federal income tax expense	3,560	3,451	2,790
Spin-off Transaction costs	(5)	(17)	4,829
Prior year contingencies	(1,769)	(2,104)	(2,296)
Other items, net	1,724	2,303	3,350
	$ 39,115	$ 38,144	$ 36,567

A summary of net deferred income tax assets by source included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2009	2008
Property and equipment	$ 19,227	$ 18,749
Insurance	53,885	48,034
Accounts receivable allowances	12,179	21,204
Compensation	39,685	40,072
Net operating losses	37,924	34,012
Assets held for sale	15,336	10,250
Other	10,555	22,278
	188,791	194,599
Valuation allowance	(35,070)	(35,552)
	$ 153,721	$ 159,047

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES (Continued)

Deferred income taxes totaling $42.8 million and $58.3 million at December 31, 2009 and 2008, respectively, were classified as current assets, and deferred income taxes totaling $110.9 million and $100.7 million at December 31, 2009 and 2008, respectively, were classified as noncurrent assets.

After the Company's emergence from bankruptcy in 2001, the realization of pre-reorganization deferred tax assets (amounts which had been considered "more likely than not" to be realized by the Company) and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of $1.4 million in 2008 and $3.0 million in 2007 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability. Following the adoption of the revised provisions for accounting for business combinations on January 1, 2009, future adjustments to pre-emergence unrecognized income tax benefits will be recorded to earnings.

In connection with the Company's emergence from bankruptcy, the Company realized a gain from the extinguishment of certain indebtedness. This gain was not taxable since the gain resulted from the reorganization under the bankruptcy code. However, the Company is required, beginning with its 2002 taxable year, to reduce certain tax attributes including (a) net operating loss carryforwards ("NOLs"), (b) certain tax credits and (c) tax bases in assets in an amount equal to such gain on extinguishment.

The Company identified deferred income tax assets for state income tax NOLs of $37.9 million and $34.0 million at December 31, 2009 and 2008, respectively, and a corresponding deferred income tax valuation allowance of $34.0 million at December 31, 2009 and 2008 for that portion of the net deferred income tax assets that were not realizable.

In July 2006, authoritative guidance was issued for accounting for uncertainty in income taxes which clarifies the accounting for uncertain income tax issues recognized in an entity's financial statements. The guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return.

The Company adopted the provisions of the guidance on January 1, 2007. A reconciliation of unrecognized tax benefits follows (in thousands):

Balance, January 1, 2007	$	7,419
Additions related to prior period tax filings		4,715
Reductions due to lapses of applicable statute of limitations		(2,921)
Balance, December 31, 2007		9,213
Additions based upon tax positions related to the current year		2,796
Reductions due to lapses of applicable statute of limitations		(2,456)
Balance, December 31, 2008		9,553
Additions based upon tax positions related to the current year		232
Reductions due to lapses of applicable statute of limitations		(2,042)
Balance, December 31, 2009	$	7,743

The Company records accrued interest and penalties associated with uncertain tax positions as income tax expense in the consolidated statement of operations. Accrued interest related to uncertain tax provisions totaled $0.1 million as of December 31, 2009 and $0.8 million as of December 31, 2008.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES (Continued)

To the extent the unrecognized income tax benefits become realized or the related accrued interest is no longer necessary, the Company's provision for income taxes would be favorably impacted. The amount, if recognized, that would favorably impact the Company's results of operations approximates $6.1 million.

The federal statute of limitations remains open for tax years 2006 through 2008. The Company is currently under IRS examination for fiscal years 2008 and 2007.

State jurisdictions generally have statutes of limitations for tax returns ranging from three to five years. The state impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company currently has various state income tax returns under examination.

During 2010, the statute of limitations associated with certain state income tax filing positions will expire and may decrease the amount of unrecognized income tax benefits. A reduction in the Company's income tax liability of approximately $2 million to $3 million for unrecognized income tax benefits is reasonably possible and may favorably impact the Company's financial position and results of operations.

NOTE 9 – INSURANCE RISKS

The Company insures a substantial portion of its professional liability risks and workers compensation risks through its limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including actuarially determined estimates.

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 liabilities 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 professional liability risks has reflected favorable adjustments related to prior year changes in estimates in each of the last three years.

The provision for loss for insurance risks, including the cost of coverage maintained with unaffiliated commercial insurance carriers, follows (in thousands):

	Year ended December 31,		
	2009	2008	2007
Professional liability:			
Continuing operations	$ 48,478	$ 33,117	$ 35,378
Discontinued operations	(4,590)	(6,287)	13,982
Workers compensation:			
Continuing operations	$ 35,505	$ 30,082	$ 36,994
Discontinued operations	(904)	1,189	3,568

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INSURANCE RISKS (Continued)

Changes in the allowance for professional liability risks and workers compensation risks for the years ended December 31 follow (in thousands) (including discontinued operations):

	2009			2008		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Allowance for insurance risks at beginning of year	$ 243,251	$ 83,341	$326,592	$ 251,392	$ 89,276	$340,668
Provision for loss for insurance risks:						
Current year	68,978	35,595	104,573	60,762	35,018	95,780
Prior years	(38,072)	(8,206)	(46,278)	(47,300)	(11,998)	(59,298)
	30,906	27,389	58,295	13,462	23,020	36,482
Provision for commercial insurance, administrative and overhead costs	12,982	7,212	20,194	13,368	8,251	21,619
Discount accretion	5,891	–	5,891	6,289	–	6,289
Contributions from managed facilities	74	212	286	86	226	312
Payments for insurance risks:						
Current year	(5,270)	(10,913)	(16,183)	(3,184)	(9,311)	(12,495)
Prior years	(44,929)	(19,937)	(64,866)	(39,466)	(19,870)	(59,336)
	(50,199)	(30,850)	(81,049)	(42,650)	(29,181)	(71,831)
Payments for commercial insurance, administrative and overhead costs	(12,982)	(7,212)	(20,194)	(13,368)	(8,251)	(21,619)
Change in reinsurance and other insurance recoverables	12,279	2,030	14,309	14,672	–	14,672
Allowance for insurance risks at end of year	$ 242,202	$ 82,122	$324,324	$ 243,251	$ 83,341	$326,592

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INSURANCE RISKS (Continued)

A summary of the assets and liabilities related to insurance risks included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2009			2008		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$ 84,953	$ 21,881	$ 106,834	$ 99,595	$ 23,940	$ 123,535
Reinsurance recoverables	89	–	89	89	–	89
Other	–	321	321	–	–	–
	85,042	22,202	107,244	99,684	23,940	123,624
Non-current:						
Insurance subsidiary investments	43,272	56,951	100,223	58,509	63,549	122,058
Reinsurance and other insurance recoverables	29,446	2,030	31,476	17,167	–	17,167
Deposits	5,000	1,410	6,410	2,000	1,466	3,466
Other	–	36	36	–	142	142
	77,718	60,427	138,145	77,676	65,157	142,833
	$ 162,760	$ 82,629	$ 245,389	$ 177,360	$ 89,097	$ 266,457
Liabilities:						
Allowance for insurance risks:						
Current	$ 47,076	$ 23,934	$ 71,010	$ 55,447	$ 25,348	$ 80,795
Non-current	195,126	58,188	253,314	187,804	57,993	245,797
	$ 242,202	$ 82,122	$ 324,324	$ 243,251	$ 83,341	$ 326,592

Provisions for loss for professional liability risks retained by the Company's limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 2% for the 2009 policy year, 3% for the 2008 policy year and 5% for all prior policy years. The discount rates are based upon the risk free interest rate for the respective year. Amounts equal to the discounted loss provision are funded annually. The Company does not fund the portion of professional liability risks related to estimated claims that have been incurred but not reported. Accordingly, these liabilities are not discounted. If the Company did not discount any of the allowances for professional liability risks, these balances would have approximated $247.3 million at December 31, 2009 and $251.8 million at December 31, 2008.

Provisions for loss for workers compensation risks retained by the Company's limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually.

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS

The Company maintains investments, consisting principally of cash and cash equivalents, asset backed securities, corporate bonds, equities, commercial paper and U.S. Treasury notes for the payment of claims and expenses related to professional liability and workers compensation risks. These investments have been categorized as available-for-sale and are reported at fair value.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

The amortized cost and estimated fair value of the Company's insurance subsidiary investments at December 31 follow (in thousands):

	2009				2008			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents (a)	$ 96,143	$ –	$ –	$ 96,143	$ 118,148	$ –	$ –	$ 118,148
Asset backed securities	52,206	411	(117)	52,500	59,509	886	(292)	60,103
Corporate bonds	34,344	609	(33)	34,920	35,110	314	(698)	34,726
Equities	12,731	268	(1,785)	11,214	13,750	402	(3,307)	10,845
Commercial paper	9,449	14	(3)	9,460	9,825	34	–	9,859
U.S. Treasury notes	2,801	19	–	2,820	11,760	152	–	11,912
	$ 207,674	$ 1,321	$ (1,938)	$ 207,057	$ 248,102	$ 1,788	$ (4,297)	$ 245,593

(a) Includes $4.7 million and $13.2 million of money market funds at December 31, 2009 and 2008, respectively.

The fair value by maturity periods at December 31, 2009 of available-for-sale investments of the Company's insurance subsidiary follows. Equities generally do not have maturity dates.

(In thousands)	Contractual maturities
Within one year	$ 135,512
One year to five years	59,158
After five years	1,173
Equities	11,214
	$ 207,057

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

Net investment income earned by the Company's insurance subsidiary investments follows (in thousands):

	Year ended December 31,		
	2009	2008	2007
Interest income	$ 3,393	$ 8,107	$ 12,405
Net amortization of premium and accretion of discount	(298)	(141)	818
Gains on sale of investments	1,598	1,244	1,350
Losses on sale of investments	(346)	(194)	(106)
Other-than-temporary impairment on investments	(444)	(2,311)	–
Investment expenses	(168)	(242)	(263)
	$ 3,735	$ 6,463	$ 14,204

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

The available-for-sale investments of the Company's insurance subsidiary which have unrealized losses at December 31, 2009 and 2008 are shown below. The investments are categorized by the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2009 and 2008.

December 31, 2009	Less than one year		One year or greater		Total	
(In thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Asset backed securities	$ 15,825	$ 57	$ 706	$ 60	$ 16,531	$ 117
Corporate bonds	8,832	33	1,100	–	9,932	33
Equities	2,979	267	4,811	1,518	7,790	1,785
Commercial paper	1,847	3	–	–	1,847	3
	$ 29,483	$ 360	$ 6,617	$ 1,578	$ 36,100	$ 1,938

December 31, 2008	Less than one year		One year or greater		Total	
(In thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Asset backed securities	$ 8,008	$ 169	$ 476	$ 123	$ 8,484	$ 292
Corporate bonds	11,950	204	7,157	494	19,107	698
Equities	5,304	2,072	2,009	1,235	7,313	3,307
	$ 25,262	$ 2,445	$ 9,642	$ 1,852	$ 34,904	$ 4,297

The unrealized losses on equities totaling $1.8 million at December 31, 2009 were due generally to market fluctuations. Accordingly, the Company believes these unrealized losses are temporary in nature.

The Company's investment policy governing insurance subsidiary investments precludes the investment portfolio managers from selling any security at a loss without prior authorization from the Company. The investment managers also limit the exposure to any one issue, issuer or type of investment. The Company intends, and has the ability, to hold insurance subsidiary investments for a long duration without the necessity of selling securities to fund the underwriting needs of its insurance subsidiary. This ability to hold securities allows sufficient time for recovery of temporary declines in the market value of equity securities and the par value of debt securities as of their stated maturity date.

The Company considered the severity and duration of its unrealized losses and recognized $0.4 million and $2.3 million pretax other-than-temporary impairments in 2009 and 2008, respectively, for various investments held in its insurance subsidiary investment portfolio. Because the Company considered the remaining unrealized losses at December 31, 2009 and 2008 to be temporary, the Company has not recorded any additional impairment loss related to these securities.

As a result of improved professional liability underwriting results of the Company's limited purpose insurance subsidiary, the Company received distributions of $34 million in 2009, $39 million in 2008 and $37 million in 2007 from its limited purpose insurance subsidiary in accordance with applicable regulations. These distributions had no impact on earnings and the proceeds were used primarily to repay borrowings under the Company's revolving credit facility.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – LEASES

The Company leases real estate and equipment under cancelable and non-cancelable arrangements. The following table sets forth rent expense by business segment (in thousands):

	Year ended December 31,		
	2009	2008	2007
Hospital division:			
Buildings:			
Ventas	$ 91,218	$ 86,871	$ 84,358
Other landlords	31,501	34,089	30,210
Equipment	24,775	25,356	25,307
	147,494	146,316	139,875
Health services division:			
Buildings:			
Ventas	152,436	144,723	140,501
Other landlords	39,876	39,373	45,220
Equipment	2,523	2,516	2,878
	194,835	186,612	188,599
Rehabilitation division:			
Buildings	245	161	84
Equipment	5,533	5,394	4,557
	5,778	5,555	4,641
Pharmacy division:			
Buildings	–	–	3,705
Equipment	–	–	620
	–	–	4,325
Corporate:			
Buildings	99	155	285
Equipment	42	35	44
	141	190	329
	$ 348,248	$ 338,673	$ 337,769

Future minimum payments under non-cancelable operating leases are as follows (in thousands):

	Minimum payments		
	Ventas	Other	Total
2010	$ 243,984	$ 68,328	$ 312,312
2011	250,325	64,977	315,302
2012	255,474	57,657	313,131
2013	178,915	57,226	236,141
2014	141,519	54,958	196,477
Thereafter	47,399	215,465	262,864

At December 31, 2009, the Company leased from Ventas and its affiliates 38 LTAC hospitals and 159 nursing centers under four master lease agreements (the "Master Lease Agreements").

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – LEASES (Continued)

Under the Master Lease Agreements, the base term for 28 nursing center and eight LTAC hospital leases (which are contained in four renewal bundles) is scheduled to expire in April 2013 (the "2013 Lease Renewals"). At the Company's option, the 2013 Lease Renewals may be extended for one five-year renewal term beyond the base term at the then existing rental rate plus the then existing escalation amount per annum. If the Company elects to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed.

In April 2009, the Company provided Ventas with notices to renew the Master Lease Agreements for an additional five years for 86 nursing centers and 22 LTAC hospitals (collectively, the "2010 Renewal Facilities"). The initial lease term for the 2010 Renewal Facilities was scheduled to expire in April 2010. No additional rent or other consideration was paid in connection with these renewals. The effectiveness of the renewals is contingent upon there being no events of default under the Master Lease Agreements in April 2010.

The base terms for 45 nursing centers and eight LTAC hospitals as well as the 2010 Renewal Facilities were initially set to expire in April 2008 and 2010, respectively, but were each renewed for additional five-year terms. The Company may further extend the term of these leases for two additional five-year renewal terms beyond the first renewal term at the greater of (1) the then existing rental rate plus the then existing escalation amount per annum or (2) the then fair market value rental rate. The fair market value rental rate is determined through an appraisal procedure set forth in the Master Lease Agreements. The then fair market value rental rate may be materially higher than the existing rental rate. In such a situation the Company may be forced to either not exercise the renewal or pay the higher rental rate, either of which could have a material adverse effect on the Company's business, financial position, results of operations and liquidity. If the Company elects to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed.

NOTE 12 – LONG-TERM DEBT

Capitalization

A summary of long-term debt at December 31 follows (in thousands):

	2009	2008
Revolving credit facility due 2012	$ 147,000	$ 348,700
Other	733	814
Total debt, average life of 3 years (weighted average rate 2.4% for 2009 and 3.3% for 2008)	147,733	349,514
Amounts due within one year	(86)	(81)
Long-term debt	$ 147,647	$ 349,433

Interest rates under the Company's revolving credit facility are based, at the Company's option, upon (a) the London Interbank Offered Rate plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. The Company's revolving credit facility is collateralized by substantially all of the Company's assets including certain owned real property and is guaranteed by substantially all of the Company's subsidiaries. The terms of the Company's revolving credit facility include a certain defined fixed payment ratio covenant and covenants which limit acquisitions and annual capital expenditures. The Company was in compliance with the terms of its revolving credit facility at December 31, 2009.

Under the terms of the Company's revolving credit facility, the aggregate amount of the credit may be increased from $500 million to $600 million at the Company's option subject to lender approval and certain other conditions. The term of the Company's revolving credit facility expires in July 2012.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12 – LONG-TERM DEBT (Continued)

Other Information

In April 2008, the Company repaid a capital lease obligation of $16.3 million in connection with the exercise of a purchase option under a hospital lease agreement.

The following table summarizes scheduled maturities of long-term debt for the years 2010 through 2014 (in thousands):

	Revolving credit facility	Other	Total
2010	$ –	$ 86	$ 86
2011	–	91	91
2012	147,000	96	147,096
2013	–	102	102
2014	–	109	109

The estimated fair value of the Company's long-term debt at December 31, 2009 and 2008 approximated the respective carrying amounts.

NOTE 13 – CONTINGENCIES

Management continually evaluates contingencies based upon the best available information. In addition, allowances for loss are provided currently for disputed items that have continuing significance, such as certain third party reimbursements and deductions that continue to be claims 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.

Professional liability risks – The Company has provided for loss 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 Notes 4 and 9.

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. In addition, the Company is a party to a tax matters agreement with PharMerica which sets forth the Company's rights and obligations related to taxes for periods before and after the Spin-off Transaction.

Litigation – The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations in the ordinary course of business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. These legal actions and investigations could potentially subject the Company to sanctions, damages, recoupments, fines and other penalties. 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 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.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13 – CONTINGENCIES (Continued)

Other indemnifications – In the ordinary course of business, the Company enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as a disposal of an operating facility. These indemnifications may cover claims related to employment-related matters, governmental regulations, environmental issues and tax matters, as well as patient, third party payor, supplier and contractual relationships. Obligations under these indemnities generally are initiated by a breach of the terms of a contract or by a third party claim or event.

NOTE 14 – CAPITAL STOCK

The Company's shareholders approved an additional 1.5 million shares of common stock in May 2008 that could be issued under the Company's incentive compensation plans.

Plan descriptions

The Company maintains plans under which approximately ten million service-based restricted shares, performance-based restricted shares and options to purchase common stock may be granted to directors, officers and other key employees. Exercise provisions vary, but most stock options are exercisable in whole or in part beginning one to four years after grant and ending seven to ten years after grant. Shares of common stock available for future grants were 1,699,946, 2,201,688 and 1,309,470 at December 31, 2009, 2008 and 2007, respectively.

Stock options

The fair value of each stock option is estimated at the date of grant using a Black-Scholes option valuation model with the following weighted average assumptions:

	Year ended December 31,		
	2009	2008	2007
Risk-free interest rate	1.75%	2.80%	4.46%
Expected dividend yield	None	None	None
Expected term	5 years	5 years	6 years
Expected volatility	50%	40%	47%
Weighted average fair value at grant date	$6.45	$9.05	$12.51

The expected term represents the period of time that stock options granted are estimated to be outstanding and was determined using the simplified method under the authoritative guidance for stock-based compensation. The expected volatility is based upon the historical prices of the Company's common stock. An estimate of expected forfeitures was determined and compensation expense was recognized only for those stock options expected to vest.

At December 31, 2009, unearned compensation costs related to non-vested stock options aggregated $1.7 million. These costs will be expensed over the remaining weighted average vesting period of approximately two years. Compensation expense related to stock options approximated $2.7 million ($2.3 million net of income taxes) for the year ended December 31, 2009, $3.5 million ($2.9 million net of income taxes) for the year ended December 31, 2008 and $16.1 million ($12.4 million net of income taxes) for the year ended December 31, 2007. Compensation expense for the year ended December 31, 2007 included $11.7 million related to the adjustment of stock options in connection with the Spin-off Transaction.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Stock options (Continued)

Activity in the various plans is summarized below:

	Shares under option	Option price per share	Weighted average exercise price
Balances, December 31, 2008	3,328,794	$ 4.89 to $28.41	$ 18.56
Granted	309,498	12.70 to 15.06	14.91
Exercised	(103,970)	4.89 to 12.23	9.20
Canceled	(84,797)	4.89 to 25.83	17.02
Balances, December 31, 2009	3,449,525	$ 4.89 to $28.41	$ 18.55

As a result of the Spin-off Transaction, adjustments to outstanding stock options as of July 31, 2007 were made in accordance with IRS guidelines which resulted in changes to both the number of shares subject to the stock option and the exercise price.

The intrinsic value of the stock options exercised during 2009, 2008 and 2007 approximated $0.6 million, $5.7 million and $9.1 million, respectively. Cash received from stock option exercises in 2009, 2008 and 2007 totaled $1.0 million, $8.9 million and $10.5 million, respectively.

A summary of stock options outstanding at December 31, 2009 follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding at December 31, 2009	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at December 31, 2009	Weighted average exercise price
$4.89 to $8.44	196,589	3 years	$ 7.95	196,589	$ 7.95
$11.53 to $15.29	1,011,238	4 years	14.14	677,285	13.89
$16.81 to $22.72	1,113,014	4 years	18.52	948,581	18.70
$23.25 to $28.41	1,128,684	3 years	24.38	926,191	24.07
	3,449,525	4 years	18.55	2,748,646	18.55

The intrinsic value of the stock options outstanding and stock options that are exercisable as of December 31, 2009 approximated $7.2 million and $5.7 million, respectively.

Service-based restricted shares

At December 31, 2009, unearned compensation costs related to non-vested service-based restricted shares aggregated $3.8 million. These costs will be expensed over the remaining weighted average vesting period of approximately three years. Compensation expense related to these awards approximated $5.9 million ($3.6 million net of income taxes) for the year ended December 31, 2009, $9.1 million ($5.6 million net of income taxes) for the year ended December 31, 2008 and $15.1 million ($9.3 million net of income taxes) for the year ended December 31, 2007. Compensation expense for the year ended December 31, 2007 included $3.9 million in connection with the Spin-off Transaction.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Service-based restricted shares (Continued)

A summary of non-vested service-based restricted shares follows:

	Non-vested service-based restricted shares	Weighted average fair value at date of grant
Balances, December 31, 2008	766,691	$ 29.82
Granted	203,186	14.86
Vested	(363,489)	29.56
Canceled	(7,696)	28.59
Balances, December 31, 2009	598,692	$ 24.92

The fair value of restricted shares vested during 2009, 2008 and 2007 was $5.4 million, $8.0 million and $9.0 million, respectively.

Performance-based restricted shares

Performance-based restricted share awards vest over a three-year period based upon the attainment of various performance measures in each performance period. Compensation expense related to these awards approximated $1.3 million ($0.8 million net of income taxes) for the year ended December 31, 2009. No material compensation costs were recorded in 2008 for these awards because none of the performance measures for the 2008 performance period were attained.

A summary of non-vested performance-based restricted shares follows:

	Non-vested performance-based restricted shares	Weighted average fair value at date of grant
Balances, December 31, 2008	138,635	
Granted	128,786	$ 15.06
Canceled	(47,235)	$ 25.34
Balances, December 31, 2009	220,186	

The performance measures and fair value for each vesting period of a performance-based restricted share award are established annually. The performance measures and fair value for the non-vested performance-based restricted shares have not been established for vesting periods with performance measures determined after December 31, 2009.

Stock repurchases

In August 2007, the Company's Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, the Company expended $50 million to purchase approximately 2.6 million shares of its common stock. The authorization expired during 2008 and the Company did not purchase any common stock in 2009 or 2008.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Stock repurchases (Continued)

Common stock repurchases are accounted for as constructive retirements in accordance with the allocation method under the authoritative guidance for the initial measurement of equity, which provides that any excess of the purchase price over par value may be allocated between capital surplus and retained earnings.

NOTE 15 – EMPLOYEE BENEFIT PLANS

The Company maintains defined contribution retirement plans covering employees who meet certain minimum eligibility requirements. Benefits are determined as a percentage of a participant's contributions and generally are vested based upon length of service. Retirement plan expense was $9.7 million for 2009, $9.4 million for 2008 and $9.3 million for 2007. Amounts equal to retirement plan expense are funded annually.

NOTE 16 – ACCRUED LIABILITIES

A summary of other accrued liabilities at December 31 follows (in thousands):

	2009	2008
Patient accounts	$ 36,546	$ 34,511
Taxes other than income	29,880	27,472
Other	11,932	14,849
	$ 78,358	$ 76,832

NOTE 17 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

On January 1, 2008, the Company adopted 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 generally accepted accounting principles.

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 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 CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17 – 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 for the twelve months ended December 31, 2009 and 2008 are summarized below (in thousands):

	Fair value measurements			Assets/liabilities at fair value	Total losses
	Level 1	Level 2	Level 3		
December 31, 2009:					
Recurring:					
Assets:					
Available-for-sale securities	$ 18,726	$ 96,880	$ –	$ 115,606	$ –
Deposits held in money market funds	351	3,000	–	3,351	–
	$ 19,077	$ 99,880	$ –	$ 118,957	$ –
Liabilities	$ –	$ –	$ –	$ –	$ –
Non-recurring:					
Assets:					
Acquired previously leased hospital	$ –	$ 18,000	$ –	$ 18,000	$ –
Nursing centers available for sale	–	–	1,000	1,000	(21,870)
	$ –	$ 18,000	$ 1,000	$ 19,000	$ (21,870)
Liabilities	$ –	$ –	$ –	$ –	$ –
December 31, 2008:					
Recurring:					
Assets:					
Available-for-sale securities	$ 35,960	$ 104,688	$ –	$ 140,648	$ –
Deposits held in money market funds	124,539	–	–	124,539	–
	$ 160,499	$ 104,688	$ –	$ 265,187	$ –
Liabilities	$ –	$ –	$ –	$ –	$ –

Recurring measurements

The Company's available-for-sale securities are held by its limited purpose insurance subsidiary and are comprised of money market funds, asset backed securities, corporate bonds, equities, commercial paper and U.S. Treasury notes. These available-for-sale securities and the insurance subsidiary's cash and cash equivalents of $91.5 million as of December 31, 2009, classified as insurance subsidiary investments, are maintained for the payment of claims and expenses related to professional liability and workers compensation risks.

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

The fair value of actively traded debt and equity securities and money market funds are based upon quoted market prices and are generally classified as Level 1. The fair value of inactively traded debt securities are 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 are generally classified as Level 2.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 17 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

Recurring measurements (Continued)

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.

(In thousands)	2009 Carrying value	2009 Fair value	2008 Carrying value	2008 Fair value
Cash and cash equivalents	$ 16,303	$ 16,303	$ 140,795	$ 140,795
Cash–restricted	5,820	5,820	5,104	5,104
Insurance subsidiary investments	207,057	207,057	245,593	245,593
Tax refund escrow investments	215	215	216	216
Long-term debt, including amounts due within one year	147,733	147,724	349,514	349,503

Non-recurring measurements

In March 2009, the Company acquired a previously leased hospital for $15.6 million in cash and $1.6 million in unamortized prepaid rent. The fair value of the assets was measured using Level 2 observable inputs, including replacement costs and direct sales comparisons of similar properties in the same geographic market or region.

In June 2009, the Company purchased the Nursing Centers from Ventas for $55.7 million. In addition, the Company paid Ventas a lease termination fee of $2.3 million. The Company used unobservable inputs for the valuation methodology that are significant to the fair value measurement and required management's judgment related to the assumptions market participants would use in pricing the assets. The valuation of these assets also included sales comparisons of similar properties and past transactions, in addition to expected proceeds negotiated with potential purchasers. In aggregate, the assets had a carrying value of $61.4 million and were adjusted to a fair value of $27.2 million, less expected selling costs of $1.4 million, resulting in an impairment charge of $35.6 million ($21.9 million net of income taxes).

During 2009, the Company sold five of the Nursing Centers for $26.2 million. During 2009, the Company also recorded additional costs of $3.9 million ($2.4 million net of income taxes) related to the disposal of the Nursing Centers.

NOTE 18 – LITIGATION

The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations in the ordinary course of its business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. These legal actions and investigations could potentially subject the Company to sanctions, damages, recoupments, fines and other penalties. 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 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.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)
(In thousands, except per share amounts)

The following table represents summary quarterly consolidated financial information (unaudited) for the years ended December 31, 2009 and 2008:

	2009 (a)			
	First	Second	Third	Fourth
Revenues	$ 1,069,474	$ 1,073,054	$ 1,057,488	$ 1,069,991
Net income (loss):				
Income from continuing operations	23,341	17,538	5,388	16,345
Discontinued operations, net of income taxes:				
Income (loss) from operations	(581)	(897)	13	2,396
Gain (loss) on divestiture of operations	–	(24,051)	52	567
Net income (loss)	22,760	(7,410)	5,453	19,308
Earnings (loss) per common share:				
Basic:				
Income from continuing operations	0.60	0.45	0.14	0.42
Discontinued operations:				
Income (loss) from operations	(0.02)	(0.02)	–	0.06
Gain (loss) on divestiture of operations	–	(0.62)	–	0.01
Net income (loss)	0.58	(0.19)	0.14	0.49
Diluted:				
Income from continuing operations	0.60	0.45	0.14	0.42
Discontinued operations:				
Income (loss) from operations	(0.02)	(0.02)	–	0.06
Gain (loss) on divestiture of operations	–	(0.62)	–	0.01
Net income (loss)	0.58	(0.19)	0.14	0.49
Shares used in computing earnings (loss) per common share:				
Basic	38,184	38,307	38,398	38,465
Diluted	38,315	38,415	38,524	38,693
Market prices:				
High	18.57	17.83	17.27	20.00
Low	11.51	10.70	11.83	13.80

	2008 (a)			
	First	Second	Third	Fourth
Revenues	$ 1,034,475	$ 1,026,041	$ 997,129	$ 1,036,219
Net income (loss):				
Income from continuing operations	17,210	19,477	2,119	21,654
Discontinued operations, net of income taxes:				
Income (loss) from operations	(2,520)	(528)	(1,321)	970
Gain (loss) on divestiture of operations	–	2,712	(22,058)	(1,430)
Net income (loss)	14,690	21,661	(21,260)	21,194
Earnings (loss) per common share:				
Basic:				
Income from continuing operations	0.45	0.50	0.05	0.56
Discontinued operations:				
Income (loss) from operations	(0.07)	(0.01)	(0.03)	0.02
Gain (loss) on divestiture of operations	-	0.07	(0.57)	(0.04)
Net income (loss)	0.38	0.56	(0.55)	0.54
Diluted:				
Income from continuing operations	0.44	0.49	0.05	0.55
Discontinued operations:				
Income (loss) from operations	(0.06)	(0.01)	(0.03)	0.03
Gain (loss) on divestiture of operations	–	0.07	(0.56)	(0.04)
Net income (loss)	0.38	0.55	(0.54)	0.54
Shares used in computing earnings (loss) per common share:				
Basic	37,444	37,714	38,034	38,123
Diluted	38,061	38,474	38,894	38,265
Market prices:				
High	28.74	32.34	33.25	28.30
Low	20.25	21.34	25.80	8.12

(a) See accompanying discussion of certain quarterly items.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED) (Continued)

SIGNIFICANT QUARTERLY ADJUSTMENTS

The following is a description of significant quarterly adjustments recorded during 2009 and 2008:

Third quarter 2009

The provision for income taxes included a favorable adjustment of $1.7 million related to the resolution of state income tax contingencies from prior years.

Third quarter 2008

Operating results for the third quarter of 2008 included a $0.9 million pretax other-than-temporary impairment of an investment in a failed financial institution held in the Company's insurance subsidiary investment portfolio. In addition, the provision for income taxes included a favorable adjustment of $1.8 million related to the resolution of state income tax contingencies from prior years.

Second quarter 2008

Operating results for the second quarter of 2008 included pretax income of $8.3 million related to the favorable settlement of a prior year nursing center Medicaid cost report dispute. The Company also recorded a pretax charge of $1.9 million related to a prior period rent escalator adjustment for ten leased facilities.

KINDRED HEALTHCARE, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007
(In thousands)

	Balance at beginning of period	Additions: Charged to costs and expenses	Additions: Other	Deductions: Deductions or payments	Deductions: Spin-off Transaction	Balance at end of period
Allowance for loss on accounts receivable:						
Year ended December 31, 2007	$ 62,064	$ 30,093	$ 149	$ (43,315)	$ (15,686)	$ 33,305
Year ended December 31, 2008	33,305	32,336	–	(38,093)	–	27,548
Year ended December 31, 2009	27,548	29,320	–	(36,712)	–	20,156
Allowance for deferred taxes:						
Year ended December 31, 2007	$ 11,328	$ –	$ –	$ –	$ –	$ 11,328
Year ended December 31, 2008	11,328	–	34,012(a)	(9,788)	–	35,552
Year ended December 31, 2009	35,552	–	–	(482)	–	35,070

(a) The Company identified deferred income tax assets for state income tax NOLs of $34.0 million at December 31, 2008 and a corresponding deferred income tax valuation allowance of $34.0 million after determining these net deferred income tax assets were not realizable.

EXHIBIT 10.21

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and Richard E. Chapman (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "<u>Change in Control</u>" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. **Term.** The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits**. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment**. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. <u>Continuation of Benefits.</u>

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **<u>Retirement Savings Plan</u>**. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Richard E. Chapman
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. **Indemnification**. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. **Severability**. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. **Interpretation**. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. **No Waiver**. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. **Cancellation of Prior Agreement**. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Richard E. Chapman

Richard E. Chapman

EXHIBIT 10.25

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and M. Suzanne Riedman (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. **Definitions.**

a. "Base Salary" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "Cause" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of her duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and her attorney an opportunity to be heard by the Board.

c. "<u>Change in Control</u>" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate her office to a place more than 30 miles from her business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate her employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates her employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following her separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. **Continuation of Benefits.**

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **Retirement Savings Plan.** Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. Plan Amendments. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. Fringe Benefits. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. No Mitigation Required or Setoff Permitted. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. Waiver of Other Severance Benefits. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: M. Suzanne Riedman
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. **Indemnification.** The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving her by reason of her having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. **ERISA.** Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. **Severability.** The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. **Interpretation.** The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. **No Waiver.** No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. **Cancellation of Prior Agreement**. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ M. Suzanne Riedman

M. Suzanne Riedman

EXHIBIT 10.29

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and William M. Altman (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "Base Salary" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "Cause" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "Termination of Employment" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: William M. Altman
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. **Cancellation of Prior Agreement**. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ William M. Altman

William M. Altman

EXHIBIT 10.33

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and Joseph L. Landenwich (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. **Term.** The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits.** If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment.** The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 50 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. Employment at Will. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Joseph L. Landenwich
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. **Indemnification.** The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. **Severability.** The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. **Interpretation.** The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. **No Waiver.** No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. Counterparts. This Agreement may be executed in two or more counterparts each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. Cancellation of Prior Agreement. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the da.e first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Joseph L. Landenwich

Joseph L. Landenwich

EXHIBIT 10.35

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and Benjamin A. Breier (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. **Term**. The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits.** If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment.** The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. Plan Amendments. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. Fringe Benefits. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employees Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. No Mitigation Required or Setoff Permitted. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. Waiver of Other Severance Benefits. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Benjamin A. Breier
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. **Counterparts**. This Agreement may be executed in two or more counterparts each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. **Cancellation of Prior Agreement**. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Benjamin A. Breier

Benjamin A. Breier

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and Gregory C. Miller (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. **Term**. The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits**. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment**. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title 1 of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. Employment at Will. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Gregory C. Miller
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. **Indemnification**. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. **Severability**. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. **Interpretation**. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. **No Waiver**. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. **Cancellation of Prior Agreement**. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Gregory C. Miller

Gregory C. Miller

EXHIBIT 10.39

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of November 13, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (or as appropriate, one of its indirect subsidiaries) (the "Company") and Christopher M. Bird (the "Employee").

RECITALS:

A. The Employee is employed by the Company or a direct or indirect subsidiary of the Company, itself a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

D. The Company and the Employee voluntarily cancelled that certain change-in-control severance agreement, dated as of December 18, 2008, between the Company and the Employee in consideration for entering into this Agreement.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "Change in Control" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934 (the "1934 Act")) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of the Effective Date, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the 1934 Act and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason; or (ii) the Employee's termination of employment with the Company for Good Reason.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on the Effective Date (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company other than in connection with a Change-in-Control or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company for Good Reason, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate

computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had Employee remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employees Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

5. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

6. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

7. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

8. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

9. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

10. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Christopher M. Bird
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

11. **Indemnification**. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

12. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

13. **Severability**. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

14. **Interpretation**. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

15. **No Waiver**. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

16. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

17. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

18. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

19. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

20. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

21. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

22. Cancellation of Prior Agreement. The Company and the Employee hereby acknowledge and agree that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 18, 2008 between Company and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4 and 11:

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Christopher M. Bird

Christopher M. Bird

EXHIBIT 10.43

AMENDMENT TO

MEMORANDUM OF LEASE AND

SPECIFIC PROPERTY LEASE AMENDMENT

BY AND AMONG

KINDRED HEALTHCARE, INC.,

KINDRED HEALTHCARE OPERATING, INC., AND

VENTAS REALTY, LIMITED PARTNERSHIP

Master Lease No.:	1
Facility No.:	IN – 112
Property Address:	3500 Maple Avenue Terre Haute, Indiana (Vigo County)

AMENDMENT TO MEMORANDUM OF LEASE AND SPECIFIC PROPERTY LEASE AMENDMENT

THIS AMENDMENT TO MEMORANDUM OF LEASE AND SPECIFIC PROPERTY LEASE AMENDMENT (hereinafter this "Amendment") is dated as of the 14th day of October, 2009, and is between VENTAS REALTY, LIMITED PARTNERSHIP, a Delaware limited partnership (together with its successors and assigns, "Lessor") having an office at 10350 Ormsby Park Place, Suite 300, Louisville, Kentucky 40223, and KINDRED HEALTHCARE, INC., a Delaware corporation formerly known as Vencor, Inc. ("Kindred"), and KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation formerly known as Vencor Operating, Inc. ("Operator"; Operator, jointly and severally with Kindred and permitted successors and assignees of Operator and Kindred, "Tenant"), both having an office at 680 South 4th Avenue, Louisville, Kentucky 40202.

RECITALS

A. Lessor and Tenant have heretofore entered into (i) a certain Amended and Restated Master Lease Agreement No. 1 dated as of April 20, 2001 (the "2001 Lease"), (ii) a certain Second Amended and Restated Master Lease Agreement No. 1 dated as of April 27, 2007 (as the same may have been or may hereafter be amended, amended and restated, supplemented, modified, renewed, extended or replaced, the "Lease"), which superseded the 2001 Lease and demises to Tenant, among other properties, the real property described in Exhibit A attached hereto and made a part hereof, together with the improvements thereon (the "Premises"), and (iii) a Memorandum of Lease (the "Memorandum") dated as of April 20, 2001, and recorded on May 1, 2001, with the Official Recorder of Vigo County, Indiana, Instrument Number 20016619, which Memorandum provides record notice of the Lease, as it applies to the Premises.

B. The City of Terre Haute is purchasing a portion of the Premises legally described in Exhibit B attached hereto and made a part hereof (the "Parcel").

C. Lessor and Tenant desire to amend the Lease, as it relates to the Premises, and to amend the Memorandum, in combination with such purchase by the City of Terre Haute.

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the parties hereby agree as follows:

1. Effective on the date of the recording of the deed transferring the Parcel from Lessor to the City of Terre Haute, the Memorandum, and the Lease as it applies to the Premises, are amended: (a) to terminate the Memorandum and the Lease as they apply to the Parcel, and (b) to confirm and adopt, as the revised legal description for the Premises, the amended legal description (the "Amended Premises") that is attached hereto and made a part hereof as Exhibit C.

2. This Amendment is being executed solely to give notice of the Lease, as it relates to the Amended Premises, and to amend the Memorandum and the Lease as they apply to the Amended Premises, and is not intended to amend the Lease in any respect other than as expressly provided in Paragraph 1 above. Without limitation of the foregoing, Lessor and Tenant acknowledge and agree that the Lease relates to the Amended Premises and multiple other properties and that, as provided in the Lease, the Lease demises all of such properties as a unified commercial operating lease and Lessor is not obligated, and may not be required, to lease less than all of such properties pursuant to the Lease.

3. This Amendment may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto were upon the same instrument.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed these presents the day and year first above written.

TENANT:

KINDRED HEALTHCARE, INC.,
a Delaware corporation

By:	/s/ Richard Myers
Name:	Richard Myers
Title:	VP & Real Estate Counsel

KINDRED HEALTHCARE OPERATING, INC.,
a Delaware corporation

By:	/s/ Richard Myers
Name:	Richard Myers
Title:	VP & Real Estate Counsel

LESSOR:

VENTAS REALTY, LIMITED PARTNERSHIP,
a Delaware limited partnership

By:	Ventas, Inc., a Delaware corporation, its general partner
By:	/s/ T. Richard Riney
	T. Richard Riney, Executive Vice President, Chief Administrative Officer, General Counsel and Secretary

Acknowledgments

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On 8/18, 2009, before me, Jenny McGarry personally appeared Richard Myers, the VP & Real Estate Counsel of KINDRED HEALTHCARE, INC., a Delaware corporation, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature /s/ Jenny McGarry
(This area for official seal) Commission Expires: 2/16/2012

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On 8/18, 2009, before me, Jenny McGarry personally appeared Richard Myers, the VP & Real Estate Counsel of KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature /s/ Jenny McGarry
(This area for official seal) Commission Expires: 2/16/2012

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On Oct. 14, 2009, before me, Terri Parker personally appeared T. Richard Riney, who is personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he executed the same in his authorized capacity, as the Executive Vice President, Chief Administrative Officer, General Counsel and Secretary of Ventas, Inc., a Delaware corporation, in its capacity as the general partner of Ventas Realty, Limited Partnership, a Delaware limited partnership, and that by his signature on the instrument the aforesaid corporation executed the instrument, as the general partner and on behalf of the aforesaid limited partnership.

WITNESS my hand and official seal.

Signature /s/ Terri Parker

(This area for official seal)

Notary Public, State at Large, KY
My commission expires Jan. 6, 2013

EXHIBIT A

Premises

Parcel D, Situate in Terre Haute, Vigo County, Indiana (IN#112): (NTL #7161-10, Royal Oaks Healthcare & Rehab Center)

Tract I:

A part of the Southwest Quarter of Section 12, Township 12 North, Range 9 West of the Second Principal Meridian, in Vigo County, Indiana, being described as follows:

Beginning at a found stone at the Southwest corner of the Southwest Quarter of Section 12; thence on and along the West line of the Southwest Quarter North 01 degrees 34 minutes and 04 seconds West 1,495.00 feet; thence North 89 degrees 59 minutes 56 seconds East 885.52 feet; thence South 01 degrees 40 minutes 05 seconds East 1,495.07 feet to the South line of the Southwest Quarter; thence on and along said South line South 89 degrees 59 minutes 56 seconds West 888.13 feet to the true place of beginning.

EXCEPTING FROM TRACT I: That part thereof as platted into Oakwood Addition Lot Number 1 as shown by the recorded plat thereof, recorded in Plat Record 27, page 62 of the Recorder's Office of Vigo County, Indiana.

Subject to legal highways.

Tract II:

Oakwood Addition Lot Number One (1) being a subdivision of a part of the Southwest Quarter of Section 12, Township 12 North, Range 9 West as shown by the recorded plat thereof, recorded in Plat Record 27, page 62 of the Recorder's Office of Vigo County, Indiana.

PIN #: 1-18-0612300005

PIN #: 1-18-0612300008

EXHIBIT B

Parcel

Part of the Southwest quarter of Section 12, Township 12 North, Range 9 West, Vigo County, Indiana, being that part of the grantor's land lying with the right-of-way lines as depicted on the attached Right-of-Way Parcel Plat, marked EXHIBIT "D" described as follows:

Commencing at the Southwest corner of said quarter section; thence North 00 degrees 04 minutes 14 seconds East, bearing is assumed and is the basis of bearings of this description along the West line of said quarter section, a distance of 30.00 feet to the Southwest corner of a tract of land in the name of the Ventas Finance I, LLC, Parcel 06-12-300-008, also being the Southwest corner of Lot 1 of Oakwood Addition and the POINT OF BEGINNING of this description, point "17" as designated on said plat; thence North 00 degrees 04 minutes 14 seconds East, along the West line of said tract, a distance of 34.33 feet to point "16" as designated on said plat; thence South 88 degrees 26 minutes 57 seconds East, a distance of 8.80 feet to point "18" as designated on said plat; thence South 01 degree 26 minutes 55 seconds West, a distance of 5.00 feet to point "19" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 450.21 feet to point "20" as designated on said plat; thence South 01 degree 39 minutes 14 seconds East, a distance of 5.00 feet to point "21" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 17.00 to point "22" as designated on said plat; thence North 01 degree 39 minutes 14 seconds East, a distance of 5.00 feet to point "23" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 411.35 feet to point "24" as designated on said plat on the East line of said Lot 1 of Oakwood Addition; thence South 00 degrees 04 minutes 14 seconds West, along the East line of said Lot 1, a distance of 29.00 feet to Southeast corner of said Lot 1; thence North 88 degrees 22 minutes 07 seconds West, along said North right-of-way line, a distance of 887.23 feet to the POINT OF BEGINNING, containing 0.593 acres, 25,831 square feet more or less.

This description was prepared for the Vigo County Board of Commissioners by Earl D. Spires Jr., Indiana Registered Land Surveyor, License Number "INLS29900015" on the 10th day of December, 2008.

EXHIBIT C

Amended Premises

Parcel D, Situate in Terre Haute, Vigo County, Indiana (IN#112): (NTL #7161-10, Royal Oaks Healthcare & Rehab Center)

Tract I:

A part of the Southwest Quarter of Section 12, Township 12 North, Range 9 West of the Second Principal Meridian, in Vigo County, Indiana, being described as follows:

Beginning at a found stone at the Southwest corner of the Southwest Quarter of Section 12; thence on and along the West line of the Southwest Quarter North 01 degrees 34 minutes and 04 seconds West 1, 495.00 feet; thence North 89 degrees 59 minutes 56 seconds East 885.52 feet; thence South 01 degrees 40 minutes 05 seconds East 1,495.07 feet to the South line of the Southwest Quarter; thence on and along said South line South 89 degrees 59 minutes 56 seconds West 888.13 feet to the true place of beginning.

EXCEPTING FROM TRACT I: That part thereof as platted into Oakwood Addition Lot Number 1 as shown by the recorded plat thereof, recorded in Plat Record 27, page 62 of the Recorder's Office of Vigo County, Indiana.

Subject to legal highways.

Tract II:

Oakwood Addition Lot Number One (1) being a subdivision of a part of the Southwest Quarter of Section 12, Township 12 North, Range 9 West as shown by the recorded plat thereof, recorded in Plat Record 27, page 62 of the Recorder's Office of Vigo County, Indiana.

PIN #: 1-18-0612300005

PIN #: 1-18-0612300008

LESS AND EXCEPTING the following described portion:

Part of the Southwest quarter of Section 12, Township 12 North, Range 9 West, Vigo County, Indiana, being that part of the grantor's land lying with the right-of-way lines as depicted on the attached Right-of-Way Parcel Plat, marked EXHIBIT "B" described as follows:

Commencing at the Southwest corner of said quarter section; thence North 00 degrees 04 minutes 14 seconds East, bearing is assumed and is the basis of bearings of this description along the West line of said quarter section, a distance of 30.00 feet to the Southwest corner of a tract of land in the name of the Ventas Finance I, LLC, Parcel 06-12-300-008, also being the Southwest corner of Lot 1 of Oakwood Addition and the POINT OF BEGINNING of this description, point "17" as designated on said plat; thence North 00 degrees 04 minutes 14 seconds East, along the West line of said tract, a distance of 34.33 feet to point "16" as designated on said plat; thence South 88 degrees 26 minutes 57 seconds East, a distance of 8.80 feet to point "18" as designated on said plat; thence South 01 degree 26 minutes 55 seconds West, a distance of 5.00 feet to point "19" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 450.21 feet to point "20" as designated on said plat; thence South 01 degree 39 minutes 14 seconds East, a distance of 5.00 feet to point "21" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 17.00 to point "22" as designated on said plat; thence North 01 degree 39 minutes 14 seconds East, a distance of 5.00 feet to point "23" as designated on said plat; thence South 88 degrees 20 minutes 46 seconds East, a distance of 411.35 feet to point "24" as designated on said plat on the East line of said Lot 1 of Oakwood Addition; thence South 00 degrees 04 minutes 14 seconds West, along the East line of said Lot 1, a distance of 29.00 feet to Southeast corner of said Lot 1; thence North 88 degrees 22 minutes 07 seconds West, along said North right-of-way line, a distance of 887.23 feet to the POINT OF BEGINNING, containing 0.593 acres, 25,831 square feet more or less.

EXHIBIT 21

REGISTRANT'S SUBSIDIARIES

DECEMBER 31, 2009

<u>Corporations and Limited Liability Companies</u>

Cornerstone Insurance Company, a Cayman Islands corporation

Kindred Healthcare Operating, Inc., a Delaware corporation

- Homestead Health and Rehabilitation Center, L.L.C., a Delaware limited liability company
- Kindred Development 27, L.L.C., a Delaware limited liability company
- Kindred Development 29, L.L.C., a Delaware limited liability company
- Kindred Hospitals East, L.L.C., a Delaware limited liability company
  - Goddard Nursing, L.L.C., a Delaware limited liability company
  - Kindred Braintree Hospital, L.L.C., a Delaware limited liability company
  - Kindred Hospital Palm Beach, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Pittsburgh-North Shore, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Springfield, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Toledo, L.L.C., a Delaware limited liability company
  - Kindred Development 15, L.L.C., a Delaware limited liability company
  - Kindred Development 17, L.L.C., a Delaware limited liability company
  - Springfield Park View Hospital, L.L.C., a Delaware limited liability company
- Kindred Hospitals West, L.L.C., a Delaware limited liability company
- Kindred Nursing Centers East, L.L.C., a Delaware limited liability company
  - Avery Manor Nursing, L.L.C., a Delaware limited liability company
  - Braintree Nursing, L.L.C., a Delaware limited liability company
  - Country Estates Nursing, L.L.C., a Delaware limited liability company
  - Forestview Nursing, L.L.C., a Delaware limited liability company
  - Greens Nursing and Assisted Living, L.L.C., a Delaware limited liability company
  - Harborlights Nursing, L.L.C., a Delaware limited liability company
  - Highgate Nursing, L.L.C., a Delaware limited liability company

Highlander Nursing, L.L.C., a Delaware limited liability company

Kindred Development Holdings 3, L.L.C., a Delaware limited liability company

Kindred Development Holdings 5, L.L.C., a Delaware limited liability company

Kindred Development 7, L.L.C., a Delaware limited liability company

Kindred Development 8, L.L.C., a Delaware limited liability company

Kindred Development 9, L.L.C., a Delaware limited liability company

Kindred Development 10, L.L.C., a Delaware limited liability company

Kindred Development 11, L.L.C., a Delaware limited liability company

Kindred Development 12, L.L.C., a Delaware limited liability company

Kindred Development 13, L.L.C., a Delaware limited liability company

Laurel Lake Health and Rehabilitation, L.L.C., a Delaware limited liability company

Massachusetts Assisted Living, L.L.C., a Delaware limited liability company

Meadows Nursing, L.L.C., a Delaware limited liability company

Tower Hill Nursing, L.L.C., a Delaware limited liability company

Kindred Nursing Centers West, L.L.C., a Delaware limited liability company

Kindred Development 4, L.L.C., a Delaware limited liability company

Maine Assisted Living, L.L.C., a Delaware limited liability company

California Nursing Centers, L.L.C., a Delaware limited liability company

Bayberry Care Center, L.L.C., a Delaware limited liability company

Care Center of Rossmoor, L.L.C., a Delaware limited liability company

Greenbrae Care Center, L.L.C., a Delaware limited liability company

Medical Hill Rehab Center, L.L.C., a Delaware limited liability company

Pacific Coast Care Center, L.L.C., a Delaware limited liability company

Siena Care Center, L.L.C., a Delaware limited liability company

Smith Ranch Care Center, L.L.C., a Delaware limited liability company

Ygnacio Valley Care Center, L.L.C., a Delaware limited liability company

Kindred Nursing Centers South, L.L.C., a Delaware limited liability company

Kindred Nursing Centers North, L.L.C., a Delaware limited liability company

Kindred Nevada, L.L.C., a Delaware limited liability company

Kindred Holdings, L.L.C., a Delaware limited liability company

Kindred Systems, Inc., a Delaware corporation

Kindred Healthcare Services, Inc., a Delaware corporation

Ledgewood Health Care Corporation, a Massachusetts corporation (1)

Kindred Rehab Services, Inc., a Delaware corporation

- Rehab Staffing, L.L.C., a Delaware limited liability company
- People*first* Virginia, L.L.C., a Delaware limited liability company
- Kindred Hospice Services, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare & Hospice of Colorado, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare of Colorado, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare & Hospice of Indiana, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare & Hospice of Massachusetts, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare & Hospice of Ohio, L.L.C., a Delaware limited liability company
    - Peoplefirst HomeCare & Hospice of Utah, L.L.C., a Delaware limited liability company
    - PF Development 14, L.L.C., a Delaware limited liability company
    - PF Development 15, L.L.C., a Delaware limited liability company
- PF Development 5, L.L.C., a Delaware limited liability company
- PF Development 6, L.L.C., a Delaware limited liability company
- PF Development 7, L.L.C., a Delaware limited liability company
- PF Development 8, L.L.C., a Delaware limited liability company
- PF Development 9, L.L.C., a Delaware limited liability company
- PF Development 10, L.L.C., a Delaware limited liability company

KND Development 50, L.L.C., a Delaware limited liability company

KND Development 51, L.L.C., a Delaware limited liability company

KND Development 52, L.L.C., a Delaware limited liability company

KND Development 53, L.L.C., a Delaware limited liability company

KND Development 54, L.L.C., a Delaware limited liability company

KND Development 55, L.L.C., a Delaware limited liability company

KND Development 56, L.L.C., a Delaware limited liability company

KND Development 57, L.L.C., a Delaware limited liability company

KND Development 58, L.L.C., a Delaware limited liability company

KND Development 59, L.L.C., a Delaware limited liability company

KND Real Estate Holdings, L.L.C., a Delaware limited liability company

- KND Hospital Real Estate Holdings, L.L.C., a Delaware limited liability company
    - KND Real Estate 8, L.L.C., a Delaware limited liability company
    - KND Real Estate 9, L.L.C., a Delaware limited liability company
    - KND Real Estate 14, L.L.C., a Delaware limited liability company
    - KND Real Estate 21, L.L.C., a Delaware limited liability company
    - KND Real Estate 22, L.L.C., a Delaware limited liability company
    - KND Real Estate 23, L.L.C., a Delaware limited liability company
    - KND Real Estate 24, L.L.C., a Delaware limited liability company
    - KND Real Estate 25, L.L.C., a Delaware limited liability company
    - KND Real Estate 26, L.L.C., a Delaware limited liability company
    - KND Real Estate 27, L.L.C., a Delaware limited liability company
    - KND Real Estate 28, L.L.C., a Delaware limited liability company
    - KND Real Estate 29, L.L.C., a Delaware limited liability company
    - KND Real Estate 30, L.L.C., a Delaware limited liability company
- KND SNF Real Estate Holdings, L.L.C., a Delaware limited liability company
    - KND Real Estate 1, L.L.C., a Delaware limited liability company
    - KND Real Estate 2, L.L.C., a Delaware limited liability company
    - KND Real Estate 3, L.L.C., a Delaware limited liability company
    - KND Real Estate 4, L.L.C., a Delaware limited liability company

KND Real Estate 5, L.L.C., a Delaware limited liability company

KND Real Estate 6, L.L.C., a Delaware limited liability company

KND Real Estate 7, L.L.C., a Delaware limited liability company

KND Real Estate 10, L.L.C., a Delaware limited liability company

KND Real Estate 11, L.L.C., a Delaware limited liability company

KND Real Estate 12, L.L.C., a Delaware limited liability company

KND Real Estate 13, L.L.C., a Delaware limited liability company

KND Real Estate 15, L.L.C., a Delaware limited liability company

KND Real Estate 16, L.L.C., a Delaware limited liability company

KND Real Estate 17, L.L.C., a Delaware limited liability company

KND Real Estate 18, L.L.C., a Delaware limited liability company

KND Real Estate 19, L.L.C., a Delaware limited liability company

KND Real Estate 20, L.L.C., a Delaware limited liability company

KND Real Estate 31, L.L.C., a Delaware limited liability company

KND Real Estate 32, L.L.C., a Delaware limited liability company

KND Real Estate 33, L.L.C., a Delaware limited liability company

KND Real Estate 34, L.L.C., a Delaware limited liability company

KND Real Estate 35, L.L.C., a Delaware limited liability company

KND Real Estate 36, L.L.C., a Delaware limited liability company

KND Real Estate 37, L.L.C., a Delaware limited liability company

KND Real Estate 38, L.L.C., a Delaware limited liability company

KND Real Estate 39, L.L.C., a Delaware limited liability company

KND Real Estate 40, L.L.C., a Delaware limited liability company

KND Rehab Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Real Estate 41, L.L.C., a Delaware limited liability company

KND Real Estate 42, L.L.C., a Delaware limited liability company

KND Real Estate 43, L.L.C., a Delaware limited liability company

KND Real Estate 44, L.L.C., a Delaware limited liability company

KND Real Estate 45, L.L.C., a Delaware limited liability company

Helian Health Group, Inc., a Delaware corporation

Helian ASC of Northridge, Inc., a California corporation

MedEquities, Inc., a California corporation

Lafayette Health Care Center, Inc., a Georgia corporation

PersonaCare of Connecticut, Inc., a Connecticut corporation

Courtland Gardens Health Center, Inc., a Connecticut corporation

PersonaCare of Georgia, Inc., a Delaware corporation

PersonaCare of Huntsville, Inc., a Delaware corporation

PersonaCare of Ohio, Inc., a Delaware corporation

PersonaCare of Pompano East, Inc., a Delaware corporation

PersonaCare of Reading, Inc., a Delaware corporation

PersonaCare of Shreveport, Inc., a Delaware corporation

PersonaCare of Warner Robbins, Inc., a Delaware corporation

PersonaCare of Wisconsin, Inc., a Delaware corporation

Tucker Nursing Center, Inc., a Georgia corporation

Specialty Healthcare Services, Inc., a Delaware corporation

Southern California Specialty Care, Inc., a California corporation

Specialty Hospital of Cleveland, Inc., an Ohio corporation

Specialty Hospital of Philadelphia, Inc., a Pennsylvania corporation

Specialty Hospital of South Carolina, Inc., a South Carolina corporation

Caribbean Behavioral Health Systems, Inc., a Nevada corporation

JB Thomas Hospital, Inc., a Massachusetts corporation

THC - Chicago, Inc., an Illinois corporation

THC - North Shore, Inc., an Illinois corporation

THC - Houston, Inc., a Texas corporation

THC - Orange County, Inc., a California corporation

THC - Seattle, Inc., a Washington corporation

Transitional Hospitals Corporation of Indiana, Inc., an Indiana corporation

Transitional Hospitals Corporation of Louisiana, Inc., a Louisiana corporation

Transitional Hospitals Corporation of New Mexico, Inc., a New Mexico corporation

Transitional Hospitals Corporation of Nevada, Inc., a Nevada corporation

Transitional Hospitals Corporation of Tampa, Inc., a Florida corporation

Transitional Hospitals Corporation of Texas, Inc., a Texas corporation

Transitional Hospitals Corporation of Wisconsin, Inc., a Wisconsin corporation

Partnerships

Kindred Hospitals Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Central Limited Partnership, a Delaware limited partnership

Foothill Nursing Company Partnership, a California general partnership

Fox Hill Village Partnership, a Massachusetts general partnership (1)

Starr Farm Partnership, a Vermont general partnership (1)

Hillhaven-MSC Partnership, a California general partnership

Northridge Surgery Center, Ltd., a California limited partnership (2)

Northridge Surgery Center Development Ltd., a California limited partnership (3)

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(1) Only fifty percent (50%) is owned by one of the Registrant's subsidiaries
(2) Only forty-eight percent (48%) is owned by one or more of the Registrant's subsidiaries
(3) Only forty-three percent (43%) is owned by one of the Registrant's subsidiaries

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-59598, 333-62022, 333-88086, 333-116755 and 333-151580) and the Registration Statement on Form S-3 (No. 333-69646) of Kindred Healthcare, Inc. of our report dated February 26, 2010 relating to the consolidated financial statements, financial statement schedules and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

Louisville, Kentucky
February 26, 2010

Certification Required By Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934

I, Paul J. Diaz, certify that:

I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;

1.

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2010

/s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Certification Required By Rules 13a-14(a) and 15d-14(a)
under the Securities Exchange Act of 1934

I, Richard A. Lechleiter, certify that:

1. I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2010

/s/ Richard A. Lechleiter

Richard A. Lechleiter
Executive Vice President and
Chief Financial Officer

EXHIBIT 32

Section 1350 Certifications
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Kindred Healthcare, Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Annual Report on Form 10-K for the year ended December 31, 2009 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 26, 2010

/s/ Paul J. Diaz
Paul J. Diaz
President and Chief Executive Officer

Date: February 26, 2010

/s/ Richard A. Lechleiter
Richard A. Lechleiter
Executive Vice President and
Chief Financial Officer

2008 Kindred Healthcare, Inc 10K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)
☑ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008
OR

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

Commission File Number: 001-14057

KINDRED HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**61-1323993** (I.R.S. Employer Identification Number)
680 South Fourth Street **Louisville, Kentucky** (Address of principal executive offices)	**40202-2412** (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value $0.25 per share	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment of this Annual Report on Form 10-K. ☐

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

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

The aggregate market value of the shares of the Registrant held by non-affiliates of the Registrant, based on the closing price of such stock on the New York Stock Exchange on June 30, 2008, was approximately $1,090,000,000. For purposes of the foregoing calculation only, all directors and executive officers of the Registrant have been deemed affiliates.

As of January 31, 2009, there were 38,906,784 shares of the Registrant's common stock, $0.25 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 20, 2009 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

Item 1. *Business*

GENERAL

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States. At December 31, 2008, our hospital division operated 82 long-term acute care ("LTAC") hospitals (6,482 licensed beds) in 24 states. Our health services division operated 228 nursing centers (28,525 licensed beds) in 27 states. We also operated a contract rehabilitation services business that provides rehabilitative services primarily in long-term care settings. All references in this Annual Report on Form 10-K to "Kindred," "Company," "we," "us," or "our" mean Kindred Healthcare, Inc. and, unless the context otherwise requires, our consolidated subsidiaries.

All financial and statistical information presented in this Annual Report on Form 10-K reflects the continuing operations of our businesses for all periods presented unless otherwise indicated.

Spin-Off Transaction. On July 31, 2007, we completed the spin-off of our former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. Immediately after the Spin-off Transaction, our stockholders and the stockholders of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from our balance sheet effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in our operating results. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in our historical continuing operations.

In addition to the pharmacy services contracts noted above, we also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters.

Commonwealth Transaction. In February 2006, we acquired the operations of the LTAC hospitals, nursing centers and assisted living facilities operated by Commonwealth Communities Holdings LLC and certain of its affiliates (collectively, "Commonwealth") for a total purchase price of $124 million in cash (the "Commonwealth Transaction").

The Commonwealth Transaction included five freestanding LTAC hospitals and one hospital-in-hospital with a total of 421 licensed hospital beds. Three of these hospitals also operate co-located sub-acute units and skilled nursing units with a total of 168 licensed beds. In addition, we acquired the operations of nine nursing centers containing 1,316 licensed beds and four assisted living facilities with a total of 215 licensed beds. Two of these assisted living facilities share campuses with a Commonwealth nursing center. In the transaction, we also acquired the right to develop 95 additional licensed hospital beds in Massachusetts. In September 2008, we closed one of the freestanding LTAC hospitals acquired in the Commonwealth Transaction and relinquished the related licensed beds to the Commonwealth of Massachusetts. See "– Discontinued Operations."

Spin-off from Ventas. On May 1, 1998, Ventas, Inc. ("Ventas") completed the spin-off of its healthcare operations to its stockholders through the distribution of our former common stock. Ventas retained ownership of substantially all of its real property and leases a portion of such real property to us. In anticipation of the spin-off from Ventas, we were incorporated on March 27, 1998 as a Delaware corporation. For accounting purposes, the consolidated historical financial statements of Ventas became our historical financial statements following the spin-off.

Risk Factors. This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). See "Item 1A – Risk Factors."

Discontinued Operations

In recent years, we have completed several transactions related to the divestiture of unprofitable hospitals and nursing centers to improve our future operating results.

In September 2008, we purchased for resale a LTAC hospital in Massachusetts for $22.3 million that was previously leased. We recorded a pretax loss of $36.9 million ($22.7 million net of income taxes) in 2008 resulting from the losses related to the purchase, closure and planned divestiture of the hospital, including the impairment of a certificate of need intangible asset ($15.2 million), the impairment of property and equipment ($17.3 million) and other costs ($4.4 million).

In September 2008, we also announced our intention to dispose of a LTAC hospital in California and its related operations. We recorded a pretax loss of $7.4 million ($4.6 million net of income taxes) during 2008 related to the impairment of the hospital's building and equipment.

These two hospitals generated pretax losses of approximately $8 million in each of 2008 and 2007, and $5 million in 2006. At December 31, 2008, we held for sale these two hospitals. We expect to dispose of them in 2009 and generate approximately $8 million in proceeds from the sales.

We also discontinued the operations of a hospital in 2008 after terminating the hospital operating lease and ceasing operations.

In June 2007, we purchased for resale 21 nursing centers and one LTAC hospital (collectively, the "Ventas Facilities") previously leased from Ventas for $171.5 million (the "Facility Acquisitions"). In addition, we paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax income of approximately $3 million for 2008 and pretax losses of approximately $4 million and $10 million for 2007 and 2006, respectively. During 2007 and 2008, we sold the Ventas Facilities for approximately $95 million. We recorded a pretax gain of $10.5 million ($6.5 million net of income taxes) during 2008 and a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to the sale of the Ventas Facilities.

In January 2007, we acquired from HCP, Inc., formerly known as Health Care Property Investors, Inc. ("HCP"), the real estate related to 11 unprofitable leased nursing centers operated by us for resale in exchange for the real estate related to three hospitals previously owned by us (the "HCP Transaction"). As part of the HCP Transaction, we continue to operate these hospitals under a long-term lease arrangement with HCP. In addition, we paid HCP a one-time cash payment of approximately $36 million. We also amended our existing master lease with HCP to (1) terminate the current annual rent of approximately $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of approximately $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022.

During 2007, we sold all of the nursing centers acquired in the HCP Transaction and received proceeds of $77.9 million. These 11 nursing centers, which contained 1,754 licensed beds, generated pretax losses of approximately $4 million for 2007 and $1 million for 2006. In addition, we terminated a nursing center lease with another landlord during 2007. We recorded a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2008 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

HEALTHCARE OPERATIONS

We are organized into three operating divisions: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing centers. The rehabilitation division provides rehabilitation services primarily in long-term care settings. We believe that the independent focus of each division on the unique aspects of its business enhances its ability to attract patients, residents and non-affiliated customers, improve the quality of its operations and achieve operating efficiencies.

HOSPITAL DIVISION

Our hospital division provides long-term acute care services to medically complex patients through the operation of a national network of 82 hospitals with 6,482 licensed beds located in 24 states as of December 31, 2008. We operate the largest network of LTAC hospitals in the United States based upon fiscal 2008 revenues of approximately $1.8 billion (before eliminations). As a result of our commitment to the LTAC hospital business, we have developed a comprehensive program of care for medically complex patients that allows us to deliver high quality care in a cost-effective manner.

A number of the hospital division's hospitals also provide skilled nursing, sub-acute and outpatient services. Outpatient services may include diagnostic services, rehabilitation therapy, CT scanning, one-day surgery and laboratory.

In our hospitals, we treat medically complex patients, including the critically ill, suffering from multiple organ system failures, most commonly of the cardiovascular, pulmonary, kidney, gastro-intestinal and cutaneous (skin) systems. In particular, we have a core competency in treating patients with cardio-pulmonary disorders, skin and wound conditions, and life-threatening infections. Prior to being admitted to our hospitals, many of our patients have undergone a major surgical procedure or developed a neurological disorder following head and spinal cord injury, cerebral vascular incident or metabolic instability. Our expertise lies in the ability to simultaneously deliver comprehensive and coordinated medical interventions directed at all affected organ systems, while maintaining a patient-centered, integrated care plan. Medically complex patients are characteristically dependent on technology for continued life support, including mechanical ventilation, total parenteral nutrition, respiratory or cardiac monitors and kidney dialysis machines. During 2008, the average length of stay for patients in our hospitals was approximately 32 days. Approximately 62% of our hospital patients are over 65 years old.

Our hospital division patients generally have conditions that require a high level of monitoring and specialized care, yet may not need the services of a traditional intensive care unit. Due to their severe medical conditions, these patients are not clinically appropriate for admission to other post-acute settings and their medical conditions are periodically or chronically unstable. By providing a range of services required for the care of medically complex patients, we believe that our LTAC hospitals provide our patients with high quality, cost-effective care.

Our LTAC hospitals employ a comprehensive program of care for their patients that draws upon the talents of interdisciplinary teams, including physician specialists. The teams evaluate patients upon admission to determine treatment programs. Our hospital division has developed specialized treatment programs focused on the needs of medically complex patients. In addition to traditional medical services, most of our patients receive individualized treatment plans in rehabilitation, skin integrity management and clinical pharmacology. Where appropriate, the treatment programs may involve the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

Hospital Division Strategy

Our goal is to be the leading operator of LTAC hospitals in terms of both quality of care and operating efficiency. Our strategies for achieving this goal include:

Maintaining High Quality of Care. The hospital division differentiates its hospitals through its ability to care for medically complex patients in a high quality, cost-effective setting. We are committed to maintaining and improving the quality of our patient care by dedicating appropriate resources at each facility and continuing to refine our clinical initiatives and objectives. We continue to take steps to improve our quality indicators and maintain the quality of care at our hospitals, including:

- attracting and retaining high quality professional staff within each market. The hospital division believes that its future success will depend in part upon its continued ability to hire and retain qualified healthcare personnel and to promote leadership and development training,
- maintaining an integrated quality assurance and improvement program, administered by our chief medical officer and senior vice president of clinical operations, which encompasses utilization review, quality improvement, infection control and risk management,
- promoting best practices through our hospitals and standardizing products and services to promote better care,
- expanding our service excellence programs to further embed a culture of caring in each of our hospitals,
- maintaining a clinical outcomes program, which includes a concurrent review of all of our patient population against quality screenings, outcomes reporting and patient and family satisfaction surveys,
- maintaining a program whereby our hospitals are reviewed by internal quality auditors for compliance with standards of the Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals (the "Joint Commission"),
- engaging quality councils at the divisional, regional, district and hospital levels to analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division,
- incorporating the clinical advice of our chief medical officer, medical advisory board and other physicians into our operational procedures, and
- implementing an integrated risk management plan to improve quality and expand existing patient safety initiatives.

Improving Operating Efficiency. The hospital division is continually focused on improving operating efficiency and controlling costs while maintaining quality patient care. Our hospital division seeks to improve operating efficiencies and control costs by standardizing key operating procedures and optimizing the skill mix of its staff based upon the clinical needs of each hospital's patients. The initiatives we have undertaken to control our costs and improve efficiency include:

- managing labor costs by adjusting staffing to patient acuity and fluctuations in census,

- increasing the standardization of operating processes, procedures and equipment,
- improving physician participation in resource consumption, medical record documentation and intensity of service management,
- managing pharmacy costs through the use of a medication control program and evaluating medical utilization through our pharmacy and therapeutic committees in each hospital,
- centralizing administrative functions such as accounting, payroll, legal, reimbursement, compliance, tax and information systems, and
- utilizing management information technology to aid in financial and clinical reporting as well as billing and collections.

Growing Through Business Development and Acquisitions. Our growth strategy is focused on the development and expansion of our services:

- Freestanding Hospitals – At December 31, 2008, we operated 66 freestanding hospitals (5,790 licensed beds). During 2008, we opened one new freestanding hospital which added a total of 70 licensed hospital beds. During 2007, we opened four new freestanding hospitals and one replacement hospital which added a total of 261 licensed hospital beds and 39 licensed sub-acute beds. The maturation of these hospitals is a key component of our growth strategy. We currently have two new freestanding hospitals under development which will add 110 licensed hospital beds. We also have one replacement hospital under development that will increase the previous bed capacity by 19 licensed beds. Pursuant to the Medicare, Medicaid and SCHIP Extension Act of 2007 (the "SCHIP Extension Act"), a three-year moratorium has been imposed on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development. All of the freestanding hospitals that we have under development are exempt from the three-year moratorium established by the SCHIP Extension Act.
- Growing Through Selective Acquisitions – We seek growth opportunities through strategic acquisitions in selected target markets. In 2006, we completed the Commonwealth Transaction, which initially added six hospitals in Massachusetts with a total of 646 licensed beds.
- Sub-Acute Development – We are well positioned to develop sub-acute units in several of our hospitals to broaden our scope of services, promote higher quality care and take advantage of unused capacity. We currently operate six sub-acute units with 371 licensed beds and we have one hospital-based sub-acute unit with 38 licensed beds currently under development.
- Cluster Market Development – We are increasingly focused on the opportunities available to us in markets where we operate multiple hospitals or which have affiliated nursing centers. These cluster markets present opportunities to collaborate between our hospitals and nursing centers by sharing clinical expertise and sales and marketing resources. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.
- Hospital-in-Hospital – We have contracts with non-Kindred short-term acute care and other hospitals to operate LTAC hospitals with the host hospital ("HIH"). Under these arrangements, we lease space and purchase certain ancillary services from the host hospital and provide it with the option to discharge a portion of its clinically appropriate patients into the care of our hospital. These HIHs also receive patients from general short-term acute care hospitals other than the host hospital. At December 31, 2008, we operated 16 HIHs with 692 licensed beds. We have two HIHs under development which will add 79 licensed beds, which are exempt from the three-year moratorium established by the SCHIP Extension Act.

Expanding Program Development. We are a leading provider of long-term acute care to patients with pulmonary dysfunction. In addition, we have developed and continue to expand other inpatient and outpatient service areas such as wound care, post-surgical care, acute rehabilitation and pain management where we believe

opportunities exist to position our hospitals as centers of excellence in given markets. We intend to broaden our expertise beyond pulmonary services and to leverage our leadership position in pulmonary care to expand our market strength to other clinical services. We also intend to expand our sub-acute programs in selected markets.

Increasing Patient Volume, Particularly Commercial Patients. We continue to expand our sales and marketing function to grow same-store admissions and to take advantage of available capacity. We generally receive higher reimbursement rates from commercial insurers as a group than from the Medicare and Medicaid programs. As a result, we work to expand relationships with insurers to increase commercial patient volume. Each of our hospitals employs specialized staff to focus on patient admissions and the patient referral process. We have enhanced our incentive plans and developed additional training programs to improve our sales and marketing function.

Improving Relationships with Referring Providers. Substantially all of the acute and medically complex patients admitted to our hospitals are transferred to us by other healthcare providers such as general short-term acute care hospitals, intensive care units, managed care programs, physicians, nursing centers and home care settings. Accordingly, we are focused on maintaining strong relationships with these providers. In order to maintain these relationships, we employ clinical liaisons that are responsible for coordinating admissions and assessing the nature of services necessary for the proper care of the patient. The clinical liaisons also are responsible for educating healthcare professionals at the referral sources about the unique nature of the services provided by our LTAC hospitals.

Regulatory Developments

The Long-Term Acute Care Prospective Payment System ("LTAC PPS") maintains LTAC hospitals as a distinct provider type, separate from short-term acute care hospitals. Only providers certified as LTAC hospitals may be paid under this system. To maintain certification under LTAC PPS, the average length of stay of fee for service Medicare patients must be at least 25 days.

Pursuant to the SCHIP Extension Act, the Centers for Medicare and Medicaid Services ("CMS") is currently evaluating various certification criteria for designating a hospital as a LTAC hospital. If such certification criteria were developed and enacted into legislation, our hospitals may not be able to maintain their status as LTAC hospitals or may need to adjust their operations.

On August 1, 2007, CMS issued final regulations regarding Medicare hospital inpatient payments to short-term acute care hospitals as well as certain provisions affecting LTAC hospitals. These regulations adopt a new system for classifying patients into diagnostic categories called Medicare Severity Diagnosis Related Groups or more specifically, for LTAC hospitals, "MS-LTC-DRGs." LTAC PPS is based upon discharged-based MS-LTC-DRGs similar to the system used to pay short-term acute care hospitals. This new MS-LTC-DRG system replaces the previous diagnostic related group system for LTAC hospitals and became effective for discharges occurring on or after October 1, 2007. The MS-LTC-DRG system creates additional severity-adjusted categories for most diagnoses, resulting in an expansion of the aggregate number of diagnostic groups from 538 to 745. CMS stated that MS-LTC-DRG weights were developed in a budget neutral manner and as such, the estimated aggregate payments under LTAC PPS would be unaffected by the annual recalibration of MS-LTC-DRG payment weights. For more information regarding reimbursement for our hospitals, see "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

On July 31, 2008, CMS issued final regulations regarding the re-weighting of MS-LTC-DRGs for discharges occurring on or after October 1, 2008. CMS announced that this update was made in a budget neutral manner, and that estimated aggregate LTAC Medicare payments would be unaffected by these regulations. Based upon our limited experience under these final regulations, it appears that the re-weighting increased payments for the care of higher acuity patients.

SCHIP Extension Act.

The SCHIP Extension Act, which became law on December 29, 2007, contains several provisions impacting LTAC hospitals. This legislation provides for, among other things:

(1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria;

(2) enhanced medical necessity review of LTAC hospital cases;

(3) a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development;

(4) a three-year moratorium on an increase in the number of licensed beds at a LTAC hospital or satellite facility, subject to exceptions for states where there is only one other LTAC hospital and upon request following the closure or decrease in the number of licensed beds at a LTAC hospital within the state;

(5) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS;

(6) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 1, 2007;

(7) a three-year moratorium on the application of the so-called "25 Percent Rule" to freestanding LTAC hospitals;

(8) a three-year period during which LTAC hospitals that are co-located with another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS;

(9) a three-year period during which LTAC hospitals that are co-located with an urban single hospital or a hospital that generates more than 25% of the Medicare discharges in a metropolitan statistical area ("MSA Dominant hospital") may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS; and

(10) the elimination of the July 1, 2007 market basket increase in the standard federal payment rate of 0.71%, effective for discharges occurring on or after April 1, 2008.

Recent Rate Adjustments.

On May 2, 2008, CMS issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the "2008 Final Rule") that became effective for discharges occurring on or after July 1, 2008. The 2008 Final Rule projected an overall increase in payments to all Medicare certified LTAC hospitals of approximately 2.5%. Included in the 2008 Final Rule were (1) an increase to the standard federal payment rate of 2.7% (as compared to the adjusted federal rate for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.1%; (3) an increase in the high cost outlier threshold per discharge to $22,960; and (4) an extension of the rate year cycle for one year to September 30, 2009, in order to be consistent thereafter with the federal fiscal year that begins October 1 of each year.

On May 1, 2007, CMS issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the "2007 Final Rule") that became effective for discharges occurring on or after July 1, 2007. The 2007 Final Rule was amended on June 29, 2007 by revising the high cost outlier threshold. The 2007 Final Rule projected an overall decrease in payments to all Medicare certified LTAC hospitals of approximately 1.2%. Included in the 2007 Final Rule were (1) an increase to the standard federal payment rate of 0.71% (which was eliminated for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) revisions to payment methodologies impacting short-stay outliers, which reduce payments by 0.9% (currently subject to a three-year moratorium pursuant to the SCHIP Extension Act); (3) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.5%; (4) an increase in the high cost outlier threshold

per discharge to $20,707, resulting in projected reductions of 0.4%; and (5) an extension of the policy known as the "25 Percent Rule" to all LTAC hospitals (as discussed in more detail below), with a three-year phase-in, which CMS projected would not result in payment reductions for the first year of implementation (also currently subject to a three-year moratorium pursuant to the SCHIP Extension Act).

Rules Impacting Reimbursement to HIHs.

CMS has regulations governing payments to LTAC hospitals that are co-located with another hospital, such as a HIH. The rules generally limit Medicare payments to the HIH if the Medicare 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, urban single and MSA Dominant hospitals. Admissions that exceed this "25 Percent Rule" are paid using the short-term acute care inpatient payment system ("IPPS"). Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non-host hospital, are eligible for the full payment under LTAC PPS. If the HIH's admissions from the host hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of (1) the amount payable under LTAC PPS or (2) the amount payable under IPPS. At December 31, 2008, we operated 16 HIHs with 692 licensed beds.

In the 2007 Final Rule, the so-called "25 Percent Rule" was expanded to all LTAC hospitals, regardless of whether they are co-located with another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid the LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon short-term acute care hospital rates. However, as set forth above, the SCHIP Extension Act has placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals. In addition, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals that are co-located with another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS. See "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

Selected Hospital Division Operating Data

The following table sets forth certain operating and financial data for the hospital division (dollars in thousands, except statistics):

	Year ended December 31,		
	2008	2007	2006
Revenues	$ 1,837,322	$ 1,727,419	$ 1,665,885
Operating income	$ 345,367	$ 365,068	$ 383,802
Hospitals in operation at end of period	82	81	77
Licensed beds at end of period	6,482	6,358	5,990
Admissions	43,936	41,330	39,420
Patient days	1,395,049	1,328,050	1,252,342
Revenues per admission	$ 41,818	$ 41,796	$ 42,260
Revenues per patient day	$ 1,317	$ 1,301	$ 1,330
Average daily census	3,812	3,638	3,431
Average length of stay	31.8	32.1	31.8
Occupancy %	64.8	64.6	64.3
Assets at end of period	$ 847,394	$ 846,429	$ 762,943

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The term "operating income" is defined as earnings before interest, income taxes, depreciation, amortization, rent and corporate overhead. A reconciliation of "operating income" to our consolidated results of operations is included in note 7 of the notes to consolidated financial statements. The term "licensed beds" refers to the maximum number of beds permitted in a facility under its license regardless of whether the beds are actually available for patient care. "Patient days" refers to the total number of days of patient care provided for the periods indicated. "Average daily census" is computed by dividing each facility's patient days by the number of calendar days in the respective period. "Average length of stay" is computed by dividing each facility's patient days by the number of admissions in the respective period. "Occupancy %" is computed by dividing average daily census by the number of operational licensed beds, adjusted for the length of time each facility was in operation during each respective period.

Sources of Hospital Revenues

The hospital division receives payment for its hospital services from third party payors, including government reimbursement programs such as Medicare and Medicaid and non-government sources such as Medicare Advantage, commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. Patients covered by non-government payors generally are more profitable to the hospital division than those covered by the Medicare and Medicaid programs. The following table sets forth the approximate percentages of our hospital admissions, patient days and revenues derived from the payor sources indicated:

	Medicare			Medicaid			Medicare Advantage (a)			Commercial insurance and other		
Year ended December 31,	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues
2008	66%	58%	55%	10%	15%	10%	8%	8%	9%	16%	19%	26%
2007	68	60	58	10	15	10	4	4	4	18	21	28
2006	71	64	61	10	14	10				19	22	29

(a) Data not available prior to April 1, 2007.

For the year ended December 31, 2008, revenues of the hospital division totaled approximately $1.8 billion or 41% of our total revenues (before eliminations). For more information regarding the reimbursement for our hospital services, see "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

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Hospital Facilities

The following table lists by state the number of hospitals and related licensed beds we operated as of December 31, 2008:

		Number of facilities			
State	Licensed beds	Owned by us	Leased from Ventas (2)	Leased from other parties	Total
Arizona	217	–	2	2	4
California	785	4	5	1	10
Colorado	68	–	1	–	1
Florida (1)	685	1	6	2	9
Georgia (1)	72	–	–	1	1
Illinois (1)	545	–	4	1	5
Indiana	119	1	1	–	2
Kentucky (1)	414	–	1	1	2
Louisiana	168	–	1	–	1
Massachusetts (1)	676	–	2	5	7
Missouri (1)	265	–	2	1	3
Nevada	238	1	1	1	3
New Jersey (1)	117	–	–	3	3
New Mexico	61	–	1	–	1
North Carolina (1)	124	–	1	–	1
Ohio	250	–	–	3	3
Oklahoma	93	–	1	1	2
Pennsylvania	393	2	2	3	7
South Carolina (1)	59	–	–	1	1
Tennessee (1)	109	–	1	1	2
Texas	822	2	6	3	11
Virginia (1)	60	–	–	1	1
Washington (1)	80	1	–	–	1
Wisconsin	62	–	–	1	1
Totals	6,482	12	38	32	82

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."
(2) See "– Master Lease Agreements."

Quality Assessment and Improvement

The hospital division maintains a clinical outcomes program which includes a review of its patient population measured against utilization and quality standards, as well as clinical outcomes data collection and patient and family satisfaction surveys. In addition, our hospitals have integrated quality assessment and improvement programs administered by a director of quality management, which encompass quality improvement, infection control and risk management. The objective of these programs is to ensure that patients are managed appropriately in our hospitals and that quality healthcare is provided in a cost-effective manner.

The hospital division has implemented a program whereby its hospitals are reviewed by internal quality auditors for compliance with standards of the Joint Commission. The purposes of this internal review process are to (1) ensure ongoing compliance with industry recognized standards for hospitals, (2) assist management in analyzing each hospital's operations and (3) provide consulting and educational programs for each hospital to identify opportunities to improve patient care.

Hospital Division Management and Operations

Each of our hospitals has a fully credentialed, multi-specialty medical staff to meet the needs of the medically complex, long-term acute patient. Our hospitals offer a broad range of physician services including pulmonology, internal medicine, infectious diseases, neurology, nephrology, cardiology, radiology and pathology. In addition, our hospitals have a multi-disciplinary team of healthcare professionals including a professional nursing staff trained to care for long-term acute patients, respiratory, physical, occupational and speech therapists, pharmacists, registered dietitians and social workers, to address the needs of medically complex patients.

Each hospital utilizes a pre-admission assessment system to evaluate clinical needs and other information in determining the appropriateness of each potential patient admission. After admission, each patient's case is reviewed by the hospital's interdisciplinary team to determine a care plan. Where appropriate, the care plan may involve the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

A hospital chief executive officer or administrator supervises and is responsible for the day-to-day operations at each of our hospitals. Each hospital or network of hospitals also employs a chief financial officer who monitors the financial matters of the hospital or network. Within selected markets having a significant concentration of hospitals, administrative functions such as billing and collections may be shared to improve efficiency. In addition, each hospital or network of hospitals employs a chief clinical officer to oversee the clinical operations and a director of quality management to oversee our quality assurance programs. We provide centralized services in the areas of information systems design and development, training, reimbursement expertise, legal advice, tax, technical accounting support, purchasing and facilities management to each of our hospitals. We believe that this centralization improves efficiency, promotes the standardization of certain processes and allows hospital staff to focus more attention on patient care.

A division president and a chief financial officer manage the hospital division. The operations of the hospitals are divided into an east region, a central region and a west region, each headed by a senior officer of the division who reports to the division president. The clinical issues and quality concerns of the hospital division are managed by the division's chief medical officer and senior vice president of clinical operations.

Hospital Division Competition

In each geographic market that we serve, there are generally several competitors that provide similar services to those provided by our hospital division. In addition, several of the markets in which the hospital division operates have other LTAC hospitals that provide services comparable to those offered by our hospitals. Certain competing hospitals are operated by not-for-profit, non-taxpaying or governmental agencies, which can finance capital expenditures on a tax-exempt basis and receive funds and charitable contributions unavailable to our hospital division.

Competition for patients covered by non-government reimbursement sources is intense. The primary competitive factors in the LTAC hospital business include quality of services, charges for services and responsiveness to the needs of patients, families, payors and physicians. Other companies have entered the LTAC market with licensed hospitals that compete with our hospitals. The competitive position of any hospital also is affected by the ability of its management to negotiate contracts with purchasers of group healthcare services, including managed care companies, preferred provider organizations and health maintenance organizations. Such organizations attempt to obtain discounts from established hospital charges. The importance to a hospital's competitive position of obtaining contracts with preferred provider organizations, health maintenance organizations and other organizations that finance healthcare varies from market to market, depending on the number and market strength of such organizations.

HEALTH SERVICES DIVISION

Our health services division provides quality, cost-effective care through the operation of a national network of 228 nursing centers (28,525 licensed beds) located in 27 states. We are the largest publicly held operator of nursing centers in the United States based upon our fiscal 2008 revenues of approximately $2.2 billion (before eliminations). Through our nursing centers, we provide patients and residents with long-term care services, a full range of pharmacy, medical and clinical services and routine services, including daily dietary, social and recreational services.

Consistent with industry trends, patients and residents admitted to our nursing centers are increasingly more acutely ill and require a more extensive and costly level of care. This is particularly true with our Medicare population, where the average length of stay of these patients in 2008 was 36 days. To appropriately care for a more frail and unstable population, we are taking steps to improve the delivery of the clinical and hospitality services offered to our patients and residents by adjusting the level of clinical and hospitality staffing, assisting physician oversight through the selective use of nurse practitioners and improving clinical case management through the employment of clinical case managers.

We have developed transitional care units at several of our facilities. These discrete units typically consist of 12 to 36 beds offering skilled nursing services and physical, occupational and speech therapy to patients recovering from conditions such as joint replacement surgery and cardiac and respiratory ailments.

At a number of our nursing centers, we offer specialized programs for residents suffering from Alzheimer's disease and other dementias through our Reflections units. We have developed specific certification criteria for these units. These are discrete units operated by teams of professionals that are dedicated to addressing the unique problems experienced by residents with Alzheimer's disease or other dementias. We believe that we are a leading provider of nursing care to residents with Alzheimer's disease and dementia based upon the specialization and size of our program.

We also monitor and enhance the quality of care and customer service at our nursing centers through the use of performance improvement committees as well as family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Physicians serve on these committees as medical directors and advise on healthcare policies and practices. We regularly conduct surveys of residents and their families, and these surveys are reviewed by our performance improvement committees at each facility to promote quality care and customer service.

Substantially all of our nursing centers are certified to provide services under the Medicare and Medicaid programs. Our nursing centers have been certified because the quality of our services, accommodations, equipment, safety, personnel, physical environment and policies and procedures meet or exceed the standards of certification set by those programs.

Health Services Division Strategy

Our goal is to become the provider of choice in the markets we serve, which we believe will allow us to increase our census and enhance our payor mix. We have employed several initiatives to improve the quality of our services and to address the needs of a more acute patient population. The principal elements of our health services division strategy are:

Providing Quality, Clinical-Based Services. The health services division is focused on qualitative and quantitative clinical performance indicators with the goal of providing quality care under the cost containment objectives imposed by government and private payors. In an effort to continually improve the quality of our services and enhance our ability to care for complex and higher acuity residents, we pursue initiatives to:

- improve recruitment, retention, management development, succession planning and employee satisfaction,

- expand the involvement of our medical directors and increase the use of nurse practitioners,
- expand our therapy services, wound care, complex medical care and palliative care programs to improve our ability to care for a more acute patient population,
- improve our processes to monitor and promote our resident care objectives and align financial incentives with quality care and customer service goals,
- increase the number of our transitional care and sub-acute units to treat patients with rehabilitation and complex medical needs,
- improve our Reflections units to care for residents with Alzheimer's disease and other dementias,
- maximize quality outcomes by implementing the collaborative advice and recommendations of the chief medical officer, senior nursing staff and rehabilitation therapists, and
- implement recommendations of our performance improvement committees established at the division, regional and district levels that analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division.

Enhancing Sales and Marketing Programs. We conduct our nursing center marketing efforts, which focus on the quality of care provided at our facilities, at the local market level through our nursing center executive directors, clinical liaisons, admissions coordinators and/or other facility-based sales and marketing personnel. The marketing efforts of our nursing center personnel are supplemented by strategies provided by our divisional, regional and district marketing staffs. We also continue to refocus our marketing efforts to address the difference between the needs of short-term rehabilitation patients and those seeking long-term care. To better promote our services we are:

- concentrating our sales and marketing resources toward our transitional care, sub-acute and Alzheimer's units,
- working to improve our relationships with existing local referral sources and identifying and developing new referral sources and promoting our value proposition,
- expanding the number of clinical liaisons and admission coordinators, particularly at the facility level, and implementing community outreach programs,
- focusing on improving the recruiting, training and retention of sales and marketing personnel and improving accountability,
- retooling our admission and discharge procedures to address a higher volume of short-term admissions, and
- increasingly focusing on the opportunities available to us in markets where we operate multiple nursing centers or which have affiliated hospitals. These cluster markets present opportunities to collaborate between our nursing centers and hospitals by sharing clinical expertise and sales and marketing resources. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.

Increasing Operating Efficiency. The health services division continually seeks to improve operating efficiency with a view to maintaining high quality care. We believe that operating efficiency is critical to maintaining our position as a leading provider of nursing center services in the United States. To improve operating efficiency we strive to:

- increase our average occupancy levels, which leverages our revenues over the fixed costs associated with operating our nursing centers,
- centralize administrative functions such as accounting, payroll, legal, reimbursement, compliance and information systems,

- enhance our quality assurance, risk management and liability claims defense initiatives to address professional liability and workers compensation costs,
- enhance monitoring of our ancillary expenses such as rehabilitation and pharmacy costs as these expenses grow in an environment of higher admissions and higher acuity patients,
- continue to upgrade our management information systems to aid in financial and clinical reporting, and improve billing and collections, and
- manage our labor costs by improving nurse and other staff retention, maintaining competitive labor rates, and reducing reliance on overtime compensation and temporary nursing agency services.

Repositioning Nursing Center Assets. The health services division continually seeks ways to improve its existing portfolio. To reposition our nursing center portfolio, we have:

- de-licensed a total of 588 beds during 2008, allowing us to reduce multiple bed rooms and enhance the quality of life for our residents and improve the marketability of the impacted facilities to Medicare, managed care and private pay patients and residents, and have plans to de-license an additional 258 beds,
- divested 34 underperforming nursing centers with 4,600 licensed beds in the last three years, including the underperforming nursing centers acquired as part of the Facility Acquisitions,
- entered into new leases for eight nursing centers, containing 910 licensed beds, in the San Francisco market, and acquired one nursing center/ assisted living facility containing 160 licensed skilled nursing beds and 82 licensed assisted living beds in 2007,
- acquired 11 nursing centers concentrated in Massachusetts as part of the Commonwealth Transaction in 2006,
- expanded our sub-acute and transitional care units, and
- made significant capital investments to improve our existing facilities.

Selected Health Services Division Operating Data

The following table sets forth certain operating and financial data for the health services division (dollars in thousands, except statistics):

	Year ended December 31,		
	2008	2007	2006
Revenues	$ 2,155,417	$ 2,014,786	$ 1,819,320
Operating income	$ 326,932	$ 296,749	$ 241,852
Nursing centers in operation at end of period:			
Owned or leased	224	224	215
Managed	4	4	5
Licensed beds at end of period:			
Owned or leased	28,040	28,621	27,568
Managed	485	485	605
Patient days (a)	9,171,104	9,095,099	8,761,111
Revenues per patient day (a)	$ 235	$ 222	$ 208
Average daily census (a)	25,058	24,918	24,003
Occupancy % (a)	89.0	87.8	88.3
Assets at end of period	$ 574,710	$ 550,525	$ 427,376

(a) Excludes managed facilities.

Sources of Nursing Center Revenues

Nursing center revenues are derived principally from the Medicare and Medicaid programs and from private and other payors. Consistent with the nursing center industry, changes in the mix of the patient and resident population among these three categories significantly affect the profitability of our nursing center operations. Although higher acuity patients and residents generally produce the most revenue per patient day, profitability with respect to higher acuity patients is impacted by the costs associated with the higher level of nursing care and other services generally required. In addition, these patients usually have a significantly shorter length of stay.

The following table sets forth the approximate percentages of nursing center patient days and revenues derived from the payor sources indicated:

	Medicare		Medicaid		Medicare Advantage (a)		Private and other	
Year ended December 31,	Patient days	Revenues	Patient days	Revenues	Patient days	Revenues	Patient days	Revenues
2008	17%	34%	61%	43%	4%	5%	18%	18%
2007	17	34	63	44			20	22
2006	17	34	64	46			19	20

(a) Data not available prior to January 1, 2008.

For the year ended December 31, 2008, revenues of the health services division totaled approximately $2.2 billion or 49% of our total revenues (before eliminations). For more information regarding the reimbursement for our nursing center services, see "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

Nursing Center Facilities

The following table lists by state the number of nursing centers and related licensed beds we operated as of December 31, 2008:

		Number of facilities				
State	Licensed beds	Owned by us	Leased from Ventas (2)	Leased from other parties	Managed	Total
Alabama (1)	474	–	2	1	–	3
Arizona	691	–	4	1	–	5
California	2,798	4	9	11	–	24
Colorado	464	–	4	–	–	4
Connecticut (1)	736	–	6	–	–	6
Georgia (1)	537	–	4	–	–	4
Idaho	695	1	7	–	–	8
Indiana	3,641	10	13	1	–	24
Kentucky (1)	1,575	2	10	1	–	13
Maine (1)	754	–	8	–	–	8
Massachusetts (1)	4,862	–	26	12	3	41
Missouri (1)	240	–	–	2	–	2
Montana (1)	276	–	2	–	–	2
Nevada	174	–	2	–	–	2
New Hampshire (1)	512	–	3	–	–	3
North Carolina (1)	2,151	–	16	3	–	19
Ohio (1)	1,853	2	9	2	–	13
Oregon (1)	205	–	2	–	–	2
Pennsylvania	103	–	1	–	–	1
Rhode Island (1)	201	–	2	–	–	2
Tennessee (1)	1,065	–	3	5	–	8
Utah	620	–	5	–	–	5
Vermont (1)	310	–	1	–	1	2
Virginia (1)	629	–	4	–	–	4
Washington (1)	659	–	7	–	–	7
Wisconsin (1)	1,922	–	11	1	–	12
Wyoming	378	–	4	–	–	4
Totals	28,525	19	165	40	4	228

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."
(2) See "– Master Lease Agreements."

Health Services Division Management and Operations

Each of our nursing centers is managed by a state-licensed executive director who is supported by other professional personnel, including a director of nursing, nursing assistants, licensed practical nurses, staff development coordinator, activities director, social services director, clinical liaisons, admissions coordinator and business office manager. The directors of nursing are state-licensed nurses who supervise our nursing staffs that include registered nurses, licensed practical nurses and nursing assistants. Staff size and composition vary depending on the size and occupancy of each nursing center, the levels of care provided by the nursing center and the acuity level of the patients. The nursing centers contract with physicians who provide medical director services and serve on performance improvement committees. We provide our facilities with centralized information systems, federal and state reimbursement expertise, state licensing and certification maintenance, as

well as legal, finance, accounting, purchasing and facilities management support. The centralization of these services improves operating efficiencies, promotes the standardization of certain processes and permits facility staff to focus on the delivery of quality care.

Our health services division is managed by a division president and a chief financial officer. Our nursing center operations are divided into three geographic regions, each of which is headed by an operational senior vice president. These three operational senior vice presidents report to the division president. The clinical issues and quality concerns of the health services division are overseen by the division's chief medical officer and senior vice president of clinical operations with assistance from our regional and district teams. The sales and marketing efforts for the division are led by our vice president of sales and marketing with assistance from our regional and district teams. Divisional, regional and/or district staff also support the health services division in the areas of nursing, dietary services, federal and state reimbursement, human resources management, maintenance, and financial services.

Quality Assessment and Improvement

Quality of care is monitored and enhanced by our clinical operations personnel as well as our performance improvement committees and family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Additionally, physicians serve on these committees as medical directors and advise on healthcare policies and practices. Regional and district nursing professionals visit our nursing centers periodically to review practices and recommend improvements where necessary in the level of care provided and to ensure compliance with requirements under applicable Medicare and Medicaid regulations. Surveys of residents' families are conducted on a regular basis and provide an opportunity for families to rate various aspects of service and the physical condition of the nursing centers. These surveys are reviewed by performance improvement committees at each facility to promote and improve resident care.

The health services division provides training programs for nursing center executive directors, business office and other department managers, nurses and nursing assistants. These programs are designed to maintain high levels of quality patient and resident care, with an orientation towards regulatory compliance.

Substantially all of our nursing centers are certified to provide services under the Medicare and Medicaid programs. A nursing center's qualification to participate in such programs depends upon many factors, such as accommodations, equipment, clinical services, safety, personnel, physical environment and adequacy of policies and procedures.

Health Services Division Competition

Our nursing centers compete with other nursing centers and similar long-term care facilities primarily on the basis of quality of care, reputation, location and physical appearance and, in the case of private payment residents, the charges for our services. Our nursing centers also compete on a local and regional basis with other nursing centers as well as with facilities providing similar services, including hospitals, extended care centers, assisted living facilities, home health agencies and similar institutions. Some competitors may operate newer facilities and may provide services that we do not offer. Our competitors include government-owned, religious organization-owned, secular not-for-profit and for-profit institutions. Many of these competitors have greater financial and other resources than we do. Although there is limited, if any, price competition with respect to Medicare and Medicaid residents (since revenues received for services provided to these residents are based generally on fixed rates), there is substantial price competition for private payment residents.

REHABILITATION DIVISION

Our rehabilitation division provides rehabilitative services primarily in long-term care settings, but our customers also include hospitals, school districts, outpatient clinics, home health agencies, assisted living facilities and hospice providers, including the hospitals and nursing centers that we operate. We provide rehabilitative services to 514 nursing centers, 87 hospitals and 54 other locations in 40 states under the name "People*first* Rehabilitation." Approximately 63% of the rehabilitation division's revenues in 2008 were generated from contracts with our hospitals and nursing centers.

Our rehabilitation division employs approximately 8,100 therapists and had revenues of approximately $427 million (before eliminations) in 2008. We are organized into six geographic regions.

Our rehabilitation division provides contract therapy services, including physical, occupational and speech therapies, to residents and patients of nursing centers, hospitals, outpatient clinics, assisted living facilities and school districts. In addition to the standard physical, occupational and speech therapies, we provide specialized rehabilitation programs designed to meet the specific needs of the residents and patients we serve. Our specialized care programs are designed to address complex medical needs, including wound care, pain management, cognitive deficit, neurologic, orthopedic and pulmonary rehabilitation therapies. Other programs we offer include fall prevention and continence improvement.

We provide our customers with the clinical expertise necessary to facilitate positive outcomes for their residents and patients. Rehabilitation services provided to our customers include therapy record completion and documentation review, clinical audit processes, updates regarding regulatory changes and clinical care strategies. We also offer our customers various management services to strengthen their rehabilitation programs, including invoicing systems and a claims tracking system.

We believe that outsourcing therapy services allows our customers to fulfill the continuing need for the recruitment and retention of full-time and part-time therapists and offers our customers the ability to improve the quality of care provided to their residents and patients.

Rehabilitation Division Strategy

Our goals are to be the leading contract rehabilitation services provider and employer of choice in the markets we serve and to increase our market share and name recognition through the expansion of our rehabilitation programs, quality initiatives, and clinical, compliance and recruiting efforts. Our strategies for achieving these goals include:

Maintaining Quality Care and Customer Satisfaction. Our rehabilitation division is committed to providing effective and efficient care to the residents and patients of the nursing centers, hospitals and assisted living facilities that we serve. In this regard, we have taken the following measures to improve the operating efficiency of our customers and to enhance and maintain the quality of care provided to their residents and patients:

- We have specialized programs to promote the quality initiatives of our customers, including Alzheimer's disease and other dementia programs, pain management and orthopedic and neuro rehabilitation.
- We promote the competencies of our therapists by providing extensive training and implementing best practices.
- We take an integrated approach of delivering our services as a key member of the customer's interdisciplinary care team and work to enhance our customer's quality objectives.
- We have developed a proprietary nationwide rehabilitation information system that allows us to access management and clinical reports which provide quality assurance measures, identify industry trends, track patient outcomes and streamline invoicing and reporting.

- We have developed technology enhancements, such as handheld devices, which enable our therapists to be more efficient and to improve our compliance with regulatory documentation.

Effective Recruiting and Retention of Qualified Therapists. The healthcare industry is facing a shortage of qualified therapists. In order to provide the most effective and efficient care to the patients and residents we serve we must recruit and retain qualified therapists. We offer competitive incentive and recognition programs for our therapists and have increased our recruiting infrastructure to reduce open positions, decrease contract labor and improve productivity. We also promote continuing education opportunities to improve patient care and to enhance the personal knowledge, growth and satisfaction of our therapists and encourage their participation in a culture of quality and customer service.

Increasing Operating Efficiency. We seek to improve our operating efficiency by increasing the productivity of our therapists and other rehabilitation staff. We have developed standard division-wide labor productivity tools to monitor and better manage therapist productivity as well as our staffing models. We also have developed technology enhancements, such as handheld devices, which enable our therapists to be more efficient and to improve our compliance with regulatory documentation.

Growing Through Business Development and External Contract Sales. Our growth strategy is focused on the expansion of rehabilitation programs for the customers we currently serve and the development of additional external business in markets where we have a significant presence or where we believe appropriate demand exists for our services. We also believe opportunities exist for new program development in the sub-acute and wound care areas. We plan to increase our market share by demonstrating our value proposition that the quality clinical care and strong customer service provided by People*first* Rehabilitation will enhance the quality and clinical objectives of our customers. We also are developing initiatives to expand our presence in acute care settings. We will continue to promote greater brand recognition of our People*first* services by expanding our sales and marketing strategies and through the use of our People*first* website.

Growing Through Selective Acquisitions. We seek growth opportunities through strategic acquisitions in selected target markets. In 2007, for example, we acquired a rehabilitation services business operating in the states of Maryland and Virginia which had 22 customer contracts and generated approximately $7 million in annual revenues at the time of the acquisition.

Selected Rehabilitation Division Operating Data

The following table sets forth certain operating and financial data for the rehabilitation division (dollars in thousands):

	Year ended December 31,		
	2008	2007	2006
Revenues:			
Company-operated	$ 268,663	$ 239,740	$ 225,936
Non-affiliated	158,657	112,657	74,170
	$ 427,320	$ 352,397	$ 300,106
Operating income	$ 38,071	$ 34,526	$ 30,362
Number of customer contracts:			
Company-operated	310	326	330
Non-affiliated	345	318	229
Therapist productivity %	81.4	79.4	78.1
Assets at end of period	$ 45,733	$ 30,751	$ 10,621

Sources of Rehabilitation Division Revenues

The rehabilitation division receives payment for its services provided to residents and patients of the nursing centers, hospitals and assisted living facilities that we serve. The payments are based upon negotiated patient per diem rates or a negotiated fee schedule based upon the types of services rendered. For the year ended December 31, 2008, revenues of the rehabilitation division totaled approximately $427 million or 10% of our total revenues (before eliminations). As a provider of services to other healthcare providers, trends and developments in healthcare reimbursement will impact our revenues and growth. Changes in the reimbursement provided by Medicare or Medicaid to our customers can impact the demand and price for our services. For more information regarding the reimbursement for our rehabilitation services, see "– Governmental Regulation – Rehabilitation Division – Overview of Rehabilitation Division Reimbursement," "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement," and "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

Geographic Coverage

The following table lists by state the number of hospitals, nursing centers and other rehabilitation customer contracts we serviced as of December 31, 2008:

	Hospitals		Nursing centers		Other	Total	
State	Company operated	Non-affiliated	Company operated	Non-affiliated	Non-affiliated	Company operated	Non-affiliated
Alabama	–	–	3	1	–	3	1
Arizona	4	–	5	3	2	9	5
California	11	–	24	2	–	35	2
Colorado	1	–	4	8	2	5	10
Connecticut	–	–	6	10	–	6	10
Delaware	–	–	–	1	–	–	1
Florida	9	–	–	47	4	9	51
Georgia	1	–	4	1	–	5	1
Iowa	–	–	–	1	–	–	1
Idaho	–	–	8	1	9	8	10
Illinois	5	–	–	21	4	5	25
Indiana	2	–	24	3	11	26	14
Kentucky	2	–	13	17	4	15	21
Louisiana	1	–	–	–	–	1	–
Maine	–	–	8	4	–	8	4
Maryland	–	–	–	13	–	–	13
Massachusetts	7	–	42	12	–	49	12
Michigan	–	1	–	–	–	–	1
Missouri	3	–	2	1	–	5	1
Montana	–	–	2	1	2	2	3
Nebraska	–	–	–	1	–	–	1
Nevada	3	–	2	3	1	5	4
New Hampshire	–	–	3	–	–	3	–
New Jersey	2	–	–	–	–	2	–
New Mexico	1	1	–	–	–	1	1
North Carolina	1	–	19	43	2	20	45
Ohio	3	1	13	19	7	16	27
Oklahoma	2	–	–	–	–	2	–
Oregon	–	–	2	1	–	2	1
Pennsylvania	7	1	1	13	–	8	14
Rhode Island	–	–	2	3	–	2	3
South Carolina	1	–	–	–	–	1	–
Tennessee	1	–	8	7	–	9	7
Texas	11	2	–	13	4	11	19
Utah	–	–	5	–	–	5	–
Vermont	–	–	2	3	–	2	3
Virginia	1	–	4	13	–	5	13
Washington	1	–	7	10	2	8	12
Wisconsin	1	–	12	9	–	13	9
Wyoming	–	–	4	–	–	4	–
Totals	81	6	229	285	54	310	345

Sales and Marketing

The rehabilitation division's marketing and sales strategy focuses on the outsourcing needs of long-term care facilities and hospitals by emphasizing the broad range of rehabilitation programs, clinical expertise, and competitive pricing that we can provide. The rehabilitation division's new business efforts are led by the vice president of business development and six directors of business development in geographically defined regions.

Rehabilitation Division Management and Operations

We have five nursing center and three hospital regions determined predominantly by geography. Each of our rehabilitation programs has an on-site management team that reports to an area rehabilitation director. The area director is responsible for the overall management of eight to 12 on-site managers. The area directors report to their respective regional director or vice president of rehabilitation operations.

We provide our program staff with centralized information systems, federal and state reimbursement expertise, licensing support, as well as legal, finance, accounting and purchasing support. The centralization of these services improves operating efficiencies, promotes the standardization of certain processes and permits program staff to focus on the delivery of quality, medically necessary rehabilitation services.

A division president and a chief financial officer manage our rehabilitation division. A vice president of rehabilitation clinical services manages the clinical education and quality issues for the division.

Rehabilitation Division Competition

In each geographic market that we serve, there are national, regional and local rehabilitation service providers that provide rehabilitation services comparable to those offered by us. Some of our competitors may have greater financial and other resources than us, may be more established in the markets in which we compete and may be willing to provide services at lower prices. In addition, a number of long-term care facilities and hospitals may not elect to outsource rehabilitation services thereby reducing our potential customer base. While there are several large rehabilitation providers, the market generally is highly fragmented and is primarily comprised of smaller independent providers.

We believe our rehabilitation division generally competes on its reputation for providing quality service, pricing and clinical expertise.

MASTER LEASE AGREEMENTS

At December 31, 2008, we leased from Ventas and its affiliates 38 LTAC hospitals and 165 nursing centers under four master lease agreements (as amended, the "Master Lease Agreements"). Under the Master Lease Agreements, Ventas has a right to sever properties from the existing leases in order to create additional leases, a device adopted to facilitate its financing flexibility. In such circumstances, our aggregate lease obligations remain unchanged.

In April 2007, we entered into agreements with Ventas to purchase the Ventas Facilities and to renew the leases for an additional five years for 49 nursing centers (approximately 5,844 licensed beds) and eight LTAC hospitals (approximately 635 licensed beds) (collectively, the "Renewal Facilities") that were scheduled to expire in April 2008. The existing rent payments and the annual escalators were not affected by the renewals. Ventas also agreed that it would not contest the Spin-off Transaction.

We completed the Facility Acquisitions for $171.5 million in June 2007. In addition, we paid Ventas a lease termination fee of $3.5 million. The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax income of approximately $3 million for 2008 and pretax losses of approximately $4 million and $10 million for 2007 and 2006, respectively.

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In connection with the purchase of the Ventas Facilities, we and Ventas agreed to amend the Master Lease Agreements, which became effective immediately. As amended, the Master Lease Agreements include, among other things, the following amendments:

- We have an ongoing right to de-license 35% of the hospital beds in any hospital and 10% of the hospital beds in any Master Lease Agreement for conversion into skilled nursing care beds.
- We are permitted to de-license 912 beds in 70 nursing centers, which will allow us to reduce multiple bed rooms and enhance the quality of life for our residents and improve the marketability of these facilities to Medicare, managed care and private pay patients and residents. During 2008, we de-licensed a total of 574 beds.
- Insurance provisions have been modified (1) to expand the number of third party insurers that are permitted to insure our professional liability exposure and (2) to provide a one-time right for us to commute certain insurance policies that may result in the refund of insurance premiums for prior years.
- Two lease renewal bundles contained in Master Lease Agreement No. 3 were combined.
- Ventas obtained enhanced reporting and inspection rights.

The following summary description of the Master Lease Agreements is qualified in its entirety by reference to the Master Lease Agreements as filed with the Securities and Exchange Commission (the "SEC").

Term and Renewals

Each Master Lease Agreement includes land, buildings, structures and other improvements on the land, easements and similar appurtenances to the land and improvements, and permanently affixed equipment, machinery and other fixtures relating to the operation of the leased properties. There are several bundles of leased properties under each Master Lease Agreement, with each bundle containing approximately six to 20 leased properties. Under the Master Lease Agreements, the leases for 87 nursing centers and 22 LTAC hospitals (which are contained in ten renewal bundles) are scheduled to expire in April 2010 (the "2010 Leases") and the leases for 29 nursing centers and eight LTAC hospitals (which are contained in four renewal bundles) are scheduled to expire in April 2013 (the "2013 Leases"). As noted above, the base term for the Renewal Facilities was initially set to expire in April 2008, but was renewed for an additional five-year term.

At our option, the 2010 Leases and 2013 Leases may be extended for one five-year renewal term beyond the base term at the then existing rental rate plus the then existing escalation amount per annum. If we elect to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed. The renewal notices for the 2010 Leases may be delivered to Ventas between November 1, 2008 and April 29, 2009. The renewal notices for the 2013 Leases may be delivered to Ventas between November 1, 2011 and April 29, 2012. We are currently evaluating whether to renew the 2010 Leases. At the current rental terms, it may be financially and strategically beneficial for us not to renew one or more of the renewal bundles that comprise the 2010 Leases.

If we exercise our first renewal option, we may further extend the term of the 2010 Leases, the 2013 Leases and the Renewal Facilities for two additional five-year renewal terms beyond the first renewal term at the greater of (1) the then existing rental rate plus the then existing escalation amount per annum or (2) the then fair market value rental rate. The fair market value rental rate is determined through an appraisal procedure set forth in the Master Lease Agreements. The rental rate during the first renewal term and any additional renewal term in which rent due is based upon the then existing rental rate will escalate each year during such term(s) at the applicable escalation rate.

We may not extend the Master Lease Agreements beyond the base term or any previously exercised renewal term if, at the time we seek such extension and at the time such extension takes effect, (1) an event of default has occurred and is continuing or (2) a Medicare/Medicaid event of default (as described below) and/or a licensed

bed event of default (as described below) has occurred and is continuing with respect to three or more leased properties subject to a particular Master Lease Agreement. The base term and renewal term of each Master Lease Agreement are subject to termination upon default by us (subject to certain exceptions) and certain other conditions described in the Master Lease Agreements.

Rental Amounts and Escalators

Each Master Lease Agreement is commonly known as a triple-net lease or an absolute-net lease. Accordingly, in addition to rent, we are required to pay the following: (1) all insurance required in connection with the leased properties and the business conducted on the leased properties, (2) certain taxes levied on or with respect to the leased properties (other than taxes on the net income of Ventas) and (3) all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties.

Under the Master Lease Agreements, the annual aggregate base rent owed by us currently approximates $242 million. We paid rents to Ventas (including amounts classified as discontinued operations) approximating $239 million for the year ended December 31, 2008, $238 million for the year ended December 31, 2007 and $214 million for the year ended December 31, 2006.

In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements which increased the aggregate annual rents by approximately $33 million (including the Ventas Facilities) and became effective retroactively to July 19, 2006. The new aggregate annual rents were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under each of the Master Lease Agreements. As required, Ventas paid us a reset fee of approximately $4.6 million that will be amortized as a reduction of rent expense over the remaining original terms of the Master Lease Agreements. In connection with the exercise of the rent reset, the new annual rents were allocated among the facilities subject to the Master Lease Agreements in accordance with the determinations made by the final appraisers during the rent reset process.

Each Master Lease Agreement provides for rent escalations each May 1 if the patient revenues for the leased properties meet certain criteria as measured using the preceding calendar year revenues as compared to the base period. All annual rent escalators are payable in cash. In connection with the exercise of the rent reset by Ventas, the rent escalations were modified. The new contingent annual rent escalator is 2.7% for Master Lease Agreements Nos. 1, 3 and 4. The new contingent annual rent escalator for Master Lease Agreement No. 2 is based upon the Consumer Price Index with a floor of 2.25% and a ceiling of 4%. In 2008, the contingent annual rent escalator for Master Lease Agreement No. 2 was 4%. Prior to the rent reset, the contingent annual Ventas rent escalator under each Master Lease Agreement was 3.5%.

Use of the Leased Property

The Master Lease Agreements require that we utilize the leased properties solely for the provision of healthcare services and related uses and as Ventas may otherwise consent. We are responsible for maintaining or causing to be maintained all licenses, certificates and permits necessary for the leased properties to comply with various healthcare and other regulations. We also are obligated to operate continuously each leased property as a provider of healthcare services.

Events of Default

Under each Master Lease Agreement, an "Event of Default" will be deemed to occur if, among other things:

- we fail to pay rent or other amounts within five days after notice,
- we fail to comply with covenants, which failure continues for 30 days or, so long as diligent efforts to cure such failure are being made, such longer period (not over 180 days) as is necessary to cure such failure,

- certain bankruptcy or insolvency events occur, including filing a petition of bankruptcy or a petition for reorganization under the bankruptcy code,
- an event of default arises from our failure to pay principal or interest on any indebtedness exceeding $50 million,
- the maturity of any indebtedness exceeding $50 million is accelerated,
- we cease to operate any leased property as a provider of healthcare services for a period of 30 days,
- a default occurs under any guaranty of any lease or the indemnity agreements with Ventas,
- we or our subtenant lose any required healthcare license, permit or approval or fail to comply with any legal requirements as determined by a final unappealable determination,
- we fail to maintain insurance,
- we create or allow to remain certain liens,
- we breach any material representation or warranty,
- a reduction occurs in the number of licensed beds in a facility, generally in excess of 10% (or less than 10% if we have voluntarily "banked" licensed beds) of the number of licensed beds in the applicable facility on the commencement date (a "licensed bed event of default"),
- Medicare or Medicaid certification with respect to a participating facility is revoked and re-certification does not occur for 120 days (plus an additional 60 days in certain circumstances) (a "Medicare/Medicaid event of default"),
- we become subject to regulatory sanctions as determined by a final unappealable determination and fail to cure such regulatory sanctions within the specified cure period for any facility,
- we fail to cure a breach of any permitted encumbrance within the applicable cure period and, as a result, a real property interest or other beneficial property right of Ventas is at material risk of being terminated, or
- we fail to cure the breach of any of the obligations of Ventas as lessee under any existing ground lease within the applicable cure period and, if such breach is a non-monetary, non-material breach, such existing ground lease is at material risk of being terminated.

Remedies for an Event of Default

Except as noted below, upon an Event of Default under one of the Master Lease Agreements, Ventas may, at its option, exercise the following remedies:

(1) after not less than ten days notice to us, terminate the Master Lease Agreement to which such Event of Default relates, repossess any leased property, relet any leased property to a third party and require that we pay to Ventas, as liquidated damages, the net present value of the rent for the balance of the term, discounted at the prime rate,

(2) without terminating the Master Lease Agreement to which such Event of Default relates, repossess the leased property and relet the leased property with us remaining liable under such Master Lease Agreement for all obligations to be performed by us thereunder, including the difference, if any, between the rent under such Master Lease Agreement and the rent payable as a result of the reletting of the leased property, and

(3) seek any and all other rights and remedies available under law or in equity.

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In addition to the remedies noted above, under the Master Lease Agreements, in the case of a facility-specific event of default, Ventas may terminate a Master Lease Agreement as to the leased property to which the Event of Default relates, and may, but need not, terminate the entire Master Lease Agreement. Each of the Master Lease Agreements includes special rules relative to Medicare/Medicaid events of default and a licensed bed event of default. In the event a Medicare/Medicaid event of default and/or a licensed bed event of default occurs and is continuing (a) with respect to not more than two properties at the same time under a Master Lease Agreement that covers 41 or more properties and (b) with respect to not more than one property at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, Ventas may not exercise termination or dispossession remedies against any property other than the property or properties to which the event of default relates. Thus, in the event Medicare/Medicaid events of default and licensed bed events of default would occur and be continuing (a) with respect to one property under a Master Lease Agreement that covers less than 20 properties, (b) with respect to two or more properties at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, or (c) with respect to three or more properties at the same time under a Master Lease Agreement that covers 41 or more properties, then Ventas would be entitled to exercise all rights and remedies available to it under the Master Lease Agreements.

Assignment and Subletting

Except as noted below, the Master Lease Agreements provide that we may not assign, sublease or otherwise transfer any leased property or any portion of a leased property as a whole (or in substantial part), including by virtue of a change of control, without the consent of Ventas, which may not be unreasonably withheld if the proposed assignee (1) is a creditworthy entity with sufficient financial stability to satisfy its obligations under the related Master Lease Agreement, (2) has not less than four years experience in operating healthcare facilities for the purpose of the applicable facility's primary intended use, (3) has a favorable business and operational reputation and character, and (4) has all licenses, permits, approvals and authorizations to operate the facility and agrees to comply with the use restrictions in the related Master Lease Agreement. The obligation of Ventas to consent to a subletting or assignment is subject to the reasonable approval rights of any mortgagee and/or the lenders under its credit agreement. We may sublease up to 20% of each leased property for restaurants, gift shops and other stores or services customarily found in hospitals or nursing centers without the consent of Ventas, subject, however, to there being no material alteration in the character of the leased property or in the nature of the business conducted on such leased property.

In addition, each Master Lease Agreement allows us to assign or sublease (a) without the consent of Ventas, 10% of the nursing center facilities in each Master Lease Agreement and (b) with Ventas's consent (which consent will not be unreasonably withheld, delayed or conditioned), two hospitals in each Master Lease Agreement, if either (i) the applicable regulatory authorities have threatened to revoke our Medicaid or Medicare certification or an authorization necessary to operate such leased property or (ii) we cannot profitably operate such leased property. Any such proposed assignee/sublessee must satisfy the requirements listed above and it must have all licenses, permits, approvals and other authorizations required to operate the leased properties in accordance with the applicable permitted use. With respect to any assignment or sublease made under this provision, Ventas agrees to execute a nondisturbance and attornment agreement with such proposed assignee or subtenant. Upon any assignment or subletting, we will not be released from our obligations under the applicable Master Lease Agreement.

Subject to certain exclusions, we must pay to Ventas 80% of any consideration received by us on account of an assignment and 80% (50% in the case of existing subleases) of sublease rent payments (approximately equal to revenue net of specified allowed expenses attributable to a sublease, and specifically defined in the Master Lease Agreements), provided that Ventas's right to such payments will be subordinate to that of our lenders.

Ventas will have the right to approve the purchaser at a foreclosure of one or more of our leasehold mortgages by our lenders. Such approval will not be unreasonably withheld so long as such purchaser is creditworthy, reputable and has four years experience in operating healthcare facilities. Any dispute regarding whether Ventas has unreasonably withheld its consent to such purchaser will be subject to expedited arbitration.

GOVERNMENTAL REGULATION

Medicare and Medicaid

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over and certain disabled persons. Medicaid is a medical assistance program administered by each state pursuant to which healthcare benefits are available to certain indigent or disabled patients. Within the Medicare and Medicaid statutory framework, there are substantial areas subject to administrative rulings, interpretations and discretion that may affect payments made under Medicare and Medicaid. A substantial portion of our revenues are derived from patients covered by the Medicare and Medicaid programs. See "– Hospital Division – Sources of Hospital Revenues," "– Health Services Division – Sources of Nursing Center Revenues" and "– Rehabilitation Division – Sources of Rehabilitation Division Revenues."

We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. In addition, we cannot assure you that the facilities operated by us, or the provision of goods and services offered by us, will meet the requirements for participation in such programs. In addition, there are continuing efforts to reform governmental healthcare programs that could result in major changes in the healthcare delivery and reimbursement system on a national and state level and we cannot assure you that healthcare reform, future healthcare legislation or other changes in the administration or interpretation of governmental healthcare programs will not have a material adverse effect on our business, financial position, results of operations and liquidity. See "Item 1A – Risk Factors – Risk Factors Relating to Reimbursement and Regulation of Our Businesses – Changes in the reimbursement rates or methods or timing of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins."

Federal, State and Local Regulation

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities, allowable costs, services and prices for services, facility staffing requirements, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other governmental programs. Sanctions for violating these anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations, including enhanced medical necessity review of LTAC hospital cases pursuant to the SCHIP Extension Act and audits under the CMS Recovery Audit Contractor ("RAC") program which was made permanent and required to be expanded pursuant to the Tax Relief and Health Care Act of 2006. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bars on Medicare and Medicaid payments for new admissions and civil monetary penalties. Such sanctions could have a material adverse effect on our business, financial position, results of operations and liquidity. We vigorously contest such sanctions where appropriate; however, these cases can involve significant legal expense and consume our resources.

Section 1877 of the Social Security Act, commonly known as "Stark I," states that a physician who has a financial relationship with a clinical laboratory generally is prohibited from referring patients to that laboratory. The Omnibus Budget Reconciliation Act of 1993 contains provisions, commonly known as "Stark II," amending Section 1877 to expand greatly the scope of Stark I. Effective January 1995, Stark II broadened the referral limitations of Stark I to include, among other designated health services, inpatient and outpatient hospital services. Under Stark I and Stark II, a "financial relationship" is defined as an ownership interest or a compensation arrangement. If such a financial relationship exists, the entity generally is prohibited from claiming payment for services under the Medicare or Medicaid programs. Compensation arrangements generally are exempted from Stark I and Stark II if, among other things, the compensation to be paid is set in advance, does not exceed fair market value and is not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties. The U.S. Department of Health and Human Services has issued regulations that describe some of the conduct and business relationships permissible under the anti-kickback amendments. The fact that a given business arrangement does not fall within one of these safe harbors does not render the arrangement per se illegal. Business arrangements of healthcare service providers that fail to satisfy the applicable criteria, however, risk increased scrutiny and possible sanctions by enforcement authorities. These laws and regulations, however, are complex, and there is limited judicial or regulatory interpretation. We believe that business practices of providers and financial relationships between providers have become subject to increased scrutiny as healthcare reform efforts continue on the federal and state levels. Many states have adopted or are considering similar legislative proposals, some of which extend beyond the Medicaid program, to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of the source of payment for the care. While we do not believe our arrangements are in violation of these prohibitions, we cannot assure you that governmental officials charged with the responsibility for enforcing the provisions of these prohibitions will not assert that one or more of our arrangements are in violation of the provisions of such laws and regulations.

The Balanced Budget Act of 1997 (the "Balanced Budget Act") also includes a number of anti-fraud and abuse provisions. The Balanced Budget Act contains additional civil monetary penalties for violations of the anti-kickback amendments discussed above and imposes an affirmative duty on healthcare providers to ensure that they do not employ or contract with persons excluded from the Medicare program. The Balanced Budget Act also provides a minimum ten-year period for exclusion from participation in federal healthcare programs for persons or entities convicted of a prior healthcare offense.

Various states in which we operate hospitals and nursing centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals, including nurses, certified nurse's assistants, therapists and other staff. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

HIPAA. The federal Health Insurance Portability and Accountability Act of 1996, commonly known as "HIPAA," broadens the scope of existing fraud and abuse laws to include all health plans, whether or not they are reimbursed under federal programs. In addition, HIPAA also mandates the adoption of regulations aimed at standardizing transaction formats and billing codes for documenting medical services, dealing with claims submissions and protecting the privacy and security of individually identifiable health information. HIPAA regulations that standardize transactions and code sets require standard formatting for healthcare providers, like us, that submit claims electronically.

The HIPAA privacy regulations apply to "protected health information," which is defined generally as individually identifiable health information transmitted or maintained in any form or medium, excluding certain education records and student medical records. The privacy regulations seek to limit the use and disclosure of

most paper and oral communications, as well as those in electronic form, regarding an individual's past, present or future physical or mental health or condition, or relating to the provision of healthcare to the individual or payment for that healthcare, if the individual can or may be identified by such information. HIPAA provides for the imposition of civil and/or criminal penalties if protected health information is improperly disclosed.

HIPAA's security regulations require us to ensure the confidentiality, integrity, and availability of all electronically protected health information that we create, receive, maintain or transmit. We must protect against reasonably anticipated threats or hazards to the security of such information and the unauthorized use or disclosure of such information. The HIPAA unique health identifier standards require us to obtain and use national provider identifiers.

We believe we are in substantial compliance with the HIPAA regulations. Sanctions for failing to comply with HIPAA health information practices provisions include criminal penalties and/or civil sanctions. We cannot assure you that our compliance with the HIPAA regulations will not have a material adverse effect on our business, financial position, results of operations and liquidity.

Certificates of Need and State Licensing. Certificate of need, or CON, regulations control the development and expansion of healthcare services and facilities in certain states. Certain states also require regulatory approval prior to certain changes in ownership of a hospital or nursing center. Certain states that do not have CON programs may have other laws or regulations that limit or restrict the development or expansion of healthcare facilities. We operate hospitals in 12 states and nursing centers in 18 states that require state approval for the expansion of our facilities and services under CON programs. To the extent that CONs or other similar approvals are required for expansion of the operations of our hospitals or nursing centers, either through facility acquisitions, expansion or provision of new services or other changes, such expansion could be affected adversely by the failure or inability to obtain the necessary approvals, changes in the standards applicable to such approvals or possible delays and expenses associated with obtaining such approvals.

We are required to obtain state licenses to operate each of our hospitals and nursing centers and to ensure their participation in government programs. Once a hospital or nursing center becomes licensed and operational, it must continue to comply with federal, state and local licensing requirements in addition to local building and life-safety codes. All of our hospitals and nursing centers have the necessary licenses. Failure of our hospitals and nursing centers to satisfy applicable licensure and certification requirements could have a material adverse effect on our business, financial position, results of operations and liquidity.

Hospital Division

General Regulations. The hospital division is subject to various federal and state regulations. In order to receive Medicare reimbursement, each hospital must meet the applicable conditions of participation set forth by the U.S. Department of Health and Human Services relating to the type of hospital, its equipment, personnel and standard of medical care, as well as comply with state and local laws and regulations. We have developed a management system to facilitate our compliance with these various standards and requirements. Among other things, each hospital employs a person who is responsible for leading an ongoing quality assessment and improvement program. Hospitals undergo periodic on-site Medicare certification surveys, which generally are limited in frequency if the hospital is accredited by the Joint Commission. As of December 31, 2008, 81 hospitals operated by the hospital division were certified as Medicare LTAC providers and one hospital has a pending certification as a Medicare short-term acute care provider. In addition, 68 hospitals also were certified by their respective state Medicaid programs. Loss of certification could affect adversely a hospital's ability to receive payments from the Medicare and Medicaid programs.

As noted above, the hospital division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the

referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed above. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Accreditation by the Joint Commission. Hospitals may receive accreditation from the Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals. Generally, hospitals and certain other healthcare facilities are required to have been in operation at least four months in order to be eligible for accreditation by the Joint Commission. After conducting on-site surveys, the Joint Commission awards accreditation for up to three years to hospitals found to be in substantial compliance with Joint Commission standards. Accredited hospitals also are periodically resurveyed, at the option of the Joint Commission, upon a major change in facilities or organization and after merger or consolidation. As of December 31, 2008, all of the hospitals operated by the hospital division were accredited by the Joint Commission or were in the process of seeking accreditation. The hospital division intends to seek and obtain Joint Commission accreditation for any additional facilities it may operate in the future.

Peer Review. Federal regulations provide that admission to and utilization of hospitals by Medicare and Medicaid patients must be reviewed by peer review organizations or quality improvement organizations in order to ensure efficient utilization of hospitals and services. A quality improvement organization may conduct such review either prospectively or retroactively and may, as appropriate, recommend denial of payments for services provided to a patient. The review is subject to administrative and judicial appeals. Each of the hospitals operated by our hospital division employs a clinical professional to administer the hospital's integrated quality assurance and improvement program. Denials by quality improvement organizations historically have not had a material adverse effect on the hospital division's operating results.

Overview of Hospital Division Reimbursement

Medicare Reimbursement of Short-term Acute Care Hospitals – Medicare reimburses general short-term acute care hospitals under a prospective payment system. Under the short-term acute care prospective payment system, Medicare inpatient costs are reimbursed based upon a fixed payment amount per discharge using medical severity diagnostic related groups ("MS-DRGs"). The MS-DRG payment under the short-term prospective payment system is based upon the national average cost of treating a Medicare patient's condition. Although the average length of stay varies for each MS-DRG, we believe that the average stay for all Medicare patients subject to the short-term prospective payment system is approximately six days. An additional outlier payment is made for patients with higher treatment costs but these payments are designed only to cover marginal costs. Hospitals that are certified by Medicare as LTAC hospitals are excluded from the short-term prospective payment system.

Medicare Reimbursement of Long-term Acute Care Hospitals – Since October 2002, the Medicare payment system for LTAC hospitals has been based upon LTAC PPS, a prospective payment system specifically for LTAC hospitals. LTAC PPS maintains LTAC hospitals as a distinct provider type, separate from short-term acute care hospitals. Only providers certified as LTAC hospitals may be paid under this system. To maintain certification under LTAC PPS, the average length of stay of fee for service Medicare patients must be at least 25 days. Under the previous system, compliance with the 25-day average length of stay threshold was based upon all patient discharges. Pursuant to the SCHIP Extension Act, CMS is currently evaluating various certification criteria for designating a hospital as a LTAC hospital. If such certification criteria were developed and enacted into legislation, our hospitals may not be able to maintain their status as LTAC hospitals or may need to adjust their operations.

On August 1, 2007, CMS issued final regulations regarding Medicare hospital inpatient payments to short-term acute care hospitals as well as certain provisions affecting LTAC hospitals. These regulations adopt a new system for LTAC hospitals for classifying patients into diagnostic categories called "MS-LTC-DRGs." LTAC PPS is based upon discharged-based MS-LTC-DRGs similar to the system used to pay short-term acute care hospitals. This new MS-LTC-DRG system replaces the previous diagnostic related group system for LTAC hospitals and became effective for discharges occurring on or after October 1, 2007. The MS-LTC-DRG system creates additional severity-adjusted categories for most diagnoses, resulting in an expansion of the aggregate number of diagnostic groups from 538 to 745. CMS stated that MS-LTC-DRG weights were developed in a budget neutral manner and as such, the estimated aggregate payments under LTAC PPS would be unaffected by the annual recalibration of MS-LTC-DRG payment weights.

While the clinical system which groups procedures and diagnoses is identical to the prospective payment system for short-term acute care hospitals, LTAC PPS utilizes different rates and formulas. Three types of payments are used in this system: (a) short-stay outlier payment, which provides for patients whose length of stay is less than 5/6th of the geometric mean length of stay for that MS-LTC-DRG, based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) a blend of an amount comparable to what would otherwise be paid under IPPS computed as a per diem, capped at the full IPPS MS-DRG comparable payment amount and a per diem based upon the average payment for that MS-LTC-DRG under LTAC PPS; (b) MS-LTC-DRG fixed payment which provides a single payment for all patients with a given MS-LTC-DRG, regardless of length of stay, cost of care or place of discharge; and (c) high cost outlier that will provide a partial coverage of costs for patients whose cost of care far exceeds the MS-LTC-DRG reimbursement. For patients in the high cost outlier category, Medicare will reimburse 80% of the costs incurred above the MS-LTC-DRG reimbursement plus a fixed cost outlier threshold per discharge.

On July 31, 2008, CMS issued final regulations regarding the re-weighting of MS-LTC-DRGs for discharges occurring on or after October 1, 2008. CMS announced that this update was made in a budget neutral manner, and that estimated aggregate LTAC Medicare payments would be unaffected by these regulations. Based upon our limited experience under these final regulations, it appears that the re-weighting increased payments for the care of higher acuity patients.

For discharges occurring on or after July 1, 2007 and before December 29, 2007, certain short-stay outlier cases having a length of stay less than or equal to a predetermined IPPS threshold were reimbursed based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) an amount comparable to what would otherwise be paid under IPPS. These very short-stay payment provisions were suspended for three years beginning with discharges on or after December 29, 2007, pursuant to the SCHIP Extension Act.

LTAC PPS provides for an adjustment for differences in area wages resulting from salary and benefit variations. There also are additional rules for payment for patients who are transferred from a LTAC hospital to another healthcare setting and are subsequently re-admitted to the LTAC hospital. The LTAC PPS payment rates also are subject to annual adjustments.

Medicare regulations require that when two or more hospital facilities share the same provider number and are considered to be a single hospital, the "remote" or "satellite" facility must meet certain criteria with respect to the "main" facility. These criteria relate largely to demonstrating a high level of integration between the two facilities. If the criteria are not met, each facility would need to meet all Medicare requirements independently, including, for example, the minimum average length of patient stay for LTAC hospital qualification. It is advantageous for certain satellite facilities that may not independently be able to meet these Medicare requirements to maintain provider-based status so that they will be reimbursed at the higher rate for LTAC hospitals under Medicare. If CMS determines that facilities claiming to be provider-based and being reimbursed accordingly do not meet the integration requirements of the regulations, CMS may recover the amount of any excess reimbursements based upon that claimed status. We have several hospitals in which multiple facilities

share a Medicare provider number, and the failure of any one or more of them to meet the provider-based status regulations could materially and adversely affect our business, financial position, results of operations and liquidity.

We cannot predict the ultimate long-term impact of LTAC PPS. This payment system is subject to significant change. Slight variations in patient acuity or length of stay could significantly change Medicare revenues generated under LTAC PPS. In addition, our hospitals may not be able to appropriately adjust their operating costs to changes in patient acuity and length of stay or to changes in reimbursement rates. In addition, we cannot assure you that LTAC PPS will not have a material adverse effect on revenues from non-government third party payors. Various factors, including a reduction in average length of stay, have negatively impacted revenues from non-government third party payors in recent years.

SCHIP Extension Act.

The SCHIP Extension Act became law on December 29, 2007. This legislation provides for, among other things:

(1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria;

(2) enhanced medical necessity review of LTAC hospital cases;

(3) a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development;

(4) a three-year moratorium on an increase in the number of licensed beds at a LTAC hospital or satellite facility, subject to exceptions for states where there is only one other LTAC hospital and upon request following the closure or decrease in the number of licensed beds at a LTAC hospital within the state;

(5) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS;

(6) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 1, 2007;

(7) a three-year moratorium on the application of the so-called "25 Percent Rule" to freestanding LTAC hospitals;

(8) a three-year period during which LTAC hospitals that are co-located with another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS;

(9) a three-year period during which LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS; and

(10) the elimination of the July 1, 2007 market basket increase in the standard federal payment rate of 0.71%, effective for discharges occurring on or after April 1, 2008.

Recent Rate Adjustments.

On May 2, 2008, CMS issued the 2008 Final Rule that became effective for discharges occurring on or after July 1, 2008. The 2008 Final Rule projected an overall increase in payments to all Medicare certified LTAC hospitals of approximately 2.5%. Included in the 2008 Final Rule were (1) an increase to the standard federal payment rate of 2.7% (as compared to the adjusted federal rate for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.1%; (3) an increase in the high cost outlier threshold per discharge to $22,960; and (4) an extension of the rate year cycle for one year to September 30, 2009, in order to be consistent thereafter with the federal fiscal year that begins October 1 of each year.

On May 1, 2007, CMS issued the 2007 Final Rule that became effective for discharges occurring on or after July 1, 2007. The 2007 Final Rule was amended on June 29, 2007 by revising the high cost outlier threshold. The 2007 Final Rule projected an overall decrease in payments to all Medicare certified LTAC hospitals of approximately 1.2%. Included in the 2007 Final Rule were (1) an increase to the standard federal payment rate of 0.71% (which was eliminated for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) revisions to payment methodologies impacting short-stay outliers, which reduce payments by 0.9% (currently subject to a three-year moratorium pursuant to the SCHIP Extension Act); (3) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.5%; (4) an increase in the high cost outlier threshold per discharge to $20,707, resulting in projected reductions of 0.4%; and (5) an extension of the policy known as the "25 Percent Rule" to all LTAC hospitals (as discussed in more detail below), with a three-year phase-in, which CMS projected would not result in payment reductions for the first year of implementation (also currently subject to a three-year moratorium pursuant to the SCHIP Extension Act).

On May 2, 2006, CMS issued final regulatory changes regarding Medicare reimbursement to LTAC hospitals (the "2006 Final Rule") that significantly reduced Medicare revenues to our hospitals associated with short-stay outliers and high cost outliers. The 2006 Final Rule also eliminated the annual market basket adjustment. The 2006 Final Rule became effective for discharges occurring after June 30, 2006. The 2006 Final Rule also extended until July 1, 2008 CMS's authority to impose a one-time prospective budget neutrality adjustment to LTAC hospital rates.

Rules Impacting Reimbursement to HIHs.

CMS has regulations governing payments to LTAC hospitals that are co-located with another hospital, such as a HIH. The rules generally limit Medicare payments to the HIH if the Medicare 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, urban single and MSA Dominant hospitals. Admissions that exceed this "25 Percent Rule" are paid using IPPS. Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non-host hospital, are eligible for the full payment under LTAC PPS. If the HIH's admissions from the host hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of (1) the amount payable under LTAC PPS or (2) the amount payable under IPPS.

In the 2007 Final Rule, the so-called "25 Percent Rule" was expanded to all LTAC hospitals, regardless of whether they are co-located with another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon short-term acute care hospital rates. However, as set forth above, the SCHIP Extension Act has placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals. In addition, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals that are co-located with another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS.

Under the 2007 Final Rule, the 25% threshold was to be phased in over three years. Hospitals having fiscal years beginning on or after July 1, 2007 and before July 1, 2008, including most of our hospitals, had their admission cap initially established at the lesser of 75% of Medicare referrals or the actual percentage of Medicare referrals received from a primary referral source for that hospital in the base year of 2005. For most of our hospitals, this initial first year cap began on September 1, 2007. Beginning on September 1, 2008, the cap would have been reduced to the lesser of 50% of Medicare referrals or the actual percentage of Medicare referrals for that hospital in the 2005 base year. The fully phased-in cap of 25% would have applied to most of our hospitals after September 1, 2009.

Medicaid Reimbursement of Long-term Acute Care Hospitals – The Medicaid program is designed to provide medical assistance to individuals unable to afford care. Medicaid payments are made under a number of different systems, which include cost-based reimbursement, prospective payment systems or programs that negotiate payment levels with individual hospitals. Medicaid programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by state agencies and certain government funding limitations, all of which may increase or decrease the level of payments to our hospitals.

Non-government Payment – The hospital division seeks to maximize the number of non-government payment patients admitted to its hospitals, including those covered under commercial insurance and managed care health plans. Non-government payment patients typically have financial resources (including insurance coverages) to pay for their services and do not rely on government programs for support. It is important to our business to establish relationships with commercial insurers, managed care health plans and other private payors and to maintain our reputation with such payors as a provider of quality patient and resident care. We negotiate contracts with purchasers of group healthcare services, including private employers, commercial insurers and managed care companies. Some payor organizations attempt to obtain discounts from established charges. We focus on demonstrating to these payors how our services can provide them and their customers with the most viable pricing arrangements in circumstances where they may otherwise be faced with funding treatment at higher rates at other healthcare providers. The importance of obtaining contracts with commercial insurers, managed care health plans and other private payors varies among markets, depending on such factors as the number of commercial payors and their relative market strength. Failure to obtain contracts with certain commercial insurers and managed care health plans or reductions in payments for our services provided to individuals covered by commercial insurance could have a material adverse effect on our business, financial position, results of operations and liquidity.

Health Services Division

General Regulations. The development and operation of nursing centers and the provision of healthcare services are subject to federal, state and local laws relating to the adequacy of medical care, equipment, personnel, operating policies, fire prevention, rate-setting and compliance with building codes and environmental laws. Nursing centers are subject to periodic inspection by governmental and other authorities to ensure continued compliance with various standards, continued licensing under state law, certification under the Medicare and Medicaid programs and continued participation in the Veterans Administration program. The failure to obtain, maintain or renew any required regulatory approvals or licenses could adversely affect nursing center operations including their financial results.

As noted above, the health services division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

In certain circumstances, federal law mandates that conviction for certain abusive or fraudulent behavior with respect to one nursing center may subject other facilities under common control or ownership to disqualification from participation in the Medicare and Medicaid programs. In addition, some regulations provide that all nursing centers under common control or ownership within a state are subject to being delicensed if any one or more of such facilities are delicensed.

Licensure and Requirements for Participation. The nursing centers operated and managed by the health services division are licensed either on an annual or bi-annual basis and generally are certified annually for participation in Medicare and Medicaid programs through various regulatory agencies that determine compliance with federal, state and local laws. These legal requirements relate to compliance with the laws and regulations governing the operation of nursing centers including the quality of nursing care, the qualifications of the administrative and nursing personnel, and the adequacy of the physical plant and equipment. Federal regulations determine the survey process for nursing centers that is followed by state survey agencies. The state survey agencies recommend to CMS the imposition of federal sanctions and impose state sanctions on facilities for noncompliance with certain requirements. Available sanctions include, but are not limited to, imposition of civil monetary penalties, temporary suspension of payment for new admissions, appointment of a temporary manager, suspension of payment for eligible patients and suspension or decertification from participation in the Medicare and Medicaid programs.

We believe that substantially all of our nursing centers are in substantial compliance with applicable Medicare and Medicaid requirements of participation. In the ordinary course of business, however, the nursing centers periodically receive statements of deficiencies from regulatory agencies. In response, the nursing centers implement plans of correction to address the alleged deficiencies. In most instances, the regulatory agency accepts the nursing center's plan of correction and places the nursing center back into compliance with regulatory requirements. In some cases, the regulatory agency may take a number of adverse actions against the nursing center, including the imposition of fines, temporary suspension of admission of new residents to the nursing center, decertification from participation in the Medicaid and/or Medicare programs and, in extreme circumstances, revocation of the nursing center's license.

Overview of Health Services Division Reimbursement

Medicare – The Medicare Part A program provides reimbursement for extended care services furnished to Medicare beneficiaries who are admitted to nursing centers after at least a three-day stay in an acute care hospital. Covered services include supervised nursing care, room and board, social services, physical, speech and occupational therapies, pharmaceuticals, supplies and other necessary services provided by nursing centers. Medicare payments to our nursing centers are based upon certain resource utilization grouping ("RUG") payment rates developed by CMS that provide various levels of reimbursement based upon patient acuity.

The Balanced Budget Act established a Medicare prospective payment system ("PPS") for nursing centers for cost reporting periods beginning on or after July 1, 1998. The payments received under PPS cover substantially all services for Medicare residents including all ancillary services, such as respiratory therapy, physical therapy, occupational therapy, speech therapy and certain covered pharmaceuticals.

Prior to the implementation of PPS, the costs of ancillary services were reimbursed under cost-based reimbursement rules. Various legislative and regulatory actions provided a measure of relief from the impact of the Balanced Budget Act. In April 2000, the Balanced Budget Refinement Act (the "BBRA") implemented a 20% upward adjustment in the payment rates for the care of higher acuity patients. The 20% upward adjustment in the payment rates for the care of higher acuity patients under the BBRA remained in effect until a revised RUGs payment system was established by CMS. On July 28, 2005, CMS published the final rules related to the revised RUGs payment system for nursing centers. Among other things, these rules provided for a 3.1% inflation update to all RUGs categories effective October 1, 2005. In addition, effective January 1, 2006, these rules increased the indexing of RUG categories, expanded the total RUG categories from 44 to 53 and eliminated the 20% payment add-on for the care of higher acuity patients that had been in effect since 2000 under the BBRA.

On February 1, 2006, Congress passed the Deficit Reduction Act of 2005. This legislation provided for, among other things, an annual $1,740 Medicare Part B outpatient therapy cap that was effective on January 1, 2006. CMS subsequently increased the therapy cap to $1,780 on January 1, 2007 and to $1,810 on January 1, 2008. The legislation also required CMS to implement a broad process for reviewing medically necessary

therapy claims, creating an exception to the cap. The exception process, which was set to expire on January 1, 2007, was included in the Tax Relief and Health Care Act of 2006 and continued to function as an exception to the Medicare Part B outpatient therapy cap until January 1, 2008. The SCHIP Extension Act further extended the Medicare Part B outpatient therapy cap until June 30, 2008. The Medicare Improvements for Patients and Providers Act of 2008, enacted on July 15, 2008, extended the therapy cap exception process from July 1, 2008 to December 31, 2009.

On January 1, 2006, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("Medicare Part D") implemented a major expansion of the Medicare program through the introduction of a prescription drug benefit. Under Medicare Part D, dual eligible patients have their outpatient prescription drug costs covered by this new Medicare benefit, subject to certain limitations. Most of our nursing center patients whose drug costs were previously covered by state Medicaid programs are dual eligible patients who qualify for the Medicare drug benefit. Accordingly, Medicaid is no longer a primary payor for the pharmacy services provided to these residents.

Medicaid – Medicaid is a state-administered program financed by state funds and matching federal funds. The program provides for medical assistance to the indigent and certain other eligible persons. Although administered under broad federal regulations, states are given flexibility to construct programs and payment methods consistent with their individual goals. Accordingly, these programs differ in many respects from state to state.

The health services division provides to eligible individuals Medicaid-covered services consisting of nursing care, room and board and social services. In addition, states may at their option cover other services such as physical, occupational and speech therapies and pharmaceuticals. Medicaid programs also are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by the state agencies and certain government funding limitations, all of which may materially increase or decrease the level of program payments to nursing centers operated by the health services division. We believe that the payments under many of these programs may not be sufficient on an overall basis to cover the costs of serving certain patients participating in these programs. In addition, budgetary pressures impacting state fiscal budgets may further reduce Medicaid payments to our nursing centers from current levels.

There continue to be legislative and regulatory proposals that would impose further limitations on government and private payments to providers of healthcare services. The Balanced Budget Act eased existing impediments on the ability of states to reduce their Medicaid reimbursement levels. Many states are considering or have enacted measures that are designed to reduce their Medicaid expenditures and to make certain changes to private healthcare insurance. As states face budgetary issues, we anticipate further pressure on Medicaid rates that could negatively impact payments to our nursing center operations.

In addition, some states seek to increase the levels of funding contributed by the federal government to their Medicaid programs through a mechanism known as a provider tax. Under these programs, states levy a tax on healthcare providers, which increases the amount of state revenue available to expend on the Medicaid program. This increase in program revenues increases the payment made by the federal government to the state in the form of matching funds. Consequently, the state then has more funds available to support Medicaid rates for providers of Medicaid covered services. Provider tax plans are subject to approval by the federal government and were included as a provision in the Tax Relief and Health Care Act of 2006, codifying the maximum Medicaid provider tax rate at 5.5% through fiscal year 2011. Although these plans have been approved in the past, we cannot assure you that such plans will be approved by the federal government in the future.

Non-government Payment – The health services division seeks to maximize the number of non-government payment residents admitted to our nursing centers, including those covered under private insurance and managed care health plans. Non-government payment residents typically have financial resources (including insurance coverages) to pay for their monthly services and do not rely on government programs for support. It is important to our business to establish relationships with commercial insurers, managed care health

plans and other private payors and to maintain our reputation with such payors as a provider of quality patient and resident care. We negotiate contracts with purchasers of group healthcare services, including private employers, commercial insurers and managed care companies. Some payor organizations attempt to obtain discounts from established charges. We focus on demonstrating to these payors how our services can provide them and their customers with the most viable pricing arrangements in circumstances where they may otherwise be faced with funding treatment at higher rates at other healthcare providers. The importance of obtaining contracts with commercial insurers, managed care health plans and other private payors varies among markets, depending on such factors as the number of commercial payors and their relative market strength. Failure to obtain contracts with certain commercial insurers and managed care health plans or reductions in payments for our services provided to individuals covered by commercial insurance could have a material adverse effect on our business, financial position, results of operations and liquidity.

Rehabilitation Division

General Regulations. The rehabilitation division is subject to various federal and state regulations. Therapists and other healthcare professionals we employ are required to be individually licensed or certified under applicable state law. We take measures to ensure that our therapists and other healthcare professionals are properly licensed or certified. In addition, we require our therapists and other employees to participate in continuing education programs. The failure to obtain, maintain or renew required licenses or certifications by our therapists or our other healthcare professionals could adversely affect our operations, including our financial results.

As noted above, the rehabilitation division is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the antifraud and anti-kickback laws discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers. Some states also prohibit for-profit corporations from practicing therapy services through therapists directly employed by the corporation or otherwise providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of eligibility to contract with long-term care facilities, hospitals and other providers participating in Medicare, Medicaid and other federal healthcare programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Overview of Rehabilitation Division Reimbursement

The rehabilitation division receives payment for its services provided to patients and residents of the nursing centers, hospitals, outpatient centers, assisted living facilities and schools that we serve. The payments are based upon negotiated patient per diem rates or a negotiated fee schedule based upon the type of service rendered.

As noted above, various federal and state laws and regulations govern reimbursement to long-term care facilities, hospitals and other healthcare providers participating in Medicare, Medicaid and other federal healthcare programs. Though these laws and regulations are generally not applicable to our rehabilitation division, they are applicable to our customers. If our customers fail to comply with these laws and regulations they could be subject to possible sanctions, including loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties, which could materially and adversely affect our business, financial position, results of operations and liquidity. In addition, there continue to be legislative and regulatory proposals to contain healthcare costs by imposing further limitations on government and private payments to providers of healthcare services.

On February 1, 2006, Congress passed the Deficit Reduction Act of 2005. This legislation provided for, among other things, an annual $1,740 Medicare Part B outpatient therapy cap that was effective on January 1, 2006. CMS subsequently increased the therapy cap to $1,780 on January 1, 2007 and to $1,810 on January 1,

2008. The legislation also required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. The exception process, which was set to expire on January 1, 2007, was included in the Tax Relief and Health Care Act of 2006 and continued to function as an exception to the Medicare Part B outpatient therapy cap until January 1, 2008. The SCHIP Extension Act further extended the Medicare Part B outpatient therapy cap until June 30, 2008. The Medicare Improvements for Patients and Providers Act of 2008, enacted on July 15, 2008, extended the therapy cap exception process from July 1, 2008 to December 31, 2009.

Reductions in the reimbursement provided to our customers by Medicare or Medicaid could negatively impact the demand and price for our services and could have a material adverse effect on our rehabilitation revenues and growth prospects.

ADDITIONAL INFORMATION

Employees

As of December 31, 2008, we had approximately 38,900 full-time and 14,800 part-time and per diem employees. We had approximately 2,800 unionized employees at 32 of our facilities as of December 31, 2008.

The market for qualified nurses, therapists and other healthcare professionals is highly competitive. We, like other healthcare providers, have experienced difficulties in attracting and retaining qualified personnel such as nurses, certified nurse's assistants, nurse's aides, therapists and other providers of healthcare services. Our hospitals and nursing centers are particularly dependent on nurses for patient care. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract personnel. We expect to continue to experience increases in our labor costs primarily due to higher wages and greater benefits required to attract and retain qualified healthcare personnel. Salaries, wages and benefits were approximately 58% of our consolidated revenues for the year ended December 31, 2008. Our ability to manage labor costs will significantly affect our future operating results.

Professional and General Liability Insurance

Our healthcare operations are primarily insured for professional and general liability risks by our wholly owned limited purpose insurance subsidiary, Cornerstone Insurance Company ("Cornerstone"). Cornerstone insures initial losses up to specified coverage levels per occurrence and in the aggregate. On a per claim basis, coverages for losses in excess of those insured by Cornerstone are maintained through unaffiliated commercial insurance carriers. Effective January 1, 2003, Cornerstone insures all claims in all states up to a per occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk.

We believe that our insurance is adequate in amount and coverage. There can be no assurance that in the future such insurance will be available at a reasonable price or that we will be able to maintain adequate levels of professional and general liability insurance coverage.

Where You Can Find More Information

We file annual, quarterly and special reports, proxy statements and other information with the SEC under the Exchange Act.

You also may read or obtain copies of this information in person or by mail from the SEC's Public Reference Room, 100 F Street, NE, Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our filings with the SEC also are available to the public on the SEC website at *http://www.sec.gov*, which contains reports, proxy and information statements and other information. You also may inspect reports, proxy statements and other information about us at the office of the NASD, Inc. at 1735 K Street, N.W., Washington, D.C. 20006.

Our filings with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments thereto, are available free of charge on our website, through a link to the SEC's website, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. In addition, our corporate governance guidelines, code of conduct, and charters for our audit, compliance and quality, executive compensation, and nominating and governance committees of our board of directors are available on our website and upon request of our Corporate Secretary. Our website is *www.kindredhealthcare.com*. Information made available on our website is not a part of this document.

In addition, you may request a copy of our SEC filings (excluding exhibits) at no cost by writing or telephoning us at the following address or telephone number:

Kindred Healthcare, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: Investor Relations
(502) 596-7300

Item 1A. ***Risk Factors***

Certain statements made in this Annual Report on Form 10-K and the documents we incorporate by reference in this Annual Report on Form 10-K include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements regarding our 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 you must recognize that actual results may differ materially from our expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based upon management's current expectations and include known and unknown risks, uncertainties and other factors, many of which we are unable to predict or control, that may cause our 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 our filings with the SEC. Factors that may affect our plans or results include, without limitation:

- changes in the reimbursement rates or the methods or timing of payment from third party payors, including the Medicare and Medicaid programs, changes arising from and related to LTAC PPS, including potential changes in the Medicare payment rules, Medicare Part D and changes in Medicare and Medicaid reimbursements for our nursing centers,
- the impact of the SCHIP Extension Act, including the ability of our hospitals to adjust to potential LTAC certification, medical necessity reviews and the three-year moratorium on future hospital development,
- the effects of healthcare reform and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry,
- failure of our facilities to meet applicable licensure and certification requirements,
- the further consolidation of managed care organizations and other third party payors,
- our ability to meet our rental and debt service obligations,
- our ability to operate pursuant to the terms of our debt obligations and the Master Lease Agreements,
- adverse developments with respect to our results of operations or liquidity,

- the condition of the financial markets, including volatility and deterioration in the equity, capital and credit markets, which could limit the availability and terms of debt and equity financing sources to fund the requirements of our businesses, or which could negatively impact our investment portfolio,
- national and regional economic, financial, business and political conditions, including their effect on the availability and cost of labor, credit, materials and other services,
- our ability to control costs, particularly labor and employee benefit costs,
- increased operating costs due to shortages in qualified nurses, therapists and other healthcare personnel,
- our ability to attract and retain key executives and other healthcare personnel,
- the increase in the costs of defending and insuring against alleged professional liability claims and our ability to predict the estimated costs related to such claims, including the impact of differences in actuarial assumptions and estimates compared to eventual outcomes,
- our ability to successfully reduce (by divestiture of operations or otherwise) our exposure to professional liability claims,
- our ability to successfully pursue our development activities and successfully integrate new operations, including the realization of anticipated revenues, economies of scale, cost savings and productivity gains associated with such operations,
- our ability to successfully dispose of unprofitable facilities,
- events or circumstances which could result in impairment of an asset or other charges,
- changes in generally accepted accounting principles or practices, and
- our ability to maintain an effective system of internal control over financial reporting.

Many of these factors are beyond our control. We caution you that any forward-looking statements made by us are not guarantees of future performance. We disclaim 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.

You should consider carefully all the risks described below, together with all of the information included in this Annual Report on Form 10-K, in evaluating our Company and our common stock. To facilitate your consideration of all of the risks described below, these risks are organized under headings and subheadings for your convenience. If any of the risks described in this Annual Report on Form 10-K were to occur, it could have a material adverse effect on our business, financial position, results of operations, liquidity and stock price.

Risk Factors Relating to Reimbursement and Regulation of Our Businesses

Changes in the reimbursement rates or methods or timing of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins.

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for substantially all of our revenues. For the year ended December 31, 2008, we derived approximately 65% of our total revenues (before eliminations) from the Medicare and Medicaid programs and the balance from other third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Item 1 – Business."

Private third party payors are continuing their efforts to control healthcare costs through direct contracts with healthcare providers, increased utilization review and greater enrollment in managed care programs and preferred provider organizations. These private payors increasingly are demanding discounted fee structures and are requesting that healthcare providers assume more financial risk.

There are continuing efforts to reform governmental healthcare programs that could result in major changes in the healthcare delivery and reimbursement system on a national and state level, including changes directly impacting the reimbursement systems for our LTAC hospitals and nursing facilities. Though we cannot predict what, if any, reform proposals will be adopted, healthcare reform and legislation may have a material adverse effect on our business, financial position, results of operations and liquidity through decreasing funds available for our services. We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. Future changes in third party payor reimbursement rates or methods, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our net operating revenues. Our operating margins may continue to be under pressure because of deterioration in pricing flexibility, changes in payor mix, changes in length of stay and growth in operating expenses in excess of increases in payments by third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients is limited. These results could have a material adverse effect on our business, financial position, results of operations and liquidity.

We conduct business in a heavily regulated industry, and changes in regulations, the enforcement thereof or violations of regulations may result in increased costs or sanctions that reduce our revenues and profitability.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations.

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities, allowable costs, services and prices for services, facility staffing requirements, qualifications and licensure of staff, environmental and occupational health and safety, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other governmental programs. Sanctions for violating the anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid. See "Item 1 – Business – Governmental Regulation."

We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, audits, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bans on Medicare and Medicaid payments for new admissions and civil monetary penalties. RAC audits and other audits evaluating the medical necessity of services provided are expected to further intensify the regulatory environment surrounding the healthcare industry as third party firms engaged by CMS commence extensive reviews of claims data and medical and other records to identify improper payments to healthcare providers under the Medicare program. If we fail to comply with the extensive laws and regulations applicable to our businesses, we could become ineligible to receive government program reimbursement, suffer civil or criminal penalties or be required to make significant changes to our operations. In addition, we could be forced to expend considerable resources responding to an investigation, audit or other enforcement action under these laws or regulations. Furthermore, should we lose the licenses for one or more of our facilities as a result of regulatory action or otherwise, we could be in default under our Master Lease Agreements and our revolving credit facility. Failure of our staff to satisfy

applicable licensure requirements or of our hospitals and nursing centers to satisfy applicable licensure and certification requirements could have a material adverse effect on our business, financial position, results of operations and liquidity.

We are unable to predict the future course of federal, state and local regulation or legislation, including Medicare and Medicaid statutes and regulations, or the intensity of federal and state enforcement actions. Changes in the regulatory framework and sanctions from various enforcement actions could have a material adverse effect on our business, financial position, results of operations and liquidity.

If our LTAC hospitals fail to maintain their certification as long-term acute care hospitals, our profitability would likely decline.

If our LTAC hospitals, satellite LTAC facilities or HIHs fail to meet or maintain conditions for participation in the Medicare program and the standards for certification as LTAC hospitals, such as average minimum length of patient stay, they will receive payments under the prospective payment system applicable to general acute care hospitals rather than payment under the system applicable to LTAC hospitals. Payments at rates applicable to general acute care hospitals would result in our LTAC hospitals receiving less Medicare reimbursement than they currently receive for their patient services and our profitability would likely decrease. In addition, implementation of additional LTAC hospital certification criteria and medical necessity reviews may limit the population of patients eligible for our services or change the basis on which we are paid which could have a material adverse effect on our business, financial position, results of operations and liquidity. Furthermore, the SCHIP Extension Act has imposed a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development.

We face periodic reviews, audits and investigations under our contracts with federal and state government agencies and private payors, and these audits could have adverse findings that may negatively impact our business.

As a result of our participation in the Medicare and Medicaid programs, we are subject to various governmental reviews, audits and investigations to verify our compliance with these programs and applicable laws and regulations. We also are subject to audits under various government programs, including the RAC program, in which third party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments to healthcare providers under the Medicare program. Private pay sources also reserve the right to conduct audits. Our costs to respond to and defend reviews, audits and investigations may be significant and could have a material adverse effect on our business, financial position, results of operations and liquidity. Moreover, an adverse review, audit or investigation could result in:

- required refunding or retroactive adjustment of amounts we have been paid pursuant to the Medicare or Medicaid programs or from private payors;
- state or federal agencies imposing fines, penalties and other sanctions on us;
- loss of our right to participate in the Medicare or Medicaid programs or one or more private payor networks; or
- damage to our reputation in various markets.

These results could have a material adverse effect on our business, financial position, results of operations and liquidity.

Healthcare reform and regulations could adversely affect the liquidity of our customers, which could have an adverse effect on their ability to make timely payments to us for our products and services.

Healthcare reform or other regulations that limit or restrict Medicare and Medicaid payments to our customers could adversely impact the liquidity of our customers, resulting in their inability to pay us, or to timely pay us, for our products and services. In addition, if our customers fail to comply with applicable laws and

regulations they could be subject to possible sanctions, including loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These developments could have a material adverse effect on our business, financial position, results of operations and liquidity.

Further consolidation of managed care organizations and other third party payors may adversely affect our profits.

Managed care organizations and other third party payors have continued to consolidate in order to enhance their ability to influence the delivery of healthcare services. Consequently, the healthcare needs of a large percentage of the U.S. population are increasingly served by a smaller number of managed care organizations. These organizations generally enter into service agreements with a limited number of providers for needed services. In addition, private payors, including managed care payors, increasingly are demanding discounted fee structures. To the extent that these organizations terminate us as a preferred provider, engage our competitors as a preferred or exclusive provider or demand discounted fee structures, our business, financial position, results of operations and liquidity could be materially and adversely affected.

Risks Factors Relating to Our Capital and Liquidity

We may not be able to meet our substantial rent and debt service requirements.

A substantial portion of our cash flows from operations is dedicated to the payment of rents related to our leased properties as well as principal and interest obligations on our outstanding indebtedness, including our revolving credit facility. Subject to certain restrictions, we also have the ability to incur substantial additional borrowings under our revolving credit facility. If we are unable to generate sufficient funds to meet our obligations, we may be required to refinance, restructure or otherwise amend some or all of such obligations, sell assets or raise additional cash through the sale of our equity. We cannot assure you that we would be able to obtain such refinancing on terms as favorable as our current financing or that such restructuring activities, sales of assets or issuances of equity can be accomplished or, if accomplished, would raise sufficient funds to meet these obligations. In addition, our Master Lease Agreements and/or our revolving credit facility:

- require us to dedicate a substantial portion of our cash flow to payments on our rent and interest obligations, thereby reducing the availability of cash flow to fund working capital, capital expenditures and other general corporate activities,
- require us to pledge as collateral substantially all of our assets,
- require us to maintain a certain defined fixed payment ratio at a specified level, thereby reducing our financial flexibility,
- require us to limit the amount of capital expenditures we can incur in any fiscal year and also limits the aggregate amount we can expend on acquisitions, and
- require us to operate continuously each leased property despite its level of profitability and otherwise restrict our operational flexibility.

These provisions:

- could have a material adverse effect on our ability to withstand competitive pressures or adverse economic conditions (including adverse regulatory changes),
- could affect adversely our ability to make material acquisitions, obtain future financing or take advantage of business opportunities that may arise, and
- could increase our vulnerability to a downturn in general economic conditions or in our business.

Our failure to pay rent or otherwise comply with the provisions of any of our Master Lease Agreements could materially adversely affect our business, financial position, results of operations and liquidity.

We currently lease 38 of our hospitals and 165 of our nursing centers from Ventas under our Master Lease Agreements. Our failure to pay the rent or otherwise comply with the provisions of any of our Master Lease Agreements would result in an "Event of Default" under such Master Lease Agreement and also would result in a default under our revolving credit facility. Upon an Event of Default, remedies available to Ventas include, without limitation, terminating such Master Lease Agreement, repossessing and reletting the leased properties and requiring us to remain liable for all obligations under such Master Lease Agreement, including the difference between the rent under such Master Lease Agreement and the rent payable as a result of reletting the leased properties, or requiring us to pay the net present value of the rent due for the balance of the term of such Master Lease Agreement. The exercise of such remedies would have a material adverse effect on our business, financial position, results of operations and liquidity.

For additional information on the Master Lease Agreements, see "Item 1 – Business – Master Lease Agreements."

The condition of the financial markets, including volatility and deterioration in the equity, capital and credit markets, could limit the availability and terms of debt and equity financing sources to fund the capital and liquidity requirements of our businesses.

Financial markets experienced significant disruptions in 2008, which continue in 2009. These disruptions have impacted liquidity in the debt markets, making financing terms for borrowers less attractive and, in certain cases, significantly reducing the availability of certain types of debt financing. Despite the recent turmoil within the financial markets nationally and globally, we are not aware of any individual lender limitations to extend credit under our revolving credit facility. However, the obligations of each of the lending institutions in our revolving credit facility are separate and the availability of future borrowings under our revolving credit facility could be impacted by the ongoing volatility and disruptions in the financial credit markets or other events. While the term of our revolving credit facility is through July 2012, we cannot assure you that a prolonged downturn in the credit markets or other circumstances will not impact our ability to access our revolving credit facility or to refinance the credit facility. Our inability to access our revolving credit facility or refinance the credit facility would have a material adverse effect on our business, financial position, results of operations and liquidity.

Interest rates under our revolving credit facility are based, at our option, upon (a) the London Interbank Offered Rate ("LIBOR") plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. Higher interest rates could have a material adverse effect on our business, financial position, results of operations and liquidity. Moreover, current market conditions and our level of leverage raise the risk that we would not be able to refinance or amend our existing revolving credit facility to address higher interest rates.

Our revolving credit facility is collateralized by substantially all of our assets including certain owned real property and is guaranteed by substantially all of our subsidiaries. The terms of our revolving credit facility include one financial covenant and certain other provisions that limit acquisitions and annual capital expenditures. We were in compliance with the terms of our revolving credit facility at December 31, 2008. A downturn in operating earnings, however, could impair our ability to comply with the financial covenants contained within our revolving credit facility. If we anticipated a potential financial or other covenant violation, however, we would seek relief from our lenders, which likely would include some cost to us, and such relief may not be on terms as favorable as those in our existing revolving credit facility. Under these circumstances, there is also the potential that our lenders would not grant relief to us. A default due to the violation of a financial or other covenant contained within our revolving credit facility or the occurrence of an "Event of Default" under the Master Lease Agreements could require us to immediately repay all amounts then outstanding under the revolving credit facility.

Though we anticipate that the cash amounts generated internally, together with amounts available under our revolving credit facility, will be sufficient to implement our business plan for the foreseeable future, we may need additional capital if a substantial acquisition or other growth opportunity becomes available or if unexpected events occur or opportunities arise. We cannot assure you that additional capital will be available, or available on terms favorable to us. If capital is not available, we may not be able to fund internal or external business expansion or respond to competitive pressures or other market conditions. If available, we may obtain additional capital through the public or private sale of debt or equity securities. However, our ability to access the public debt or equity capital markets, on terms favorable to us or at all, may be limited by further disruptions in these markets or other events. If we sell equity securities, the transaction could be dilutive to our existing shareholders. Furthermore, these securities could have rights, preferences and privileges more favorable than those of our common stock. If we incur additional debt, our leverage would increase and could have a material adverse effect on our business, financial position, results of operations and liquidity.

Disruptions in the financial markets could negatively impact our investment portfolio.

Recent financial market disruptions have impacted the value of equity investments, bonds and other securities. We regularly hold cash in depository and money market accounts. If the financial institutions holding or managing these accounts fail or experience other disruptions, we could lose a portion or all of our cash which could have a material adverse effect on our business, financial position, results of operations and liquidity. In addition, we hold a substantial investment portfolio in our wholly owned limited purpose insurance subsidiary. Investments held in our wholly owned limited purpose insurance subsidiary consist principally of cash and cash equivalents, asset backed securities, corporate bonds, U.S. Treasury notes, equities and commercial paper that are held to satisfy the payment of claims and expenses related to professional liability and workers compensation risks. Our investment policy governing insurance subsidiary investments precludes the investment portfolio managers from selling any security at a loss without prior authorization from us. The investment managers also limit the exposure to any one issue, issuer or type of investment. We intend, and have the ability, to hold insurance subsidiary investments for a long duration without the necessity of selling securities to fund the underwriting needs of our insurance subsidiary. This ability to hold securities should allow sufficient time for recovery of temporary declines in the market value of equity securities and the par value of debt securities as of their stated maturity date. We cannot assure you, however, that we will recover declines in the market value of our investments. Furthermore, we cannot assure you that declines in the market value of our investments will not require us to further capitalize our wholly owned limited purpose insurance subsidiary or otherwise have a material adverse effect on our business, financial position, results of operations and liquidity.

Our stock price is volatile and fluctuations in our operating results, quarterly earnings and other factors may result in declines in the price of our common stock.

Equity markets are experiencing extreme price and volume fluctuations. This volatility has had a significant impact on the market price of securities issued by many companies, including us and companies in the healthcare industry. If we are unable to operate our businesses as profitably as we have in the past or as our stockholders expect us to in the future, the market price of our common stock will likely decline as stockholders could sell shares of our common stock when it becomes apparent that the market expectations may not be realized. In addition to our operating results, many economic and other factors beyond our control could have an adverse effect on the price of our common stock and increase fluctuations in our quarterly earnings.

As a result of market volatility and declines in the price of our common stock, we may fail to satisfy the listing standards of the New York Stock Exchange (the "NYSE"), the NASDAQ Stock Market or stock indexes that measure the market price of our common stock. Failing to satisfy such standards could lead to further declines in the market price of our common stock. In addition, market volatility and declines in the price of our common stock could have a material adverse effect on our ability to obtain capital or complete acquisitions through the public or private sale or issuance of our equity securities.

In addition, security holders often institute class action litigation following periods of volatility in the price of a company's securities. If the market value of our common stock experiences adverse fluctuations and we become a party to this type of litigation, regardless of the outcome, we could incur substantial legal costs and our management's attention could be diverted from the operation of our business, causing our business to decline.

Risk Factors Relating to Our Operations

We could experience significant increases to our operating costs due to shortages of qualified nurses, therapists and other healthcare professionals or union activity.

The market for qualified nurses, therapists and other healthcare professionals is highly competitive. We, like other healthcare providers, have experienced difficulties in attracting and retaining qualified personnel such as nurses, certified nurse's assistants, nurse's aides, therapists and other providers of healthcare services. Our hospitals and nursing centers are particularly dependent on nurses for patient care. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract personnel.

In addition, healthcare providers are continuing to see an increase in the amount of union activity across the country. At December 31, 2008, approximately 2,800 of the employees at 32 of our facilities were unionized. Though we cannot predict the degree to which we will be affected by future union activity, there are continuing legislative proposals that could result in increased union activity.

Various states in which we operate hospitals and nursing centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

We expect to continue to experience increases in our labor costs primarily due to higher wages and greater benefits required to attract and retain qualified healthcare personnel. Salaries, wages and benefits were approximately 58% of our consolidated revenues for the year ended December 31, 2008. Our ability to manage labor costs will significantly affect our future operating results.

If we lose our key management personnel, we may not be able to successfully manage our business and achieve our objectives.

Our future success depends in large part upon the leadership and performance of our executive management team and key employees. Our future performance will be substantially dependent on our ability to retain and motivate these individuals. Competition for these individuals is intense and there can be no assurance that we will retain our key officers and employees or that we can attract or retain other highly qualified individuals in the future. If we lose the services of one or more of our key officers or employees, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives and we may not be able to replace them with similarly qualified personnel. The loss of any of our key officers or employees could have a material adverse effect on our business, financial position, results of operations and liquidity.

If we fail to attract patients and residents and compete effectively with other healthcare providers or if our referral sources fail to view us as an attractive long-term healthcare provider, our revenues and profitability may decline.

The long-term healthcare services industry is highly competitive. Our hospitals face competition from healthcare providers that provide services comparable to those offered by our hospitals. Many competing hospitals are larger and more established than our hospitals. We may experience increased competition from

existing hospitals as well as hospitals converted, in whole or in part, to specialized care facilities. Our nursing centers compete on a local and regional basis with other nursing centers and other long-term healthcare providers. Some of our competitors operate newer facilities and may offer services not provided by us or are operated by entities having greater financial and other resources than us. Our rehabilitation division competes with national, regional and local rehabilitation service providers within our markets. Several of these competitors may have greater financial and other resources than us, may be more established in the markets in which we compete and may be willing to provide services at lower prices. We cannot assure you that increased competition in the future will not adversely affect our business, financial position, results of operations and liquidity.

In addition, we rely significantly on appropriate referrals from physicians, hospitals and other healthcare providers in the communities in which we deliver our services to attract appropriate patients and residents. Our referral sources are not obligated to refer business to us and may refer business to other healthcare providers. We believe many of our referral sources refer patients and residents to us as a result of the quality of our patient service and our efforts to establish and build a relationship with them. If any of our facilities fail to achieve or maintain a reputation for providing high quality care, or are perceived to provide a lower quality of care than comparable facilities within the same geographic area, or customers of our rehabilitation therapy services perceive that they could receive higher quality services from other providers, our ability to attract and retain patients at such facility could be adversely affected. We believe that the perception of our quality of care by potential residents or patients or their families seeking to contract for our services is influenced by a variety of factors, including physician and other healthcare professional referrals, community information and referral services, newspapers and other print and electronic media, results of patient surveys, recommendations from family and friends, and published quality care statistics compiled by CMS or other industry data. If we lose, or fail to maintain, existing relationships with our referral resources, fail to develop new relationships or if we are perceived by our referral sources for any reason as not providing high quality patient care, the quality of our patient mix could suffer and our revenue and profitability could decline.

Significant legal actions could subject us to increased operating costs and substantial uninsured liabilities, which could materially and adversely affect our business, financial position, results of operations and liquidity.

We incur significant costs for professional liability claims, particularly in our nursing center and hospital operations. In addition to large compensatory claims, plaintiffs' attorneys increasingly are seeking significant punitive damages and attorney's fees. Furthermore, there are continuing efforts to limit the ability of healthcare providers to utilize arbitration as a process to resolve professional liability claims. As a result of these factors, our professional liability costs are significant and can be unpredictable.

We insure a substantial portion of our professional liability risks primarily through a wholly owned limited purpose insurance subsidiary. Provisions for loss for our professional liability risks are based upon management's best available information including actuarially determined estimates. 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 liabilities 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. Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between our estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. Differences between the ultimate claims costs and our historical provisions for loss and actuarial assumptions and estimates could have a material adverse effect on our business, financial position, results of operations and liquidity.

Our limited purpose insurance subsidiary insures initial losses up to specified coverage levels per occurrence and in the aggregate. On a per claim basis, coverages for losses in excess of those insured by the limited purpose insurance subsidiary are maintained through unaffiliated commercial insurance carriers. Effective January 1, 2003, the limited purpose insurance subsidiary insures all claims in all states up to a per

occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk. We maintain professional and general liability insurance in amounts and coverage that management believes are sufficient for our operations. However, our insurance may not cover all claims against us or the full extent of our liability nor continue to be available at a reasonable cost. Moreover, the cost of insurance coverage maintained with unaffiliated commercial insurance carriers is costly and may continue to increase. If we are unable to maintain adequate insurance coverage or are required to pay punitive damages that are uninsured, we may be exposed to substantial liabilities.

In our rehabilitation division contracts, we generally indemnify our customers from claim denials associated with our services. From time to time, we may be subject to indemnification obligations under these contracts.

We also are subject to lawsuits under the federal False Claims Act and comparable state laws for submitting fraudulent bills for services to the Medicare and Medicaid programs. These lawsuits, which may be initiated by whistleblowers, can involve significant monetary damages, fines, attorney fees and the award of bounties to private plaintiffs who successfully bring these suits and to the government programs.

We have limited operational and strategic flexibility since we lease a substantial number of our facilities.

We lease a substantial number of our facilities from Ventas and other third parties. Under our leases, we generally are required to operate continuously our leased properties as a provider of healthcare services. In addition, these leases generally limit or restrict our ability to assign the lease to another party. Our failure to comply with these lease provisions would result in an event of default under the leases and subject us to material damages, including potential defaults under our revolving credit facility. Given these restrictions, we may be forced to continue operating unprofitable facilities to avoid defaults under our leases. See "Item 1 – Business – Master Lease Agreements."

Possible changes in the acuity of residents and patients as well as payor mix and payment methodologies may significantly affect our profitability.

The sources and amount of our revenues are determined by a number of factors, including the occupancy rates of our facilities, length of stay, the payor mix of residents and patients, rates of reimbursement among payors and patient acuity. Changes in patient acuity as well as payor mix among private pay, Medicare and Medicaid can significantly affect our profitability. In particular, any significant decrease in our population of high acuity residents and patients or any significant increase in our Medicaid population could have a material adverse effect on our business, financial position, results of operations and liquidity, especially if state Medicaid programs continue to limit, or more aggressively seek limits on, reimbursement rates.

We may be unable to reduce costs to offset completely any decreases in our revenues.

Reduced levels of occupancy in our facilities and reductions in reimbursements from Medicare, Medicaid or other payors would adversely impact our revenues and liquidity. We may be unable to put in place corresponding reductions in costs in response to declines in census or other revenue shortfalls. The inability to timely adjust our operations to address a decrease in our revenues could have a material adverse effect on our business, financial position, results of operations and liquidity.

We are exposed to the credit risk of our payors which in the future may cause us to make larger allowances for doubtful accounts or incur bad debt write-offs.

Due to deteriorating economic conditions or other factors, commercial payors and customers may default on their payments to us and individual patients may default on co-payments and deductibles for which they are responsible under the terms of either commercial insurance programs or Medicare. Although we review the credit risk of our commercial payors and customers regularly, such risks will nevertheless arise from events or circumstances that are difficult to anticipate or control, such as a general economic downturn. If our payors default on their payments to us in the future, we may have to make larger allowances for doubtful accounts or incur bad debt write-offs, both of which may have an adverse impact on our profitability.

Delays in collection of our accounts receivable could adversely affect our business, financial position, results of operations and liquidity.

Prompt billing and collection are important factors in our liquidity. Billing and collection of our accounts receivable are subject to the complex regulations that govern Medicare and Medicaid reimbursement and rules imposed by non-government payors. Our inability, or the inability of our customers, to bill and collect on a timely basis pursuant to these regulations and rules could subject us to payment delays that could negatively impact our business, financial position, results of operations and liquidity. In addition, we may experience delays in reimbursement as a result of the failure to receive prompt approvals related to change of ownership applications for acquired or other facilities or from delays caused by our or other third parties' information system failures.

Acquisitions, investments and strategic alliances that we have made or may make in the future may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.

We intend to selectively pursue strategic acquisitions of, investments in, and strategic alliances with LTAC hospitals, nursing centers, rehabilitation operations and other related healthcare operations. Acquisitions may involve significant cash expenditures, debt incurrence, additional operating losses, amortization of certain intangible assets of acquired companies, dilutive issuances of equity securities and expenses that could have a material adverse effect on our business, financial position, results of operations and liquidity. Acquisitions, investments and strategic alliances involve numerous risks, including:

- limitations on our ability to identify acquisitions that meet our target criteria and limitations on our ability to complete such acquisitions on reasonable terms and valuations,
- limitations on our ability to access equity or capital to fund acquisitions, including difficulty in obtaining financing for acquisitions at a reasonable cost, or that such financing will not contain restrictive covenants that limit our operating flexibility or ability to access additional capital when needed,
- entry into markets in which we may have limited or no experience,
- difficulties integrating acquired operations, personnel and information systems, and in realizing projected efficiencies and cost savings,
- diversion of management's time from existing operations,
- potential loss of key employees or customers of acquired companies,
- inaccurate assessment of assets and liabilities and exposure to undisclosed or unforeseen liabilities of acquired companies, including liabilities for failure to comply with healthcare laws, and
- inability to operate acquired facilities profitably or succeed in achieving improvements in their financial performance.

We continue to seek acquisitions and other strategic opportunities for each of our businesses that may negatively impact our business, financial position, results of operations and liquidity.

We continue to seek acquisitions and other strategic opportunities for each of our businesses. Accordingly, we are often engaged in evaluating potential transactions and other strategic alternatives and, from time to time, we engage in preliminary discussions that may result in one or more transactions. Although there is uncertainty that any of our discussions will result in definitive agreements or the completion of any transactions, our business, short-term and long-term financial position, results of operations and liquidity may be impacted if we complete any such transactions or if we incur substantial costs or other losses in connection with such transactions, whether or not such transactions are completed. Moreover, although we would enter into transactions to enhance shareholder value, our ability to achieve this objective would be subject to integration risks, the ability to retain and attract key personnel, the ability to realize synergies and other risks.

In addition to acquisitions, we also may pursue strategic opportunities involving the construction of new hospitals or nursing centers. The construction of new facilities involves numerous risks, including construction delays, cost over-runs, and the satisfaction of zoning and other regulatory requirements. We may be unable to operate newly constructed facilities profitably and such facilities may involve significant cash expenditures, debt incurrence, additional operating losses, and expenses that could have a material adverse effect on our business, financial position, results of operations and liquidity. Furthermore, the SCHIP Extension Act has imposed a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development.

We depend on the proper functioning and availability of our information systems.

We are dependent on the proper functioning and availability of our information systems. Though we have taken steps to protect the safety and security of our information systems and the data maintained within those systems, there can be no assurance that our safety and security measures and disaster recovery plan will prevent damage or interruption of our systems and operations and we may be vulnerable to losses associated with the improper functioning, security breach or unavailability of our information systems. Failure to maintain proper functioning and available information systems could have a material adverse effect on our business, financial position, results of operations and liquidity.

In addition, certain software programs supporting our business and information systems are licensed to us by independent software developers. Our inability, or the inability of these developers, to continue to maintain and upgrade our information systems and software programs could disrupt or reduce the efficiency of our operations. In addition, costs and potential problems and interruptions associated with the implementation of new or upgraded systems and technology or with maintenance or adequate support of existing systems also could disrupt or reduce the efficiency of our operations and could have a material adverse effect on our business, financial position, results of operations and liquidity.

Terrorist attacks or natural disasters may seriously harm our business.

Terrorist attacks or acts of nature, such as floods, fires, hurricanes, tornadoes or earthquakes, may cause damage or disruption to us, our employees and our facilities, which could have an adverse impact on our residents and patients. In order to provide care for our residents and patients, we are dependent upon consistent and reliable delivery of food, pharmaceuticals, power and other products to our facilities and the availability of employees to provide services at our facilities. If the delivery of goods or the ability of employees to reach our facilities were interrupted due to a natural disaster or a terrorist attack, it would have a significant impact on our business. Furthermore, the impact, or impending threat, of a natural disaster has in the past and may in the future require that we evacuate one or more facilities, which would be costly and would involve substantial risks to our operations and potentially to our residents and patients. The impact of natural disasters and terrorist attacks is inherently uncertain. Such events could severely damage or destroy one or more of our facilities, harm our business, reputation and financial performance or otherwise cause our business to suffer in ways that we cannot predict.

Certain events or circumstances could result in the impairment of our assets or other charges, including, without limitation, impairments of goodwill and identifiable intangible assets that result in material non-cash charges to earnings.

We regularly review the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. On an ongoing basis, we also evaluate, based upon the fair value of our reporting units, whether the carrying value of our goodwill is impaired. If circumstances suggest that the recorded amounts of any of these assets cannot be recovered based upon estimated future cash flows, the carrying values of such assets are reduced to fair value. If the carrying value of any of these assets is impaired, we may incur a material non-cash charge to earnings.

Although we have determined that there was no goodwill or other indefinite lived intangible asset impairments as of December 31, 2008, continued declines in the value of our common stock or adverse changes in the operating environment and related key assumptions used to determine the fair value of our reporting units and indefinite lived intangible assets may result in future impairment charges for a portion or all of these assets. An impairment charge could have a material adverse effect on our business, financial position and results of operations.

The inability or failure of management in the future to conclude that we maintain effective internal control over financial reporting, or the inability of our independent registered public accounting firm to issue a report of our internal control over financial reporting, could have a material adverse effect on our business, financial position, results of operations and liquidity.

Under the Sarbanes-Oxley Act of 2002, our management is required to report in our Annual Report on Form 10-K on the effectiveness of our internal control over financial reporting, and our independent registered public accounting firm also is required to audit the effectiveness of our internal control over financial reporting. Significant resources are required to establish that we are in full compliance with the financial reporting controls and procedures. If we fail to have, or management or our independent registered public accounting firm is unable to conclude that we maintain, effective internal controls and procedures for financial reporting, we could be unable to provide timely and reliable financial information which could have a material adverse effect on our business, financial position, results of operations and liquidity.

Different interpretations of accounting principles could have a material adverse effect on our business, financial position, results of operations and liquidity.

Generally accepted accounting principles are complex, continually evolving and may be subject to varied interpretation by third parties, including the SEC. Such varied interpretations could result from differing views related to specific facts and circumstances. Differences in interpretation of generally accepted accounting principles could have a material adverse effect on our business, financial position, results of operations and liquidity.

Risk Factors Relating to the KPS Spin-Off

If the Spin-off Transaction does not qualify as a tax-free transaction, tax could be imposed on us and our shareholders.

As a condition to closing the Spin-off Transaction in 2007, we received a private letter ruling from the Internal Revenue Service (the "IRS") that the spin-off of KPS and the subsequent merger of KPS and distribution of PharMerica common stock qualified for tax-free treatment to holders of our common stock (except with respect to cash received in lieu of a fractional share) and, generally, to us.

Though the IRS ruling has been received, the ruling does not address all of the issues that are relevant to determining whether the Spin-off Transaction will qualify for tax-free treatment because the IRS will not rule on certain issues. As a condition to closing, we received an opinion of counsel that the Spin-off Transaction generally qualifies for tax-free treatment to us and our shareholders. The opinion of counsel is intended to address certain of those matters that the ruling does not. The IRS ruling and opinion of counsel do not address, however, state, local or foreign tax consequences of the Spin-off Transaction, merger and distribution of PharMerica common stock.

The IRS ruling and the opinion of counsel relied on representations, assumptions and undertakings made by us and PharMerica (and its subsidiaries), including representations and undertakings from PharMerica regarding the conduct of its business and other matters after the closing of the Spin-off Transaction. If such representations, assumptions or undertakings are incorrect, neither the IRS ruling nor the opinion of counsel would be valid. In

addition, current law generally creates a presumption that the spin-off of KPS in the Spin-off Transaction would be taxable to us, but not to our shareholders, if PharMerica or its shareholders were to engage in certain transactions that result in a change in ownership of its stock during the four-year period beginning two years before the Spin-off Transaction, unless it is established that the Spin-off Transaction and such transactions were not part of a plan or series of related transactions to effect a change in ownership of the stock of PharMerica.

Furthermore, notwithstanding the IRS private letter ruling and the opinion of counsel, the IRS could determine that the Spin-off Transaction should be treated as a taxable transaction to us and our shareholders if it determines that any of the representations, assumptions or undertakings that were included in the request for the private letter ruling are false or have been violated or if it disagrees with the conclusions in the opinion of counsel that are not covered by the IRS ruling. If the spin-off of KPS in the Spin-off Transaction fails to qualify for tax-free treatment, the deemed receipt of shares of KPS will be treated as a taxable distribution to our shareholders. In addition, events occurring after the distribution of common stock of PharMerica could cause us to recognize a gain on the spin-off of KPS.

We may be required to satisfy certain indemnification obligations to PharMerica or may not be able to collect on indemnification rights from PharMerica.

Under the terms of the Spin-off Transaction, we indemnified PharMerica, and PharMerica indemnified us, for certain damages, liabilities and expenses resulting from a breach by the other of certain covenants contained in a master transaction agreement and other agreements entered into as part of the Spin-off Transaction.

These indemnification obligations could be significant and we cannot presently determine the amount, if any, of indemnification obligations for which we may be liable or for which we may seek payment. Our ability to satisfy these obligations will depend upon our future financial performance and other factors. Similarly, the ability of PharMerica to satisfy any such obligations to us will depend on its future financial performance and other factors. We cannot assure you that we will have the ability to satisfy any obligations to PharMerica or that PharMerica will have the ability to satisfy any obligations to us.

Item 1B. ***Unresolved Staff Comments***

Not applicable.

Item 2. ***Properties***

For information concerning the hospitals and nursing centers operated by us, see "Item 1 – Business – Hospital Division – Hospital Facilities," "Item 1 – Business – Health Services Division – Nursing Center Facilities," and "Item 1 – Business – Master Lease Agreements." We believe that our facilities are adequate for our future needs in such locations.

Our corporate headquarters is located in a 287,000 square foot building in Louisville, Kentucky.

We are subject to various federal, state and local laws and regulations governing the use, discharge and disposal of hazardous materials, including medical waste products. Compliance with these laws and regulations is not expected to have a material adverse effect on us. It is possible, however, that environmental issues may arise in the future which we cannot predict.

Item 3. ***Legal Proceedings***

We are a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions arising in the ordinary course of our business. We cannot predict the ultimate outcome of pending litigation and regulatory and other government investigations. The U.S. Department

of Justice, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to our businesses in the future which may, either individually or in the aggregate, have a material adverse effect on our business, financial position, results of operations and liquidity. See "Item 1A – Risk Factors – Risk Factors Relating to Our Operations – Significant legal actions could subject us to increased operating costs and substantial uninsured liabilities, which could materially and adversely affect our business, financial position, results of operations and liquidity."

Item 4. ***Submission of Matters to a Vote of Security Holders***

Not applicable.

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PART II

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

MARKET PRICE FOR COMMON STOCK AND DIVIDEND HISTORY

Our common stock is quoted on the NYSE under the ticker symbol "KND." The prices in the table below, for the calendar quarters indicated, represent the high and low sale prices for our common stock as reported on the NYSE.

	Sales price of common stock			
2008	**High**		**Low**	
First quarter	$	28.74	$	20.25
Second quarter	$	32.34	$	21.34
Third quarter	$	33.25	$	25.80
Fourth quarter	$	28.30	$	8.12
2007	**High**		**Low**	
First quarter	$	34.44	$	24.46
Second quarter	$	36.67	$	30.56
Third quarter	$	31.80	$	17.35
Fourth quarter	$	26.02	$	17.35

On July 31, 2007, we completed the Spin-off Transaction. Immediately after the Spin-off Transaction, our stockholders and the stockholders of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

Our revolving credit facility contains covenants that limit, among other things, our ability to pay dividends. Any determination to pay dividends in the future will be dependent upon our results of operations, financial position, contractual restrictions, restrictions imposed by applicable laws and other factors deemed relevant by our Board of Directors. We have not paid, and do not anticipate that we will pay in the foreseeable future, any cash dividends on our common stock. Accordingly, investors must rely on sales of their common stock after price appreciation which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

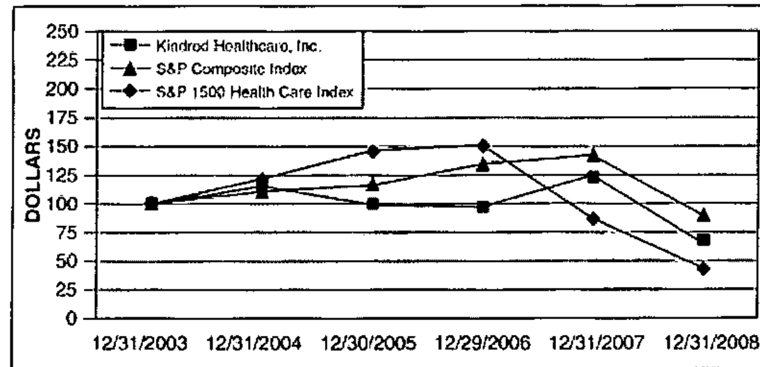
As of January 31, 2009, there were 482 holders of record of our common stock.

See "Part III – Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for disclosures regarding our equity compensation plans.

As required by Section 303A.12 of the NYSE listing standards, on May 28, 2008, Paul J. Diaz, our President and Chief Executive Officer, certified that he was not aware of any violation by us of NYSE corporate governance listing standards. The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are included as exhibits to this Annual Report on Form 10-K.

PERFORMANCE GRAPH

The following graph summarizes the cumulative total return to shareholders of our common stock from December 31, 2003 to December 31, 2008, compared to the cumulative total return on the Standard & Poor's 500 Stock Index (the "S&P Composite Index") and the Standard & Poor's 1500 Health Care Index (the "S&P 1500 Health Care Index"). The graph assumes an investment of $100 in each of our common stock, the S&P Composite Index, and the S&P 1500 Health Care Index on December 31, 2003, and also assumes the reinvestment of all cash dividends. In accordance with SEC rules, the July 31, 2007 distribution of the KPS shares to our shareholders in connection with the Spin-off Transaction is treated for purposes of the graph as a special stock dividend in calculating shareholder return and prior period prices have been adjusted accordingly.



	12/31/03	12/31/04	12/30/05	12/29/06	12/31/07	12/31/08
Kindred Healthcare, Inc.	$ 100.00	$ 115.24	$ 99.12	$ 97.15	$ 124.66	$ 64.98
S&P Composite Index	100.00	110.88	116.33	134.70	142.10	89.53
S&P 1500 Health Care Index	100.00	121.89	146.60	150.90	87.15	43.58

Item 6. ***Selected Financial Data***

KINDRED HEALTHCARE, INC.
SELECTED FINANCIAL DATA
(In thousands, except per share amounts)

	Year ended December 31,				
	2008	2007	2006	2005	2004
Statement of Operations Data:					
Revenues	$ 4,151,396	$ 4,179,891	$ 4,090,365	$ 3,700,819	$ 3,273,550
Salaries, wages and benefits	2,409,673	2,358,914	2,217,582	1,973,280	1,808,146
Supplies	320,410	546,075	671,857	558,651	460,459
Rent	344,952	343,717	294,186	249,487	234,833
Other operating expenses	868,026	743,497	660,731	593,285	531,633
Other income	(17,407)	(7,701)	–	–	–
Depreciation and amortization	121,413	120,421	116,182	96,310	83,721
Interest expense	15,373	17,044	13,920	8,096	12,814
Investment income	(7,101)	(16,109)	(14,491)	(11,033)	(6,422)
	4,055,339	4,105,858	3,959,967	3,468,076	3,125,184
Income from continuing operations before reorganization items and income taxes	96,057	74,033	130,398	232,743	148,366
Reorganization items	–	–	–	(1,639)	(304)
Income from continuing operations before income taxes	96,057	74,033	130,398	234,382	148,670
Provision for income taxes	37,164	34,385	51,417	93,695	60,727
Income from continuing operations	58,893	39,648	78,981	140,687	87,943
Discontinued operations, net of income taxes:					
Income (loss) from operations	(1,832)	(9,497)	(238)	5,603	(1,541)
Loss on divestiture of operations	(20,776)	(77,021)	(32)	(1,381)	(15,822)
Net income (loss)	$ 36,285	$ (46,870)	$ 78,711	$ 144,909	$ 70,580
Earnings (loss) per common share:					
Basic:					
Income from continuing operations	$ 1.56	$ 1.02	$ 2.02	$ 3.77	$ 2.46
Discontinued operations:					
Income (loss) from operations	(0.05)	(0.24)	(0.01)	0.15	(0.05)
Loss on divestiture of operations	(0.55)	(1.99)	–	(0.04)	(0.44)
Net income (loss)	$ 0.96	$ (1.21)	$ 2.01	$ 3.88	$ 1.97
Diluted:					
Income from continuing operations	$ 1.51	$ 0.99	$ 1.93	$ 3.11	$ 2.08
Discontinued operations:					
Income (loss) from operations	(0.05)	(0.23)	(0.01)	0.12	(0.04)
Loss on divestiture of operations	(0.53)	(1.93)	–	(0.03)	(0.37)
Net income (loss)	$ 0.93	$ (1.17)	$ 1.92	$ 3.20	$ 1.67
Shares used in computing earnings (loss) per common share:					
Basic	37,830	38,791	39,108	37,328	35,774
Diluted	38,906	39,983	40,923	45,239	42,403
Financial Position:					
Working capital	$ 477,365	$ 383,705	$ 386,450	$ 312,281	$ 273,905
Assets	2,181,761	2,079,552	2,016,127	1,760,561	1,593,293
Long-term debt	349,433	275,814	130,090	26,323	32,544
Stockholders' equity	914,975	862,124	995,578	870,536	719,785

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

You should read the following discussion together with the selected financial data in Item 6 and our consolidated financial statements and the notes thereto included in this Annual Report on Form 10-K. All financial and operating data presented in Items 6 and 7 reflects the continuing operations of our business for all periods presented unless otherwise indicated.

Overview

We are a healthcare services company that through our subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States. At December 31, 2008, our hospital division operated 82 LTAC hospitals with 6,482 licensed beds in 24 states. Our health services division operated 228 nursing centers with 28,525 licensed beds in 27 states. We also operated a contract rehabilitation services business which provides rehabilitative services primarily in long-term care settings.

On July 31, 2007, we completed the Spin-off Transaction. See "Item 1 – Business – General – Spin-off Transaction" and note 2 of the notes to consolidated financial statements.

In recent years, we have completed several strategic divestitures to improve our future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2008 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

The operating results of acquired businesses have been included in our accompanying consolidated financial statements from the respective acquisition dates.

Critical Accounting Policies

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates and judgments that affect the reported amounts and related disclosures of commitments and contingencies. We rely on historical experience and on various other assumptions that we believe to be reasonable under the circumstances to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

We believe the following critical accounting policies, among others, affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

We have agreements with third party payors that provide for payments to each of our operating divisions. These payment arrangements may be based upon prospective rates, reimbursable costs, established charges, discounted charges or per diem payments. Net patient service revenue is recorded at the estimated net realizable amounts from Medicare, Medicaid, other third party payors and individual patients for services rendered. Retroactive adjustments that are likely to result from future examinations by third party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods based upon new information or final settlements.

We recorded income of approximately $10 million in 2008 related to the favorable settlement of a prior year nursing center Medicaid cost report dispute. Favorable settlements of prior year hospital Medicare cost reports aggregated $3 million in 2007 and $8 million in 2006.

During 2007, we also recorded a pretax credit of approximately $3 million to reflect a change in estimate for hospital Medicare in-house accounts receivable and a pretax credit of approximately $4 million to adjust certain nursing center Medicaid revenues.

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

	Year ended December 31,		
	2008	2007	2006
Medicare	$ 1,755,332	$ 1,865,380	$ 1,896,201
Medicaid	1,107,457	1,094,269	1,054,415
Other third parties	1,557,270	1,541,064	1,487,303
	4,420,059	4,500,713	4,437,919
Eliminations:			
Rehabilitation	(268,663)	(236,539)	(212,044)
Pharmacy	–	(84,283)	(135,510)
	(268,663)	(320,822)	(347,554)
	$ 4,151,396	$ 4,179,891	$ 4,090,365

Collectibility of accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, we consider a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of the change.

The provision for doubtful accounts totaled $31 million for 2008, $27 million for 2007 and $31 million for 2006. During 2007, we recorded a $6 million charge related to accounts receivable for certain hospitals acquired in 2006.

Allowances for insurance risks

We insure a substantial portion of our professional liability risks and workers compensation risks through a wholly owned limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including actuarially determined estimates.

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 liabilities 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.

Provisions for loss for professional liability risks retained by our limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 3% for the 2008 policy year and 5% for all prior policy years. Amounts equal to the discounted loss provision are funded

annually. We do 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. The allowance for professional liability risks aggregated $243 million at December 31, 2008 and $251 million at December 31, 2007. If we did not discount any of the allowances for professional liability risks, these balances would have approximated $252 million at December 31, 2008 and $264 million at December 31, 2007.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $39 million in 2008, $37 million in 2007 and $34 million in 2006 from our limited purpose insurance subsidiary. These distributions had no impact on earnings.

Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between our estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. For example, a 1% variance in the allowance for professional liability risks at December 31, 2008 would impact our operating income by approximately $2 million.

The provision for professional liability risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $34 million for 2008, $37 million for 2007 and $52 million for 2006. Changes in estimates for prior year professional liability costs reduced professional liability costs by approximately $38 million, $35 million and $24 million in 2008, 2007 and 2006, respectively. While we expect that professional liability costs for 2009 may be higher than the costs recorded over the last three years, we believe that our professional liability costs appear to be moderating.

With respect to our discontinued operations, we recorded a favorable pretax adjustment of $10 million in 2008, a pretax charge aggregating $2 million in 2007 and a favorable pretax adjustment of $19 million in 2006 resulting from changes in estimates for professional liability reserves related to prior years.

Provisions for loss for workers compensation risks retained by our limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually. The allowance for workers compensation risks aggregated $83 million at December 31, 2008 and $89 million at December 31, 2007. The provision for workers compensation risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $31 million for 2008, $38 million for 2007 and $35 million for 2006.

See notes 4 and 9 of the notes to consolidated financial statements.

Accounting for income taxes

The provision for income taxes is based upon our estimate of annual taxable income or loss for each respective accounting period. We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. We also recognize as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

In 2006, we reached a settlement with the IRS related to all disputed federal income tax issues for fiscal 2000 and 2001. In connection with the settlement, we paid approximately $3 million of employer payroll taxes to the IRS in 2007. Because of fresh-start accounting rules related to our reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

Our effective income tax rate was 38.7% in 2008, 46.4% in 2007 and 39.4% in 2006. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction. We recorded favorable income tax adjustments related to the resolution of certain income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million in each of 2008 and 2007, and $3 million in 2006.

In July 2006, the Financial Accounting Standards Board (the "FASB") issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material impact on our business, financial position, results of operations or liquidity.

There are significant uncertainties with respect to capital loss carryforwards that could affect materially the realization of certain deferred tax assets. Accordingly, we have recognized deferred tax assets to the extent it is more likely than not they will be realized and a valuation allowance is provided for deferred tax assets to the extent that it is uncertain that the deferred tax asset will be realized. We recognized net deferred tax assets totaling $159 million at December 31, 2008 and $174 million at December 31, 2007.

After our emergence from bankruptcy, the realization of pre-reorganization deferred tax assets and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of approximately $1 million in 2008, $3 million in 2007 and $80 million in 2006 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability. Following the effective date of SFAS 141R (as defined), adjustments to pre-emergence unrecognized income tax benefits of $3 million will be recorded to earnings.

We are 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. While we believe our tax positions are appropriate, we cannot assure you that the various authorities engaged in the examination of our income tax returns will not challenge our positions.

See note 8 of the notes to consolidated financial statements.

Valuation of long-lived assets and goodwill

We regularly review the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest that the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

In assessing the carrying values of long-lived assets, we estimate 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 facility 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 our ability to renew the lease or divest a particular property), we define the group of facilities under a master lease agreement 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 are aggregated for purposes of evaluating the carrying values of long-lived assets.

Our other intangible assets with finite lives are amortized under SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," using the straight-line method over their estimated useful lives ranging from one to five years.

In accordance with SFAS 142, we are required to perform an impairment test for goodwill and indefinite lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. Also, in the fourth quarter of 2008, the market value of our common stock declined significantly below book equity value. The decline was generally attributable to our announcement of weaker than expected third quarter operating results (particularly in our hospital division) and the related reduction in our earnings outlook for the fourth quarter of 2008 and fiscal 2009 as compared with investor expectations. In addition, the deterioration in the debt and equity markets resulting from weak global economic conditions also may have contributed to the decline in the market value of our common stock. The significant difference between book equity value and the market value of our common stock at December 31, 2008 was an indication that the carrying value of our goodwill may have been impaired.

We perform our annual goodwill impairment test at the end of each fiscal year for each of our reporting units. A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. Because the components within our operating segments have similar economic characteristics, we aggregate the components of our operating segments into one reporting unit. Accordingly, we have determined that our reporting units are hospitals, nursing centers, and rehabilitation services.

The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. If the carrying value of the reporting unit is greater than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. Based upon the results of the step one impairment test for goodwill and the impairment test of indefinite lived intangible assets in each of the last three years, no impairment charges were recorded in connection with our annual impairment tests.

Since quoted market prices for our reporting units are not available, we applied judgment in determining the fair value of these reporting units for purposes of performing the goodwill impairment test. We relied on widely accepted valuation techniques, including equally weighted discounted cash flow and market multiple analyses approaches, which capture both the future income potential of the reporting unit and the market behaviors and actions of market participants in the industry that includes the reporting unit. These types of analyses require us to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. The market multiple analysis estimates fair value by applying cash flow multiples to the reporting unit's operating results. The multiples are derived from comparable publicly traded companies with similar operating and investment characteristics to the reporting units.

Our analysis indicated that the estimated fair value of each reporting unit exceeded its book equity value. Our conclusions were supported by both quantitative and qualitative factors, including the estimate of an implied control premium for acquisitions in our industry, the significant improvements in our fourth quarter operating results and consideration of our updated business expectations. These results significantly exceeded both our third quarter results and fourth quarter expectations (particularly in our hospital division) and represent information not available to investors in determining the market value of our common stock at December 31, 2008.

We performed sensitivity analyses on our estimated fair value for each of our reporting units. Two key assumptions in our fair value estimate are the weighted average cost of capital used for discounting our cash flow estimates and the market multiple applied to operating performance. At December 31, 2008, the fair value of each reporting unit exceeded its carrying value, and the excess approximated $476 million for hospitals,

$70 million for nursing centers and $158 million for rehabilitation services. We noted that an increase of 100 basis points in the weighted average cost of capital would decrease the fair value by approximately $80 million for hospitals, $21 million for nursing centers and $11 million for rehabilitation services, and would not result in an impairment of goodwill attributable to any of the reporting units. A decrease of 100 basis points in the market multiple applied to operating results would decrease the fair value by approximately $90 million for hospitals, $62 million for nursing centers and $12 million for rehabilitation services, and would not result in an impairment of goodwill attributable to any of the reporting units.

The fair values of our indefinite lived intangible assets, primarily hospital certificates of need, are estimated using an excess earnings method, a form of discounted cash flow, which is based upon the concept that net after-tax cash flows provide a return supporting all of the assets of a business operation. The fair values of our indefinite lived intangible assets are derived from projections which include management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. At December 31, 2008, the fair value of our hospital certificates of need intangible assets exceeded its carrying value by approximately $15 million. We noted that an increase of 100 basis points in the weighted average cost of capital would decrease the fair value by approximately $8 million, and would not result in an impairment of the hospital certificates of need intangible assets.

Although we have determined that there was no goodwill or other indefinite lived intangible asset impairments as of December 31, 2008, continued declines in the value of our common stock or adverse changes in the operating environment and related key assumptions used to determine the fair value of our reporting units and indefinite lived intangible assets may result in future impairment charges for a portion or all of these assets. An impairment charge could have a material adverse effect on our business, financial position and results of operations, but would not be expected to have an impact on our cash flows or liquidity.

Recently Issued Accounting Pronouncements

In June 2008, the FASB issued FASB Staff Position Emerging Issues Task Force ("EITF") 03-6-1 ("EITF 03-6-1"), "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities," which clarifies that share-based payment awards that entitle the holder to receive nonforfeitable dividends before vesting would be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per common share. The provisions of EITF 03-6-1 will be effective for fiscal years beginning after December 15, 2008. The adoption of EITF 03-6-1 is not expected to have a material impact on our earnings per common share calculation.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS 141R"), "Business Combinations," which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at the acquisition date and expensing acquisition and restructuring costs. SFAS 141R will be applied prospectively and is effective for business combinations which occur during fiscal years beginning after December 15, 2008. We cannot determine the impact that SFAS 141R will have on our business, financial position, results of operations or liquidity. However, any business combination entered into after the adoption may significantly impact our financial position and results of operations when compared to acquisitions accounted for under previous generally accepted accounting principles and may result in more earnings volatility and generally lower earnings due to the expensing of acquisition costs and restructuring costs.

In December 2007, the FASB issued SFAS No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements," which will change the accounting and reporting for minority interests. SFAS 160 will recharacterize minority interests as noncontrolling interests and they will be classified as a

component of stockholders' equity. The new consolidation method will significantly change the accounting for transactions with minority-interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on our business, financial position, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 157 ("SFAS 157"), "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 generally accepted accounting principles. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position SFAS No. 157-2 ("SFAS 157-2"), "Effective Date of FASB Statement No. 157," which deferred the effective date of SFAS 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Accordingly, we deferred the adoption of SFAS 157-2 until January 2009. The provisions of SFAS 157 apply to assets and liabilities, including investments, loans and transfers (including sales and securitizations) of financial assets, derivatives, financial liabilities, and other various financial assets and liabilities. The adoption of SFAS 157 did not, and SFAS 157-2 is not expected to, have a material impact on our business, financial position, results of operations or liquidity.

In October 2008, the FASB issued FASB Staff Position SFAS No. 157-3 ("SFAS 157-3"), "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," which clarifies the application of SFAS 157 and provides key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. SFAS 157-3 is effective upon issuance and did not have a material impact on our business, financial position, results of operations or liquidity.

Impact of Medicare and Medicaid Reimbursement

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for substantially all of our revenues. For the year ended December 31, 2008, we derived approximately 65% of our total revenues (before eliminations) from the Medicare and Medicaid programs and the balance from other third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers.

The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Part I – Item 1 – Business – Governmental Regulation" for an overview of the reimbursement systems impacting our businesses and "Part I – Item 1A – Risk Factors."

Results of Operations – Continuing Operations

For the years ended December 31, 2008, 2007 and 2006

A summary of our operating data follows (dollars in thousands, except statistics):

	Year ended December 31,		
	2008	2007	2006
Revenues:			
Hospital division	$ 1,837,322	$ 1,727,419	$ 1,665,885
Health services division	2,155,417	2,014,786	1,819,320
Rehabilitation division	427,320	352,397	300,106
Pharmacy division	–	406,111	652,608
	4,420,059	4,500,713	4,437,919
Eliminations:			
Rehabilitation	(268,663)	(236,539)	(212,044)
Pharmacy	–	(84,283)	(135,510)
	(268,663)	(320,822)	(347,554)
	$ 4,151,396	$ 4,179,891	$ 4,090,365
Operating income (loss):			
Hospital division	$ 345,367	$ 365,068	$ 383,802
Health services division	326,932	296,749	241,852
Rehabilitation division	38,071	34,526	30,362
Pharmacy division	–	17,557	48,461
Corporate:			
Overhead	(133,019)	(167,717)	(157,157)
Insurance subsidiary	(6,657)	(7,077)	(7,125)
	(139,676)	(174,794)	(164,282)
	$ 570,694	$ 539,106	$ 540,195

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Operating data (Continued):

	Year ended December 31,		
	2008	2007	2006
Hospital data:			
End of period data:			
Number of hospitals	82	81	77
Number of licensed beds	6,482	6,358	5,990
Revenue mix %:			
Medicare	55	58	61
Medicaid	10	10	10
Medicare Advantage (a)	9	4	
Commercial insurance and other	26	28	29
Admissions:			
Medicare	29,028	28,140	28,152
Medicaid	4,233	4,204	3,908
Medicare Advantage	3,587	1,681	
Commercial insurance and other	7,088	7,305	7,360
	43,936	41,330	39,420
Admissions mix %:			
Medicare	66	68	71
Medicaid	10	10	10
Medicare Advantage	8	4	
Commercial insurance and other	16	18	19
Patient days:			
Medicare	806,427	793,497	798,915
Medicaid	208,423	203,192	181,350
Medicare Advantage	117,945	55,033	
Commercial insurance and other	262,254	276,328	272,077
	1,395,049	1,328,050	1,252,342
Average length of stay:			
Medicare	27.8	28.2	28.4
Medicaid	49.2	48.3	46.4
Medicare Advantage	32.9	32.7	
Commercial insurance and other	37.0	37.8	37.0
Weighted average	31.8	32.1	31.8
Revenues per admission:			
Medicare	$ 35,127	$ 35,489	$ 36,035
Medicaid	43,816	42,439	41,521
Medicare Advantage	45,148	43,157	
Commercial insurance and other	66,345	65,406	66,463
Weighted average	41,818	41,796	42,260
Revenues per patient day:			
Medicare	$ 1,264	$ 1,259	$ 1,270
Medicaid	890	878	895
Medicare Advantage	1,373	1,318	
Commercial insurance and other	1,793	1,729	1,798
Weighted average	1,317	1,301	1,330
Medicare case mix index (discharged patients only)	1.15	1.11	1.11
Average daily census	3,812	3,638	3,431
Occupancy %	64.8	64.6	64.3

(a) Data not available prior to April 1, 2007.

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Operating data (Continued):

	Year ended December 31,		
	2008	2007	2006
Nursing center data:			
End of period data:			
Number of nursing centers:			
Owned or leased	224	224	215
Managed	4	4	5
	228	228	220
Number of licensed beds:			
Owned or leased	28,040	28,621	27,568
Managed	485	485	605
	28,525	29,106	28,173
Revenue mix %:			
Medicare	34	34	34
Medicaid	43	44	46
Medicare Advantage (a)	5		
Private and other	18	22	20
Patient days (b):			
Medicare	1,550,728	1,552,930	1,495,554
Medicaid	5,630,421	5,693,398	5,638,641
Medicare Advantage	331,566		
Private and other	1,658,389	1,848,771	1,626,916
	9,171,104	9,095,099	8,761,111
Patient day mix %:			
Medicare	17	17	17
Medicaid	61	63	64
Medicare Advantage	4		
Private and other	18	20	19
Revenues per patient day:			
Medicare Part A	$ 437	$ 411	$ 384
Total Medicare (including Part B)	474	447	420
Medicaid	164	155	148
Medicare Advantage	350		
Private and other	230	236	219
Weighted average	235	222	208
Average daily census	25,058	24,918	24,003
Occupancy %	89.0	87.8	88.3
Rehabilitation data:			
Revenue mix %:			
Company-operated	63	68	75
Non-affiliated	37	32	25
Therapist productivity %	81.4	79.4	78.1

(a) Data not available prior to 2008.
(b) Excludes managed facilities.

The Year in Review

We achieved success on a number of fronts in 2008 despite a difficult economic environment. More importantly, fiscal 2008 provided further evidence to support our fundamental management philosophy: If we take care of our people and focus on quality and customer service, our business results will follow.

Financial highlights for the year include:

- we reported solid revenue gains in each of our three operating divisions in 2008. Excluding our former pharmacy division that was spun off in July 2007, our consolidated 2008 revenues of $4.2 billion grew a solid 8%;
- diluted earnings per share from continuing operations totaled $1.51, significantly better than our expectations at the beginning of the year;
- routine and hospital development capital spending totaled $149 million in 2008, all of which was financed through internal sources;
- operating cash flows for 2008 grew 12% to $183 million;
- cash levels at December 31, 2008 increased to $141 million, providing significant financial flexibility in a generally difficult credit environment; and
- the remaining unborrowed capacity under our revolving credit facility totaled $151 million at the end of the year. The credit facility, with its favorable pricing, financial covenants and other terms, is scheduled to expire in July 2012.

Our hospital division maintained strong admissions growth during 2008 with particularly solid growth in non-government admissions. We have dedicated more resources to educating referral sources on the quality, capabilities and cost-effectiveness of our services. These efforts have led to increased Medicare admissions and further penetration into the managed care market. Despite the positive admissions growth, declining length of stay, cost management issues and weakness in certain newer facilities negatively impacted our hospital operating results for 2008. As we move into 2009, we have renewed our efforts to better control variable costs and are leveraging our management resources to improve the operations of our underperforming hospitals.

In our health services division, reimbursement rate increases, growth in managed care volumes and reductions in professional liability costs resulted in better operating results in 2008. Our investments in clinical resources at the operating level have improved overall admissions and the mix of Medicare and managed care patients as well. Our overall admissions growth was strong in 2008, which improved our occupancy to 89% from 87.8% in 2007. In addition, our quality investments in staffing, training and physical plant continue to enhance our capabilities to serve higher acuity patients and residents.

People*first* Rehabilitation continued its growth beyond the Kindred portfolio of hospitals and nursing centers by signing 67 new contracts with non-affiliated customers. In 2008, approximately 37% of our People*first* revenues were derived from non-affiliated customers, up from 32% in 2007. Further growth in volumes and revenues helped to offset declines in our operating margins from wage rate pressures associated with an increasingly competitive marketplace for therapists and the start-up costs associated with non-affiliated customer contract growth.

We also have made great progress over the past few years in the recruitment, retention and development of our people. Our investments in employee orientation, continuing clinical education, leadership development and employee recognition programs have helped to make Kindred an employer of choice in many of our local markets. Our employee turnover percentages, a leading indicator in our businesses, have consistently improved in each of the last five years.

Our commitment to our employees is the key driver in our ongoing efforts to improve clinical quality and customer service. During 2008, improvements in the quality of our services were evidenced by the following accomplishments:

- Our nursing centers received 51 quality awards from the American Health Care Association;
- The key quality metrics in our hospital division – ventilator pneumonia and blood stream infection rates – improved and continued to exceed national benchmarks; and
- People*first* Rehabilitation therapists achieved additional improvements in the functional outcomes of over 115,000 patients discharged from our care.

As a provider of healthcare services, we are ever aware of the continued rise in the cost of providing quality healthcare. In that regard, we have taken the following measures that demonstrate our continued commitment to cost-effective, quality patient care:

- We successfully renegotiated our pharmacy services agreement with PharMerica resulting in anticipated cost reductions of approximately $10 million per year during 2009 and 2010;
- We continued to improve our professional liability underwriting results, reducing aggregate expenses by approximately $3 million from 2007; and
- We continued to use technology, such as the rollout of hand held devices for our People*first* Rehabilitation therapists, to improve productivity, reduce costs and improve patient safety.

Despite the turmoil in the financial markets, we remain committed to growing and repositioning our operations to capture new opportunities and we believe further opportunities exist for the expansion of our services. During 2008, we continued to execute our strategic development plan as reflected by the following:

- We opened a new hospital with 70 licensed beds;
- We have five hospitals containing 208 licensed hospital beds currently under development, one of which will become operational in 2009 and the remainder in 2010; and
- We further repositioned our hospital portfolio by divesting three underperforming LTAC hospitals.

We expect that the general economic environment will be difficult in 2009. We also anticipate that healthcare reform will be a central focus of lawmakers at both the federal and state levels. As one of the largest providers of post-acute care services, we intend to be actively engaged in those discussions and believe that we are adapting our operations to address the needs of patients and their families as well as the concerns of federal and state policy-makers and other third party payors.

Our focus on the quality of care provided to our patients and residents, our commitment to taking care of our employees and our efforts to effectively use and preserve our capital resources have positioned us well for the future. We are in position to efficiently respond to a challenging economic, political and regulatory landscape in order to deliver high quality care to our patients and residents, produce a valuable work experience for our employees and provide profitability for our shareholders.

Hospital Division

Revenues increased 6% in 2008 to $1.8 billion and 4% in 2007 to $1.7 billion. During each of the past two years, revenues have grown through increases in same-store volumes, expansion of services and ongoing development of new hospitals. Despite growth in patient volumes and services, revenues in 2007 were negatively impacted by significant reductions in Medicare reimbursement and pricing pressures from commercial insurance and managed care payors. See "Part I – Item 1 – Business – Governmental Regulation" for a discussion of the reductions in hospital Medicare reimbursement.

On a same-store basis, aggregate admissions rose 4% in 2008 and 2% in 2007, while non-government same-store admissions increased 15% in 2008 and 18% in 2007.

Hospital operating margins have declined in each of the past two years primarily because the growth in wage and benefit costs have exceeded overall revenue growth. Hospital wage and benefit costs increased 9% to $842 million in 2008 and increased 6% to $772 million in 2007 compared to $730 million in 2006. Average hourly wage rates grew 4% in 2008 and 2% in 2007, while employee benefit costs increased 9% in 2008 and 7% in 2007.

Professional liability costs were $11 million in 2008, $12 million in 2007 and $18 million in 2006.

Health Services Division

Revenues increased 7% in 2008 to $2.2 billion and 11% in 2007 to $2.0 billion. Revenue growth in each of the past two years was primarily attributable to reimbursement rate increases, growth in managed care volumes and in 2007, Medicare volumes. Revenues for 2008 included pretax income of approximately $10 million related to the favorable settlement of a prior year nursing center Medicaid cost report dispute.

On a same-store basis, aggregate patient days were relatively unchanged in both 2008 and 2007 compared to prior periods.

Nursing center operating margins improved in each of the past two years primarily due to same-store growth in managed care volumes, the favorable impact of acquired nursing centers and reductions in professional liability costs. Nursing center wage and benefit costs increased 5% to $1.1 billion in 2008 and increased 9% to $1.1 billion in 2007 compared to $961 million in 2006. Average hourly wage rates increased 4% in 2008 and 5% in 2007, while employee benefit costs increased 5% in 2008 and 9% in 2007.

Professional liability costs were $22 million in 2008, $24 million in 2007 and $33 million in 2006.

Revenues associated with acquisitions, including the Commonwealth Transaction, aggregated $257 million in 2008, $218 million in 2007 and $104 million in 2006. Operating income associated with acquisitions approximated $47 million in 2008, $37 million in 2007 and $10 million in 2006.

Rehabilitation Division

Revenues increased 21% to $427 million in 2008 and 17% to $352 million in 2007. The increase in revenues in both periods was primarily attributable to growth in both new customers and the volume of services provided to existing customers. Revenues derived from non-affiliated customers aggregated $158 million in 2008, $112 million in 2007 and $74 million in 2006.

Despite growth in volumes and revenues in both 2008 and 2007, operating margins declined in both periods primarily due to wage pressures resulting from an increasingly competitive marketplace for therapists and start-up costs associated with external customer growth. Operating income for 2006 included a pretax charge of approximately $3 million related primarily to revisions to prior estimates for accrued contract labor costs.

Pharmacy Division

The Spin-off Transaction was completed on July 31, 2007. As a result, our consolidated operating results for 2007 included the results of our former pharmacy division for seven months. For accounting purposes, our former pharmacy division was not treated as a discontinued operation in our historical consolidated financial statements. See note 2 of the notes to consolidated financial statements.

Corporate Overhead

Operating income for our operating divisions excludes allocations of corporate overhead. These costs aggregated $133 million in 2008, $168 million in 2007 and $157 million in 2006. As a percentage of consolidated revenues, corporate overhead totaled 3.2% in 2008, 4.0% in 2007 and 3.8% in 2006. Excluding the items discussed in the quarterly consolidated financial information, corporate overhead totaled $133 million in 2008, $145 million in 2007 and $147 million in 2006 and as a percentage of consolidated revenues, corporate overhead totaled 3.2% in 2008, 3.4% in 2007 and 3.6% in 2006.

We recorded approximately $17 million and $8 million in other income in 2008 and 2007, respectively, related to the information systems and transition services agreements with PharMerica.

Corporate expenses included the operating losses from our limited purpose insurance subsidiary of $7 million in each of 2008, 2007 and 2006.

Capital Costs

Rent expense was relatively unchanged at $345 million in 2008 and increased 17% to $344 million in 2007. Rent expense in 2008 was favorably impacted by the purchase in 2007 and 2008 of 13 previously leased facilities and the elimination of pharmacy division rent expense in connection with the Spin-off Transaction. A substantial portion of the increase in 2007 resulted from the rent reset under the Master Lease Agreements, contractual inflation, contingent rent increases, growth in the number of leased facilities, and acquisition and development activities.

In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements. These new aggregate annual rents of approximately $239 million (including the Ventas Facilities) became effective retroactively to July 19, 2006 and were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under the Master Lease Agreements. Aggregate annual Ventas rents prior to the rent reset approximated $206 million (including the Ventas Facilities). Aggregate Ventas rent expense totaled $237 million in 2008, $230 million in 2007 and $198 million in 2006.

Depreciation and amortization expense increased to $122 million in 2008 from $120 million in 2007 and $116 million in 2006.

Interest expense aggregated $15 million in 2008 compared to $17 million in 2007 and $14 million in 2006. The decrease in 2008 was primarily attributable to a decline in interest rates under our revolving credit facility compared to a year ago. The increase in 2007 was primarily attributable to increased borrowings under our revolving credit facility related to our acquisition and development activities.

Investment income related primarily to our insurance subsidiary investments totaled $7 million in 2008 compared to $16 million in 2007 and $15 million in 2006. Investment income was negatively impacted in 2008 by declining investment yields and approximately $2 million of pretax other-than-temporary impairments of investments held in our insurance subsidiary investment portfolio.

Income Taxes

The provision for income taxes is based upon our estimate of annual taxable income or loss for each respective accounting period and includes the effect of certain non-taxable and non-deductible items. Our effective income tax rate was 38.7% in 2008, 46.4% in 2007 and 39.4% in 2006. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction. We recorded favorable income tax adjustments related to the resolution of certain income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million in each of 2008 and 2007, and $3 million in 2006.

We have reduced our net deferred tax assets by a valuation allowance to the extent we do not believe it is "more likely than not" that the asset ultimately will be realizable.

In 2006, we reached a settlement with the IRS related to all disputed federal income tax issues for fiscal 2000 and 2001. In connection with the settlement, we paid approximately $3 million of employer payroll taxes to the IRS in 2007. Because of fresh-start accounting rules related to our reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

We had no net operating loss carryforwards at December 31, 2008. Our aggregate net operating loss carryforwards aggregated $10 million at December 31, 2007.

Consolidated Results

Income from continuing operations before income taxes increased 30% to $96 million in 2008 from $74 million in 2007 and declined 43% in 2007 from $130 million in 2006. Net income from continuing operations increased 49% to $59 million in 2008 and declined 50% in 2007 to $40 million.

Results of Operations – Discontinued Operations

Net loss from discontinued operations aggregated $2 million in 2008, $10 million in 2007 and $0.2 million in 2006. Discontinued operations included a favorable pretax adjustment of $10 million ($6 million net of income taxes) in 2008, a pretax charge of approximately $2 million ($1 million net of income taxes) in 2007 and a favorable pretax adjustment of $19 million ($12 million net of income taxes) in 2006 resulting from changes in estimates for professional liability reserves related to prior years.

We recorded a pretax loss on divestiture of operations of $44 million ($27 million net of income taxes) during 2008 related to the planned divestiture of two LTAC hospitals. We recorded a pretax gain on divestiture of operations of $10 million ($6 million net of income taxes) during 2008 and a pretax loss on divestiture of operations of $113 million ($69 million net of income taxes) during 2007 related to the sale of the Ventas Facilities. During 2007, we also recorded a pretax loss on divestiture of operations related to the HCP Transaction of $13 million ($8 million net of income taxes).

See notes 3, 4 and 9 of the notes to consolidated financial statements.

Liquidity

Operating cash flows and capital spending

Cash flows provided by operations (including discontinued operations) aggregated $183 million for 2008, $163 million for 2007 and $130 million for 2006. During each year we maintained sufficient liquidity to fund our ongoing capital expenditure program and finance our ongoing hospital development expenditures as well as our acquisition and strategic divestiture activities.

Our operating cash flows in 2008 and 2007 increased primarily as a result of improved accounts receivable collections and lower income tax payments. Federal income tax payments totaled $6 million in 2008, $17 million in 2007 and $55 million in 2006.

Cash and cash equivalents totaled $141 million at December 31, 2008 compared to $33 million at December 31, 2007. Our long-term debt at December 31, 2008 aggregated $350 million (substantially all of which related to borrowings under our revolving credit facility). Based upon our existing cash levels, expected operating cash flows and capital spending (including planned acquisition and development activities), and the availability of borrowings under our revolving credit facility, we believe that we have the necessary financial resources to satisfy our expected short-term and long-term liquidity needs.

In May 2008, we received a cash distribution of $7 million related to a partnership land sale. We have a noncontrolling ownership interest in the partnership that is accounted for under the equity method of accounting. No gain or loss was recognized on the land sale.

In April 2008, we repaid a capital lease obligation of approximately $16 million in connection with a purchase option under a hospital lease agreement.

Revolving credit facility and financing activities

In July 2007, we completed certain amendments to our revolving credit facility. Under the terms of the revolving credit facility as amended, the aggregate amount of the credit was increased to $500 million. The credit may be increased to $600 million at our option subject to lender approval and certain other conditions. The term of the revolving credit facility was extended by an additional three years until July 2012. The revolving credit facility also establishes permitted acquisitions and certain investments by us at $500 million in the aggregate and allows for up to $150 million of certain restricted payments including, among other things, the repurchase of common stock and payment of cash dividends.

Interest rates under the revolving credit facility are based, at our option, upon (a) LIBOR plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. The revolving credit facility is collateralized by substantially all of our assets including certain owned real property and is guaranteed by substantially all of our subsidiaries. The revolving credit facility constitutes a working capital facility for general corporate purposes and permitted acquisitions and investments in healthcare facilities and companies up to certain limits. The terms of our revolving credit facility include a certain defined fixed payment ratio covenant and covenants which limit acquisitions and annual capital expenditures. We were in compliance with the terms of our revolving credit facility at December 31, 2008.

Despite the recent turmoil within the financial markets nationally and globally, we are not aware of any individual lender limitations to extend credit under our revolving credit facility. However, the obligations of each of the lending institutions in our revolving credit facility are separate and the availability of future borrowings under our revolving credit facility could be impacted by the ongoing volatility and disruptions in the financial credit markets or other events.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $39 million in 2008, $37 million in 2007 and $34 million in 2006 from our limited purpose insurance subsidiary. These proceeds were used primarily to repay borrowings under our revolving credit facility.

Strategic divestitures

In September 2008, we purchased for resale a previously leased LTAC hospital for $22 million and announced our intention to dispose of another LTAC hospital and its related operations. We expect to dispose of these two hospitals in 2009 and generate approximately $8 million in proceeds from the sales.

Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. We used these proceeds to reduce outstanding borrowings under our revolving credit facility.

In June 2007, we paid approximately $176 million to purchase the Ventas Facilities with borrowings under our revolving credit facility. During 2007 and 2008, we sold the Ventas Facilities for approximately $95 million. See note 3 of the notes to consolidated financial statements.

In January 2007, we paid $37 million as part of the consideration to complete the HCP Transaction. We also divested the 11 nursing centers acquired in the HCP Transaction during 2007 and received proceeds of $78 million, which were used to repay borrowings under our revolving credit facility.

Equity transactions

In August 2007, our Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, we expended $50 million to purchase approximately 2.6 million shares of our common stock. We financed these repurchases from both internally generated funds and borrowings under our revolving credit facility. We did not purchase any common stock in 2008 and the authorization expired during 2008.

During 2005 and 2006, we repurchased approximately 3.8 million shares of our common stock in the open market at an aggregate cost of $100 million. We financed these repurchases from both internally generated funds and borrowings under our revolving credit facility.

In connection with the exercise of our Series A warrants and Series B warrants in April 2006, we issued approximately 10.1 million shares of common stock and received net proceeds of approximately $142 million. These proceeds were used to repurchase approximately 5.8 million shares of our common stock in the open market in 2006.

Debt and lease obligations

Future payments of principal and interest due under long-term debt agreements and lease obligations as of December 31, 2008 follows (in thousands):

	Payments due by period					
	Revolving	Other	Non-cancelable operating leases			
	credit	long-term				
Year	facility (a)	debt	Ventas (b)	Other	Subtotal	Total
2009	$ 11,561	$ 127	$ 242,853	$ 70,115	$ 312,968	$ 324,656
2010	11,561	128	162,009	66,136	228,145	239,834
2011	11,561	128	122,494	62,921	185,415	197,104
2012	355,066	127	124,309	58,073	182,382	537,575
2013	–	127	41,640	57,192	98,832	98,959
Thereafter	–	393	–	291,381	291,381	291,774
	$ 389,749	$ 1,030	$ 693,305	$ 605,818	$ 1,299,123	$ 1,689,902

(a) Revolving credit facility interest is based upon the weighted average interest rate of 3.3% as of December 31, 2008.
(b) See "Part I – Business – Master Lease Agreements – Rental Amounts and Escalators."

As previously discussed, we adopted the provisions of FIN 48 on January 1, 2007. As of December 31, 2008, we had approximately $10 million of total gross unrecognized tax benefits and $1 million of accrued interest related to uncertain tax positions. Because future cash outflows related to these unrecognized tax benefits are uncertain, they are excluded from the table above.

Capital Resources

Excluding acquisitions, capital expenditures totaled $149 million in 2008, $186 million in 2007 and $151 million in 2006. Excluding acquisitions, capital expenditures (including hospital development) could approximate $150 million to $170 million in 2009. We believe that our capital expenditure program is adequate to improve and equip existing facilities. Capital expenditures in each of the last three years were financed primarily through internally generated funds. At December 31, 2008, the estimated cost to complete and equip construction in progress approximated $64 million.

During 2008, we acquired four previously leased nursing centers for approximately $24 million. Annual rents associated with the four nursing centers approximated $3 million. These transactions were financed through borrowings under our revolving credit facility.

During 2007, we acquired eight previously leased nursing centers and one previously leased hospital for approximately $113 million. Annual rents associated with these facilities approximated $10 million. In July 2007, we acquired a combined nursing center and assisted living facility for approximately $20 million. These transactions were financed through borrowings under our revolving credit facility.

In February 2007, we entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8 million.

In February 2006, we completed the Commonwealth Transaction for a total purchase price of $124 million in cash and the assumption of certain operating lease obligations. The acquisition was financed primarily with borrowings under our revolving credit facility.

We expended $11 million during 2006 for acquisitions in our former pharmacy division. We financed these acquisitions primarily through the use of operating cash flows.

At December 31, 2008, the remaining permitted acquisition amount under our revolving credit facility aggregated $299 million.

Other Information

Effects of Inflation and Changing Prices

We derive a substantial portion of our revenues from the Medicare and Medicaid programs. Congress and certain state legislatures have enacted or may enact additional significant cost containment measures limiting our ability to recover our cost increases through increased pricing of our healthcare services. Medicare revenues in LTAC hospitals and nursing centers are subject to fixed payments under the Medicare prospective payment systems.

Medicaid reimbursement rates in many states in which we operate nursing centers also are based upon fixed payment systems. Generally, these rates are adjusted annually for inflation. However, these adjustments may not reflect the actual increase in the costs of providing healthcare services.

We believe that our operating margins may continue to be under pressure as the growth in operating expenses, particularly professional liability, labor and employee benefits costs, exceeds payment increases from third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients is limited.

See "Part I – Item 1 – Business – Governmental Regulation" for a detailed discussion of Medicare and Medicaid reimbursement regulations.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The following discussion of our exposure to market risk contains "forward-looking statements" that involve risks and uncertainties. Given the unpredictability of interest rates as well as other factors, actual results could differ materially from those projected in such forward-looking information.

Our exposure to market risk relates to changes in the prime rate, federal funds rate and LIBOR which affect the interest paid on certain borrowings.

The following table provides information about our financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted average interest rates by expected maturity date.

Interest Rate Sensitivity
Principal (Notional) Amount by Expected Maturity
Average Interest Rate
(Dollars in thousands)

	Expected maturities							Fair value 12/31/08
	2009	2010	2011	2012	2013	Thereafter	Total	
Liabilities:								
Long-term debt, including amounts due within one year:								
Fixed rate	$ 81	$ 86	$ 91	$ 96	$ 102	$ 358	$ 814	$ 803(a)
Average interest rate	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%		
Variable rate (b)	$ –	$ –	$ –	$ 348,700	$ –	$ –	$ 348,700	$ 348,700

(a) Calculated based upon the net present value of future principal and interest payments using a discount rate of 6%.

(b) Interest on borrowings under our revolving credit facility is payable, at our option, at (1) LIBOR plus an applicable margin ranging from 1.25% to 2.00% or (2) the applicable margin ranging from 0.25% to 1.00% plus the higher of the prime rate or 0.5% over the federal funds rate. The applicable margin is based upon our average daily excess availability as defined in our revolving credit facility.

Item 8. ***Financial Statements and Supplementary Data***

The information required by this Item 8 is included in appendix pages F-2 through F-41 of this Annual Report on Form 10-K.

Item 9. ***Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

Not applicable.

Item 9A. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting

We have carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can

only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2008, the disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2008, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based upon our assessment and those criteria, management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2008.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2008 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, who also audited our consolidated financial statements included in this Annual Report on Form 10-K, as stated in their report which appears in our consolidated financial statements.

Item 9B. ***Other Information***

Not applicable.

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PART III

Item 10. *Directors, Executive Officers and Corporate Governance*

EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names, ages (as of January 1, 2009) and present and past positions of our current executive officers:

Name	Age	Position
Paul J. Diaz	47	President and Chief Executive Officer
Edward L. Kuntz	63	Executive Chairman of the Board
Frank J. Battafarano	58	Chief Operating Officer
Richard A. Lechleiter	50	Executive Vice President and Chief Financial Officer
Lane M. Bowen	58	Executive Vice President and President, Health Services Division
Benjamin A. Breier	37	Executive Vice President and President, Hospital Division
Richard E. Chapman	60	Executive Vice President and Chief Administrative and Information Officer
Christopher M. Bird	44	President, People*first* Rehabilitation Division
William M. Altman	49	Senior Vice President, Strategy and Public Policy
Joseph L. Landenwich	44	Senior Vice President of Corporate Legal Affairs and Corporate Secretary
Gregory C. Miller	39	Senior Vice President, Corporate Development and Financial Planning
M. Suzanne Riedman	57	Senior Vice President and General Counsel

Paul J. Diaz has served as one of our directors since May 2002, as our Chief Executive Officer since January 1, 2004 and as our President since January 2002. Mr. Diaz served as our Chief Operating Officer from January 2002 to December 31, 2003.

Edward L. Kuntz has served as our Executive Chairman of the Board since January 1, 2004. Mr. Kuntz served as our Chairman of the Board and Chief Executive Officer from January 1999 to December 31, 2003. He also served as our President from November 1998 to January 2002. He served as our Chief Operating Officer and a director from November 1998 to January 1999.

Frank J. Battafarano has served as our Chief Operating Officer since March 2008. He served as our Executive Vice President from February 2005 to March 2008 and as President, Hospital Division from November 1998 to March 2008.

Richard A. Lechleiter, a certified public accountant, has served as our Executive Vice President and Chief Financial Officer since February 2005. He served as Senior Vice President and Chief Financial Officer from February 2002 to February 2005.

Lane M. Bowen has served as our Executive Vice President since February 2005 and as President, Health Services Division since October 2002.

Benjamin A. Breier has served as our Executive Vice President and President, Hospital Division since March 2008. He served as President, People*first* Rehabilitation division from August 2005 to March 2008. Prior to joining us, Mr. Breier served as Senior Vice President, Operations for Concentra, Inc., a leading provider of workers compensation and occupational health services, from December 2003 to August 2005.

Richard E. Chapman has served as our Executive Vice President and Chief Administrative and Information Officer since February 2005. He served as Chief Administrative and Information Officer and Senior Vice President from January 2001 to February 2005.

Christopher M. Bird has served as our President, People*first* Rehabilitation division since April 2008. Prior to joining us, Mr. Bird served as Vice President, Operations and Business Development, Outpatient Services Division with Tenet Healthcare Corp., which owns and operates acute care hospitals and related

ancillary healthcare businesses, from May 2006 to April 2008. Mr. Bird served as Division Vice President, Western Division, with DaVita, Inc., a provider of dialysis services for patients suffering from chronic kidney failure, from December 2001 to April 2006.

William M. Altman, an attorney, has served as our Senior Vice President, Strategy and Public Policy since January 1, 2008. He served as Senior Vice President, Compliance and Government Programs from April 2002 to December 2007.

Joseph L. Landenwich, an attorney and certified public accountant, has served as our Senior Vice President of Corporate Legal Affairs and Corporate Secretary since December 2003. Mr. Landenwich served as Vice President of Corporate Legal Affairs and Corporate Secretary from November 1999 to December 2003.

Gregory C. Miller has served as our Senior Vice President, Corporate Development and Financial Planning since January 2005. He served as our Vice President, Corporate Development and Financial Planning from January 2004 to January 2005.

M. Suzanne Riedman, an attorney, has served as our Senior Vice President and General Counsel since August 1999. She served as our Vice President and Associate General Counsel from April 1998 to August 1999.

The information required by this Item, other than the information set forth above under "Executive Officers of the Registrant," is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 11. *Executive Compensation*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 14. *Principal Accounting Fees and Services*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a)(1) and (a)(2) Index to Consolidated Financial Statements and Financial Statement Schedules:

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Financial Statement Schedule (a):	
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(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

(a)(3) **Index to Exhibits:**

Exhibit number	Description of document
2.1	Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code. Exhibit 2.1 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.2	Order Confirming the Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code, as entered by the United States Bankruptcy Court for the District of Delaware on March 16, 2001. Exhibit 2.2 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.3	Purchase and Sale Agreement by and among those entities listed on Schedule P thereto as buying entities, those entities listed on Schedule P thereto as selling entities and Jeffrey A. Goldshine, Douglas B. Noble, and Mary Catherine Rumsey, and solely for purposes of Article III thereof and the Guaranty, Kindred Healthcare Operating, Inc., dated as of October 24, 2005. Exhibit 2.1 to the Company's Current Report on Form 8-K dated October 24, 2005 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.4*	Master Transaction Agreement, dated as of October 25, 2006, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.5	Amendment No. 1 To Master Transaction Agreement, dated as of June 4, 2007, among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 4, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.6*	Amendment No. 2 To Master Transaction Agreement, dated as of July 31, 2007, among AmerisourceBergen Corporation, PharMerica Long-Term Care, Inc. (formerly named PharMerica, Inc.), Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., PharMerica Corporation (formerly named Safari Holding Corporation), Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 2.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.1	Amended and Restated Certificate of Incorporation of the Company. Exhibit 4.1 to the Company's Registration Statement on Form S-3 filed August 31, 2001 (Comm. File No. 333-68838) is hereby incorporated by reference.
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation. Exhibit 3.1 to the Company's Form 10-Q for the quarterly period ended March 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.3	Amended and Restated Bylaws of the Company. Exhibit 3.1 to the Company's Current Report on Form 8-K dated December 17, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
4.1	Articles IV, IX, X and XII of the Restated Certificate of Incorporation of the Company is included in Exhibit 3.1.

Exhibit number	Description of document
10.1	Second Amended and Restated Credit Agreement dated as of July 18, 2007 among the Company, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, J.P. Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, Citicorp USA, Inc., as Syndication Agent, and General Electric Capital Corporation, The CIT Group/Business Credit, Inc. and Wells Fargo Foothill, as Co-Documentation Agents. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.2	Tax Allocation Agreement dated as of April 30, 1998 by and between Vencor, Inc. and Ventas, Inc. Exhibit 10.9 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.3	Agreement of Indemnity-Third Party Leases dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.4	Agreement of Indemnity-Third Party Contracts dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.12 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.5	Form of Indemnification Agreement between the Company and certain of its officers and employees. Exhibit 10.31 to the Ventas, Inc. Form 10-K for the year ended December 31, 1995 (Comm. File No. 1-10989) is hereby incorporated by reference.
10.6	Form of Indemnification Agreement between the Company and each member of its Board of Directors. Exhibit 10.21 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.7**	Kindred Deferred Compensation Plan, Third Amendment and Restatement effective as of January 1, 2009. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.8	Tax Refund Escrow Agreement and First Amendment to the Tax Allocation Agreement made and entered into as of the 20th of April 2001 by and between the Company and each of its subsidiaries and Ventas, Inc., Ventas Realty Limited Partnership and Ventas LP Realty, L.L.C. Exhibit 10.31 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.9**	Vencor, Inc. Supplemental Executive Retirement Plan dated January 1, 1998, as amended. Exhibit 10.27 to the Company's Registration Statement on Form S-4 (Reg. No. 333-57953) is hereby incorporated by reference.
10.10**	Amendment No. Two to Supplemental Executive Retirement Plan dated as of January 15, 1999. Exhibit 10.48 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.11**	Amendment No. Three to Supplemental Executive Retirement Plan dated as of December 31, 1999. Exhibit 10.49 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.12**	Amendment No. 4 to the Vencor, Inc. Supplemental Executive Retirement Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended March 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.13**	Amendment No. 5 to Supplemental Executive Retirement Plan. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended September 30, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.14**	Amendment No. 6 to Supplemental Executive Retirement Plan. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.15**	Amended and Restated Kindred Healthcare, Inc. Long-Term Incentive Plan. Exhibit 10.2 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.16**	Amended and Restated Kindred Healthcare, Inc. Short-Term Incentive Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.17**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Edward L. Kuntz. Exhibit 10.1 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.18**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Edward L. Kuntz. Exhibit 10.2 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.19**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.3 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.20**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.4 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.21**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard E. Chapman.
10.22**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard E. Chapman.
10.23**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Frank J. Battafarano. Exhibit 10.7 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.24**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Frank J. Battafarano. Exhibit 10.8 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.25**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and M. Suzanne Riedman.
10.26**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and M. Suzanne Riedman.
10.27**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.5 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.28**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.6 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.29**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and William M. Altman.
10.30**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and William M. Altman.
10.31**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.9 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.32**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.10 to the Company's Current Report on Form 8-K dated December 18, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.33**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Joseph L. Landenwich.
10.34**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Joseph L. Landenwich.
10.35**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier.
10.36**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier.
10.37**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller.
10.38**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller.
10.39**	Employment Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Christopher M. Bird.
10.40**	Change-in-Control Severance Agreement dated as of December 18, 2008 by and between Kindred Healthcare Operating, Inc. and Christopher M. Bird.
10.41	Second Amended and Restated Master Lease Agreement No. 1 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.42	Amendment to Memorandum of Lease and Specific Property Lease Amendment dated as of June 8, 2007 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.47 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.43	Second Amended and Restated Master Lease Agreement No. 2 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.

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Exhibit number	Description of document
10.44	Second Amended and Restated Master Lease Agreement No. 3 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.45	Second Amended and Restated Master Lease Agreement No. 4 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.46	Amendment to Master Lease and Memorandum of Lease dated as of August 7, 2007 by and among Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.51 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.47	Master Lease among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated May 16, 2001. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.48	First Amendment to Master Lease dated effective August 1, 2001 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.53 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.49	Second Amendment to Master Lease dated as of November 18, 2003 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.54 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.50	Third Amendment to Master Lease dated and effective as of June 30, 2004 by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee. Exhibit 10.55 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.51	Fourth Amendment to Master Lease by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated February 26, 2006. Exhibit 10.71 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.52	Fifth Amendment to Master Lease by and among Health Care Property Investors, Inc., Health Care Property Partners, Texas HCP Holding, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C., Kindred Nursing Centers Limited Partnership and Transitional Hospitals Corporation of Wisconsin, Inc., collectively, as Lessee, dated January 31, 2007. Exhibit 10.72 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.53	Sixth Amendment to Master Lease by and among Health Care Property Investors, Inc., Health Care Property Partners, Texas HCP Holding, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C., Kindred Nursing Centers Limited Partnership and Transitional Hospitals Corporation of Wisconsin, Inc., collectively, as Lessee, dated December 8, 2008.
10.54	Master Lease Agreement dated as of February 28, 2006 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended March 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.55	First Amendment to Master Lease Agreement dated as of June 20, 2007 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant. Exhibit 10.59 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.56	Master Lease Agreement dated as of February 28, 2006 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant. Exhibit 10.7 to the Company's Form 10-Q for the quarterly period ended March 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.57	First Amendment to Master Lease Agreement dated as of July 25, 2007 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant. Exhibit 10.61 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.58	Second Amendment to Master Lease Agreement dated as of December 5, 2007 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant. Exhibit 10.62 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.59	Third Amendment to Master Lease Agreement dated as of September 26, 2008 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.60	Agreement and Plan of Reorganization between the Company and Ventas, Inc. Exhibit 10.1 to the Company's Form 10, as amended, dated April 27, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.61**	The Company's 2000 Stock Option Plan. Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.62**	The Company's Restricted Share Plan. Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.63**	Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 22, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.64**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.65**	Form of Kindred Healthcare, Inc. Incentive Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated.

Exhibit number	Description of document
10.66**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.67**	Form of Kindred Healthcare, Inc. Stock Bonus Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.70 to the Company's Form 10-K for the year ended December 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.68**	Form of Kindred Healthcare, Inc. Performance Unit Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.69**	Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.70**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.71**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.72**	Form of Amendment No. 1 to Non-Discretionary Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.73**	Form of Amendment No. 1 to Discretionary Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.74	Tax Matters Agreement, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Pharmacy Services, Inc. and Safari Holding Corporation, in each case on behalf of itself and its Affiliates. Exhibit 10.2 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.75	Other Debt Instruments – Copies of debt instruments for which the related debt is less than 10% of total assets will be furnished to the SEC upon request.
21	List of Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
31	Rule 13a-14(a)/15d-14(a) Certifications.
32	Section 1350 Certifications.

* The Company will furnish supplementally to the SEC upon request a copy of any omitted exhibit or annex.

** Compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(b) of this Annual Report on Form 10-K.

(b) Exhibits.

The response to this portion of Item 15 is submitted as a separate section of this Annual Report on Form 10-K.

(c) Financial Statement Schedules.

The response to this portion of Item 15 is included in appendix page F-41 of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 25, 2009

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Joel Ackerman **Joel Ackerman**	Director	February 25, 2009
/s/ Ann C. Berzin **Ann C. Berzin**	Director	February 25, 2009
/s/ Jonathan D. Blum **Jonathan D. Blum**	Director	February 25, 2009
/s/ Thomas P. Cooper, M.D. **Thomas P. Cooper, M.D.**	Director	February 25, 2009
/s/ Garry N. Garrison **Garry N. Garrison**	Director	February 25, 2009
/s/ Isaac Kaufman **Isaac Kaufman**	Director	February 25, 2009
/s/ John H. Klein **John H. Klein**	Director	February 25, 2009
/s/ Eddy J. Rogers, Jr. **Eddy J. Rogers, Jr.**	Director	February 25, 2009
/s/ Edward L. Kuntz **Edward L. Kuntz**	Executive Chairman of the Board	February 25, 2009
/s/ Paul J. Diaz **Paul J. Diaz**	President and Chief Executive Officer (Principal Executive Officer)	February 25, 2009
/s/ Richard A. Lechleiter **Richard A. Lechleiter**	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 25, 2009
/s/ John J. Lucchese **John J. Lucchese**	Senior Vice President and Corporate Controller (Principal Accounting Officer)	February 25, 2009

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(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of Kindred Healthcare, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Kindred Healthcare, Inc. and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

Louisville, Kentucky
February 25, 2009

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year ended December 31,		
	2008	2007	2006
Revenues	$ 4,151,396	$ 4,179,891	$ 4,090,365
Salaries, wages and benefits	2,409,673	2,358,914	2,217,582
Supplies	320,410	546,075	671,857
Rent	344,952	343,717	294,186
Other operating expenses	868,026	743,497	660,731
Other income	(17,407)	(7,701)	–
Depreciation and amortization	121,413	120,421	116,182
Interest expense	15,373	17,044	13,920
Investment income	(7,101)	(16,109)	(14,491)
	4,055,339	4,105,858	3,959,967
Income from continuing operations before income taxes	96,057	74,033	130,398
Provision for income taxes	37,164	34,385	51,417
Income from continuing operations	58,893	39,648	78,981
Discontinued operations, net of income taxes:			
Loss from operations	(1,832)	(9,497)	(238)
Loss on divestiture of operations	(20,776)	(77,021)	(32)
Net income (loss)	$ 36,285	$ (46,870)	$ 78,711
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	$ 1.56	$ 1.02	$ 2.02
Discontinued operations:			
Loss from operations	(0.05)	(0.24)	(0.01)
Loss on divestiture of operations	(0.55)	(1.99)	–
Net income (loss)	$ 0.96	$ (1.21)	$ 2.01
Diluted:			
Income from continuing operations	$ 1.51	$ 0.99	$ 1.93
Discontinued operations:			
Loss from operations	(0.05)	(0.23)	(0.01)
Loss on divestiture of operations	(0.53)	(1.93)	–
Net income (loss)	$ 0.93	$ (1.17)	$ 1.92
Shares used in computing earnings (loss) per common share:			
Basic	37,830	38,791	39,108
Diluted	38,906	39,983	40,923

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED BALANCE SHEET
(In thousands, except per share amounts)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 140,795	$ 32,877
Cash–restricted	5,104	5,360
Insurance subsidiary investments	196,983	231,693
Accounts receivable less allowance for loss of $27,548 – 2008 and $33,305 – 2007	611,032	598,108
Inventories	22,325	22,035
Deferred tax assets	58,296	59,936
Income taxes	47,257	43,128
Other	20,843	20,510
	1,102,635	1,013,647
Property and equipment, at cost:		
Land	46,388	45,768
Buildings	702,178	588,145
Equipment	572,682	499,417
Construction in progress	71,388	92,781
	1,392,636	1,226,111
Accumulated depreciation	(656,676)	(542,773)
	735,960	683,338
Goodwill	72,244	69,100
Intangible assets less accumulated amortization of $1,817 – 2008 and $1,095 – 2007	64,367	79,956
Assets held for sale	7,786	15,837
Insurance subsidiary investments	48,610	49,166
Deferred tax assets	100,751	113,854
Other	49,408	54,654
	$ 2,181,761	$ 2,079,552
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 178,246	$ 180,367
Salaries, wages and other compensation	281,542	261,608
Due to third party payors	33,122	41,980
Professional liability risks	55,447	64,740
Other accrued liabilities	76,832	80,663
Long-term debt and capital lease obligation due within one year	81	584
	625,270	629,942
Long-term debt	349,433	275,814
Capital lease obligation	–	15,760
Professional liability risks	187,804	186,652
Deferred credits and other liabilities	104,279	109,260
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.25 par value; authorized 1,000 shares; none issued and outstanding	–	–
Common stock, $0.25 par value; authorized 175,000 shares; issued 38,909 shares – 2008 and 38,339 shares – 2007	9,727	9,585
Capital in excess of par value	812,141	790,367
Accumulated other comprehensive income (loss)	(3,619)	1,250
Retained earnings	96,726	60,922
	914,975	862,124
	$ 2,181,761	$ 2,079,552

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)

	Shares of common stock	Par value common stock	Capital in excess of par value	Deferred compensation	Accumulated other comprehensive income/(loss)	Retained earnings	Total
Balances, December 31, 2005	37,331	$ 9,333	$ 673,358	$ (14,228)	$ (60)	$ 202,133	$ 870,536
Comprehensive income:							
Net income						78,711	78,711
Net unrealized investment gains, net of income taxes					1,124		1,124
Comprehensive income							79,835
Conversion to SFAS 123R (as defined) as of January 1, 2006			(14,228)	14,228			–
Grant of non-vested restricted stock	343	86	(86)				–
Issuance of common stock in connection with employee benefit plans	111	27	1,560				1,587
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(124)	(31)	(2,549)			(765)	(3,345)
Issuance of common stock in connection with warrant exercises	8,795	2,198	140,115				142,313
Cashless warrant exercise	1,351	338	21,455			(21,793)	–
Repurchase of common stock, at cost	(7,829)	(1,957)	(125,351)			(67,002)	(194,310)
Stock-based compensation amortization			18,557				18,557
Pre-emergence deferred tax valuation allowance adjustment			79,832				79,832
Income tax benefit in connection with the issuance of common stock under employee benefit plans			391				391
Other					182		182
Balances, December 31, 2006	39,978	9,994	793,054	–	1,246	191,284	995,578
Comprehensive loss:							
Net loss						(46,870)	(46,870)
Net unrealized investment gains, net of income taxes					349		349
Comprehensive loss							(46,521)
Grant of non-vested restricted stock	437	109	(109)				–
Issuance of common stock in connection with employee benefit plans	597	150	10,457			(142)	10,465
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(114)	(28)	(2,564)			(293)	(2,885)
Spin-off Transaction (as defined)						(80,220)	(80,220)
Repurchase of common stock, at cost	(2,559)	(640)	(46,520)			(2,837)	(49,997)
Stock-based compensation amortization			31,222				31,222
Pre-emergence income tax liability adjustment			2,950				2,950
Income tax benefit in connection with the issuance of common stock under employee benefit plans			1,877				1,877
Other					(345)		(345)
Balances, December 31, 2007	38,339	9,585	790,367	–	1,250	60,922	862,124
Comprehensive income:							
Net income						36,285	36,285
Net unrealized investment losses, net of income taxes					(3,044)		(3,044)
Comprehensive income							33,241
Grant of non-vested restricted stock	166	41	(41)				–
Issuance of common stock in connection with employee benefit plans	504	126	9,016			(277)	8,865
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(100)	(25)	(2,326)			(53)	(2,404)
Stock-based compensation amortization			12,637				12,637
Pre-emergence income tax liability adjustment			1,385				1,385
Income tax benefit in connection with the issuance of common stock under employee benefit plans			1,103				1,103
Other					(1,825)	(151)	(1,976)
Balances, December 31, 2008	38,909	$ 9,727	$ 812,141	$ –	$ (3,619)	$ 96,726	$ 914,975

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year ended December 31,		
	2008	2007	2006
Cash flows from operating activities:			
Net income (loss)	$ 36,285	$ (46,870)	$ 78,711
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	122,265	124,280	124,042
Amortization of stock-based compensation costs	12,637	31,222	18,557
Provision for doubtful accounts	32,336	30,093	35,149
Deferred income taxes	20,793	(9,148)	(1,976)
Loss on divestiture of discontinued operations	20,776	77,021	32
Other	1,029	(4,022)	(7,826)
Change in operating assets and liabilities:			
Accounts receivable	(46,610)	(97,292)	(141,220)
Inventories and other assets	(11,489)	18,123	(10,713)
Accounts payable	(5,080)	6,804	20,805
Income taxes	9,052	11,477	(12,875)
Due to third party payors	(8,309)	14,196	1,142
Other accrued liabilities	(606)	7,499	26,156
Net cash provided by operating activities	183,079	163,383	129,984
Cash flows from investing activities:			
Purchase of property and equipment	(148,677)	(186,488)	(151,074)
Acquisitions	(48,824)	(351,097)	(135,086)
Sale of assets	27,984	148,490	13,644
Purchase of insurance subsidiary investments	(121,693)	(142,897)	(215,969)
Sale of insurance subsidiary investments	119,810	151,725	230,830
Net change in insurance subsidiary cash and cash equivalents	31,064	(6,246)	(12,583)
Net change in other investments	7,002	1,514	1,668
Other	2,568	4,982	(5,860)
Net cash used in investing activities	(130,766)	(380,017)	(274,430)
Cash flows from financing activities:			
Proceeds from borrowings under revolving credit	1,498,000	1,746,600	1,459,900
Repayment of borrowings under revolving credit	(1,424,300)	(1,600,800)	(1,330,700)
Repayment of long-term debt	(76)	(71)	(3,311)
Repayment of capital lease obligation	(16,268)	–	–
Payment of deferred financing costs	(508)	(3,059)	(1,177)
Proceeds from borrowing related to Spin-off Transaction	–	125,000	–
Issuance of common stock	8,865	10,465	143,900
Repurchase of common stock	–	(49,997)	(194,310)
Other	(10,108)	516	7,581
Net cash provided by financing activities	55,605	228,654	81,883
Change in cash and cash equivalents	107,918	12,020	(62,563)
Cash and cash equivalents at beginning of period	32,877	20,857	83,420
Cash and cash equivalents at end of period	$ 140,795	$ 32,877	$ 20,857
Supplemental information:			
Interest payments	$ 14,661	$ 15,961	$ 10,689
Income tax payments	7,590	23,402	65,453
Rental payments to Ventas, Inc.	239,367	237,860	213,523

See accompanying notes.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ACCOUNTING POLICIES

Reporting entity

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States (collectively, "Kindred" or the "Company").

Basis of presentation

The consolidated financial statements include all subsidiaries. Significant intercompany transactions have been eliminated. Investments in affiliates in which the Company has a 50% or less interest are accounted for by either the equity or cost method.

On July 31, 2007, the Company completed the spin-off of its former institutional pharmacy business. See Note 2.

In recent years, the Company has completed several transactions related to the divestiture of unprofitable hospitals, nursing centers and other healthcare businesses to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2008 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See Notes 3 and 4.

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include amounts based upon the estimates and judgments of management. The Company evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluation, as considered necessary. Actual amounts may differ from those estimates.

Impact of recent accounting pronouncements

In June 2008, the Financial Accounting Standards Board (the "FASB") issued FASB Staff Position Emerging Issues Task Force ("EITF") 03-6-1 ("EITF 03-6-1"), "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities," which clarifies that share-based payment awards that entitle the holder to receive nonforfeitable dividends before vesting would be considered participating securities. As participating securities, these instruments should be included in the calculation of basic earnings per common share. The provisions of EITF 03-6-1 will be effective for fiscal years beginning after December 15, 2008. The adoption of EITF 03-6-1 is not expected to have a material impact on the Company's earnings per common share calculation.

In December 2007, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 141 (revised 2007) ("SFAS 141R"), "Business Combinations," which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at the acquisition date and expensing acquisition and restructuring costs. SFAS 141R will be applied prospectively and is effective for business combinations which occur during fiscal years beginning after December 15, 2008. The Company cannot determine the impact that SFAS 141R will have on its business, financial position, results of operations or liquidity. However, any business combination entered into after the adoption may significantly impact the Company's financial position and results of operations when compared to acquisitions accounted for under previous generally accepted accounting principles and may result in more earnings volatility and generally lower earnings due to the expensing of acquisition costs and restructuring costs.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Impact of recent accounting pronouncements (Continued)

In December 2007, the FASB issued SFAS No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements," which will change the accounting and reporting for minority interests. SFAS 160 will recharacterize minority interests as noncontrolling interests and they will be classified as a component of stockholders' equity. The new consolidation method will significantly change the accounting for transactions with minority-interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on the Company's business, financial position, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 157 ("SFAS 157"), "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 generally accepted accounting principles. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position SFAS No. 157-2 ("SFAS 157-2"), "Effective Date of FASB Statement No. 157," which deferred the effective date of SFAS 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. Accordingly, the Company deferred the adoption of SFAS 157-2 until January 2009. The provisions of SFAS 157 apply to assets and liabilities, including investments, loans and transfers (including sales and securitizations) of financial assets, derivatives, financial liabilities, and other various financial assets and liabilities. The adoption of SFAS 157 did not, and SFAS 157-2 is not expected to, have a material impact on the Company's business, financial position, results of operations or liquidity.

In October 2008, the FASB issued FASB Staff Position SFAS No. 157-3 ("SFAS 157-3"), "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," which clarifies the application of SFAS 157 and provides key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. SFAS 157-3 is effective upon issuance and did not have a material impact on the Company's business, financial position, results of operations or liquidity.

SFAS 157 defines fair value 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. SFAS 157 also 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 standard 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 CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Impact of recent accounting pronouncements (Continued)

The Company's financial assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	December 31, 2008			
	Fair value measurements			Assets/ liabilities at fair value
	Level 1	Level 2	Level 3	
Assets:				
Available-for-sale securities	$ 35,960	$ 104,688	$ –	$ 140,648
Deposits held in money market funds	124,539	–	–	124,539
	$ 160,499	$ 104,688	$ –	$ 265,187
Liabilities	$ –	$ –	$ –	$ –

The Company's available-for-sale securities are held by its wholly owned limited purpose insurance subsidiary and are comprised of money market funds, asset backed securities, corporate bonds, U.S. Treasury notes, equities and commercial paper. These available-for-sale securities and the insurance subsidiary's cash and cash equivalents of $104.9 million, classified as insurance subsidiary investments, are maintained for the payment of claims and expenses related to professional liability and workers compensation risks.

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

The fair value of actively traded debt and equity securities and money market funds are based upon quoted market prices and are generally classified as Level 1. The fair value of inactively traded debt securities are 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 are generally classified as Level 2.

The estimated fair value of the Company's long-term debt at December 31, 2008 and 2007 approximated the respective carrying amounts.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation. These changes did not have any impact on the Company's business, financial position, results of operations or liquidity.

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 and other third party payors.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Revenues (Continued)

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

	Year ended December 31,		
	2008	2007	2006
Medicare	$ 1,755,332	$ 1,865,380	$ 1,896,201
Medicaid	1,107,457	1,094,269	1,054,415
Other third parties	1,557,270	1,541,064	1,487,303
	4,420,059	4,500,713	4,437,919
Eliminations:			
Rehabilitation	(268,663)	(236,539)	(212,044)
Pharmacy	–	(84,283)	(135,510)
	(268,663)	(320,822)	(347,554)
	$ 4,151,396	$ 4,179,891	$ 4,090,365

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less when purchased.

Insurance subsidiary investments

The Company maintains investments 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. The fair value of publicly traded debt and equity securities and money market funds are based upon quoted market prices or observable inputs such as interest rates using either a market or income valuation approach. The Company's insurance subsidiary investments are classified in the accompanying consolidated balance sheet based upon their expected maturities. Expected maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations prior to the stated maturity date.

The Company follows the guidance provided by EITF No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" to assess whether the Company's investments with unrealized loss positions are other-than-temporarily impaired. Unrealized gains and losses, net of deferred income taxes, are reported as a component of accumulated other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary are determined using the specific identification method and are reported in the Company's statement of operations. See Note 10.

Accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Accounts receivable (Continued)

receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of change.

The provision for doubtful accounts totaled $31.2 million for 2008, $27.0 million for 2007 and $31.3 million for 2006. During 2007, the Company recorded a $5.9 million charge related to accounts receivable for certain hospitals acquired in 2006.

Inventories

Inventories consist primarily of pharmaceutical and medical supplies and are stated at the lower of cost (first-in, first-out) or market.

Property and equipment

Property and equipment is carried at cost less accumulated depreciation. Depreciation expense, computed by the straight-line method, was $120.5 million for 2008, $115.9 million for 2007 and $111.0 million for 2006. Depreciation rates for buildings range generally from 20 to 45 years. Leasehold improvements are depreciated over their estimated useful lives or the remaining lease term, whichever is shorter. Estimated useful lives of equipment vary from five to 15 years. Depreciation expense is not recorded for property and equipment classified as held for sale.

Interest costs incurred during the construction of the Company's development projects are capitalized. Capitalized interest for the years ended December 31, 2008, 2007 and 2006 was $2.9 million, $2.6 million and $0.9 million, respectively. Repairs and maintenance are expensed as incurred.

Long-lived assets

The Company regularly reviews the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

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 facility 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 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 are aggregated for purposes of evaluating the carrying values of long-lived assets.

Goodwill and other intangible assets

Intangible assets are comprised primarily of goodwill, certificates of need, customer relationship assets and non-compete agreements primarily originating from business combinations accounted for as purchase transactions.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

A summary of goodwill follows (in thousands):

	Hospital division	Health services division	Rehabilitation division	Pharmacy division	Total
Balances, December 31, 2006	$ 62,613	$ –	$ –	$ 45,239	$ 107,852
Commonwealth Transaction (as defined)	4,985	–	–	–	4,985
Acquisitions	–	639	863	580	2,082
Spin-off Transaction	–	–	–	(45,819)	(45,819)
Balances, December 31, 2007	67,598	639	863	–	69,100
Acquisitions	–	–	1,165	–	1,165
Other	979	–	1,000	–	1,979
Balances, December 31, 2008	$ 68,577	$ 639	$ 3,028	$ –	$ 72,244

In accordance with SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," the Company is required to perform an impairment test for goodwill and indefinite lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. Also, in the fourth quarter of 2008, the market value of the Company's common stock declined significantly below book equity value. The decline was generally attributable to the Company's announcement of weaker than expected third quarter operating results (particularly in its hospital division) and the related reduction in the Company's earnings outlook for the fourth quarter of 2008 and fiscal 2009 as compared with investor expectations. In addition, the deterioration in the debt and equity markets resulting from weak global economic conditions also may have contributed to the decline in the market value of the Company's common stock. The significant difference between book equity value and the market value of the Company's common stock at December 31, 2008 was an indication that the carrying value of the Company's goodwill may have been impaired.

The Company performs its annual goodwill impairment test at the end of each fiscal year for each of its reporting units. A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. Because the components within the Company's operating segments have similar economic characteristics, the Company aggregates the components of its operating segments into one reporting unit. Accordingly, the Company has determined that its reporting units are hospitals, nursing centers, and rehabilitation services.

The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit's fair value to its carrying value. If the carrying value of the reporting unit is greater than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss. Based upon the results of the step one impairment test for goodwill and the impairment test of indefinite lived intangible assets in each of the last three years, no impairment charges were recorded in connection with the Company's annual impairment tests.

Since quoted market prices for the Company's reporting units are not available, the Company applied judgment in determining the fair value of these reporting units for purposes of performing the goodwill impairment test. The Company relied on widely accepted valuation techniques, including equally weighted discounted cash flow and market multiple analyses approaches, which capture both the future income potential of the reporting unit and the market behaviors and actions of market participants in the industry that includes the

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

reporting unit. These types of analyses require the Company to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. The market multiple analysis estimates fair value by applying cash flow multiples to the reporting unit's operating results. The multiples are derived from comparable publicly traded companies with similar operating and investment characteristics to the reporting units.

The Company's analysis indicated that the estimated fair value of each reporting unit exceeded its book equity value. The Company's conclusions were supported by both quantitative and qualitative factors, including the estimate of an implied control premium for acquisitions in the Company's industry, the significant improvements in the Company's fourth quarter operating results and consideration of the Company's updated business expectations. These results significantly exceeded both the Company's third quarter results and fourth quarter expectations (particularly in its hospital division) and represent information not available to investors in determining the market value of the Company's common stock at December 31, 2008.

The Company performed sensitivity analyses on its estimated fair value for each of its reporting units. Two key assumptions in the Company's fair value estimate are the weighted average cost of capital used for discounting its cash flow estimates and the market multiple applied to operating performance. At December 31, 2008, the fair value of each reporting unit exceeded its carrying value, and the excess approximated $476 million for hospitals, $70 million for nursing centers and $158 million for rehabilitation services. The Company noted that an increase of 100 basis points in the weighted average cost of capital would decrease the fair value by approximately $80 million for hospitals, $21 million for nursing centers and $11 million for rehabilitation services, and would not result in an impairment of goodwill attributable to any of the reporting units. A decrease of 100 basis points in the market multiple applied to operating results would decrease the fair value by approximately $90 million for hospitals, $62 million for nursing centers and $12 million for rehabilitation services, and would not result in an impairment of goodwill attributable to any of the reporting units.

The fair values of the Company's indefinite lived intangible assets, primarily hospital certificates of need, are estimated using an excess earnings method, a form of discounted cash flow, which is based upon the concept that net after-tax cash flows provide a return supporting all of the assets of a business operation. The fair values of the Company's indefinite lived intangible assets are derived from projections which include management's best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. At December 31, 2008, the fair value of the Company's hospital certificates of need intangible assets exceeded its carrying value by approximately $15 million. The Company noted that an increase of 100 basis points in the weighted average cost of capital would decrease the fair value by approximately $8 million, and would not result in an impairment of the hospital certificates of need intangible assets.

Although the Company has determined that there was no goodwill or other indefinite lived intangible asset impairments as of December 31, 2008, continued declines in the value of the Company's common stock or adverse changes in the operating environment and related key assumptions used to determine the fair value of the

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

Company's reporting units and indefinite lived intangible assets may result in future impairment charges for a portion or all of these assets. An impairment charge could have a material adverse effect on the Company's business, financial position and results of operations, but would not be expected to have an impact on the Company's cash flows or liquidity.

The Company's other intangible assets include both finite and indefinite lived intangible assets. The Company's other intangible assets with finite lives are amortized under SFAS 142 using the straight-line method over their estimated useful lives ranging from one to five years. A summary of intangible assets at December 31 follows (in thousands):

	2008				2007			
	Cost	Accumulated amortization	Carrying value	Weighted average life	Cost	Accumulated amortization	Carrying value	Weighted average life
Current:								
Employment contract	$ 141	$ (58)	$ 83	1 year	$ 37	$ (21)	$ 16	1 year
Non-current:								
Certificates of need (indefinite life)	61,856	–	61,856		77,080	–	77,080	
Customer relationship assets	1,044	(310)	734	4 years	1,044	(62)	982	4 years
Non-compete agreements	2,834	(1,507)	1,327	5 years	2,927	(1,033)	1,894	5 years
Medicare license (indefinite life)	450	–	450		–	–	–	
	66,184	(1,817)	64,367		81,051	(1,095)	79,956	
	$ 66,325	$ (1,875)	$ 64,450		$ 81,088	$ (1,116)	$ 79,972	

During 2008, a certificate of need intangible asset totaling $15.2 million was determined to be fully impaired upon the decision to close a long-term acute care ("LTAC") hospital in Massachusetts. See Note 3.

Amortization expense computed by the straight-line method totaled $0.9 million for 2008, $4.5 million for 2007 and $5.2 million for 2006. Amortization expense for intangible assets transferred to PharMerica (as defined) in connection with the Spin-off Transaction totaled $2.4 million for 2007 and $3.4 million for 2006.

Estimated annual amortization expense for intangible assets at December 31, 2008 will approximate $0.9 million, $0.8 million, $0.3 million, $0.1 million and zero for the years 2009, 2010, 2011, 2012 and 2013, respectively.

Insurance risks

Provisions for loss for professional liability risks and workers compensation risks are based upon management's best available information including actuarially determined estimates. The provisions for loss related to professional liability risks retained by the Company's wholly owned limited purpose insurance subsidiary are discounted based upon actuarial estimates of claim payment patterns. Provisions for loss related to

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Insurance risks (Continued)

workers compensation risks retained by the Company's limited purpose insurance subsidiary are not discounted. To the extent that expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited. See Notes 4 and 9.

Earnings (loss) per common share

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of warrants, stock options and non-vested restricted stock. See Note 6.

Stock option accounting

The Company recognizes compensation expense in its consolidated financial statements using a Black-Scholes option valuation model for non-vested stock options. See Note 14.

NOTE 2 – SPIN-OFF TRANSACTION

On July 31, 2007, the Company completed the spin-off of its former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to the Company. Immediately after the Spin-off Transaction, the stockholders of the Company and of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from the balance sheet of the Company effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in the operating results of the Company. In accordance with SFAS No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in the historical continuing operations of the Company.

In addition to the pharmacy services contracts noted above, the Company also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters. The Company recorded $17.4 million and $7.7 million in other income in 2008 and 2007, respectively, related to the information systems and transition services agreements.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2 – SPIN-OFF TRANSACTION (Continued)

A summary of the net assets of KPS which were transferred to PharMerica in the Spin-off Transaction follows (in thousands):

Assets:				
Current assets	$	140,934		
Property and equipment, net		24,008		
Goodwill		45,819		
Intangible assets, net		35,655		
Other long-term assets		19,370	$	265,786
Liabilities:				
Current liabilities	$	56,024		
Long-term debt		125,000		
Other long-term liabilities		4,542		185,566
Net assets transferred in 2007				80,220
Deferred income tax assets transferred in 2008				151
Total net assets transferred through 2008			$	80,371

The net assets transferred by the Company were recorded as a reduction to retained earnings.

NOTE 3 – DIVESTITURES

In recent years, the Company has completed certain strategic divestitures to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. See Note 4.

2008 divestitures

In September 2008, the Company purchased for resale a LTAC hospital in Massachusetts for $22.3 million that was previously leased. The Company recorded a pretax loss of $36.9 million ($22.7 million net of income taxes) in 2008 resulting from the losses related to the purchase, closure and planned divestiture of the hospital, including the impairment of a certificate of need intangible asset ($15.2 million), the impairment of property and equipment ($17.3 million) and other costs ($4.4 million). The impairments were a result of the Company's decision to acquire the real estate for resale, close the hospital and relinquish the licensed beds to the Commonwealth of Massachusetts.

In September 2008, the Company also announced its intention to dispose of a LTAC hospital in California and its related operations. The hospital operations have been closed but the Company continues to operate a co-located 64-bed skilled nursing unit. The Company recorded a pretax loss of $7.4 million ($4.6 million net of income taxes) during 2008 related to the impairment of the hospital's building and equipment. The impairment of the building and equipment was a result of the Company's voluntary termination of its participation in the Medicare program.

These two hospitals generated pretax losses of approximately $8 million in each of 2008 and 2007, and
$5 million in 2006. The Company expects to dispose of these two hospitals in 2009 and generate approximately $8 million in proceeds from the sales.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 – DIVESTITURES (Continued)

2008 divestitures (Continued)

The Company also discontinued the operations of a hospital in 2008 after terminating the hospital operating lease and ceasing operations.

2007 divestitures

In June 2007, the Company purchased for resale 21 nursing centers and one LTAC hospital (collectively, the "Ventas Facilities") previously leased from Ventas, Inc. ("Ventas") for $171.5 million (the "Facility Acquisitions"). In addition, the Company paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax income of approximately $3 million in 2008 and pretax losses of approximately $4 million in 2007 and $10 million in 2006.

During 2007 and 2008, the Company sold the Ventas Facilities for approximately $95 million. The Company recorded a pretax gain of $10.5 million ($6.5 million net of income taxes) during 2008 and a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to sale of the Ventas Facilities.

In January 2007, the Company acquired from HCP, Inc., formerly known as Health Care Property Investors, Inc. ("HCP"), the real estate related to 11 unprofitable leased nursing centers operated by the Company for resale in exchange for the real estate related to three hospitals previously owned by the Company (the "HCP Transaction"). As part of the HCP Transaction, the Company continues to operate these hospitals under a long-term lease arrangement with HCP. In addition, the Company paid HCP a one-time cash payment of approximately $36 million. The Company also amended its existing master lease with HCP to (1) terminate the current annual rent of approximately $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of approximately $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022. During 2007, the Company sold all of the nursing centers acquired in the HCP Transaction and received proceeds of $77.9 million. These 11 nursing centers, which contained 1,754 licensed beds, generated pretax losses of approximately $4 million for 2007 and $1 million for 2006. In addition, the Company terminated a nursing center lease with another landlord during 2007. The Company recorded a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

In accordance with SFAS 144, assets not sold at December 31, 2008 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet.

NOTE 4 – DISCONTINUED OPERATIONS

In accordance with SFAS 144, the divestiture of unprofitable businesses discussed in Notes 1 and 3 have been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the losses or impairments related to these divestitures have been classified as discontinued operations, net of income taxes, in the accompanying consolidated statement of operations. At December 31, 2008, the Company held for sale two hospitals.

Discontinued operations included a favorable pretax adjustment of $9.7 million ($6.0 million net of income taxes) in 2008, a pretax charge of approximately $1.5 million ($0.9 million net of income taxes) in 2007 and a favorable pretax adjustment of $19.3 million ($11.8 million net of income taxes) in 2006, resulting from changes in estimates for professional liability reserves related to prior years.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

A summary of discontinued operations follows (in thousands):

	Year ended December 31,		
	2008	2007	2006
Revenues	$ 42,578	$ 202,763	$ 288,011
Salaries, wages and benefits	28,057	117,892	157,590
Supplies	4,541	14,869	19,698
Rent	2,882	10,091	26,223
Other operating expenses	9,231	71,538	77,042
Depreciation	852	3,859	7,860
Interest expense	2	6	1
Investment income	(8)	(51)	(15)
	45,557	218,204	288,399
Loss from operations before income taxes	(2,979)	(15,441)	(388)
Income tax benefit	(1,147)	(5,944)	(150)
Loss from operations	(1,832)	(9,497)	(238)
Loss on divestiture of operations, net of income taxes	(20,776)	(77,021)	(32)
	$ (22,608)	$ (86,518)	$ (270)

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	Year ended December 31,		
	2008	2007	2006
Revenues:			
Hospital division:			
Hospitals	$ 33,687	$ 59,726	$ 64,013
Ancillary services	–	–	2
	33,687	59,726	64,015
Health services division	8,891	143,037	223,996
	$ 42,578	$ 202,763	$ 288,011
Operating income (loss):			
Hospital division:			
Hospitals	$ (5,470)	$ (334)	$ 4,811
Ancillary services	–	–	1
	(5,470)	(334)	4,812
Health services division	6,219	(1,202)	28,869
	$ 749	$ (1,536)	$ 33,681
Rent:			
Hospital division:			
Hospitals	$ 2,858	$ 4,388	$ 5,060
Ancillary services	–	–	–
	2,858	4,388	5,060
Health services division	24	5,703	21,163
	$ 2,882	$ 10,091	$ 26,223
Depreciation:			
Hospital division:			
Hospitals	$ 852	$ 1,544	$ 2,078
Ancillary services	–	–	–
	852	1,544	2,078
Health services division	–	2,315	5,782
	$ 852	$ 3,859	$ 7,860

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	December 31,	
	2008	2007
Long-term assets:		
Property and equipment, net	$ 7,730	$ 15,595
Other	56	242
	7,786	15,837
Current liabilities (included in other accrued liabilities)	(111)	(717)
	$ 7,675	$ 15,120

NOTE 5 – ACQUISITIONS

The following is a summary of the Company's significant acquisition activities. The operating results of the acquired businesses have been included in the accompanying consolidated financial statements of the Company from the respective acquisition dates. The purchase price of the acquired businesses and acquired leased facilities resulted from negotiations with each of the sellers that were based upon both the historical and expected future cash flows of the respective businesses and real estate values.

2008 acquisitions

During 2008, the Company acquired four previously leased nursing centers for $23.9 million. Annual rents associated with these facilities approximated $2.6 million. These transactions were financed through borrowings under the Company's revolving credit facility.

2007 acquisitions

During 2007, the Company acquired eight previously leased nursing centers and one previously leased hospital for $112.5 million. Annual rents associated with these facilities approximated $9.6 million. These transactions were financed through borrowings under the Company's revolving credit facility.

In July 2007, the Company acquired a combined nursing center and assisted living facility for $20.3 million. Goodwill and identifiable intangible assets recorded in connection with the acquisition aggregated $0.8 million. This transaction was financed through borrowings under the Company's revolving credit facility.

In February 2007, the Company entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8.1 million.

Unaudited pro formas related to acquired new businesses have not been presented as the acquisitions are not material, either individually or in the aggregate.

Commonwealth Transaction

In February 2006, the Company acquired the operations of the LTAC hospitals, nursing centers and assisted living facilities operated by Commonwealth Communities Holdings LLC and certain of its affiliates (the "Commonwealth Transaction"). The Commonwealth Transaction was financed primarily through the use of the Company's revolving credit facility. Goodwill recorded in connection with the Commonwealth Transaction aggregated $38.7 million. The purchase price also included identifiable intangible assets of $75.9 million related

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – ACQUISITIONS (Continued)

Commonwealth Transaction (Continued)

to the value of acquired certificates of need with indefinite lives and other intangible assets of $5.2 million which will be amortized over approximately three years. The net cash paid through December 31, 2008 included approximately $0.3 million of contingent consideration which continues to be held in escrow. During 2008 and 2007, a portion of the contingent consideration previously held in escrow was settled, resulting in an increase of $1 million and $6 million, respectively, in goodwill. The Company has asserted various claims against the sellers under the acquisition agreement that may result in changes in the allocation of the purchase price.

A summary of the Commonwealth Transaction follows (in thousands):

Fair value of assets acquired, including goodwill and other intangible assets	$	130,453
Fair value of liabilities assumed		(6,763)
Net cash paid through December 31, 2006		123,690
Additional payment of transaction costs during 2007		12
Net cash paid through December 31, 2008	$	123,702

The unaudited pro forma effect of the Commonwealth Transaction assuming the transaction occurred on January 1, 2006 follows (in thousands, except per share amounts):

	Year ended December 31, 2006
Revenues	$ 4,130,156
Income from continuing operations	79,008
Net income	78,738
Earnings per common share:	
Basic:	
Income from continuing operations	$ 2.02
Net income	$ 2.01
Diluted:	
Income from continuing operations	$ 1.93
Net income	$ 1.92

Unaudited pro forma financial data has been derived by combining the historical financial results of the Company and the operations acquired in the Commonwealth Transaction for the period presented.

Pharmacy acquisitions

During 2006, the Company acquired three institutional pharmacy businesses for an aggregate cost of $15.3 million. These acquisitions were financed primarily through the use of operating cash flows.

NOTE 6 – EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of warrants, stock options and non-vested restricted stock.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 – EARNINGS (LOSS) PER SHARE (Continued)

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

	Year ended December 31,		
	2008	2007	2006
Earnings (loss):			
Income from continuing operations	$ 58,893	$ 39,648	$78,981
Discontinued operations, net of income taxes:			
Loss from operations	(1,832)	(9,497)	(238)
Loss on divestiture of operations	(20,776)	(77,021)	(32)
Net income (loss)	$ 36,285	$(46,870)	$78,711
Shares used in the computation:			
Weighted average shares outstanding – basic computation	37,830	38,791	39,108
Dilutive effect of certain securities:			
Warrants	–	–	1,119
Employee stock options	567	767	450
Non-vested restricted stock	509	425	246
Adjusted weighted average shares outstanding – diluted computation	38,906	39,983	40,923
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	$ 1.56	$ 1.02	$ 2.02
Discontinued operations:			
Loss from operations	(0.05)	(0.24)	(0.01)
Loss on divestiture of operations	(0.55)	(1.99)	–
Net income (loss)	$ 0.96	$ (1.21)	$ 2.01
Diluted:			
Income from continuing operations	$ 1.51	$ 0.99	$ 1.93
Discontinued operations:			
Loss from operations	(0.05)	(0.23)	(0.01)
Loss on divestiture of operations	(0.53)	(1.93)	–
Net income (loss)	$ 0.93	$ (1.17)	$ 1.92
Number of antidilutive stock options and non-vested restricted stock excluded from shares used in the diluted earnings (loss) per share computation	1,310	149	2,179

NOTE 7 – BUSINESS SEGMENT DATA

At December 31, 2008, the Company operated three business segments: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing centers. The rehabilitation division provides rehabilitation services primarily in long-term care settings. For segment purposes, the Company defines operating income as earnings before interest, income taxes, depreciation, amortization and rent. Operating income reported for each of the Company's business segments excludes the allocation of corporate overhead. The accounting policies of each of the segments are the same and are described in Note 1.

Beginning January 1, 2008, certain incentive compensation costs were charged to the operating divisions that had previously been classified as corporate overhead. These charges approximated $5.1 million for the hospital division, $4.3 million for the health services division and $1.2 million for the rehabilitation division for the year ended December 31, 2008. Segment operating results for prior periods were not restated to reflect this reclassification.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – BUSINESS SEGMENT DATA (Continued)

The Spin-off Transaction was completed on July 31, 2007. As a result, the Company's consolidated operating results for 2007 included the results of the Company's former pharmacy division for seven months. For accounting purposes, the Company's former pharmacy division was not treated as a discontinued operation in the Company's historical consolidated financial statements. See Note 2.

The Company identifies its segments in accordance with the aggregation provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This information is consistent with information used by the Company in managing its businesses and aggregates businesses with similar economic characteristics.

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

	Year ended December 31,		
	2008	2007	2006
Revenues:			
Hospital division	$ 1,837,322	$ 1,727,419	$ 1,665,885
Health services division	2,155,417	2,014,786	1,819,320
Rehabilitation division	427,320	352,397	300,106
Pharmacy division	–	406,111	652,608
	4,420,059	4,500,713	4,437,919
Eliminations:			
Rehabilitation	(268,663)	(236,539)	(212,044)
Pharmacy	–	(84,283)	(135,510)
	(268,663)	(320,822)	(347,554)
	$ 4,151,396	$ 4,179,891	$ 4,090,365
Income from continuing operations:			
Operating income (loss):			
Hospital division	$ 345,367	$ 365,068	$ 383,802
Health services division	326,932	296,749	241,852
Rehabilitation division	38,071	34,526	30,362
Pharmacy division	–	17,557	48,461
Corporate:			
Overhead	(133,019)	(167,717)	(157,157)
Insurance subsidiary	(6,657)	(7,077)	(7,125)
	(139,676)	(174,794)	(164,282)
Operating income	570,694	539,106	540,195
Rent	(344,952)	(343,717)	(294,186)
Depreciation and amortization	(121,413)	(120,421)	(116,182)
Interest, net	(8,272)	(935)	571
Income before income taxes	96,057	74,033	130,398
Provision for income taxes	37,164	34,385	51,417
	$ 58,893	$ 39,648	$ 78,981

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – BUSINESS SEGMENT DATA (Continued)

	Year ended December 31,		
	2008	2007	2006
Rent:			
Hospital division	$ 146,316	$ 139,875	$ 117,609
Health services division	192,891	194,547	167,013
Rehabilitation division	5,555	4,641	3,697
Pharmacy division	–	4,325	5,554
Corporate	190	329	313
	$ 344,952	$ 343,717	$ 294,186
Depreciation and amortization:			
Hospital division	$ 48,150	$ 40,958	$ 45,045
Health services division	50,036	50,662	38,251
Rehabilitation division	1,965	1,176	533
Pharmacy division	–	6,510	8,835
Corporate	21,262	21,115	23,518
	$ 121,413	$ 120,421	$ 116,182
Capital expenditures, excluding acquisitions (including discontinued operations):			
Hospital division	$ 69,217	$ 95,084	$ 70,154
Health services division	50,093	46,940	41,229
Rehabilitation division	1,162	2,037	603
Pharmacy division	–	4,115	9,851
Corporate:			
Information systems	26,363	24,431	28,146
Other	1,842	13,881	1,091
	$ 148,677	$ 186,488	$ 151,074

	December 31, 2008	December 31, 2007
Assets at end of period:		
Hospital division	$ 847,394	$ 846,429
Health services division	574,710	550,525
Rehabilitation division	45,733	30,751
Corporate	713,924	651,847
	$ 2,181,761	$ 2,079,552
Goodwill:		
Hospital division	$ 68,577	$ 67,598
Health services division	639	639
Rehabilitation division	3,028	863
	$ 72,244	$ 69,100

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES

The provision for income taxes is based upon management's estimate of annual taxable income or loss for each respective accounting period. The Company recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Company also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

Provision for income taxes consists of the following (in thousands):

	Year ended December 31,		
	2008	2007	2006
Current:			
Federal	$ 20,040	$ 36,392	$ 46,686
State	3,577	5,917	9,345
	23,617	42,309	56,031
Deferred	13,547	(7,924)	(4,614)
	$ 37,164	$ 34,385	$ 51,417

Reconciliation of federal statutory tax expense to the provision for income taxes follows (in thousands):

	Year ended December 31,		
	2008	2007	2006
Income tax expense at federal rate	$ 33,620	$ 25,912	$ 45,639
State income tax expense, net of federal income tax expense	3,362	2,590	4,565
Spin-off Transaction costs	(17)	4,829	–
Prior year contingencies	(2,104)	(2,296)	(2,697)
Other items, net	2,303	3,350	3,910
	$ 37,164	$ 34,385	$ 51,417

A summary of net deferred income tax assets by source included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2008	2007
Property and equipment	$ 18,749	$ 27,601
Insurance	48,034	48,608
Accounts receivable allowances	21,204	25,567
Compensation	40,072	38,279
Net operating losses	–	3,956
Assets held for sale	10,250	14,009
Other	22,278	27,098
	160,587	185,118
Valuation allowance	(1,540)	(11,328)
	$ 159,047	$ 173,790

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES (Continued)

Deferred income taxes totaling $58.3 million and $59.9 million at December 31, 2008 and 2007, respectively, were classified as current assets, and deferred income taxes totaling $100.7 million and $113.9 million at December 31, 2008 and 2007, respectively, were classified as noncurrent assets.

In 2006, the Company reached a settlement with the Internal Revenue Service (the "IRS") related to all disputed federal income tax issues for fiscal 2000 and 2001. In connection with the settlement, the Company paid $2.9 million of employer payroll taxes to the IRS in 2007. Because of fresh-start accounting rules related to the Company's reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

After the Company's emergence from bankruptcy, the realization of pre-reorganization deferred tax assets (amounts which had been considered "more likely than not" to be realized by the Company) and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of $1.4 million in 2008, $3.0 million in 2007 and $79.8 million in 2006 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability. Following the effective date of SFAS 141R, adjustments to pre-emergence unrecognized income tax benefits of $3 million will be recorded to earnings.

In connection with the Company's emergence from bankruptcy, the Company realized a gain from the extinguishment of certain indebtedness. This gain was not taxable since the gain resulted from the reorganization under the bankruptcy code. However, the Company is required, beginning with its 2002 taxable year, to reduce certain tax attributes including (a) net operating loss carryforwards ("NOLs"), (b) certain tax credits and (c) tax bases in assets in an amount equal to such gain on extinguishment.

The Company had no NOLs at December 31, 2008. The Company had NOLs of $10.3 million (after the conclusion of the Company's 2000 and 2001 federal tax examinations and the reductions in the attributes discussed above) at December 31, 2007. A deferred tax valuation allowance of $2.3 million related to NOLs was recorded at December 31, 2007.

FIN 48

In July 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes" which clarifies the accounting for uncertain income tax issues recognized in an entity's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return.

The Company adopted the provisions of FIN 48 on January 1, 2007. A reconciliation of the 2007 and 2008 activity related to unrecognized tax benefits follows (in thousands):

Balance, January 1, 2007	$	7,419
Additions related to prior period tax filings		4,715
Reductions due to lapses of applicable statute of limitations		(2,921)
Balance, December 31, 2007		9,213
Additions based upon tax positions related to the current year		2,796
Reductions due to lapses of applicable statute of limitations		(2,456)
Balance, December 31, 2008	$	9,553

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – INCOME TAXES (Continued)

FIN 48 (Continued)

The Company records accrued interest and penalties associated with uncertain tax positions as income tax expense in the consolidated statement of operations. Accrued interest related to uncertain tax provisions totaled $0.8 million as of December 31, 2008 and $1.5 million as of December 31, 2007.

To the extent the unrecognized income tax benefits become realized or the related accrued interest is no longer necessary, the Company's provision for income taxes would be favorably impacted. The amount, if recognized, that would favorably impact the Company's results of operations approximates $9.6 million.

The federal statute of limitations remains open for tax years 2005 through 2008. The IRS currently has no open examinations.

State jurisdictions generally have statutes of limitations for tax returns ranging from three to five years. The state income tax impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company currently has various state income tax returns under examination.

During 2009, the statutes of limitations associated with certain state income tax filing positions will expire and may decrease the amount of unrecognized income tax benefits. A reduction in the Company's income tax liability of up to approximately $2 million for unrecognized income tax benefits and up to $1 million of accrued interest is reasonably possible and may favorably impact the Company's financial position and results of operations.

NOTE 9 – INSURANCE RISKS

The Company insures a substantial portion of its professional liability risks and workers compensation risks through a wholly owned limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including actuarially determined estimates.

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 liabilities 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. See Note 4.

The provision for loss for insurance risks, including the cost of coverage maintained with unaffiliated commercial insurance carriers, follows (in thousands):

	Year ended December 31,		
	2008	2007	2006
Professional liability:			
Continuing operations	$ 34,190	$ 36,834	$ 52,194
Discontinued operations	(7,360)	12,526	(1,958)
Workers compensation:			
Continuing operations	$ 30,721	$ 37,861	$ 35,402
Discontinued operations	550	2,701	3,896

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INSURANCE RISKS (Continued)

A summary of the assets and liabilities related to insurance risks included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2008			2007		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$ 109,494	$ 87,489	$ 196,983	$ 127,017	$ 104,676	$ 231,693
Reinsurance recoverables	89	–	89	4,334	–	4,334
	109,583	87,489	197,072	131,351	104,676	236,027
Non-current:						
Insurance subsidiary investments	48,610	–	48,610	49,166	–	49,166
Reinsurance recoverables	17,167	–	17,167	4,530	–	4,530
Deposits	2,000	1,466	3,466	6,250	1,455	7,705
Other	–	142	142	–	261	261
	67,777	1,608	69,385	59,946	1,716	61,662
	$ 177,360	$ 89,097	$ 266,457	$ 191,297	$ 106,392	$ 297,689
Liabilities:						
Allowance for insurance risks:						
Current	$ 55,447	$ 25,348	$ 80,795	$ 64,740	$ 26,144	$ 90,884
Non-current	187,804	57,993	245,797	186,652	63,132	249,784
	$ 243,251	$ 83,341	$ 326,592	$ 251,392	$ 89,276	$ 340,668

Provisions for loss for professional liability risks retained by the Company's limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 3% for the 2008 policy year and 5% for all prior policy years. 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 $251.8 million at December 31, 2008 and $263.8 million at December 31, 2007.

Provisions for loss for workers compensation risks retained by the Company's limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually.

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS

The Company maintains investments, consisting principally of cash and cash equivalents, asset backed securities, corporate bonds, U.S. Treasury notes, equities and commercial paper for the payment of claims and expenses related to professional liability and workers compensation risks. These investments have been categorized as available-for-sale and are reported at fair value.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

The amortized cost and estimated fair value of the Company's insurance subsidiary investments at December 31 follow (in thousands):

	2008				2007			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents (a)	$ 118,148	$ –	$ –	$ 118,148	$ 149,212	$ –	$ –	$ 149,212
Asset backed securities	59,509	886	(292)	60,103	52,098	444	(33)	52,509
Corporate bonds	35,110	314	(698)	34,726	35,824	126	(215)	35,735
U.S. Treasury notes	11,760	152	–	11,912	6,141	445	–	6,586
Equities	13,750	402	(3,307)	10,845	14,498	2,278	(886)	15,890
Commercial paper	9,825	34	–	9,859	20,912	15	–	20,927
	$ 248,102	$ 1,788	$ (4,297)	$ 245,593	$ 278,685	$ 3,308	$ (1,134)	$ 280,859

(a) Includes $13.2 million and $9.3 million of money market funds at December 31, 2008 and 2007, respectively.

The fair value by maturity periods at December 31, 2008 of available-for-sale investments of the Company's insurance subsidiary follows. Equities generally do not have maturity dates. Expected maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations prior to the stated maturity date.

(In thousands)	Expected maturities	Contractual maturities
Within one year	$ 186,138	$ 177,463
One year to five years	46,758	55,433
After five years	1,852	1,852
Equities	10,845	10,845
	$ 245,593	$ 245,593

Net investment income earned by the Company's insurance subsidiary investments follows (in thousands):

	Year ended December 31,		
	2008	2007	2006
Interest income	$ 8,107	$ 12,405	$ 10,894
Net amortization of premium and accretion of discount	(141)	818	864
Gains on sale of investments	1,244	1,350	846
Losses on sale of investments	(194)	(106)	(249)
Other-than-temporary impairment on investments	(2,311)	–	–
Investment expenses	(242)	(263)	(222)
	$ 6,463	$ 14,204	$ 12,133

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

The available-for-sale investments of the Company's insurance subsidiary which have unrealized losses at December 31, 2008 are shown below. The investments are categorized by the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008.

	Less than one year		One year or greater		Total	
(In thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Asset backed securities	$ 8,008	$ 169	$ 476	$ 123	$ 8,484	$ 292
Corporate bonds	11,950	204	7,157	494	19,107	698
U.S. Treasury notes	–	–	–	–	–	–
Equities	5,304	2,072	2,009	1,235	7,313	3,307
Commercial paper	–	–	–	–	–	–
	$ 25,262	$ 2,445	$ 9,642	$ 1,852	$ 34,904	$ 4,297

As of December 31, 2008, the unrealized losses on asset backed securities and corporate bonds totaling $1.0 million were due generally to changes in interest rates. The unrealized losses on equities totaling $3.3 million were due generally to market fluctuations. Accordingly, the Company believes these unrealized losses are the result of temporary interest rate and market fluctuations.

The Company's investment policy governing insurance subsidiary investments precludes the investment portfolio managers from selling any security at a loss without prior authorization from the Company. The investment managers also limit the exposure to any one issue, issuer or type of investment. The Company intends, and has the ability, to hold insurance subsidiary investments for a long duration without the necessity of selling securities to fund the underwriting needs of its insurance subsidiary. This ability to hold securities allows sufficient time for recovery of temporary declines in the market value of equity securities and the par value of debt securities as of their stated maturity date.

The Company considered the severity and duration of its unrealized losses during 2008 and recognized
$2.3 million pretax other-than-temporary impairments in 2008 for investments in the financial services industry held in its insurance subsidiary investment portfolio. Because the Company considers the remaining unrealized losses at December 31, 2008 to be temporary, the Company has not recorded any additional impairment loss related to these securities.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – LEASES

The Company leases real estate and equipment under cancelable and non-cancelable arrangements. The following table sets forth rent expense by business segment (in thousands):

	Year ended December 31,		
	2008	2007	2006
Hospital division:			
Buildings:			
Ventas	$ 86,871	$ 84,358	$ 71,171
Other landlords	34,089	30,210	22,329
Equipment	25,356	25,307	24,109
	146,316	139,875	117,609
Health services division:			
Buildings:			
Ventas	150,361	145,916	127,263
Other landlords	39,959	45,697	36,965
Equipment	2,571	2,934	2,785
	192,891	194,547	167,013
Rehabilitation division:			
Buildings	161	84	74
Equipment	5,394	4,557	3,623
	5,555	4,641	3,697
Pharmacy division:			
Buildings	–	3,705	4,739
Equipment	–	620	815
	–	4,325	5,554
Corporate:			
Buildings	155	285	277
Equipment	35	44	36
	190	329	313
	$ 344,952	$ 343,717	$ 294,186

Future minimum payments under non-cancelable operating leases are as follows (in thousands):

	Minimum payments		
	Ventas	Other	Total
2009	$ 242,853	$ 70,115	$ 312,968
2010	162,009	66,136	228,145
2011	122,494	62,921	185,415
2012	124,309	58,073	182,382
2013	41,640	57,192	98,832
Thereafter	–	291,381	291,381

At December 31, 2008, the Company leased from Ventas and its affiliates 38 LTAC hospitals and 165 nursing centers under four Master Lease Agreements (the "Master Lease Agreements").

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – LEASES (Continued)

Under the Master Lease Agreements, the leases for 87 nursing centers and 22 LTAC hospitals (which are contained in ten renewal bundles) are scheduled to expire in April 2010 (the "2010 Leases") and the leases for 29 nursing centers and eight LTAC hospitals (which are contained in four renewal bundles) are scheduled to expire in April 2013 (the "2013 Leases").

At the Company's option, the 2010 Leases and 2013 Leases may be extended for one five-year renewal term beyond the base term at the then existing rental rate plus the then existing escalation amount per annum. If the Company elects to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed. The renewal notices for the 2010 Leases may be delivered to Ventas between November 1, 2008 and April 29, 2009. The renewal notices for the 2013 Leases may be delivered to Ventas between November 1, 2011 and April 29, 2012.

In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements. These new aggregate annual rents of approximately $239 million (including the Ventas Facilities) became effective retroactively to July 19, 2006 and were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under the Master Lease Agreements. Aggregate annual rents prior to the rent reset approximated $206 million (including the Ventas Facilities). As required, Ventas paid the Company a reset fee of approximately $4.6 million that will be amortized as a reduction of rent expense over the remaining original terms of the Master Lease Agreements. In connection with the exercise of the rent reset, the new annual rents were allocated among the facilities subject to the Master Lease Agreements in accordance with the determinations made by the final appraisers during the rent reset process. The new contingent annual rent escalator is 2.7% for Master Lease Agreements Nos. 1, 3 and 4. The new contingent annual rent escalator for Master Lease Agreement No. 2 is based upon the Consumer Price Index with a floor of 2.25% and a ceiling of 4%. In 2008, the contingent annual rent escalator for Master Lease Agreement No. 2 was 4%. Prior to the rent reset, the contingent annual Ventas rent escalator under each Master Lease Agreement was 3.5%.

NOTE 12 – LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION

Capitalization

A summary of long-term debt and capital lease obligation at December 31 follows (in thousands):

	2008	2007
Revolving credit facility due 2012	$ 348,700	$ 275,000
Capital lease obligation due 2027 (8.04% discount rate)	–	16,268
Other	814	890
Total debt, average life of 4 years (weighted average rate 3.3%)	349,514	292,158
Amounts due within one year	(81)	(584)
Long-term debt and capital lease obligation	$ 349,433	$ 291,574

Interest rates under the Company's revolving credit facility are based, at the Company's option, upon (a) the London Interbank Offered Rate ("LIBOR") plus an applicable margin ranging from 1.25% to 2.00% or (b) the applicable margin ranging from 0.25% to 1.00% plus the higher of the prime rate or 0.5% over the federal funds rate.

In July 2007, the Company completed certain amendments to its revolving credit facility. Under the terms of the revolving credit facility as amended, the aggregate amount of the credit was increased to $500 million. The credit may be increased to $600 million at the Company's option subject to lender approval and certain other conditions. The term of the revolving credit facility was extended by an additional three years until July 2012.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12 – LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION (Continued)

Capitalization (Continued)

The revolving credit facility also establishes permitted acquisitions and certain investments by the Company at $500 million in the aggregate and allows for up to $150 million of certain restricted payments including, among other things, the repurchase of common stock and payment of cash dividends.

The revolving credit facility is collateralized by substantially all of the Company's assets including certain owned real property and is guaranteed by substantially all of the Company's subsidiaries. The revolving credit facility constitutes a working capital facility for general corporate purposes and permitted acquisitions and investments in healthcare facilities and companies up to certain limits. The terms of the revolving credit facility include a certain defined fixed payment ratio covenant and covenants which limit acquisitions and annual capital expenditures. The Company was in compliance with the terms of its revolving credit facility at December 31, 2008.

Despite the recent turmoil within the financial markets nationally and globally, the Company is not aware of any individual lender limitations to extend credit under its revolving credit facility. However, the obligations of each of the lending institutions in the Company's revolving credit facility is separate and the availability of future borrowings under the Company's revolving credit facility could be impacted by the ongoing volatility and disruptions in the financial credit markets or other events.

Other Information

In April 2008, the Company repaid a capital lease obligation of $16.3 million in connection with a purchase option under a hospital lease agreement.

The following table summarizes scheduled maturities of long-term debt for the years 2009 through 2013 (in thousands):

	Revolving credit facility	Other	Total
2009	$ –	$ 81	$ 81
2010	–	86	86
2011	–	91	91
2012	348,700	96	348,796
2013	–	102	102

The estimated fair value of the Company's long-term debt at December 31, 2008 and 2007 approximated the respective carrying amounts.

NOTE 13 – CONTINGENCIES

Management continually evaluates contingencies based upon the best available information. In addition, allowances for loss are provided currently for disputed items that have continuing significance, such as certain third party reimbursements and deductions that continue to be claims 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.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13 – CONTINGENCIES (Continued)

Professional liability risks – The Company has provided for loss 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 Notes 4 and 9.

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. In addition, the Company is a party to a tax matters agreement with PharMerica which sets forth the Company's rights and obligations related to taxes for periods before and after the Spin-off Transaction.

Litigation – The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions in the ordinary course of business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. The U.S. Department of Justice (the "DOJ"), the Centers for Medicare and Medicaid Services ("CMS") or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company's businesses in the future 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.

Other indemnifications – In the ordinary course of business, the Company enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as a disposal of an operating facility. These indemnifications may cover claims related to employment-related matters, governmental regulations, environmental issues and tax matters, as well as patient, third party payor, supplier and contractual relationships. Obligations under these indemnities generally are initiated by a breach of the terms of a contract or by a third party claim or event.

NOTE 14 – CAPITAL STOCK

The Company's shareholders approved an additional 1.5 million shares of common stock in May 2008 that could be issued under the Company's incentive compensation plans.

Plan descriptions

The Company maintains plans under which approximately ten million service-based restricted shares, performance-based restricted shares and options to purchase common stock may be granted to directors, officers and other key employees. Exercise provisions vary, but most stock options are exercisable in whole or in part beginning one to four years after grant and ending seven to ten years after grant. Shares of common stock available for future grants were 2,201,688, 1,309,470 and 1,663,490 at December 31, 2008, 2007 and 2006, respectively.

Stock options

The fair value of each stock option is estimated at the date of grant using a Black-Scholes option valuation model with the following weighted average assumptions:

	Year ended December 31,		
	2008	2007	2006
Risk-free interest rate	2.80%	4.46%	4.62%
Expected dividend yield	None	None	None
Expected term	5 years	6 years	5 years
Expected volatility	40%	47%	51%
Weighted average fair value at grant date	$9.05	$12.51	$11.03

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Stock options (Continued)

The expected term represents the period of time that stock options granted are estimated to be outstanding and was determined using the simplified method under SFAS No. 123 (revised 2004) ("SFAS 123R"), "Share-Based Payment." The expected volatility is based upon the historical prices of the Company's common stock. An estimate of expected forfeitures was determined and compensation expense was recognized only for those stock options expected to vest.

At December 31, 2008, unearned compensation costs related to non-vested stock options aggregated $2.6 million. These costs will be expensed over the remaining weighted average vesting period of approximately two years. Compensation expense related to stock options approximated $3.5 million ($2.9 million net of income taxes) for the year ended December 31, 2008, $16.1 million ($12.4 million net of income taxes) for the year ended December 31, 2007 and $7.4 million ($6.2 million net of income taxes) for the year ended December 31, 2006. Compensation expense for the year ended December 31, 2007 included $11.7 million related to the adjustment of stock options in connection with the Spin-off Transaction.

Activity in the various plans is summarized below:

	Shares under option	Option price per share	Weighted average exercise price
Balances, December 31, 2007	3,562,352	$ 4.89 to $28.41	$ 17.93
Granted	355,667	11.53 to 25.83	24.34
Exercised	(535,785)	4.89 to 23.80	18.28
Canceled	(53,440)	4.89 to 25.83	17.76
Balances, December 31, 2008	3,328,794	$ 4.89 to $28.41	$ 18.56

As a result of the Spin-off Transaction, adjustments to outstanding stock options as of July 31, 2007 were made in accordance with IRS guidelines which resulted in changes to both the number of shares subject to the stock option and the exercise price.

The intrinsic value of the stock options exercised during 2008, 2007 and 2006 approximated $5.7 million, $9.1 million and $1.2 million, respectively. Cash received from stock option exercises in 2008, 2007 and 2006 totaled $8.9 million, $10.5 million and $1.6 million, respectively.

A summary of stock options outstanding at December 31, 2008 follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding at December 31, 2008	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at December 31, 2008	Weighted average exercise price
$4.89 to $8.44	289,142	4 years	$ 7.99	289,142	$ 7.99
$11.53 to $15.29	739,027	4 years	13.72	704,027	13.83
$16.81 to $22.72	1,155,674	5 years	18.52	790,407	18.87
$23.25 to $28.41	1,144,951	4 years	24.39	836,185	23.86
	3,328,794	4 years	18.56	2,619,761	17.91

The intrinsic value of the stock options outstanding and stock options that are exercisable as of December 31, 2008 approximated $1.7 million each.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Service-based restricted shares

At December 31, 2008, unearned compensation costs related to non-vested service-based restricted shares aggregated $6.9 million. These costs will be expensed over the remaining weighted average vesting period of approximately two years. Compensation expense related to these awards approximated $9.1 million ($5.6 million net of income taxes) for the year ended December 31, 2008, $15.1 million ($9.3 million net of income taxes) for the year ended December 31, 2007 and $11.2 million ($6.9 million net of income taxes) for the year ended December 31, 2006. Compensation expense for the year ended December 31, 2007 included $3.9 million in connection with the Spin-off Transaction.

A summary of non-vested service-based restricted shares follows:

	Non-vested restricted shares	Weighted average fair value at date of grant
Balances, December 31, 2007	942,780	$ 30.95
Granted	182,859	24.98
Vested	(342,576)	30.41
Canceled	(16,372)	28.20
Balances, December 31, 2008	766,691	$ 29.82

The fair value of restricted shares vested during 2008, 2007 and 2006 was $8.0 million, $9.0 million and $10.8 million, respectively.

Performance-based restricted shares

During 2008, performance-based restricted shares were granted totaling 142,359 shares in which the awards vest over a three year period based upon the attainment of various performance measures in each performance period. No material compensation costs were recorded in 2008 for these awards because none of the performance measures for the 2008 performance period were attained.

Stock repurchases

In August 2007, the Company's Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, the Company expended $50 million to purchase approximately 2.6 million shares of its common stock. The Company did not purchase any common stock in 2008 and the authorization expired during 2008.

During 2005 and 2006, the Company repurchased approximately 3.8 million shares of its common stock in the open market at an aggregate cost of $100.0 million. The Company financed these repurchases from both operating cash flows and borrowings under its revolving credit facility.

Common stock repurchases are accounted for as constructive retirements in accordance with the allocation method under paragraph 12 of Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins," which provides that any excess of the purchase price over par value may be allocated between capital surplus and retained earnings.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CAPITAL STOCK (Continued)

Warrants

In connection with the exercise of the Company's Series A warrants and Series B warrants in April 2006, the Company issued approximately 10.1 million shares of common stock and received net proceeds of $142.3 million. These proceeds were used to repurchase approximately 5.8 million shares of the Company's common stock in the open market in 2006.

NOTE 15 – EMPLOYEE BENEFIT PLANS

The Company maintains defined contribution retirement plans covering employees who meet certain minimum eligibility requirements. Benefits are determined as a percentage of a participant's contributions and generally are vested based upon length of service. Retirement plan expense was $9.5 million for 2008, $9.4 million for 2007 and $10.8 million for 2006. Amounts equal to retirement plan expense are funded annually.

NOTE 16 – ACCRUED LIABILITIES

A summary of other accrued liabilities at December 31 follows (in thousands):

	2008	2007
Patient accounts	$ 34,511	$ 37,131
Taxes other than income	27,472	26,234
Other	14,849	17,298
	$ 76,832	$ 80,663

NOTE 17 – FAIR VALUE OF FINANCIAL INSTRUMENTS

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.

	2008		2007	
(In thousands)	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	$ 140,795	$ 140,795	$ 32,877	$ 32,877
Cash–restricted	5,104	5,104	5,360	5,360
Insurance subsidiary investments	245,593	245,593	280,859	280,859
Tax refund escrow investments	216	216	213	213
Long-term debt, including amounts due within one year	349,514	349,503	275,890	275,878

NOTE 18 – LITIGATION

The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions arising in the ordinary course of its business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. 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 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.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)
(In thousands, except per share amounts)

	2008 (a)			
	First	Second	Third	Fourth
Revenues	$ 1,048,523	$ 1,041,911	$ 1,010,680	$ 1,050,282
Net income (loss):				
Income from continuing operations	16,507	19,807	786	21,793
Discontinued operations, net of income taxes:				
Income (loss) from operations	(1,817)	(858)	12	831
Gain (loss) on divestiture of operations	–	2,712	(22,058)	(1,430)
Net income (loss)	14,690	21,661	(21,260)	21,194
Earnings (loss) per common share:				
Basic:				
Income from continuing operations	0.44	0.52	0.02	0.57
Discontinued operations:				
Income (loss) from operations	(0.05)	(0.02)	–	0.02
Gain (loss) on divestiture of operations	–	0.07	(0.58)	(0.04)
Net income (loss)	0.39	0.57	(0.56)	0.55
Diluted:				
Income from continuing operations	0.43	0.51	0.02	0.56
Discontinued operations:				
Income (loss) from operations	(0.05)	(0.02)	–	0.02
Gain (loss) on divestiture of operations	–	0.07	(0.56)	(0.03)
Net income (loss)	0.38	0.56	(0.54)	0.55
Shares used in computing earnings (loss) per common share:				
Basic	37,444	37,714	38,034	38,123
Diluted	38,618	38,943	39,369	38,684
Market prices (b):				
High	28.74	32.34	33.25	28.30
Low	20.25	21.34	25.80	8.12

	2007 (a)			
	First	Second	Third	Fourth
Revenues	$ 1,098,087	$ 1,085,739	$ 999,418	$ 996,647
Net income (loss):				
Income (loss) from continuing operations	17,166	10,617	(7,753)	19,618
Discontinued operations, net of income taxes:				
Loss from operations	(2,067)	(2,848)	(1,309)	(3,273)
Loss on divestiture of operations	(7,266)	(69,702)	–	(53)
Net income (loss)	7,833	(61,933)	(9,062)	16,292
Earnings (loss) per common share:				
Basic:				
Income (loss) from continuing operations	0.44	0.26	(0.20)	0.53
Discontinued operations:				
Loss from operations	(0.05)	(0.07)	(0.03)	(0.09)
Loss on divestiture of operations	(0.19)	(1.76)	–	–
Net income (loss)	0.20	(1.57)	(0.23)	0.44
Diluted:				
Income (loss) from continuing operations	0.43	0.26	(0.20)	0.51
Discontinued operations:				
Loss from operations	(0.05)	(0.07)	(0.03)	(0.08)
Loss on divestiture of operations	(0.18)	(1.71)	–	–
Net income (loss)	0.20	(1.52)	(0.23)	0.43
Shares used in computing earnings (loss) per common share:				
Basic	39,212	39,591	39,013	37,365
Diluted	39,997	40,645	39,013	38,366
Market prices (b):				
High	34.44	36.67	31.80	26.02
Low	24.46	30.56	17.35	17.35

(a) See accompanying discussion of certain quarterly items.

(b) On July 31, 2007, the Company completed the Spin-off Transaction. Immediately after the Spin-off Transaction, stockholders of the Company held approximately 50% of the outstanding common stock of PharMerica.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED) (Continued)

SIGNIFICANT QUARTERLY ADJUSTMENTS

The following is a description of significant quarterly adjustments recorded during 2008 and 2007:

Third quarter 2008

Operating results for the third quarter of 2008 included a $0.9 million pretax other-than-temporary impairment of an investment in a failed financial institution held in the Company's insurance subsidiary investment portfolio. In addition, the provision for income taxes included a favorable adjustment of $1.8 million related to the resolution of certain income tax contingencies for prior years.

Second quarter 2008

Operating results for the second quarter of 2008 included pretax income of $10.3 million related to the favorable settlement of a prior year nursing center Medicaid cost report dispute. The Company also recorded a pretax charge of $1.9 million related to a prior period rent escalator adjustment for ten leased facilities which the Company does not believe is material to the financial statements for the current or prior periods.

Fourth quarter 2007

Operating results for the fourth quarter of 2007 included a pretax charge of $1.1 million for costs incurred in connection with the Spin-off Transaction, a pretax charge of $0.4 million for employee severance costs, a pretax charge of $1.7 million for professional fees associated with the Company's strategic planning process and a pretax gain of $0.6 million from an asset sale. In addition, the provision for income taxes included a net charge of $0.4 million related to income tax items associated with the Spin-off Transaction.

The Company also recorded certain other adjustments in the fourth quarter of 2007, including a pretax charge of $5.9 million related to accounts receivable for certain hospitals acquired in 2006, a pretax credit of $2.6 million to reflect a change in estimate for hospital Medicare in-house accounts receivable and a pretax credit of $3.7 million to adjust certain nursing center Medicaid revenues. The aggregate effect of these changes in estimates did not have a material effect on the Company's consolidated fourth quarter 2007 results of operations.

Third quarter 2007

Operating results for the third quarter of 2007 included a non-cash pretax charge of $17.7 million for compensation costs resulting from the Spin-off Transaction (primarily related to the adjustment of stock options adjusted in the Spin-off Transaction and the vesting of certain stock-based and other compensation), a pretax charge of $3.9 million for professional fees and other costs incurred in connection with the Spin-off Transaction and a pretax charge of $0.9 million for employee severance costs. In addition, the provision for income taxes included a net charge of $2.2 million related to income tax items associated with the Spin-off Transaction and the favorable resolution of certain income tax contingencies for prior years.

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KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED) (Continued)

SIGNIFICANT QUARTERLY ADJUSTMENTS (Continued)

Second quarter 2007

Operating results for the second quarter of 2007 included a pretax charge of $2.8 million for professional fees and other costs incurred in connection with the Spin-off Transaction and a pretax charge of $3.4 million for employee severance costs. The Company also recorded a pretax charge of $4.6 million related to an unfavorable judgment rendered in connection with a civil dispute with a hospital vendor. In addition, operating results for the second quarter of 2007 included pretax income of $5.5 million related to a favorable settlement of a rehabilitation therapy contract dispute from prior years.

First quarter 2007

Operating results for the first quarter of 2007 included a pretax charge of $4.1 million for professional fees and other costs incurred in connection with the Spin-off Transaction.

KINDRED HEALTHCARE, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED DECEMBER 31, 2008, 2007 AND 2006
(In thousands)

	Balance at beginning of period	Additions		Deductions		Balance at end of period
		Charged to costs and expenses	Acquisitions	Deductions or payments	Spin-off Transaction	
Allowance for loss on accounts receivable:						
Year ended December 31, 2006	$ 62,078	$ 35,149	$ 509	$ (35,672)	$ –	$ 62,064
Year ended December 31, 2007	62,064	30,093	149	(43,315)	(15,686)	33,305
Year ended December 31, 2008	33,305	32,336	–	(38,093)	–	27,548
Allowance for deferred taxes:						
Year ended December 31, 2006	$ 126,178	$ –	$ –	$ (114,850)	$ –	$ 11,328
Year ended December 31, 2007	11,328	–	–	–	–	11,328
Year ended December 31, 2008	11,328	–	–	(9,788)	–	1,540

Exhibit 10.21

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and Richard E. Chapman (the "Executive").

WITNESSETH:

WHEREAS, the Executive is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for Executive's continued employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of Parent (the "Board") has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive. In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company in an executive capacity as Executive Vice President and Chief Administrative and Information Officer.

3. Extent of Services. Executive, subject to the direction and control of the Board, shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the term, Executive shall devote his working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than his current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board.

(b) In addition to Base Salary, Executive shall be entitled to receive bonuses and other incentive compensation as the Board may approve from time to time, including participation in the Company's annual short-term incentive compensation plan and its long-term compensation plan, in accordance with the terms and conditions of such plans as may be in effect from time to time.

5. Benefits.

(a) Executive shall be entitled to participate in any and all Executive pension benefit, welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for Executives of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates in effect from time to time for executives of the Company.

(c) Executive shall be entitled to four weeks of paid vacation each year. The Executive shall schedule the timing of such vacations in a reasonable manner. The Executive may also be entitled to such other leave, with or without compensation as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board- and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(i) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(ii) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive, or ;

(iii) the Company shall require Executive to relocate Executive's principal business office more than 30 miles from its location on the Effective Date; or

(iv) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following any termination of Executive's employment hereunder, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the Executive benefit plans and programs of the Company at the time such payments are due. In addition, subject to Section 7(e) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) the prorated portion of any Target Bonus (as defined below) Executive would have received for the year of termination of employment. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

For purposes of this Agreement: "Target Bonus" shall mean the full amount of the targeted annual short-term incentive bonus that would be payable to the Executive, assuming the targeted performance criteria on which such annual short-term incentive bonus is based were deemed to be satisfied, in respect of services for the calendar year in which the date in question occurs.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the

denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) For a period of 18 months following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I or ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e, as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(4) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Company and Executive are responsible, respectively, immediately prior to the Date of Termination.

(5) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had he remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of

clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively shall be the same as the portion for which Executive and Company are responsible, respectively; immediately prior to the Date of Termination.

(6) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(7) Company shall adopt such amendments to its Executive benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(10) Following the Executive's Date of Termination, the Executive shall receive the computer which Executive is utilizing as of the Date of Termination.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following Executive's separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall

Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any plans, programs, contracts or arrangements of the Company or their respective affiliates that provide for severance payments or benefits upon a termination of employment, other than the Change in Control Severance Agreement between the Company and Executive (the "Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity; provided, however, that the foregoing shall not restrict Executive or any other person from conducting general solicitations or advertisements not directed specifically at employees of the Company or its affiliates, or from employing any employee who responds to any such general solicitation or advertisement or who otherwise initiates a request for employment. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:

Richard E. Chapman
680 South Fourth Street
Louisville, KY 40202

If to Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated July 28, 1998, and any amendments thereto, between the Company (or its predecessor) and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz, President and
Chief Executive Officer

Solely for the purpose of Section 7
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz, President and
Chief Executive Officer

/s/ Richard E. Chapman

RICHARD E. CHAPMAN

Exhibit 10.22

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008, by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **RICHARD E. CHAPMAN** (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "Change in Control" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "Termination of Employment" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a

purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "**Window Period**" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. **Term**. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits**. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment**. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **Retirement Savings Plan**. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer which Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **Golden Parachute Tax Reimbursement**. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the

Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of its receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. No Mitigation Required or Setoff Permitted. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. Waiver of Other Severance Benefits. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. Employment at Will. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or

induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:

Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee:

Richard E. Chapman
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. **Severability**. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. **Interpretation**. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. **No Waiver**. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. Cancellation of Prior Agreement. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of May 1, 1998, as amended, between Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Richard E. Chapman

RICHARD E. CHAPMAN

Exhibit 10.25

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and M. Suzanne Riedman (the "Executive").

W I T N E S S E T H:

WHEREAS, the Executive is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for Executive's continued employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of Parent (the "Board") has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive. In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company in an executive capacity as Senior Vice President and General Counsel.

3. Extent of Services. Executive, subject to the direction and control of the Board, shall have the power and authority commensurate with her executive status and necessary to perform her duties hereunder. During the term, Executive shall devote her working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than her current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in her Base Salary from time to time, as approved by the Board.

(b) In addition to Base Salary, Executive shall be entitled to bonuses and other incentive compensation as the Board may approve from time to time, including participation in the Company's annual short-term incentive compensation plan and its long-term compensation plan, in accordance with the terms and conditions of such plans as may be in effect from time to time.

5. Benefits.

(a) Executive shall be entitled to participate in any and all Executive pension benefit, welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for Executives of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates in effect from time to time for executives of the Company.

(c) Executive shall be entitled to four weeks of paid vacation each year. The Executive shall schedule the timing of such vacations in a reasonable manner. The Executive may also be entitled to such other leave, with or without compensation as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In

such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from her full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of her duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and her attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(i) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(ii) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive; or

(iii) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following any termination of Executive's employment hereunder, the Company shall pay Executive her Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the Executive benefit plans and programs of the Company at the time such payments are due. In addition,

subject to Section 7(e) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or her designated beneficiary or estate, as the case may be) the prorated portion of any Target Bonus (as defined below) Executive would have received for the year of termination of employment. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

For purposes of this Agreement: "Target Bonus" shall mean the full amount of the targeted annual short-term incentive bonus that would be payable to the Executive, assuming the targeted performance criteria on which such annual short-term incentive bonus is based were deemed to be satisfied, in respect of services for the calendar year in which the date in question occurs.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate her employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) For a period of 18 months following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if she had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions of such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(4) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions of such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Company and Executive are responsible, respectively, immediately prior to the Date of Termination.

(5) For the Benefit Continuation Period,, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had she remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions of such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(7) Company may adopt such amendments to its Executive benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(10) Following the Executive's Date of Termination, the Executive shall receive the computer which Executive is utilizing as of the Date of Termination.

(b) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(c) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following Executive's separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall

Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any plans, programs, contracts or arrangements of the Company or their respective affiliates that provide for severance payments or benefits upon a termination of employment, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate her damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder (including, without limitation, the provision of in-kind benefits provided under Section 7(b) hereof) shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity; provided, however, that the foregoing shall not restrict Executive or any other person from conducting general solicitations or advertisements not directed specifically at employees of the Company or its affiliates, or from employing any employee who responds to any such general solicitation or advertisement or who otherwise initiates a request for employment. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
M. Suzanne Riedman
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated July 28, 1998, and any amendments thereto, between the Company (or its predecessor) and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz, President and Chief
Executive Officer

Solely for the purpose of Section 7
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz, President and Chief
Executive Officer

/a/ M. Suzanne Riedman

M. SUZANNE RIEDMAN

Exhibit 10.26

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008, by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **M. SUZANNE RIEDMAN** (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of her duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and her attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate her office to a place more than 30 miles from her business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a

purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate her employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "Window Period" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates her employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following her separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. **Continuation of Benefits**.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if Employee had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **Retirement Savings Plan**. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **Golden Parachute Tax Reimbursement**. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or

any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of its receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. No Mitigation Required or Setoff Permitted. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. Waiver of Other Severance Benefits. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. Employment at Will. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan, including, without limitation, that certain employment agreement dated as of December __, 2008, as amended between the Company and Employee.

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:	Kindred Healthcare Operating, Inc. 680 South Fourth Street Louisville, KY 40202 Attention: General Counsel
If to Employee:	M. Suzanne Riedman 680 South Fourth Street Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or

proceeding involving her by reason of her having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. Cancellation of Prior Agreement. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of May 1, 1998, as amended, between the Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ M. Suzanne Riedman

M. SUZANNE RIEDMAN

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and William M. Altman (the "Executive").

WITNESSETH:

WHEREAS, the Executive is employed by the Company, a wholly-owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for the terms of Executive's employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of the Parent has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive (the "Term"). In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company in an executive capacity.

3. Extent of Services. Executive, subject to the direction and control of the Board of Directors (the "Board"), shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the Term, Executive shall devote his entire working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than his current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board.

(b) In addition to Base Salary, Executive will be eligible to receive a bonus of his Base Salary and other incentive compensation as the Board may approve from time to time including participation in the Company's annual short-term incentive compensation plan and its long-term incentive compensation plan, in accordance with the terms and conditions of such plans as may be in effect from time to time.

5. Benefits.

(a) Executive shall be entitled to participate in any and all pension benefit, welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for officers of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates in effect from time to time for officers of the Company.

(c) Executive shall be entitled to four weeks of paid vacation each year. The Executive shall schedule the timing of such vacations in a reasonable manner. The Executive may also be entitled to such other leave, with or without compensation, as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(i) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(ii) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive;

(iii) the Company shall require Executive to relocate Executive's principal business office more than 30 miles from its location on the Effective Date; or

(iv) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following any termination of Executive's employment hereunder, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the benefit plans and programs of the Company at the time such payments are due. In addition, subject to Section 7(e) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) the prorated portion of any Target Bonus (as defined below) Executive would have received for the year of termination of employment. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

For purposes of this Agreement: "Target Bonus" shall mean the full amount of the targeted annual incentive bonus that would be payable to the Executive, assuming the targeted performance criteria on which such annual incentive bonus is based were deemed to be satisfied, in respect of services for the calendar year in which the date in question occurs.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) For a period of 18 months following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I or ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(4) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Company and Executive are responsible, respectively, immediately prior to the Date of Termination.

(5) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had if he had remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(7) Company may adopt such amendments to its executive benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any

outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Following the Executive's Date of Termination, the Executive shall receive the computer which Executive is utilizing as of the Date of Termination.

(10) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement,

"Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any severance plans or arrangements of the Company or their respective affiliates that specifically provide for severance payments, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Change in Control Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity; provided, however, that the foregoing shall not restrict Executive or any other person from conducting general solicitations or advertisements not directed specifically at employees of the Company or its affiliates, or from employing any employee who responds to any such general solicitation or advertisement or who otherwise initiates a request for employment. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever.

13. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder (including, without limitation, the provision of in-kind benefits provided under Section 7(b) hereof) shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
William M. Altman
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated December 21, 2001, between the Company and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purpose of Section 7
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ William M. Altman

WILLIAM M. ALTMAN

Exhibit 10.30

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008 by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **WILLIAM M. ALTMAN**, (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "<u>Change in Control</u>" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "Termination of Employment" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a

purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "**Window Period**" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. **Term.** The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits.** If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment.** The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. Retirement Savings Plan. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. Plan Amendments. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. Fringe Benefits. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the Separation from Service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. Golden Parachute Tax Reimbursement. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or

any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of the Company's receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. **No Mitigation Required or Setoff Permitted.** In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. **Waiver of Other Severance Benefits.** The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. **Employment at Will.** Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. **Disputes.** Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:	Kindred Healthcare Operating, Inc. 680 South Fourth Street Louisville, KY 40202 Attention: General Counsel
If to Employee:	William M. Altman 680 South Fourth Street Louisville, Kentucky 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent

it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. Cancellation of Prior Agreement. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of December 21, 2001, between the Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ William M. Altman

WILLIAM M. ALTMAN

Exhibit 10.33

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT is made as of the 18th day of December 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and Joseph L. Landenwich (the "Executive").

WITNESSETH:

WHEREAS, the Executive is employed by the Company, a wholly-owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for the terms of Executive's employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of the Parent has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive (the "Term"). In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company as Senior Vice President of Corporate Legal Affairs and Corporate Secretary.

3. Extent of Services. Executive, subject to the direction and control of the Board of Directors (the "Board"), shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the Term, Executive shall devote his entire working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than Executive's current base salary per year existing on the date hereof payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board.

(b) In addition to Base Salary, Executive will be eligible to receive bonuses and other incentive compensation as the Board may approve from time to time, including participation in the Company's annual short-term incentive compensation plan and its long-term incentive compensation plan, in accordance with the terms and conditions of such plans as may be in effect from time to time.

5. Benefits.

(a) Executive shall be entitled to participate in any and all pension benefit, welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for officers of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates in effect from time to time for officers of the Company.

(c) Executive shall be entitled to paid time off each year consistent with the Company's policies. The Executive shall schedule the timing of such paid time off in a reasonable manner. The Executive also may be entitled to such other leave, with or without compensation, as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by

Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(i) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(ii) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive;

(iii) the Company shall require Executive to relocate Executive's principal business office more than 30 miles, provided that the Executive and the Company acknowledge that Executive's principal business office is 680 South Fourth Street, Louisville, Kentucky 40202; or

(iv) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following any termination of Executive's employment hereunder, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the benefit plans and programs of the Company at the time such payments are due. In addition, subject to Section 7(e) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) the prorated portion of any Target Bonus (as defined below) Executive would have received for the year of termination of employment. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

For purposes of this Agreement: "Target Bonus" shall mean the full amount of the targeted annual incentive bonus that would be payable to the Executive, assuming the targeted performance criteria on which such annual incentive bonus is based were deemed to be satisfied, in respect of services for the calendar year in which the date in question occurs.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the

denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) For a period of 18 months following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I or ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e. as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(4) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Company and Executive are responsible, respectively, immediately prior to the Date of Termination.

(5) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had if he had remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of

clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(7) Company may adopt such amendments to its executive benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(10) Following the Executive's Date of Termination, the Executive shall receive the computer which Executive is utilizing as of the Date of Termination.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following Executive's separation

from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any severance plans or arrangements of the Company or their respective affiliates that specifically provide for severance payments, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Change in Control Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder (including, without limitation, the provision of in-kind benefits provided under Section 7(b) hereof) shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
Joseph L. Landenwich
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated February 25, 2003, between the Company and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

Solely for the purpose of Section 7

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

/s/ Joseph L. Landenwich

JOSEPH L. LANDENWICH

Exhibit 10.34

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008 by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **JOSEPH L. LANDENWICH**, (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success has been and continues to be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "Cause" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "Termination of Employment" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his

employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "**Window Period**" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. **Continuation of Benefits.**

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e. as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. <u>Retirement Savings Plan</u>. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. <u>Plan Amendments</u>. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. <u>Fringe Benefits</u>. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. <u>General Release of Claims</u>. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. <u>Golden Parachute Tax Reimbursement</u>. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or

any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of the Company's receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. **Disputes**. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:	Kindred Healthcare Operating, Inc. 680 South Fourth Street Louisville, KY 40202 Attention: General Counsel
If to Employee:	Joseph L. Landenwich 680 South Fourth Street Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it

is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. **Cancellation of Prior Agreement**. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement dated February 25, 2003, between the Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Joseph L. Landenwich
JOSEPH L. LANDENWICH

Exhibit 10.35

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (this "Agreement") is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and Benjamin A. Breier (the "Executive").

WITNESSETH:

WHEREAS, the Executive is employed by the Company, a wholly-owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for the terms of Executive's employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of the Parent has determined that it is in the best interests of the Company to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive (the "Term") specifying the effective date of such notice. In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company as Executive Vice-President and President, Hospital Division, reporting directly to Frank J. Battafarano, Chief Operating Officer.

3. Extent of Services. Executive, subject to the direction and control of the Board of Directors of the Parent (the "Board") and the Company, shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the Term, Executive shall devote his entire working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than his current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board in its sole discretion.

(b) During the Term, in addition to Base Salary, Executive will be eligible to participate in the Company's annual short-term and long-term incentive compensation plans, in accordance with the terms and conditions of such plans as may be in effect from time to time, subject to the following:

(1) the Executive's target bonus under the short-term incentive plan is 60% of Base Salary (the "Target Bonus"), with a maximum of 75%. Base Salary for 2008 shall be prorated for Executive's base salary rate prior to March 1, 2008, and the Base Salary rate on and after March 1, 2008.

(2) the Executive's target bonus under the long-term incentive plan is 45% of Base Salary (the "Target Long-Term Bonus"), with a maximum of 90%. Base Salary for 2008 shall be calculated based on the rate on or after March 1, 2008, with no proration.

5. Benefits.

(a) Executive shall be entitled to participate in any and all pension benefit (whether tax qualified or non-qualified), welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for officers of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates as in effect from time to time for officers of the Company.

(c) Executive shall be entitled to earn paid time off each year up to a maximum of 208 hours per year, subject to the Company's policies, as in effect from time to time. The Executive shall schedule the timing of such paid time off in a reasonable manner. The Executive also may be entitled to such other leave, with or without compensation, as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(1) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation, the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(2) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive;

(3) the Company shall require Executive to relocate Executive's principal business office more than 30 miles, provided that the Executive and the Company acknowledge that Executive's principal business office is 680 South Fourth Street, Louisville, Kentucky 40202; or

(4) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination, and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following the termination of Executive's employment hereunder for any reason, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the benefit plans and programs of the Company at the time such payments are due. In addition, subject to Section 7(c) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) an amount equal to the product of (i) the annual bonus under the short-term incentive plan to which the Executive would have been entitled for the year of termination of employment had Executive's employment with the Company not been terminated, as determined in accordance with Section 4(b)(1) hereof, if any, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which such termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b)(1) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) With respect to the Company's long-term incentive plan, the Company shall provide and pay the following amounts:

(i) for the year in which the Executive's Date of Termination occurs, the Executive shall be entitled to a long-term incentive award equal to the product of (A) the long-term incentive bonus, if any, Executive would have been

entitled to in respect of the calendar year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined based on actual performance and in accordance with the terms and conditions of the Company's long-term incentive plan, and (B) a fraction, the numerator of which is the number of days in the period commencing on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the same schedule and in the same manner as if the Executive had remained employed with the Company through settlement of such long-term incentive award, as determined in accordance with the terms and conditions of the Company's long-term incentive plan.

(ii) with respect to years prior to the year in which the Executive's Date of Termination occurs and to the extent not yet paid, the Company shall pay to Executive any amounts earned by the Executive prior to the Date of Termination under the Company's long-term incentive plan. Such amount shall be paid on the same schedule and in the same manner as if the Executive had remained employed with the Company through settlement of such long-term incentive award, as determined in accordance with the terms and conditions of the Company's long-term incentive plan.

(4) For the 18-month period following the Date of Termination, (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits"), by treating the end of the this period as the applicable qualifying event (i.e., as a termination of employment for purposes of ERISA § 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by law.

(5) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had if he had remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively, shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(7) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Company shall adopt such amendments to its benefit plans and other agreements referred to in this Agreement, if any, as are necessary to effectuate the provisions of this Section 7. To the extent an applicable plan or agreement cannot be so amended due to nondiscrimination or other requirements applicable to the plan, Company shall adopt or implement an alternative written plan or program to accomplish the purpose.

(10) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments owed to the Executive hereunder; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided in subsection (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days, and provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company, its Parent and their successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any severance plans or arrangements of the Company or its affiliates that specifically provide for severance payments, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Change in Control Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder (including without

limitation the provision of in-kind benefits provided under Section 7(b) hereof) shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-Solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
Benjamin A. Breier
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Survival. Any provision of this Agreement creating obligations extending beyond the Term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

21. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated March 1, 2008, between the Company and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

22. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purpose of Section 7 and Section 9
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Benjamin A. Breier

BENJAMIN A. BREIER

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008 by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **BEN BREIER** (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success will be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "Termination of Employment" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his

employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "**Window Period**" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. <u>Continuation of Benefits</u>.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which the Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **<u>Retirement Savings Plan</u>**. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **<u>Plan Amendments</u>**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **<u>Fringe Benefits</u>**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **<u>General Release of Claims</u>**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **<u>Golden Parachute Tax Reimbursement</u>**. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or

any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of the Company's receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. No Mitigation Required or Setoff Permitted. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. Waiver of Other Severance Benefits. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. Employment at Will. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. **Non-solicitation**. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. **Successors; Binding Agreement**. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. **Notices**. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company:	Kindred Healthcare Operating, Inc. 680 South Fourth Street Louisville, KY 40202 Attention: General Counsel
If to Employee:	Ben Breier 680 South Fourth Street Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

12. **Indemnification**. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the

extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. **ERISA**. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. **Severability**. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. **Interpretation**. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. **No Waiver**. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. **Survival**. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. **Amendments**. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. **Entire Agreement**. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. **Governing Law**. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. **Section 409A**. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. **Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. **Cancellation of Prior Agreement**. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of August 1, 2005, between Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Ben Breier

BEN BREIER

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (the "Agreement") is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and Gregory C. Miller (the "Executive").

W I T N E S S E T H:

WHEREAS, the Executive is employed by the Company, a wholly-owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for the terms of Executive's employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of the Parent has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The initial term of this Agreement shall be for a one-year period commencing on the Effective Date. The term shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive (the "Term") specifying the effective date of such notice. In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company as Senior Vice President of Development and Financial Planning, reporting directly to Paul J. Diaz, President and Chief Executive Officer.

3. Extent of Services. Executive, subject to the direction and control of the Board of Directors of the Parent (the "Board") and the Company, shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the Term, Executive shall devote his entire working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of not less than his current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board.

(b) In addition to Base Salary, Executive will be eligible to receive bonuses and other incentive compensation as the Board may approve from time to time, including participation in the Company's annual short-term incentive compensation plan and its long-term incentive compensation plan, in accordance with the terms and conditions of such plans as may be in effect from time to time.

5. Benefits.

(a) Executive shall be entitled to participate in any and all pension benefit (whether tax qualified or non-qualified), welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for officers of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates in effect from time to time for officers of the Company.

(c) Executive shall be entitled to earn paid time off each year up to a maximum of 208 hours per year, subject to the Company's policies. The Executive shall schedule the timing of such paid time off in a reasonable manner. The Executive also may be entitled to such other leave, with or without compensation, as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

6. Termination of Employment.

(a) Death or Disability. Executive's employment shall terminate automatically upon Executive's death during the Term. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition

of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment during the Term for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(i) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(ii) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive;

(iii) the Company shall require Executive to relocate Executive's principal business office more than 30 miles, provided that the Executive and the Company acknowledge that Executive's principal business office is 680 South Fourth Street, Louisville, Kentucky 40202; or

(iv) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following the termination of Executive's employment hereunder for any reason, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the benefit plans and programs of the Company at the time such payments are due. In addition, subject to Section 7(e) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) the prorated portion of any Target Bonus (as defined below) Executive would have received for the year of termination of employment. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

For purposes of this Agreement: "Target Bonus" shall mean the full amount of the targeted annual short-term incentive bonus that would be payable to the Executive, assuming the targeted performance criteria on which such annual short-term incentive bonus is based were deemed to be satisfied, in respect of services for the calendar year in which the date in question occurs.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the

denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) For a period of 18 months following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(4) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Company and Executive are responsible, respectively, immediately prior to the Date of Termination.

(5) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had if he had remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of

clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(7) Company may adopt such amendments to its executive benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(3), (4) and (5) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following Executive's separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall

Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company, its Parent and their successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used in this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any severance plans or arrangements of the Company or its affiliates that specifically provide for severance payments, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Change in Control Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder (including, without limitation, the provision of in-kind benefits provided under Section 7(b) hereof) shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever. This Section 13 shall survive this Agreement.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
Gregory C. Miller
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Survival. Any provision of this Agreement creating obligations extending beyond the Term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

21. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement dated January 1, 2006, between the Company and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

22. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the

Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under Section 409A of the Code. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

Solely for the purpose
of Section 7 and Section 9

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

/s/ Gregory C. Miller

GREGORY C. MILLER

Exhibit 10.38

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

This CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008 by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **GREGORY C. MILLER** (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success will be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "<u>Change in Control</u>" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the Securities Exchange Act of 1934) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "**Change-in-Control Date**" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "**Good Reason**" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "**Person**" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "**Target Bonus**" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his

employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "Window Period" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. Term. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. Severance Benefits. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. Cash Payment. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the

seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For a period of three years following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment) for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and Company are responsible, respectively, shall be the same as the portion for which Company and Employee are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. **Retirement Savings Plan**. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. **Plan Amendments**. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. **Fringe Benefits**. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. **General Release of Claims**. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. Golden Parachute Tax Reimbursement. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or

any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of the Company's receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. **No Mitigation Required or Setoff Permitted.** In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. **Waiver of Other Severance Benefits.** The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. **Employment at Will.** Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. **Disputes.** Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company: Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Gregory C. Miller
680 South Fourth Street
Louisville, KY 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the

extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. Cancellation of Prior Agreement. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of January 1, 2006, between Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Gregory C. Miller

GREGORY C. MILLER

EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (this "Agreement") is made as of the 18th day of December, 2008 (the "Effective Date"), by and between Kindred Healthcare Operating, Inc., a Delaware corporation (the "Company"), and Christopher M. Bird (the "Executive").

W I T N E S S E T H:

WHEREAS, the Executive is employed by the Company, a wholly-owned subsidiary of Kindred Healthcare, Inc. ("Parent"), and the parties hereto desire to provide for the terms of Executive's employment by the Company; and

WHEREAS, the Executive Compensation Committee of the Board of Directors of the Parent has determined that it is in the best interests of the Company and Parent to enter into this Agreement.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and Executive agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby agrees to be employed by the Company on the terms and conditions herein set forth. The term of this Agreement shall be for a one-year period commencing on the Effective Date and shall be automatically extended by one additional day for each day beyond the Effective Date that the Executive remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Executive (the "Term") specifying the effective date of such notice. In such event, the Agreement shall terminate on the first anniversary of the effective date of such election notice.

2. Duties. Executive is engaged by the Company as President, Peoplefirst Rehabilitation, reporting directly to Frank J. Battafarano, Chief Operating Officer.

3. Extent of Services. Executive, subject to the direction and control of the Board and the Company, shall have the power and authority commensurate with his executive status and necessary to perform his duties hereunder. During the Term, Executive shall devote his entire working time, attention, labor, skill and energies to the business of the Company, and shall not, without the consent of the Company, be actively engaged in any other business activity, whether or not such business activity is pursued for gain, profit or other pecuniary advantage. Notwithstanding the foregoing, during the Term, Executive may, subject to the approval of the Board which approval may be withheld in the Board's sole discretion, devote reasonable time to activities other than those required under this Agreement involving professional, charitable, community, educational and similar organizations, including membership on the board of directors of such organizations.

4. Compensation. As compensation for services hereunder rendered, Executive shall receive during the Term:

(a) A base salary ("Base Salary") of no less than his current base salary per year payable in equal installments in accordance with the Company's normal payroll procedures. Executive may receive increases in his Base Salary from time to time, as approved by the Board in its sole discretion.

(b) During the Term, in addition to Base Salary, Executive will be eligible to participate in the Company's short-term and long-term incentive plans, as such plans may be in effect from time to time, on a pro-rated basis for 2008 based on an April 21, 2008 start date, and in each subsequent full or partial year of employment, subject to the following:

(1) the Executive's target bonus under the short-term incentive plan is 60% of Base Salary (the "Target Bonus"), with a maximum of 75%.

(2) the Executive's target bonus under the long-term incentive plan is 45% of Base Salary (the "Target Long-Term Bonus"), with a maximum of 90%.

5. Benefits. During the Term:

(a) Executive shall be entitled to participate in any and all pension benefit (whether tax qualified or non-qualified), welfare benefit (including, without limitation, medical, dental, disability and group life insurance coverages) and fringe benefit plans from time to time in effect for officers of the Company and its affiliates.

(b) Executive shall be entitled to participate in such bonus, stock option, or other incentive compensation plans of the Company and its affiliates as in effect from time to time for officers of the Company.

(c) Executive shall be entitled to earn paid time off each year up to a maximum of 208 hours per year, subject to the Company's policies, as in effect from time to time. The Executive shall schedule the timing of such paid time off in a reasonable manner. The Executive also may be entitled to such other leave, with or without compensation, as shall be mutually agreed by the Company and Executive.

(d) Executive may incur reasonable expenses for promoting the Company's business, including expenses for entertainment, travel and similar items. The Company shall reimburse Executive for all such reasonable expenses in accordance with the Company's reimbursement policies and procedures, as may be in effect from time to time.

(e) Executive acknowledges that the Company has reimbursed Executive for certain relocation expenses incurred by Executive in accordance with the Company's Officer Relocation Policy. In the event Executive voluntarily terminates his employment with the Company without Good Reason on or before April 21, 2009, Executive will reimburse the Company for a pro rata amount of Executive's relocation and other expenses paid pursuant to the Company's Officer Relocation Policy and the full

amount of any payments made by the Company related to any expenses invoiced to Executive under the Tenet Relocation Benefit Agreement between Executive and Tenet Healthcare Corporation.

6. Termination of Employment.

(a) Death or Disability. Executive's employment hereunder shall terminate automatically upon Executive's death. If the Company determines in good faith that the Disability of Executive has occurred during the Term (pursuant to the definition of Disability set forth below) it may give to Executive written notice of its intention to terminate Executive's employment. In such event, Executive's employment with the Company shall terminate effective on the 30th day after receipt of such notice by Executive (the "Disability Effective Date"), provided that, within the 30 days after such receipt, Executive shall not have returned to full-time performance of Executive's duties. For purposes of this Agreement, "Disability" shall mean Executive's absence from his full-time duties hereunder for a period of 90 days due to disability as defined in the long-term disability plan provided to Executive by the Company.

(b) Cause. The Company may terminate Executive's employment hereunder for Cause. For purposes of this Agreement, "Cause" shall mean the Executive's (i) conviction of or plea of nolo contendere to a crime involving moral turpitude; or (ii) willful and material breach by Executive of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company and its affiliates, but with respect to (ii) only if the Board adopts a resolution by a vote of at least 75% of its members so finding after giving the Executive and his attorney an opportunity to be heard by the Board and a reasonable opportunity of not less than 30 days to remedy or correct the purported breaching conduct. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or based upon advice of counsel for the Company shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company.

(c) Good Reason. Executive's employment may be terminated during the Term by Executive for Good Reason. "Good Reason" shall exist upon the occurrence, without Executive's express written consent, of any of the following events:

(1) a material adverse change in Executive's authority, duties or responsibilities (including, without limitation, the Company assigning to Executive duties of a substantially nonexecutive or nonmanagerial nature) (other than any such change directly attributable to the fact that the Company is no longer publicly owned);

(2) the Company shall materially reduce the Base Salary or annual bonus opportunity of Executive;

(3) the Company shall require Executive to relocate Executive's principal business office more than 30 miles, provided that the Executive and the Company acknowledge that Executive's principal business office is 680 South Fourth Street, Louisville, Kentucky 40202; or

(4) a material breach by the Company of Section 5(a) or Section 9(c) of this Agreement.

For purposes of this Agreement, "Good Reason" shall not exist until after Executive has given the Company notice of the applicable event within 90 days of the initial occurrence of such event and which is not remedied within 30 days after receipt of written notice from Executive specifically delineating such claimed event and setting forth Executive's intention to terminate employment if not remedied; provided, that if the specified event cannot reasonably be remedied within such 30-day period and the Company commences reasonable steps within such 30-day period to remedy such event and diligently continues such steps thereafter until a remedy is effected, such event shall not constitute "Good Reason" provided that such event is remedied within 60 days after receipt of such written notice.

(d) Notice of Termination. Any termination by the Company for Cause, or by Executive for Good Reason, shall be communicated by Notice of Termination given in accordance with this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Executive's employment under the provision so indicated and (iii) specifies the intended termination date (which date, in the case of a termination for Good Reason, shall be not more than thirty days after the giving of such notice). The failure by Executive or the Company to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of Executive or the Company, respectively, hereunder or preclude Executive or the Company, respectively, from asserting such fact or circumstance in enforcing Executive's or the Company's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if Executive's employment is terminated by the Company for Cause, or by Executive for Good Reason, the later of the date specified in the Notice of Termination or the date that is one day after the last day of any applicable cure period, (ii) if Executive's employment is terminated by the Company other than for Cause or Disability, or Executive resigns without Good Reason, the Date of Termination shall be the date on which the Company or Executive notified Executive or the Company, respectively, of such termination, and (iii) if Executive's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of Executive or the Disability Effective Date, as the case may be.

7. Obligations of the Company Upon Termination. Following the termination of Executive's employment during the Term for any reason, the Company shall pay Executive his Base Salary through the Date of Termination and any amounts owed to Executive pursuant to the terms and conditions of the benefit plans and programs of the Company at the time such payments are due.

In addition, subject to Section 7(c) hereof and the conditions set forth below, Executive shall be entitled to the following additional payments:

(a) Death or Disability. If, during the Term, Executive's employment shall terminate by reason of Executive's death or Disability, the Company shall pay to Executive (or his designated beneficiary or estate, as the case may be) an amount equal to the product of (i) the annual bonus to which the Executive would have been entitled for the year of termination of employment had Executive's employment with the Company not been terminated, as determined in accordance with Section 4(b) hereof, if any, multiplied by (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which such termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan.

(b) Good Reason; Other than for Cause. If, during the Term, the Company shall terminate Executive's employment other than for Cause (but not for Disability), or the Executive shall terminate his employment for Good Reason:

(1) in satisfaction of the annual bonus Executive would otherwise be eligible to receive under the short-term incentive plan in respect of the calendar year in which the Date of Termination occurs, the Company shall pay to Executive an amount equal to the product of (i) the annual bonus, if any, to which the Executive would have been entitled for the year in which the Date of Termination occurs had Executive's employment with the Company not been terminated, as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company as provided in Section 4(b) hereof, and (ii) a fraction, the numerator of which is the number of days in the period beginning on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the date when such amounts would otherwise have been payable to the Executive if Executive's employment with the Company had not terminated as determined in accordance with the terms and conditions of the applicable short-term incentive plan of the Company.

(2) Within 14 days following Executive's Date of Termination, the Company shall pay to Executive a cash severance payment in an amount equal to 1.5 times the sum of the Executive's Base Salary and Target Bonus as of the Date of Termination.

(3) In lieu of any amounts otherwise due under the Company's long-term incentive plan, the Company shall provide and pay the following amounts:

(i) for the year in which the Executive's Date of Termination occurs, the Executive shall be entitled to a long-term incentive award equal to the product of (A) the long-term incentive bonus, if any, Executive would have been entitled to in respect of the calendar year in which the Date of Termination occurs had Executive's employment with the Company had not been terminated, as determined based on actual performance and in accordance with the terms and conditions of the Company's long-term incentive plan, and (B) a fraction, the numerator of which is the number of days in the period commencing on the first day of the calendar year in which the Date of Termination occurs and ending on the Date of Termination and the denominator of which is 365. Such amount shall be paid on the same schedule and in the same manner as if the Executive had remained employed with the Company through settlement of such long-term incentive award, as determined in accordance with the terms and conditions of the Company's long-term incentive plan.

(ii) with respect to years prior to the year in which the Executive's Date of Termination occurs and to the extent not yet paid, the Company shall pay to Executive any amounts earned by the Executive prior to the Date of Termination under the Company's long-term incentive plan. Such amount shall be paid on the same schedule and in the same manner as if the Executive had remained employed with the Company through settlement of such long-term incentive award, as determined in accordance with the terms and conditions of the Company's long-term incentive plan.

(4) For the 18-month period following the Date of Termination (the "Benefit Continuation Period"), the Executive shall be treated as if he had continued to be an Executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Executive is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Executive shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, the Executive shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits"), by treating the end of the this period as the applicable qualifying event (i.e., as a termination of employment for purposes of ERISA § 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by law.

(5) For the Benefit Continuation Period, Company shall maintain in force, at its expense, the Executive's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Executive and Company are responsible, respectively, shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(6) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Executive equivalent to the coverage that the Executive would have had if he had remained employed under the disability insurance plans applicable to Executive on the Date of Termination. Executive shall be responsible for any employee contributions for such insurance coverage. Should Executive become disabled during such period, Executive shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of the premiums in respect of such short-term and long-term disability benefits for which Executive and Company are responsible, respectively, shall be the same as the portion for which Executive and Company are responsible, respectively, immediately prior to the Date of Termination.

(7) Within fifteen (15) days after the Date of Termination, the Company shall pay to Executive a cash payment in an amount, if any, necessary to compensate Executive for the Executive's unvested interests under the Company's retirement savings plan which are forfeited by Executive in connection with the termination of Executive's employment.

(8) Any outstanding unvested stock options, stock performance units or similar equity awards (other than restricted stock awards) held by Executive on the Date of Termination shall continue to vest in accordance with their original terms (including any related performance measures) for the duration of the Benefit Continuation Period as if Executive had remained an employee of the Company through the end of such period and any such stock option, stock performance unit or other equity award (other than restricted stock awards) that has not vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date. In addition, Executive shall have the right to continue to exercise any outstanding vested stock options held by Executive during the Benefit Continuation Period; provided that in no event shall Executive be entitled to exercise any such option beyond the original expiration date of such option. Any outstanding restricted stock award held by Executive as of the Date of Termination that would have vested during the Benefit Continuation Period had Executive remained an employee of the Company through the end of such period shall be immediately vested as of the Date of Termination and any restricted stock award that would not have vested as of the conclusion of such period shall be immediately cancelled and forfeited as of such date.

(9) Company shall adopt such amendments to its benefit plans and other agreements referred to in this Agreement, if any, as are necessary to effectuate the provisions of this Section 7. To the extent an applicable plan or agreement cannot be so amended due to nondiscrimination or other requirements applicable to the plan, Company shall adopt or implement an alternative written plan or program to accomplish the purpose.

(10) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 7 during any taxable year of Executive affect the provision of in-kind benefits pursuant to this Section 7 in any other taxable year of Executive.

(c) Cause; Other than for Good Reason. If Executive's employment shall be terminated during the Term for Cause or Executive terminates employment without Good Reason (and other than due to such Executive's death) during the Term, this Agreement shall terminate without further additional obligations to Executive under this Agreement.

(d) Death after Termination. In the event of the death of Executive during the period Executive is receiving payments pursuant to this Agreement, Executive's designated beneficiary shall be entitled to receive the balance of the payments owed to the Executive hereunder; or in the event of no designated beneficiary, the remaining payments shall be made to Executive's estate.

(e) General Release of Claims. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 7 are subject to the condition that Executive has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Executive's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Executive's delivery of such executed release pursuant to this Section 7 shall by paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided in subsection (b)(4), (5) and (6) of this Section 7 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days, and provided further that if such release is not executed and delivered within such 60-day period, Executive shall reimburse the Company for the full cost of coverage during such period.

(f) Six Month Delay for Specified Employees. Notwithstanding anything herein to the contrary, if at the time of Executive's separation from service Executive is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder (the "Code") and the deferral of the payment payable pursuant to Section 7(b)(2) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Executive would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Executive) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Executive's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Executive's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all reasonable attorneys' and accountants' fees of the Executive in connection therewith, including any litigation to enforce any arbitration award.

9. Successors.

(a) This Agreement is personal to Executive and without the prior written consent of the Company shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon the Company, its Parent and their successors and assigns.

(c) The Company shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company, or any business of the Company for which Executive's services are principally performed, to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession had taken place. As used this Agreement, "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

10. Other Severance Benefits. Executive hereby agrees that in consideration for the payments to be received under Section 7(b) of this Agreement, Executive waives any and all rights to any payments or benefits under any severance plans or arrangements of the Company or its affiliates that specifically provide for severance payments, other than the Change in Control Severance Agreement between the Company and Executive (the "Change in Control Severance Agreement"); provided that any payments payable to Executive under Section 7(b) hereof shall be offset by any payments payable under the Change in Control Severance Agreement.

11. Withholding. All payments to be made to Executive hereunder will be subject to all applicable required withholding of taxes.

12. No Mitigation. Executive shall have no duty to mitigate his damages by seeking other employment and, should Executive actually receive compensation from any such other employment, the payments required hereunder (including without limitation the provision of in-kind benefits provided under Section 7(b) hereof) shall not be reduced or offset by any such compensation. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Executive or others.

13. Non-solicitation. From the date hereof through the Term and for a period of one year thereafter (collectively, the "Non-Solicitation Period"), Executive shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Executive or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Executive will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Executive is in violation of any covenant contained herein, for any reason whatsoever. This Section 13 shall survive this Agreement.

14. Notices. Any notice required or permitted to be given under this Agreement shall be in writing and shall be deemed to have been duly given when delivered or sent by telephone facsimile transmission, personal or overnight couriers, or registered mail with confirmation or receipt, addressed as follows:

If to Executive:
Christopher M. Bird
680 South Fourth Street
Louisville, KY 40202

If to Company:
Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attn: General Counsel

15. Waiver of Breach and Severability. The waiver by either party of a breach of any provision of this Agreement by the other party shall not operate or be construed as a waiver of any subsequent breach by either party. In the event any provision of this Agreement is found to be invalid or unenforceable, it may be severed from the Agreement and the remaining provisions of the Agreement shall continue to be binding and effective.

16. Entire Agreement; Amendment. This instrument contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements, promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter hereof. No provisions of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Executive and such officer of the Company specifically designated by the Board.

17. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Delaware.

18. Headings. The headings in this Agreement are for convenience only and shall not be used to interpret or construe its provisions.

19. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

20. Survival. Any provision of this Agreement creating obligations extending beyond the Term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

21. Cancellation of Prior Agreement. The Executive hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain employment agreement effective on April 21, 2008, between the Company and the Executive, and that such agreement is cancelled, terminated and of no further force and effect.

22. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Executive to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with 409A and agrees to maintain, to the maximum extent practicable without violating 409A, the original intent and economic benefit to Executive of the applicable provision; provided that nothing herein shall require the Company to provide Executive with any gross-up for any tax, interest or penalty incurred by Executive under 409A. Furthermore, notwithstanding anything herein to the contrary, no payment or benefit payable under this Agreement shall be required to be paid or provided in calendar year 2008 if the payment of such payment or benefit would constitute an impermissible acceleration under Section 409A of the Code and the transition guidance thereunder and such payment shall instead be paid on January 1, 2009, without interest.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

Solely for the purpose of Section 7

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz

President and Chief Executive Officer

/s/ Christopher M. Bird

CHRISTOPHER M. BIRD

Exhibit 10.40

CHANGE-IN-CONTROL SEVERANCE AGREEMENT

THIS CHANGE-IN-CONTROL SEVERANCE AGREEMENT (the "Agreement") is made as of December 18, 2008 by and between **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation, (the "Company") and **CHRISTOPHER M. BIRD** (the "Employee").

RECITALS:

A. The Employee is employed by the Company, a wholly owned subsidiary of Kindred Healthcare, Inc. (the "Parent").

B. The Company recognizes that the Employee's contribution to the Company's growth and success will be significant.

C. The Company wishes to encourage the Employee to remain with and devote full time and attention to the business affairs of the Company and wishes to provide income protection to the Employee for a period of time in the event of a Change in Control.

NOW, THEREFORE, in consideration of the mutual covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

AGREEMENT:

1. Definitions.

a. "**Base Salary**" shall mean the Employee's regular annual rate of base pay in gross as of the date in question as elected under Paragraph 3(a).

b. "**Cause**" shall mean the Employee's (i) conviction of or plea of *nolo contendere* to a crime involving moral turpitude; or (ii) willful and material breach by Employee of his duties and responsibilities, which is committed in bad faith or without reasonable belief that such breaching conduct is in the best interests of the Company, but with respect to (ii) only if the Board of Directors of Parent (the "Board") adopts a resolution by a vote of at least 75% of its members so finding after giving the Employee and his attorney an opportunity to be heard by the Board.

c. "**Change in Control**" The term "Change in Control" shall mean any one of the following events occurring after the date of this Agreement:

(i) An acquisition (other than directly from Parent) of any voting securities of Parent (the "Voting Securities") by any "Person" (as defined in Paragraph 1(f) hereof) immediately after which such Person has "Beneficial Ownership" (within the meaning of Rule 13d-3 under the 1934 Act) of 20% or more of the combined voting power of Parent's then outstanding Voting Securities; provided, however, that in determining whether a Change in Control has occurred, Voting Securities which are acquired in an acquisition by (i) Parent or any of its subsidiaries, (ii) an employee benefit plan (or a trust forming a part thereof) maintained by Parent or any of its subsidiaries or (iii) any Person in connection with an acquisition referred to in the immediately preceding clauses (i) and (ii) shall not constitute an acquisition which would cause a Change in Control.

(ii) The individuals who, as of December 18, 2008, constituted the Board of Directors of Parent (the "Incumbent Board") cease for any reason to constitute over 50% of the Board; provided, however, that if the election, or nomination for election by Parent's stockholders, of any new director was approved by a vote of over 50% of the Incumbent Board, such new director shall, for purposes of this Section 1(c)(ii), be considered as though such person were a member of the Incumbent Board; provided, further, however, that no individual shall be considered a member of the Incumbent Board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board of Directors of Parent (a "Proxy Contest"), including by reason of any agreement intended to avoid or settle any Election Contest or Proxy Contest.

(iii) Consummation of a merger, consolidation or reorganization involving Parent, unless each of the following events occurs in connection with such merger, consolidation or reorganization:

(A) the stockholders of Parent, immediately before such merger, consolidation or reorganization, own, directly or indirectly immediately following such merger, consolidation or reorganization, over 50% of the combined voting power of all voting securities of the corporation resulting from such merger or consolidation or reorganization (the "Surviving Company") over which any Person has Beneficial Ownership in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, consolidation or reorganization;

(B) the individuals who were members of the Incumbent Board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute over 50% of the members of the board of directors of the Surviving Company; and

(C) no Person (other than Parent, any of its subsidiaries, any employee benefit plan (or any trust forming a part thereof) maintained by Parent, the Surviving Company or any Person who, immediately prior to such merger, consolidation or reorganization had Beneficial Ownership of 20% or more of the then outstanding Voting Securities) has Beneficial Ownership of 20% or more of the combined voting power of the Surviving Company's then outstanding voting securities.

(iv) Approval by Parent's stockholders of a complete liquidation or dissolution of Parent.

(v) Approval by Parent's stockholders of an agreement for the sale or other disposition of all or substantially all of the assets of Parent to any Person (other than a transfer to a subsidiary of Parent).

(vi) Any other event that the Board shall determine constitutes an effective Change in Control of Parent.

(vii) Notwithstanding the foregoing, a Change in Control shall not be deemed to occur solely because any Person (the "Subject Person") acquired Beneficial Ownership of more than the permitted amount of the outstanding Voting Securities as a result of the acquisition of Voting Securities by Parent which, by reducing the number of Voting Securities outstanding, increases the proportional number of shares Beneficially Owned by the Subject Person; provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of Voting Securities by Parent, and after such share acquisition by Parent, the Subject Person becomes the Beneficial Owner of any additional Voting Securities which increases the percentage of the then outstanding Voting Securities Beneficially Owned by the Subject Person, then a Change in Control shall occur.

d. "Change-in-Control Date" shall mean the date immediately prior to the effectiveness of the Change in Control.

e. "Good Reason" The Employee shall have good reason to terminate employment with the Company if (i) the Employee's title, duties, responsibilities or authority is reduced or diminished from those in effect on the Change-in-Control Date without the Employee's written consent; (ii) the Employee's compensation is reduced; (iii) the Employee's benefits are reduced, other than pursuant to a uniform reduction applicable to all managers of the Company; or (iv) the Employee is asked to relocate his office to a place more than 30 miles from his business office on the Change-in-Control Date.

f. "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Securities Exchange Act of 1934 and used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

g. "Target Bonus" shall mean the Employee's target annual short-term incentive bonus for the calendar year in which the date in question occurs.

h. "**Termination of Employment**" shall mean (i) the termination of the Employee's employment by the Company other than such a termination in connection with an offer of immediate reemployment by a successor or assign of the Company or a purchaser of the Company or its assets under terms and conditions which would not permit the Employee to terminate his employment for Good Reason or otherwise during any Window Period; or (ii) the Employee's termination of employment with the Company for Good Reason or during any Window Period.

i. "**Window Period**" shall mean either of two 30-day periods of time commencing 30 days after (i) a Change in Control and (ii) one year after a Change in Control.

2. **Term**. The initial term of this Agreement shall be for a three-year period commencing on December 18, 2008 (the "Effective Date") (the "Term"). The Term shall be automatically extended by one additional day for each day beyond the Effective Date that the Employee remains employed by the Company until such time as the Company elects to cease such extension by giving written notice of such election to the Employee. In such event, the Agreement shall terminate on the third anniversary of the effective date of such election notice. Notwithstanding the foregoing, this Agreement shall automatically terminate if and when the Employee terminates his employment with the Company or two years after the Change-in-Control Date, whichever first occurs.

3. **Severance Benefits**. If at any time following a Change in Control and continuing for two years thereafter, the Company terminates the Employee without Cause, or the Employee terminates employment with the Company either for Good Reason or during any Window Period, then as compensation for services previously rendered the Employee shall be entitled to the following benefits:

a. **Cash Payment**. The Employee shall be paid a cash severance payment equal to three times the greater of:

(i) the sum of the Employee's Base Salary and Target Bonus as of the Termination of Employment, or

(ii) the sum of the Employee's Base Salary and Target Bonus as of the Change-in-Control Date.

Payment shall be made in a single lump sum upon the effective date of Employee's Termination of Employment. For purposes of clarification, the Employee shall not be entitled to payment of an annual bonus (or pro-rated portion thereof) pursuant to the applicable short-term incentive plan of the Company for the year in which the Employee's Termination of Employment occurs. Notwithstanding anything herein to the contrary, if at the time of Employee's separation from service Employee is a "specified employee" as defined in Section 409A of the Internal Revenue Code of 1986, as amended and the regulations promulgated

thereunder (the "Code") and the deferral of the payment payable pursuant to this Section 3(a) is necessary in order to prevent any accelerated or additional tax under Section 409A of the Code, then the payment to which Employee would otherwise be entitled during the first six months following his separation from service shall be deferred and accumulated (without any reduction in such payment ultimately paid to Employee) for a period of six months from the date of separation from service and paid in a lump sum on the first day of the seventh month following such separation from service (or, if earlier, the date of Employee's death), together with interest during such period at a rate computed by adding 2.00% to the Prime Rate as published in the Money Rates section of the Wall Street Journal, or other equivalent publication if the Wall Street Journal no longer publishes such information, on the first publication date of the Wall Street Journal or equivalent publication after the date of Employee's separation from service (provided that if more than one such Prime Rate is published on any given day, the highest of such published rates shall be used).

b. Continuation of Benefits.

(i) For the three-year period following the Termination of Employment (the "Benefit Continuation Period"), the Employee shall be treated as if he had continued to be an executive for all purposes under the Company's health insurance plan and dental insurance plan; or if the Employee is prohibited from participating in such plans, the Company shall otherwise provide such benefits. Employee shall be responsible for any employee contributions for such insurance coverage. Following the Benefit Continuation Period, Employee shall be entitled to receive continuation coverage under Part 6 of Title I of ERISA ("COBRA Benefits") by treating the end of this period as the applicable qualifying event (i.e., as a termination of employment for purposes of ERISA Section 603(2)) and with the concurrent loss of coverage occurring on the same date, to the extent allowed by applicable law.

(ii) For the Benefit Continuation Period, the Company shall maintain in force, at its expense, the Employee's life insurance in effect under the Company's voluntary life insurance benefit plan as of the Change-in-Control Date or as of the date of Termination of Employment, whichever coverage limits are greater. For purposes of clarification, the portion of the premiums in respect of such voluntary life insurance for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iii) For the Benefit Continuation Period, the Company shall provide short-term and long-term disability insurance benefits to Employee equivalent to the coverage that the Employee would have had had he remained employed under the disability insurance plans applicable to Employee on the date of Termination of Employment, or, at the Employee's election, the plans applicable to Employee as of the Change-in-Control Date. Should Employee become disabled during such period, Employee shall be entitled to receive such benefits, and for such duration, as the applicable plan provides. For purposes of clarification, the portion of

the premiums in respect of such short-term and long-term disability benefits for which Employee and the Company are responsible, respectively, shall be the same as the portion for which Employee and the Company are responsible, respectively, immediately prior to the date of Termination of Employment or the Change-in-Control Date, as applicable.

(iv) Notwithstanding anything in this Agreement to the contrary, in no event shall the provision of in-kind benefits pursuant to this Section 3 during any taxable year of Employee affect the provision of in-kind benefits pursuant to this Section 3 in any other taxable year of Employee.

c. <u>Retirement Savings Plan</u>. Within fifteen (15) days after the date of Termination of Employment, the Company shall pay to Employee a cash payment in an amount, if any, necessary to compensate Employee for the Employee's unvested interests under the Company's retirement savings plan which are forfeited by Employee in connection with the Termination of Employment.

d. <u>Plan Amendments</u>. The Company shall adopt such amendments to its employee benefit plans, if any, as are necessary to effectuate the provisions of this Agreement.

e. <u>Fringe Benefits</u>. Following the Employee's Termination of Employment, the Employee shall receive the computer that Employee is utilizing as of the date of such Termination of Employment. In addition, following Employee's Termination of Employment, Employee shall be entitled to be reimbursed for any legal or accounting services utilized by Employee to minimize any personal income tax obligations arising from the Change in Control, in an amount not to exceed $5,000, such reimbursement shall be made in the calendar year following the calendar year in which the separation from service occurs, subject to the Company's receipt of appropriate invoices from the Employee evidencing the expenses to be reimbursed.

f. <u>General Release of Claims</u>. Notwithstanding anything herein to the contrary, the amounts payable pursuant to this Section 3 are subject to the condition that Employee has delivered to the Company an executed copy of an irrevocable general release of claims in a form satisfactory to the Company within the 60 day period immediately following the Employee's separation from service (the "Release Period"). Any payment that otherwise would be made prior to Employee's delivery of such executed release pursuant to this Section 3 shall be paid on the first business day following the conclusion of the Release Period; provided that in-kind benefits provided pursuant to subsections (b)(i), (ii) and (iii) of this Section 3 shall continue in effect after separation from service pending the execution and delivery of such release for a period not to exceed 60 days; provided further that if such release is not executed and delivered within such 60-day period, Employee shall reimburse the Company for the full cost of coverage during such period.

4. **Golden Parachute Tax Reimbursement**. Whether or not any payments are made pursuant to Section 3 above, if a Change in Control occurs at any time and the Employee reasonably determines that any payment or distribution by the Company or any of its affiliates to or for the benefit of the Employee, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise pursuant to or by reason of any other agreement, policy, plan, program or arrangement, including without limitation any restricted stock, stock option, stock appreciation right or similar right, or the lapse or termination of any restriction on or the vesting or exercisablility of any of the foregoing (individually and collectively, the "Payment"), would be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code") (or any successor provision thereto) by reason of being considered "contingent on a change in ownership or control," within the meaning of Section 280G of the Code (or any successor provision thereto), or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest and penalties, being hereinafter collectively referred to as the "Excise Tax"), then the Company or Parent shall pay to the Employee an additional payment or payments (individually and collectively, the "Gross-Up Payment"). The Gross-Up Payment shall be in an amount such that, after payment by the Employee of all taxes required to be paid by the Employee with respect to the receipt thereof under the terms of any federal, state or local government or taxing authority (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed with respect to the Gross-Up Payment, the Employee retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payment. The Gross-Up Payment shall be paid to the Employee within 30 days of the Company's receipt of written notice from the Employee that such Excise Tax has been paid or will be payable at any time in the future, but in no event later than the end of the year immediately following the year in which the related taxes are remitted to the appropriate taxing authority.

5. **No Mitigation Required or Setoff Permitted**. In no event shall Employee be obligated to seek other employment or take other action by way of mitigation of the amounts payable to Employee under the terms of this Agreement, and all such amounts shall not be reduced whether or not Employee obtains other employment. Further, the Company's and Parent's obligations to make any payments hereunder shall not be subject to or affected by any setoff, counterclaims or defenses which the Company or Parent may have against Employee or others.

6. **Waiver of Other Severance Benefits**. The benefits payable pursuant to this Agreement are in lieu of any other severance benefits which may otherwise be payable by the Company or its affiliates to the Employee upon termination of employment pursuant to a severance program of the Company or its affiliates (including, without limitation, any benefits to which Employee might otherwise be entitled under any employment agreement or other severance or change in control or similar agreement between Employee and the Company or any of its affiliates).

7. **Employment at Will**. Notwithstanding anything to the contrary contained herein, the Employee's employment with the Company is not for any specified term and may be terminated by the Employee or by the Company at any time, for any reason, with or without cause, without any liability, except with respect to the payments provided hereunder or as required by law or any other contract or employee benefit plan.

8. Disputes. Any dispute or controversy arising under, out of, or in connection with this Agreement shall, at the election and upon written demand of either party, be finally determined and settled by binding arbitration in the City of Louisville, Kentucky, in accordance with the Labor Arbitration rules and procedures of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof. The Company shall pay all costs of the arbitration and all attorneys' and accountants' fees of the Employee in connection therewith, including any litigation to enforce any arbitration award.

9. Non-solicitation. During the Term and for a period of one year thereafter (collectively, the "Non-solicitation Period"), Employee shall not directly or indirectly, individually or on behalf of any person other than the Company, aid or endeavor to solicit or induce any of the Company's or its affiliates' employees to leave their employment with the Company or such affiliates in order to accept employment with Employee or any other person, corporation, limited liability company, partnership, sole proprietorship or other entity. If the restrictions set forth in this section would otherwise be determined to be invalid or unenforceable by a court of competent jurisdiction, the parties intend and agree that such court shall exercise its discretion in reforming the provisions of this Agreement to the end that the Employee will be subject to a non-solicitation covenant which is reasonable under the circumstances and enforceable by the Company. It is agreed that no adequate remedy at law exists for the parties for violation of this section and that this section may be enforced by any equitable remedy, including specific performance and injunction, without limiting the right of the Company to proceed at law to obtain such relief as may be available to it. The running of the Non-solicitation Period shall be tolled for any period of time during which Employee is in violation of any covenant contained herein, for any reason whatsoever.

10. Successors; Binding Agreement. This Agreement shall not be terminated by the voluntary or involuntary dissolution of the Company or by any merger or consolidation where the Company is not the surviving corporation, or upon any transfer of all or substantially all of the Company's stock or assets. In the event of such merger, consolidation or transfer, the provisions of this Agreement shall be binding upon and shall inure to the benefit of the surviving corporation or corporation to which such stock or assets of the Company shall be transferred.

11. Notices. Any notice or other communication hereunder shall be in writing and shall be effective upon receipt (or refusal of receipt) if delivered personally, or sent by overnight courier if signature for the receiving party is obtained, or sent by certified or registered mail, postage prepaid, to the other party at the address set forth below:

If to the Company: Kindred Healthcare Operating, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: General Counsel

If to Employee: Christopher M. Bird
680 South Fourth Street
Louisville, Kentucky 40202

Either party may change its specified address by giving notice in writing to the other.

12. Indemnification. The Company shall indemnify, defend and hold the Employee harmless from and against any liability, damages, costs and expenses (including attorneys' fees) in connection with any claim, cause of action, investigation, litigation or proceeding involving him by reason of his having been an officer, director, employee or agent of the Company, except to the extent it is judicially determined that the Employee was guilty of gross negligence or willful misconduct in connection with the matter giving rise to the claim for indemnification. This indemnification shall be in addition to and shall not be substituted for any other indemnification or similar agreement or arrangement which may be in effect between the Employee and the Company or may otherwise exist. The Company also agrees to maintain adequate directors and officers liability insurance, if applicable, for the benefit of Employee for the term of this Agreement and for five years thereafter.

13. ERISA. Many or all of the employee benefits addressed in Paragraph 3(b) and (c) exist under plans which constitute employee welfare benefit plans ("Welfare Plans") within the meaning of Section 3(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Any payments pursuant to this Agreement which could cause any of such Plans not to constitute a Welfare Plan shall be deemed instead to be made pursuant to a separate "employee pension benefit plan" within the meaning of Section 3(2) of ERISA or a "top hat" plan under Section 201(2) of ERISA as to which the applicable portions of the document constituting the Welfare Plan shall be deemed to be incorporated by reference. None of the benefits hereunder may be assigned in any way.

14. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision, which other provision shall remain in full force and effect.

15. Interpretation. The headings used herein are for convenience only and do not limit or expand the contents of this Agreement. Use of any male gender pronoun shall be deemed to include the female gender also.

16. No Waiver. No waiver of a breach of any provision of this Agreement shall be construed to be a waiver of any other breach of this Agreement. No waiver of any provision of this Agreement shall be enforceable unless it is in writing and signed by the party against whom it is sought to be enforced.

17. Survival. Any provisions of this Agreement creating obligations extending beyond the term of this Agreement shall survive the expiration or termination of this Agreement, regardless of the reason for such termination.

18. Amendments. Any amendments to this Agreement shall be effective only if in writing and signed by the parties hereto.

19. Entire Agreement. This Agreement constitutes the entire agreement of the parties with respect to the subject matter hereof.

20. Governing Law. This Agreement shall be interpreted in accordance with and governed by the law of the State of Delaware.

21. Section 409A. If any provision of this Agreement (or any award of compensation or benefits provided under this Agreement) would cause Employee to incur any additional tax or interest under Section 409A of the Code, the Company shall reform such provision to comply with Section 409A and agrees to maintain, to the maximum extent practicable without violating Section 409A of the Code, the original intent and economic benefit to Employee of the applicable provision; provided that nothing herein shall require the Company to provide Employee with any gross-up for any tax, interest or penalty incurred by Employee under Section 409A of the Code.

22. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed to be an original, and all of which together shall constitute one and the same instrument.

23. Cancellation of Prior Agreement. The Employee hereby acknowledges and agrees that this Agreement is intended to and does hereby replace that certain change-in-control severance agreement, dated as of March 24, 2008, between Company (or its predecessor) and the Employee, and that such agreement is cancelled, terminated and of no further force and effect.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

Solely for the purposes of
Sections 3, 4, 5 and 12:
KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and Chief Executive Officer

/s/ Christopher M. Bird

CHRISTOPHER M. BIRD

SIXTH AMENDMENT TO MASTER LEASE

THIS SIXTH AMENDMENT TO MASTER LEASE (the "Amendment") is made and entered into and effective as of December 8, 2008 (the "Effective Date"), by and among HCP, INC., a Maryland corporation (formerly known as Health Care Property Investors, Inc.) ("HCP"), HEALTH CARE PROPERTY PARTNERS, a California general partnership ("HCPP") and TEXAS HCP HOLDING, L.P., a Delaware limited partnership ("THCP," and together with HCP and HCPP, collectively, as their interest may appear, "Lessor"), on the one hand, and KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company ("Kindred East"), KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company ("Kindred West"), KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership ("Kindred Centers"), KINDRED HOSPITALS LIMITED PARTNERSHIP, a Delaware limited partnership ("Kindred Hospitals"), and TRANSITIONAL HOSPITALS CORPORATION OF WISCONSIN, INC., a Wisconsin corporation ("THCW" and together with Kindred East, Kindred West, Kindred Centers and Kindred Hospitals, collectively, and jointly and severally, "Lessee"), with respect to the following:

RECITALS

A. Lessor is the "Lessor" and Lessee is the "Lessee" pursuant to that certain Master Lease dated as of May 16, 2001 (the "Original Lease"), as amended by that certain First Amendment to Master Lease dated as of August 1, 2001 (the "First Amendment"), that certain Second Amendment to Master Lease effective as of July 1, 2003 (the "Second Amendment"), that certain Third Amendment to Master Lease dated as of June 30, 2004 (the "Third Amendment"), that certain Fourth Amendment to Master Lease effective as of March 1, 2006 (the "Fourth Amendment"), and that certain Fifth Amendment to Master Lease effective as of January 31, 2007 (the "Fifth Amendment" and together with the First Amendment, the Second Amendment, the Third Amendment, and the Fourth Amendment collectively, the "Prior Amendments"). The Original Lease together with the Prior Amendments are collectively referred to herein as the "Lease." The Lease covers the Land, Leased Improvements, Related Rights and Fixtures of twelve (12) separate health care Facilities, all as more particularly described in the Lease. All terms used in this Amendment with initial capital letters and not defined herein shall have the meanings given to such terms in the Lease.

B. Due to a scrivener's error, the legal description attached to the Fifth Amendment as Exhibit A-11 [Dallas, TX Facility] was incorrect and Lessor and Lessee now desire to amend the Lease to replace such Exhibit A-11 in its entirety to correct such error, but only upon the terms and conditions set forth herein.

AGREEMENT

IN CONSIDERATION OF the foregoing Recitals and the mutual promises and covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Lessor and Lessee agree as follows:

1. Correction to Legal Description of Dallas, TX Facility. The legal description in Exhibit A-11 attached to the Fifth Amendment is hereby replaced, in its entirety, with Exhibit A-11 attached to this Amendment.

2. Governing Law. THIS AMENDMENT WAS NEGOTIATED IN THE STATE OF CALIFORNIA, WHICH STATE THE PARTIES AGREE HAS A SUBSTANTIAL RELATIONSHIP TO THE PARTIES, THE LEASE AND TO THE UNDERLYING TRANSACTION EMBODIED HEREBY. ACCORDINGLY, IN ALL RESPECTS THE LEASE, AS HEREBY AMENDED (AND ANY AGREEMENT FORMED PURSUANT TO THE TERMS HEREOF) SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF CALIFORNIA (WITHOUT REGARD OF PRINCIPLES OR CONFLICTS OF LAW) AND ANY APPLICABLE LAWS OF THE UNITED STATES OF AMERICA, EXCEPT THAT ALL PROVISIONS OF THE LEASE, AS HEREBY AMENDED, RELATING TO THE CREATION OF THE LEASEHOLD ESTATE AND ALL REMEDIES SET FORTH IN ARTICLE XVI OF THE LEASE RELATING TO RECOVERY OF POSSESSION OF THE LEASED PROPERTY OF ANY FACILITY (SUCH AS AN ACTION FOR UNLAWFUL DETAINER OR OTHER SIMILAR ACTION) SHALL BE CONSTRUED AND ENFORCED ACCORDING TO, AND GOVERNED BY, THE LAWS OF THE STATE IN WHICH THE LEASED PROPERTY OF SUCH FACILITY IS LOCATED.

3. Full Force and Effect; Counterparts; Facsimile Signatures. Except as hereby amended, the Lease shall remain in full force and effect. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute a single instrument. Delivery of an executed counterpart of a signature page to this Amendment via telephone facsimile transmission shall be as effective as delivery of a manually executed counterpart of this Amendment.

[Signature Page Follows]

IN WITNESS WHEREOF, Lessor and Lessee have executed this Amendment as of the Effective Date.

LESSOR:

HCP, INC., a Maryland corporation

By: /s/ Brian J. Maas

Its: Senior Vice President

HEALTH CARE PROPERTY PARTNERS,
a California general partnership

By: HCP, INC., a Maryland corporation,
its Managing General Partner

By: /s/ Brian J. Maas

Its: Senior Vice President

TEXAS HCP HOLDING, L.P.,
a Delaware limited partnership

By: TEXAS HCP G. P., INC.,
a Delaware corporation, its General Partner

By: /s/ Brian J. Maas

Its: Senior Vice President

LESSEE: KINDRED NURSING CENTERS EAST, L.L.C.,
a Delaware limited liability company

By: /s/ Douglas L. Curnutte
Its: Vice President of Facilities & Real Estate Development
By: /s/ Richard E. Myers
Its: Real Estate Counsel

KINDRED NURSING CENTERS WEST, L.L.C.,
a Delaware limited liability company

By: /s/ Douglas L. Curnutte
Its: Vice President of Facilities & Real Estate Development
By: /s/ Richard E. Myers
Its: Real Estate Counsel

KINDRED NURSING CENTERS LIMITED
PARTNERSHIP, a Delaware limited partnership

By: Kindred Healthcare Operating, Inc.,
its general partner

By: /s/ Douglas L. Curnutte
Its: Vice President of Facilities & Real Estate Development
By: /s/ Richard E. Myers
Its: Real Estate Counsel

LESSEE (continued): KINDRED HOSPITALS LIMITED PARTNERSHIP,
a Delaware limited partnership

By: Kindred Hospitals West, LLC, a Delaware limited liability company, its general partner

By: /s/ Douglas L. Curnutte

Its: Vice President of Facilities & Real Estate Development

By: /s/ Richard E. Myers

Its: Real Estate Counsel

TRANSITIONAL HOSPITALS CORPORATION OF WISCONSIN, INC., a Wisconsin corporation

By: /s/ Douglas L. Curnutte

Its: Vice President of Facilities & Real Estate Development

CONSENT, REAFFIRMATION AND AGREEMENT OF GUARANTORS

The undersigned Guarantors hereby (i) consent to the foregoing Sixth Amendment to Master Lease, (ii) reaffirm to Lessor that their obligations under the Guaranty remain in full force and effect with respect to the Lease, as amended hereby and (iii) agrees that (A) its obligations under the Guaranty shall extend to Lessee's duties, covenants and obligations pursuant to the Lease, as hereby amended, and (B) the Guaranty as hereby reaffirmed and extended shall be for the benefit of each party comprising Lessor under the Lease, as hereby amended.

KINDRED HEALTHCARE, INC.,
a Delaware corporation

By: /s/ Douglas L. Curnutte
Its: Vice President of Facilities & Real Estate Development
By: /s/ Richard E. Myers
Its: Real Estate Counsel

KINDRED HEALTHCARE OPERATING, INC.,
a Delaware corporation

By: /s/ Douglas L. Curnutte
Its: Vice President of Facilities & Real Estate Development
By: /s/ Richard E. Myers
Its: Real Estate Counsel

EXHIBIT A-11

Legal Description Of The Land Of The Dallas, Texas Facility (Facility No. 4610)

Real property in the County of Dallas, State of Texas, described as follows:

Being Lot 8, in Block 7503, of VENCOR HOSPITAL ADDITION, as Addition to the City of Dallas, Dallas County, Texas, according to the Map thereof recorded in Volume 97203, Page 992, of the Map records of Dallas County, Texas, and being more particularly described on as follows:

Being situated in the City of Dallas and being partly in the Daniel Barrow Survey, Abstract No. 177 and the Heirs of James M. Houx Survey, Abstract No. 579; being all of that certain tract of land described in a Correction Cash Warranty Deed from Vencor Operating, Inc. to Vencor Hospitals Limited Partnership, dated October 30, 1998 and recorded in Volume 98213, Page 7177 of the Deed Records of Dallas County, Texas and same being legally described as Lot 8, Block 7503, Vencor Hospital Addition, according to the plat thereof filed October 17, 1997 and recorded in Volume 97203, Page 00992, Deed Records of Dallas County, Texas ("D.R.D.C.T."); said tract being more particularly described as follows;

Beginning at the Southwest end of a right-of-way corner clip between the North line of Stults Road (60 foot wide right-of-way) and the West line of Greenville Avenue (100 foot wide right-of-way), a 1/2 inch diameter iron rod with red plastic cap stamped RPLS-4701 found for corner;

Thence: North 88 degrees 54 minutes 17 seconds West, along the South line of said Lot 8 and the North line of Stults Road, a distance of 229.54 feet to the Southwest corner of said Lot 8 and the Southeast corner of Lot 9E, Block 7503 of New Mt. Zion Baptist Church Addition No. 2, according to the plat thereof recorded in Volume 94164, Page 01917, D.R.D.C.T., a 1/2 inch diameter iron rod with yellow plastic cap stamped Bowden-4775, found for corner; from which, a 5/8 inch diameter iron rod with yellow plastic cap stamped KSC-4019, found at the intersection of the North line of Stults Road with the East line of Shepherd Road, bears North 88 degrees 54 minutes 17 seconds West, a distance of 230.0 feet; a found 1/2 inch diameter iron rod with yellow plastic cap stamped West-682, bears North 00 degrees 15 minutes 00 seconds East, a distance of 0.30 feet; and a found 1/2 inch diameter iron rod, bears South 78 degrees 42 minutes 58 seconds East, a distance of 0.60 feet;

Thence: North 00 degrees 15 minutes 00 seconds East, along the common line of said Lot 8 and said Lot 9E, a distance of 556.05 feet to a 1 inch diameter iron pipe found for the Northwest corner of said Lot 8 and the Southwest corner of that certain called 2.66 acre tract described in a deed to Gold Claw Properties, Inc. recorded in Volume 91172, Page 2902, D.R.D.C.T.;

Thence: South 73 degrees 21 minutes 44 seconds East, along the common line of said Lot 8 and said 2.66 acre tract, a distance of 392.33 feet to the West line of the above mentioned Greenville Avenue, a 1/2 inch diameter iron rod with red plastic cap stamped RPLS-4701, found for the Northeast corner of said Lot 8;

Thence: South 17 degrees 12 minutes 28 seconds West, along the East line of said Lot 8 and the West line of said Greenville Avenue, a distance of 459.30 feet to the Northeast end of the above mentioned right-of-way corner clip, a 1/2 inch diameter iron rod with red plastic cap stamped RPLS-4701, found for corner;

Thence: South 54 degrees 09 minutes 05 seconds West, along said right-of-way corner clip, a distance of 15.98 feet to the Point of Beginning and containing 3.641 acres of land, more or less.

Exhibit 10.64

NON-QUALIFIED
STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this __ day of ____, 20__ between Kindred Healthcare, Inc. (the "Company") and _________ (the "Participant").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan") to promote the interests of the Company and its Affiliates and stockholders by providing the Company's key employees, who are largely responsible for the management, growth and protection of the business of the Company, incentives and rewards to encourage them to continue in the employ of the Company.

WHEREAS, the Plan provides for the grant to Participants in the Plan of non-qualified stock options to purchase shares of Common Stock of the Company.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant a non-qualified stock option (the "Option") with respect to _________ (______) shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is ____ __, 20__.

3. Incorporation of Plan. All terms, conditions and restrictions of the Plan are incorporated herein and made part hereof as if stated herein. If there is any conflict between the terms and conditions of the Plan and this Agreement, the terms and conditions of this Agreement, as interpreted by the Committee, shall govern. All capitalized terms used and not defined herein shall have the meanings given to such terms in the Plan.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $____.

5. Vesting Date.

(a) Except as provided in Section 5(b) and Section 6, the Option shall become exercisable as follows:

(i) ______ of the Options shall vest on ______.

(ii) An additional ______ Options shall vest on ______.

(iii) An additional _____ Options shall vest on _____.

(iv) An additional _____ Options shall vest on _____.

(b) Notwithstanding the foregoing, in the event of a Change in Control or the death or Disability of the Participant while employed with the Company, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, the Option shall expire on _____ _, _____. In addition, the following shall apply to the Option:

(i) In the event that the employment of the Participant with the Company shall terminate for any reason other than Disability, Retirement, Cause or death (A) the Option, to the extent that it is exercisable at the time of such termination, shall remain exercisable for 90 days after such termination, at which time the Option shall expire, and (B) the Option, to the extent that it is not exercisable at the time of such termination, shall expire at the commencement of business on the date of such termination; provided, however, that the Option shall not be exercisable after the expiration of its term.

(ii) In the event that the employment of the Participant with the Company shall terminate on account of the Retirement of the Participant, (A) the Participant shall be entitled to exercise the Option to the extent that the Option is exercisable at the time of such termination, for two years after Retirement, and (B) the Option, to the extent that it is not exercisable at the time of such termination, shall expire at the commencement of business on the date of such termination; provided, however, that the Option shall not be exercisable after the expiration of its term.

(iii) In the event that the employment of the Participant with the Company shall terminate on account of the Disability or death of the Participant, the Option shall become immediately exercisable and the Participant shall be entitled to exercise the Option at any time within two years after the date of death or determination of Disability; provided, however, that the Option shall not be exercisable after the expiration of its term.

(iv) In the event of the termination of the Participant's employment for Cause, the Option shall expire at the commencement of business on the date of such termination.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the exercise price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the exercise price as of the Exercise Date.

8. Adjustment Upon Changes in Common Stock.

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Options outstanding on the date on which such change occurs and in the exercise price of any such Options.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Option outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the Participant an amount in cash for each share subject to the Option, the excess of (A) the value of the property (including cash) received by the holder of a share of Common Stock as a result of such event over (B) the exercise price of such Option; or

(ii) provide for the exchange of each Option outstanding immediately prior to such event (whether or not then vested or exercisable) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to such Option would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, and/or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Option.

9. Construction of Agreement. Any provision of this Agreement (or portion thereof) which is deemed invalid, illegal or unenforceable in any jurisdiction shall, as to that jurisdiction and subject to this section, be ineffective to the extent of such invalidity, illegality or unenforceability, without affecting in any way the remaining provisions thereof in such jurisdiction or rendering that or any other provisions of this Agreement invalid, illegal, or unenforceable in any other jurisdiction. No waiver of any provision or violation of this Agreement by the Company shall be implied by the Company's forbearance or failure to take action.

10. Delays or Omissions. No delay or omission to exercise any right, power or remedy accruing to any party hereto upon any breach or default of any party under this Agreement, shall impair any such right, power or remedy of such party nor shall it be

construed to be a waiver of any such breach or default, or an acquiescence therein, or of or in any similar breach or default thereafter occurring nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party of any breach or default under this Agreement, or any waiver on the part of any party or any provisions or conditions of this Agreement, shall be in writing and shall be effective only to the extent specifically set forth in such writing.

11. Limitation on Transfer. During the lifetime of the Participant, the Option shall be exercisable only by the Participant. The Option shall not be assignable or transferable other than by will or by the laws of descent and distribution and in accordance with the Plan.

12. Integration. This Agreement, and the other documents referred to herein or delivered pursuant hereto which form a part hereof contain the entire understanding of the parties with respect to its subject matter. There are no restrictions, agreements, promises, representations, warranties, covenants or undertakings with respect to the subject matter hereof other than those expressly set forth herein and in the Plan. This Agreement, including without limitation the Plan, supersedes all prior agreements and understandings between the parties with respect to its subject matter.

13. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

14. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to the provisions governing conflict of laws.

15. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan. The Participant hereby acknowledges that all decisions, determinations and interpretations of the Committee in respect of the Plan, this Agreement and the Option shall be final and conclusive.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on his own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan as of the day and year first written above.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and Chief Financial Officer

Name of Individual

Exhibit 10.65

INCENTIVE STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this __ day of ____, 20__ between Kindred Healthcare, Inc. (the "Company") and _________ (the "Participant").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan") to promote the interests of the Company and its Affiliates and stockholders by providing the Company's key employees, who are largely responsible for the management, growth and protection of the business of the Company, incentives and rewards to encourage them to continue in the employ of the Company.

WHEREAS, the Plan provides for the grant to Participants in the Plan of incentive stock options to purchase shares of Common Stock of the Company.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant an incentive stock option (the "Option") with respect to _________ (_____) shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is _____ __, 20__.

3. Incorporation of Plan. All terms, conditions and restrictions of the Plan are incorporated herein and made part hereof as if stated herein. If there is any conflict between the terms and conditions of the Plan and this Agreement, the terms and conditions of this Agreement, as interpreted by the Committee, shall govern. All capitalized terms used and not defined herein shall have the meanings given to such terms in the Plan.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $____.

5. Vesting Date.

(a) Except as provided in Section 5(b) and Section 6, the Options shall become exercisable as follows:

(i) ____ of the Options shall vest on ______.

(ii) An additional ______ Options shall vest on ______.

(iii) An additional ______ Options shall vest on ______.

(iv) An additional _____ Options shall vest on _____.

(b) Notwithstanding the foregoing, in the event of a Change in Control or the death or Disability of the Participant while employed with the Company, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, the Option shall expire on ____ __, ____. In addition, the following shall apply to the Option:

(i) In the event that the employment of the Participant with the Company shall terminate for any reason other than Disability, Retirement, Cause or death (A) the Option, to the extent that it is exercisable at the time of such termination, shall remain exercisable for 90 days after such termination, at which time the Option shall expire, and (B) the Option, to the extent that it is not exercisable at the time of such termination, shall expire at the commencement of business on the date of such termination; provided, however, that the Option shall not be exercisable after the expiration of its term.

(ii) In the event that the employment of the Participant with the Company shall terminate on account of the Retirement of the Participant, (A) the Participant shall be entitled to exercise the Option to the extent that the Option is exercisable at the time of such termination, for 90 days after Retirement, and (B) the Option, to the extent that it is not exercisable at the time of such termination, shall expire at the commencement of business on the date of such termination; provided, however, that the Option shall not be exercisable after the expiration of its term.

(iii) In the event that the employment of the Participant with the Company shall terminate on account of the Disability or death of the Participant, the Option shall become immediately exercisable and the Participant shall be entitled to exercise the Option at any time within one year after the date of death or determination of Disability; provided, however, that the Option shall not be exercisable after the expiration of its term.

(iv) In the event of the termination of the Participant's employment for Cause, the Option shall expire at the commencement of business on the date of such termination.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the exercise price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the exercise price as of the Exercise Date.

8. Adjustment Upon Changes in Common Stock.

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Options outstanding on the date on which such change occurs and in the exercise price of any such Options.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Option outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the Participant an amount in cash for each share subject to the Option, the excess of (A) the value of the property (including cash) received by the holder of a share of Common Stock as a result of such event over (B) the exercise price of such Option; or

(ii) provide for the exchange of each Option outstanding immediately prior to such event (whether or not then vested or exercisable) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to such Option would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, and/or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Option.

9. Construction of Agreement. Any provision of this Agreement (or portion thereof) which is deemed invalid, illegal or unenforceable in any jurisdiction shall, as to that jurisdiction and subject to this section, be ineffective to the extent of such invalidity, illegality or unenforceability, without affecting in any way the remaining provisions thereof in such jurisdiction or rendering that or any other provisions of this Agreement invalid, illegal, or unenforceable in any other jurisdiction. No waiver of any provision or violation of this Agreement by the Company shall be implied by the Company's forbearance or failure to take action.

10. Delays or Omissions. No delay or omission to exercise any right, power or remedy accruing to any party hereto upon any breach or default of any party under this Agreement, shall impair any such right, power or remedy of such party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of or in any similar breach or default thereafter

occurring nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party of any breach or default under this Agreement, or any waiver on the part of any party or any provisions or conditions of this Agreement, shall be in writing and shall be effective only to the extent specifically set forth in such writing.

11. Limitation on Transfer. During the lifetime of the Participant, the Option shall be exercisable only by the Participant. The Option shall not be assignable or transferable other than by will or by the laws of descent and distribution and in accordance with the Plan.

12. Integration. This Agreement, and the other documents referred to herein or delivered pursuant hereto which form a part hereof contain the entire understanding of the parties with respect to its subject matter. There are no restrictions, agreements, promises, representations, warranties, covenants or undertakings with respect to the subject matter hereof other than those expressly set forth herein and in the Plan. This Agreement, including without limitation the Plan, supersedes all prior agreements and understandings between the parties with respect to its subject matter.

13. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

14. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to the provisions governing conflict of laws.

15. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan. The Participant hereby acknowledges that all decisions, determinations and interpretations of the Committee in respect of the Plan, this Agreement and the Option shall be final and conclusive.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on Participant's own behalf, thereby representing that Participant has carefully read and understands this Agreement and the Plan as of the day and year first written above.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and
Chief Financial Officer

Name of Individual

RESTRICTED SHARE AWARD AGREEMENT

THIS AGREEMENT, made as of this __ day of ____, 20__ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and __________ (the "Participant").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to participants in the Plan of restricted shares of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock").

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Restricted Stock. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant __________ (______) shares of Common Stock (the "Shares," and this grant shall be referred to herein as the "Award"). The Shares shall vest only in accordance with the provisions of this Agreement and of the Plan. The certificates representing the Shares, together with stock powers duly authorized in blank by the Participant, shall be deposited with the Company to be held by it until the Shares vest in accordance with Section 3 hereof or are forfeited in accordance with Section 4. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Non-Transferability. Prior to the vesting of the Shares as described in Section 3 hereof, neither the Shares nor the rights represented thereby shall be assignable, transferable, pledged or otherwise encumbered under any circumstances. In addition, the Shares and the rights represented thereby shall not be assignable or transferable for 90 days after the date of this Agreement. Such 90 day transfer restriction shall not subject the Shares to a substantial risk of forfeiture. Any purported or attempted transfer of such Shares or such rights in contravention of this Section 2 shall be null and void and shall result in the immediate forfeiture of the Shares.

3. Vesting of Shares.

(a) Except as provided in Section 3(b) and Section 4, the Shares subject to this Award shall vest and become fully transferable without restriction according to the following schedule:

(i) ______ of the Shares subject to this Award shall vest ______, ______.

(ii) An additional ______ of the Shares subject to this Award shall vest on ______, ______.

(iii) An additional ______ of the Shares subject to this Award shall vest on ______, ______.

(iv) An additional ______ of the Shares subject to this Award will vest on ______, ______.

(b) Notwithstanding the foregoing, in the event of (1) a Change in Control or (2) the death or Disability of the Participant, the Shares shall automatically vest, all restrictions on the Shares shall lapse and the Company shall deliver to Participant a certificate representing the Shares; provided, however, in no event may the vesting of any Shares held by an Participant subject to Section 16(b) of the Exchange Act be accelerated until such time as the vesting would not violate Section 16(b).

4. Forfeiture of Shares. If the employment of the Participant with the Company shall terminate for any reason other than death or Disability, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be forfeited and reconveyed to the Company by Participant without additional consideration and Participant shall have no further rights with respect thereto.

5. Modification and Waiver. Except as provided in this Agreement and in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Participant and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

6. Rights as Stockholder. Participant shall be considered a stockholder of the Company with respect to all such Shares that have not been forfeited and shall have all rights appurtenant thereto, including the right to vote or consent to all matters that may be presented to the stockholders and to receive all dividends and other distributions paid on such Shares. If any dividends or distributions are paid in Common Stock, such Common Stock shall be subject to the same restrictions as the Shares with respect to which it was paid.

7. Adjustment Upon Changes in Common Stock

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Award outstanding on the date on which such change occurs.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Share outstanding immediately prior to such event (whether or not then vested), and, in full consideration of such cancellation, pay to the Participant an equitable amount in cash for each Share equal to the value of the property (including cash) received by the holder of a share of Common Stock; or

(ii) provide for the exchange of each Share outstanding immediately prior to such event (whether or not then vested) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to the Award would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Shares.

8. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

9. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

10. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern except as specifically provided in Section 2 and Section 7 hereof.

11. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Shares and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Shares and such matters.

12. No Contract of Employment. This Agreement shall not confer upon the Participant any right with respect to the continuation of such Participant's employment by the Company or prohibit the Company at any time from terminating such employment or increasing or decreasing the base salary or other compensation for such Participant.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on the Participant's own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and
Chief Financial Officer

Exhibit 10.68

PERFORMANCE UNIT AWARD AGREEMENT

THIS AGREEMENT, made as of this __ day of ____, 20__ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and _________ (the "Participant").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to participants in the Plan of the right to receive shares of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock"), upon the achievement of specified performance goals.

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Performance Units. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant _________ Performance Units. The Performance Units shall vest only in accordance with the provisions of this Agreement and of the Plan. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Performance Goals/Performance Period.

(a) The Committee shall establish the Performance Goals applicable to a particular Performance Period within ninety (90) days of the commencement of such Performance Period in accordance with the terms and conditions of Section 9(b) of the Plan. As soon as reasonably practicable following the establishment of such Performance Goals, the Committee shall communicate the Performance Goals to the Participant.

(b) The Performance Periods applicable to the Performance Units during which the Performance Goals shall be measured shall be as follows:

(i) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__;

(ii) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__; and

(iii) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__.

(c) As soon as practicable after the end of the applicable Performance Period, the Committee shall determine and certify the extent to which the Performance Goals for such Performance Period were achieved, if at all. If the Performance Goals are

achieved in full, and the Participant remains employed with the Company as of the last day of the applicable Performance Period, the Company shall pay to the Participant an amount equal to the number of Units earned with respect to such Performance Period, such payment to be made as soon as reasonably practicable following the Committee's certification pursuant to Section 2(c) of this Agreement, but in no event later than March 15th of the calendar year immediately following the calendar year in which the relevant Performance Period ends. The Committee may determine, in its sole and absolute discretion, at the time of payment hereunder whether such payment shall be made (a) in cash (equal to the Fair Market Value of a Share multiplied by the number of Performance Units), (b) in Shares or (c) in a combination of cash and Shares.

3. Non-Transferability. No Performance Unit shall be assignable or transferable otherwise than by will or the laws of descent and distribution. Any purported or attempted transfer of a Performance Unit in contravention of this Section 3 shall be null and void and shall result in the immediate forfeiture of the Performance Unit.

4. Consequences Upon Change in Control. Upon a Change in Control, to the extent not already vested and paid, the Performance Units shall become fully vested and immediately payable as if the Performance Goals were fully achieved, without any proration, in which case payment shall be in cash equal to the product of the number of Performance Units and the greater of (i) the Fair Market Value of a Share on the date of such Change in Control and (ii) the highest price per Share paid in connection with such Change in Control. Any payment pursuant to this Section 4 shall be made no later than March 15th of the calendar year immediately following the calendar year in which such Change in Control occurs.

5. Effect of Termination of Employment.

(a) If the employment of Participant shall terminate with the Company prior to the expiration of the applicable Performance Period for any reason other than for death or Disability, the Performance Units shall immediately terminate and be of no further force or effect.

(b) In the event that the employment of Participant with the Company shall terminate on account of the Disability or death of Participant prior to the expiration of the Period, all Performance Units shall be paid to Participant or Participant's estate, as the case may be, as if all applicable Performance Goals had been fully achieved; provided that such payment shall be prorated to reflect the portion of the Performance Period during which Participant was employed; provided further that such payment shall be made as soon as reasonably practicable following the date of such termination of employment but in no event later than March 15th of the calendar year immediately following the calendar year in which such termination occurs.

6. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in

writing signed by the Participant and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

7. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

8. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Performance Units and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Performance Units and such matters.

11. No Contract of Employment. This Agreement shall not confer upon the Participant any right with respect to the continuation of such Participant's employment by the Company or prohibit the Company at any time from terminating such employment or increasing or decreasing the base salary or other compensation for such Participant.

12. Code Section 409A. Each Performance Unit is intended not to be subject to Section 409A of the Code by reason of being a short-term deferral and shall be interpreted accordingly. In the event any of the payments provided to a Participant pursuant to this Agreement would result in a violation of Section 409A of the Code (including any regulations promulgated thereunder), the Company will use its reasonable best efforts to amend this Agreement in the least restrictive manner necessary in order, where applicable (i) to ensure that such compensation is not considered "nonqualified deferred compensation" for purposes of Section 409A of the Code, or (ii) to comply with the provisions of Section 409A, in each case, where possible, without any diminution in the value of the compensation to be paid or provided to the Participant pursuant to this Agreement; provided, that nothing in this Agreement shall require the Company to provide any gross-up or other tax reimbursement to a Participant in connection with any violation of Section 409A or otherwise.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on the Participant's own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By:	Richard A. Lechleiter
Title:	Executive Vice President and Chief Financial Officer

Exhibit 10.69

KINDRED HEALTHCARE, INC.

2001 EQUITY PLAN FOR
NON-EMPLOYEE DIRECTORS
(AMENDED AND RESTATED)

ARTICLE 1. PURPOSE

The purpose of this amended and restated 2001 Equity Plan for Non-Employee Directors is to promote the interests of Kindred Healthcare, Inc., its subsidiaries and shareholders, by allowing the Company to attract and retain highly qualified non-employee directors by permitting them to obtain or increase their proprietary interest in the Company.

ARTICLE 2. DEFINITIONS AND CONSTRUCTION

2.1 *Definitions.* As used in the Plan, defined terms shall have the respective meanings provided by such definitions, and the terms set forth below shall have the following meanings:

(a) "Affiliates" shall mean any of the Company's direct or indirect "subsidiaries" (within the meaning of Section 424 of the Code), except that partnerships, limited liability companies and other entities shall be treated as corporations for purposes of applying the definition of the term "subsidiary."

(b) "Award" shall mean an Option or Restricted Shares, as the context may require.

(c) "Award Agreement" shall mean an Option Agreement or a Restricted Share Agreement, as the context may require.

(d) "Board" shall mean the Board of Directors of the Company.

(e) "Cause" shall mean, unless otherwise defined in an Award Agreement, a felony conviction of a Non-Employee Director or the failure of a Non-Employee Director to contest prosecution for a felony, or a Non-Employee Director's willful misconduct or dishonesty, any of which is determined by the Committee to be directly and materially harmful to the business or reputation of the Company or its Affiliates.

(f) "Change in Control" shall mean any of the following events:

(i) any Person (as this term is used in Sections 3(a)(9) and 13(d)(3) of the Exchange Act, but excluding any person described in and satisfying the conditions of Rule 13d-1(b)(i) thereunder) (an "Acquiring Person") becomes the "beneficial owner" (as such term is defined in Rule 13d-3 promulgated under the Exchange Act) (a "Beneficial Owner"), directly or indirectly, of securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding securities, other than beneficial ownership by the Company, any employee benefit plan of the Company or any Person organized, appointed or established pursuant to the terms of any such benefit plan;

(ii) the consummation of an agreement approved by the Company's shareholders which provides for the sale of substantially all of the assets of the Company to one or more Persons, in any case other than with or to an entity 50% or more of which is controlled by, or is under common control with, the Company;

(iii) during any two-year period, commencing after the effective date of the Plan, individuals who at the date on which the period commences constitute a majority of the Board (the "Incumbent Directors") cease to constitute a majority thereof for any reason; provided, however, that a director who was not an Incumbent Director shall be deemed to be an Incumbent Director if such director was elected by, or on the recommendation of, at least two-thirds of the Incumbent Directors (either actually or by prior operation of this provision), other than any director who is so approved in connection with any actual or threatened contest for election to positions on the Board; or

(iv) the Company is merged, combined, consolidated, recapitalized or otherwise organized with one or more other entities that are not Affiliates, as a result of which less than 50% of the outstanding voting securities of the surviving or resulting entity immediately after the reorganization are, or will be, owned, directly or indirectly, by shareholders of the Company, determined on the basis of record ownership as of the date of determination of holders entitled to vote on the transaction (or in the absence of a vote, the day immediately prior to the event).

(g) "Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, and any successor thereto.

(h) "Committee" shall mean the Executive Compensation Committee of the Board or such other committee as the Board shall designate from time to time.

(i) "Company" shall mean Kindred Healthcare, Inc., a Delaware corporation.

(j) "Disability" shall mean a physical or mental condition that would make the Non-Employee Director unable to perform such director's duties for a continuous period of not less than six months. For purposes of this Plan, a Non-Employee Director shall be deemed to have ceased to be a director as a result of a Disability for purposes of this Plan on the date as of which the Non-Employee Director is determined to have the Disability by the Board.

(k) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended from time to time.

(l) "Fair Market Value" of the Shares shall mean, as of any applicable date, the closing sale price of the Shares on the New York Stock Exchange, NASDAQ, NASDAQ Bulletin Board or any national or regional stock exchange in which the Shares are primarily traded, or if no such reported sale of the Shares shall have occurred on such date, on the next preceding date on which there was such a reported sale. If there shall be any material alteration in the present system of reporting sale prices of the Shares, or if the Shares shall no longer be listed on the New York Stock Exchange, NASDAQ, NASDAQ Bulletin Board or a national or regional stock

exchange, or if the Committee determines that trading does not reflect an accurate value, the Fair Market Value of the Shares as of a particular date shall be determined by such method as shall be determined by the Committee.

(m) "Grantee" shall mean a Non-Employee Director who has been granted an Option or Restricted Shares, or the personal representative, heir or legatee of a Grantee who has the right to exercise the Option or receive the Restricted Shares upon the death of the Non-Employee Director.

(n) "Non-Employee Director" shall mean a member of the Board who is not an employee of the Company or any of its Affiliates.

(o) "Option" shall mean an option to purchase Shares granted to a Grantee pursuant to the Plan.

(p) "Option Agreement" shall mean a written agreement between the Company and a Grantee evidencing the granting of an Option and containing terms and conditions concerning the exercise of the Option.

(q) "Option Spread" shall mean, with respect to an Option, the excess if any, of the Fair Market Value of a Share as of the date of exercise of the Option over the Option Exercise Price (defined in Section 4.3).

(r) "Person" shall have the meaning ascribed to such term in Section 3(a)(9) of the Exchange Act and as used in Sections 13(d) and 14(d) thereof, including a "group" as defined in Section 13(d).

(s) "Plan" shall mean this 2001 Equity Plan for Non-Employee Directors (Amended and Restated), as the same may be amended from time to time.

(t) "Restricted Share Agreement" shall mean a written agreement between the Company and a Grantee evidencing the granting of Restricted Shares and containing terms and conditions concerning such Restricted Shares.

(u) "Restricted Shares" shall mean restricted Shares of the Company granted to a Grantee pursuant to the Plan.

(v) "Retirement" shall mean termination of service on the Board after having served continuously as a Director for at least three years and after having given the Company reasonable advance written notice of the director's intent to retire prior to the date of retirement, provided, however, such notice is not required if the termination of service is due to the director failing to be re-elected by the shareholders of the Company.

(w) "Shares" shall mean the shares of the Company's common stock, par value $.25 per share.

2.2 *Gender and Number.* Except where otherwise indicated by the context, reference to the masculine gender shall include the feminine gender, the plural shall include the singular and the singular shall include the plural.

2.3 *Severability.* In the event any provision of the Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of the Plan, and the Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

ARTICLE 3. SHARES SUBJECT TO THE PLAN

The common stock to be offered under the Plan shall be the Shares, which Shares may be unissued Shares or treasury Shares. Subject to the adjustments provided for in Section 6, the aggregate number of Shares that may be covered by Awards granted under the Plan shall not exceed 600,000 Shares, inclusive of all Shares subject to Awards granted under the Plan since its adoption in 2001. Shares subject to, but not delivered under, an Award terminating or expiring for any reason prior to its exercise, in the case of an Option, or vesting, in the case of Restricted Shares, in full shall be deemed available for Awards to be granted thereafter during the term of the Plan. In addition, any Shares tendered and/or withheld for the payment of all or a part of an Option shall again become available for Awards to be granted thereafter during the term of the Plan.

ARTICLE 4. GRANTS OF AWARDS

4.1 *Non-Discretionary Grants.* Upon the appointment or election of a person as a Non-Employee Director for the first time while this Plan is in effect, such Non-Employee Director shall receive a one-time grant of an Option for 15,000 Shares. In addition, on January 10 of each calendar year during the term of the Plan, each Non-Employee Director who is acting as a director on such January 10 shall receive a grant of an Option for 5,000 Shares. Notwithstanding anything herein to the contrary, no Options shall be granted under this Section 4.1 after May 31, 2007.

4.2 *Discretionary Grants.* Subject to shareholder approval of this Plan at the 2007 Annual Meeting of the Shareholders, the Executive Compensation Committee shall have the authority to grant Awards at its discretion to Non-Employee Directors pursuant to this Plan.

4.3 *Terms and Conditions.*

(a) Unless otherwise provided in the applicable Award Agreement, each Award of an Option granted under the Plan shall have the following terms and conditions:

(i) The exercise price of the Option (the "Option Exercise Price") shall be equal to 100% of the Fair Market Value of the Shares on the date the Option is granted.

(ii) The term of the Option shall be ten years from the date of grant unless sooner terminated as provided herein.

(iii) Subject to Section 4.4, the Option shall become exercisable in four equal annual installments, with the first installment becoming exercisable on the first anniversary of the date of grant of the Option. Notwithstanding this Section 4, upon a Change in Control, the Optionee shall have the right to exercise the Option in full as to all Shares subject to the Option.

(b) Unless otherwise provided in the applicable Award Agreement, each Award of Restricted Shares granted under the Plan shall have the following terms and conditions:

(i) Any dividends paid with respect to Shares will be paid to holders of Restricted Shares granted, but not yet vested or forfeited, promptly without condition.

(ii) Subject to Section 4.4, the Restricted Shares shall vest in four equal annual installments, with the first installment vesting on the first anniversary of the date of grant of the Restricted Shares. Notwithstanding the provisions of this Section 4, upon a Change in Control, all Restricted Shares shall immediately vest.

4.4 *Termination of Award.* Unless otherwise provided in the applicable Award Agreement, each Award granted under the Plan shall be subject to the following termination provisions:

(a) *Options granted pursuant to Section 4.1.*

(i) If the Grantee ceases to be a director of the Company for any reason other than Retirement, failure to be nominated by the Board for re-election, death, Disability, or removal for Cause the Option shall terminate three months after the Grantee ceases to be a director of the Company (unless the Grantee dies during such period), or on the Option's expiration date, if earlier, and shall be exercisable during such three-month period only with respect to the number of Shares which the Grantee was entitled to purchase on the day preceding the day on which the Grantee ceased to be a director.

(ii) If the Grantee ceases to be a director of the Company because of Retirement or failure to be nominated by the Board for re-election, the Option shall terminate on the Option's expiration date and shall be exercisable until the Option's expiration date only with respect to the number of Shares as to which the Option shall have been exercisable on the date preceding the day on which the Grantee ceased to be a director.

(iii) If the Grantee ceases to be a director of the Company because of removal for Cause, the Option shall immediately terminate on the date of the Grantee's removal.

(iv) In the event of the Grantee's death or Disability while serving as a director of the Company, or the Grantee's death within three months after the Grantee ceases to be a director (other than by reason of removal for Cause, Retirement or failure to be nominated by the Board for re-election), the Option shall terminate upon the earlier to occur of (A) 12 months after the date of the Grantee's death or Disability, or (B) the Option's expiration date. The Option shall be exercisable during such period after the Grantee's death or Disability with respect to the number of Shares as to which the Option shall have been exercisable on the date preceding the Grantee's death or Disability, as the case may be.

(b) *Awards Granted pursuant to Section 4.2.*

(i) If the Grantee ceases to be a director of the Company for any reason other than failure to be nominated by the Board for re-election, death, Disability, Retirement, or removal for Cause: (A) Options shall terminate three months after the Grantee ceases to be a director of the Company (unless the Grantee dies during such period), or on the Option's expiration date, if earlier, and shall be exercisable during such three-month period only with respect to the number of Shares which the Grantee was entitled to purchase on the day preceding the day on which the Grantee ceased to be a director, and (B) all unvested Restricted Shares shall be immediately cancelled and forfeited.

(ii) If the Grantee ceases to be a director of the Company because of removal for Cause, Options shall immediately terminate and Restricted Shares shall be immediately cancelled and forfeited on the date of the Grantee's removal.

(iii) If the Grantee ceases to be a director of the Company because of failure to be nominated by the Board for re-election: (A) Options shall terminate on the Option's expiration date and shall be exercisable until the Option's expiration date only with respect to the number of Shares as to which the Option shall have been exercisable on the date preceding the day on which the Grantee ceased to be a director, and (B) all unvested Restricted Shares shall be immediately cancelled and forfeited.

(iv) In the event of the Grantee's Retirement, Disability or death while serving as a director of the Company, or the Grantee's death within three months after the Grantee ceases to be a director (other than by reason of removal for Cause), Options and Restricted Shares shall immediately vest in full and Options shall be exercisable until the Options' expiration date.

4.5 *Restrictions on Transferability of Awards.* During the lifetime of the Grantee, each Option shall be exercisable only by the Grantee and an Award is non-transferable and will not be subject in any manner to sale, transfer, alienation, pledge, encumbrance or charge; provided, however, that (i) the Committee may, in its sole discretion, permit the transfer of an Award to a family trust for estate planning purposes and (ii) in the event a Non-Employee Director eligible to receive an Award was nominated to or chosen to serve on the Board pursuant to an arrangement between the Company and another Person, such Non-Employee Director may, upon notice in writing to the Board, direct the initial issuance of the Award (and any subsequent issuances of any Awards) to such other Person (irrespective of Section 4.1) or transfer his Award to such other Person (following an issuance or transfer under such circumstances, such other Person shall be a "Permitted Transferee").

4.6 *Award Agreement.* Each Award shall be evidenced by an Award Agreement which shall set forth the number of Shares for which the Award was granted, the provisions set forth in this Article 4 relating to the Award and such other terms and conditions consistent with the Plan.

4.7 *Exercise of Options.* Options shall be exercisable at such times and be subject to such restrictions and conditions as the Committee shall approve at the time of grant, which need not be the same for each grant or for each Non-Employee Director. Except

as provided in Section 4.3(a)(iii), however, in no event may any Option become exercisable within six months of the date of grant in the case of any Non-Employee Director subject to Section 16(b) of the Exchange Act. Options shall be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of Shares with respect to which the Option is to be exercised and accompanied by full payment of the Option Exercise Price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the Option Spread for each Share specified in the notice of exercise as of the Exercise Date. In addition, Options may be exercised through a registered broker-dealer pursuant to such cashless exercise procedures which are, from time to time, deemed acceptable by the Company.

4.8 *Payment of Option Exercise Price.* The Option Exercise Price for Shares as to which an Option, or portion thereof, is exercised shall be paid to the Company in full at the time of exercise either (a) in cash or other cash equivalent acceptable to the Company, (b) by tendering Shares, if permitted by the Committee, having a Fair Market Value (determined as of the close of the business day immediately preceding the day on which the Option is exercised) equal to the Option Exercise Price (provided, however, that in the case of a Non-Employee Director subject to Section 16(b) of the Exchange Act, such Shares have been held by the Non-Employee Director for at least six months prior to their tender), (c) a combination of (a) and (b) or any other reasonable consideration that the Committee may deem appropriate, or (d) pursuant to the cashless exercise provision set forth in Section 4.7.

ARTICLE 5. ADMINISTRATION

5.1 *The Committee.* The Plan shall be administered by the Committee. The Committee shall meet at such times and places as it determines and may meet through a telephone conference call. A majority of its members shall constitute a quorum, and the decision of the majority of those present at any meeting at which a quorum is present shall constitute the decision of the Committee. Any decision reduced to writing and signed by a majority of the members of the Committee shall be fully effective as if it had been made by a majority at a meeting duly held. To the extent required by law and Rule 16b-3 promulgated under the Exchange Act, the Committee may delegate its authority hereunder.

5.2 *Section 16 Compliance.* It is the intention of the Company that the Plan and the administration of the Plan comply in all respects with Section 16(b) of the Exchange Act and the rules and regulations promulgated thereunder. If any Plan provision, or any aspect of the administration of the Plan, is found not to be in compliance with Section 16(b) of the Exchange Act, the provision or administration shall be deemed null and void, and in all events the Plan shall be construed in favor of its meeting the requirements of Rule 16b-3 promulgated under the Exchange Act.

5.3 *Section 409A Compliance.* In the event any of the compensation or benefits provided to a Grantee pursuant to this Plan would result in a violation of Section 409A of the Code (including any regulations promulgated thereunder), the Company will use its

reasonable best efforts to amend the Plan in the least restrictive manner necessary in order, where applicable (i) to ensure that such compensation is not considered "nonqualified deferred compensation" for purposes of Section 409A of the Code, or (ii) to comply with the provisions of Section 409A, in each case, where possible, without any diminution in the value of the compensation or benefits to be paid or provided to the Grantee pursuant to this Agreement; provided, that nothing in this Agreement shall require the Company to provide any gross-up or other tax reimbursement to the Grantee in connection with any violation of Section 409A or otherwise.

ARTICLE 6. ADJUSTMENTS UPON CHANGE IN CAPITALIZATION

Notwithstanding the limitations set forth in Article 3, in the event of a merger, reorganization, consolidation, recapitalization, reclassification, split-up, spin-off, separation, liquidation, stock dividend, stock split, reverse stock split, property dividend, share repurchase, share combination, share exchange, issuance of warrants, rights or debentures or other change in corporate structure of the Company affecting the Shares, the Committee shall, subject to any required action by the shareholders of the Company, make an appropriate and equitable adjustment in the maximum number of Shares available under the Plan and in the number, class and the Option Exercise Price of Shares subject to Awards granted under the Plan to prevent dilution or enlargement of the rights of Non-Employee Directors under the Plan and outstanding Awards; provided, that the number of Shares subject to any Award shall always be a whole number.

Restricted Shares shall be treated as outstanding Shares for the purpose of any transaction listed above. But unless otherwise provided herein or in any Award Agreement, such transaction shall not affect the restrictions applicable to the Restricted Shares.

ARTICLE 7. AMENDMENTS AND DISCONTINUANCE

7.1 *In General.* Except as provided in Sections 7.2 and 7.3 the Board may discontinue, amend, modify or terminate the Plan at any time.

7.2 *Awards Previously Granted.* No amendment, modification or termination of the Plan shall in any manner adversely affect any outstanding Award without the written consent of the Grantee holding such Award. Notwithstanding the foregoing, however, the Company may terminate any outstanding Award(s), in which case the Company, in full consideration for such termination, shall pay with respect to any Award, or portion thereof, so terminated, (i) an amount equal to the Black-Scholes value of such Option, or portion thereof, determined based on the assumptions used for purposes of the Company's then most recent proxy statement or, if not so used based on assumptions determined by the Committee or (ii) the Fair Market Value as of the date of termination of the Shares granted as Restricted Shares. Such payment shall be made as soon as practicable after the payment amounts are determined.

7.3 *Shareholder Approval.* No amendment to the Plan shall be effective unless approved by the shareholders of the Company to the extent shareholder approval is necessary to satisfy the requirements of the Code, Rule 16b-3 of the Exchange Act, or any New York Stock Exchange or securities exchange listing requirements.

7.4 *No Option Repricing.* The Company shall not reprice any Options, provided that the adjustments under Article 6 are not considered repricings. For purposes of the Plan, the term "reprice" shall mean lowering the Option Exercise Price of previously awarded Options.

ARTICLE 8. EFFECTIVE DATE AND TERMINATION OF THE PLAN

8.1 *Effective Date.* The Plan was initially adopted by the Board on May 21, 2001 (the "effective date"); no grants may be made under the Plan after May 31, 2017. The amendments to this Plan adopted by the Board on March 19, 2004 were approved by shareholders at the 2004 Annual Meeting of Shareholders. The amendments to this Plan adopted by the Board on April 2, 2007 are subject to shareholder approval at the 2007 Annual Meeting of Shareholders.

8.2 *Termination Date.* The Plan shall terminate on the earliest to occur of (1) the date when all of the Shares available under the Plan shall have been acquired through the exercise of Options or the vesting of Restricted Shares granted under the Plan; (2) 10 years after the date of shareholder approval at the 2007 Annual Meeting of Shareholders; or (3) such earlier date as the Board may determine.

ARTICLE 9. NO RIGHT TO RE-ELECTION

Neither the Plan, nor any action taken under the Plan, shall be construed as conferring upon a Non-Employee Director any right to continue as a director of the Company, to be renominated by the Board or re-elected by the shareholders of the Company.

ARTICLE 10. INDEMNIFICATION; DECISIONS BINDING

10.1 *Indemnification.* No member of the Board or the Committee, nor any officer or employee acting on behalf of the Board or the Committee, shall be personally liable for any action, determination or interpretation taken or made with respect to the Plan, and all members of the Board, the Committee and each officer or employee of the Company acting on their behalf shall, to the extent permitted by law, be fully indemnified and protected by the Company with respect to any such action, determination or interpretation.

10.2 *Determinations of the Committee.* Any grant, determination, prescription or other act of the Committee made in good faith shall be final and conclusively binding upon all persons.

ARTICLE 11. GOVERNING LAW

The provisions of the Plan and all agreements under the Plan shall be construed, administered and enforced according to the laws of the State of Delaware without regard to its conflict of laws rules.

NON-QUALIFIED STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this __ day of ____, ____ between Kindred Healthcare, Inc. (the "Company") and _________ (the "Non-Employee Director").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the grant to Non-Employee Directors of non-qualified stock options to purchase shares of common stock of the Company, par value $.25 per share (the "Common Stock").

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Non-Employee Director a non-qualified stock option (the "Option") with respect to __ shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is _____ __, ____.

3. Non-Transferability. Prior to the vesting of the Option as described in Section 5 hereof, the Option and the rights represented thereby shall be non-transferable and will not be subject in any manner to sale, transfer, alienation, pledge, encumbrance or charge; provided, however, that (i) the Committee may, in its sole discretion, permit the transfer of the Option to a family trust for estate planning purposes and (ii) in the event the Non-Employee Director was nominated to or chosen to serve on the Board pursuant to an arrangement between the Company and another Person, such Non-Employee Director may, upon notice in writing to the Board, direct the initial issuance of the Option to such other Person or transfer such Option to such other Person. Any purported or attempted transfer of such Option or such rights in contravention of this Section 3 shall be null and void and shall result in the immediate forfeiture of the Option.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $____.

5. Vesting Date.

(a) Except as provided in Section 5(b) and Section 6, the Option shall become exercisable as follows: Approximately one-fourth of the Option shall become exercisable on each of the first, second, third and fourth anniversaries of the Grant Date; provided that, the number of shares to become exercisable on any Vesting Date shall be rounded up to the nearest share, but in no event shall more than the total number of shares underlying the Option become exercisable in the aggregate.

(b) Notwithstanding the foregoing, in the event of a Change in Control, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, the Option shall expire on ____ __, ____. In addition, the following shall apply to the Option:

(i) if the Non-Employee Director ceases to be a director of the Company for any reason other than failure to be nominated by the Board of Directors for re-election, death, Disability, Retirement or removal for Cause, the Option shall terminate three months after the Non-Employee Director ceases to be a director of the Company (unless the Non-Employee Director dies during such period), or on the Option's expiration date, if earlier, and shall be exercisable during such three-month period only with respect to the number of shares which the Non-Employee Director was entitled to purchase on the day preceding the day on which the Non-Employee Director ceased to be a director;

(ii) if the Non-Employee Director ceases to be a director of the Company because of removal for Cause, the Option shall immediately terminate;

(iii) if the Non-Employee Director ceases to be a director of the Company because of failure to be nominated by the Board of Directors for re-election, the Option shall terminate on the Option's expiration date and shall be exercisable until the Option's expiration date only with respect to the number of shares which the Non-Employee Director was entitled to purchase on the day preceding the day on which the Non-Employee Director ceased to be a director; and

(iv) in the event of the Non-Employee Director's Retirement, Disability or death while serving as a director of the Company, or the Non-Employee Director's death within three months after the Non-Employee Director ceases to be a director (other than by reason of removal for Cause), the Option shall immediately vest in full and shall be exercisable until the Option's expiration date.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the Option Exercise Price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the Option Exercise Price as of the Exercise Date.

8. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Non-Employee Director and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

11. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

12. Non-Employee Director Acknowledgment. The Non-Employee Director hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

13. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Option and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Option and such matters.

14. No Right to Re-Election. This Agreement shall not confer upon the Non-Employee Director any right to continue as a director of the Company, to be renominated by the Board or re-elected by the shareholders of the Company.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Non-Employee Director has hereunto signed this Agreement on the Non-Employee Director's own behalf, thereby representing that the Non-Employee Director has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and
Chief Financial Officer

Exhibit 10.71

RESTRICTED SHARE AWARD AGREEMENT

THIS AGREEMENT, made as of this __ day of ____ ____ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and __________ (the "Non-Employee Director").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to Non-Employee Directors of restricted shares of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock").

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Restricted Stock. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Non-Employee Director __________ (__) shares of Common Stock (the "Shares," and this grant shall be referred to herein as the "Award"). The Shares shall vest only in accordance with the provisions of this Agreement and of the Plan. The certificates representing the Shares, together with stock powers duly authorized in blank by the Non-Employee Director, shall be deposited with the Company to be held by it until the Shares vest in accordance with Section 3 hereof or are forfeited in accordance with Section 4. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Non-Transferability. Prior to the vesting of the Shares as described in Section 3 hereof, the Shares and the rights represented thereby shall be non-transferable and will not be subject in any manner to sale, transfer, alienation, pledge, encumbrance or charge; provided, however, that (i) the Committee may, in its sole discretion, permit the transfer of the Shares to a family trust for estate planning purposes and (ii) in the event the Non-Employee Director was nominated to or chosen to serve on the Board pursuant to an arrangement between the Company and another Person, such Non-Employee Director may, upon notice in writing to the Board, direct the initial issuance of the Shares to such other Person or transfer such Shares to such other Person. Any purported or attempted transfer of such Shares or such rights in contravention of this Section 2 shall be null and void and shall result in the immediate forfeiture of the Shares.

3. Vesting of Shares.

(a) Except as provided in Section 3(b) and Section 4, the Shares subject to this Award shall vest and become fully transferable without restriction according to the following schedule:

(i) All of the Shares subject to this Award shall vest ____ __, ____.

(b) Notwithstanding the foregoing or anything in the Plan to the contrary, in the event of (1) a Change in Control, or (2) the Disability or death of the Non-Employee Director while serving as a director of the Company, the Shares shall automatically immediately vest, all restrictions on the Shares shall lapse and the Company shall deliver to Non-Employee Director a certificate representing the Shares; provided, however, in no event may the vesting of any Shares held by an Non-Employee Director be accelerated until such time as the vesting would not violate Section 16(b).

4. Forfeiture of Shares. Notwithstanding anything in the Plan to the contrary, if the Non-Employee Director ceases to be a director of the Company for any reason other than death or Disability, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be immediately cancelled and forfeited without additional consideration and Non-Employee Director shall have no further rights with respect thereto. Notwithstanding anything in the Plan to the contrary, if the Non-Employee Director ceases to be a director of the Company because of removal for Cause or Retirement, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be cancelled and forfeited on the date of removal or Retirement, as the case may be, without additional consideration and Non-Employee Director shall have no further rights with respect thereto.

5. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Non-Employee Director and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

6. Rights as Stockholder. Non-Employee Director shall be considered a stockholder of the Company with respect to all such Shares that have not been forfeited and shall have all rights appurtenant thereto, including the right to vote or consent to all matters that may be presented to the stockholders and to receive all dividends and other distributions paid on such Shares. If any dividends or distributions are paid in Common Stock, such Common Stock shall be subject to the same restrictions as the Shares with respect to which it was paid.

7. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

8. Non-Employee Director Acknowledgment. The Non-Employee Director hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. Except as provided in Section 3 and Section 4 of this Agreement, if any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Shares and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Shares and such matters.

11. No Right to Re-Election. This Agreement shall not confer upon the Non-Employee Director any right to continue as a director of the Company, to be renominated by the Board or re-elected by the shareholders of the Company.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Non-Employee Director has hereunto signed this Agreement on the Non-Employee Director's own behalf, thereby representing that the Non-Employee Director has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By:	Richard A. Lechleiter
Title:	Executive Vice President and Chief Financial Officer

AMENDMENT NO. 1 TO
NON-QUALIFIED STOCK OPTION GRANT AGREEMENT

THIS AMENDMENT NO. 1 TO NON-QUALIFIED STOCK OPTION GRANT AGREEMENT (the "Amendment") is made as of the __ day of January, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE, INC.**, a Delaware corporation (the "Company"), and _______________ (the "Director").

WHEREAS, in order to promote effective Board processes consistent with good corporate governance, the Executive Compensation Committee of the Board of Directors of the Company (the "Committee") has amended and restated the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (as amended and restated, the "Plan") to permit non-employee directors who are in good standing with the Company to maintain their proprietary interests in the Company after they retire or otherwise do not stand for re-election to the Board of Directors.

WHEREAS, the Plan provides for the grant to non-employee directors of non-qualified stock options to purchase shares of common stock of the Company, par value $.25 per share (the "Common Stock").

WHEREAS, the Committee previously granted to the Director non-qualified stock options to purchase shares of Common Stock pursuant to a Non-Qualified Stock Option Grant Agreement dated ____ __, ____ (the "Grant Agreement").

WHEREAS, the Company and the Director desire to amend the Grant Agreement pursuant to the terms of this Amendment.

WHEREAS, the Company and the Director agree that the terms and provisions of the Grant Agreement shall continue except as specifically amended herein.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and the Director agree as follows:

1. Amendment to Section 6. As of the Effective Date, Section 6 of the Grant Agreement shall be revised in its entirety to read as follows:

"6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, the Option shall expire on ____ __, ____. In addition, the following shall apply to the Option:

(i) if the Director ceases to be a director of the Company for any reason other than Retirement, failure to be nominated by the Board of Directors for re-election, death, Disability or removal for Cause, the Option shall terminate three months after the Director ceases to be a director of the Company (unless the Director dies during such period), or on the Option's expiration date, if earlier, and shall be exercisable during such three-month period only with respect to the number of shares which the Director was entitled to purchase on the day preceding the day on which the Director ceased to be a director;

(ii) If the Director ceases to be a director of the Company because of Retirement or failure to be nominated by the Board of Directors for re-election, the Option shall terminate on the Option's expiration date and shall be exercisable until the Option's expiration date only with respect to the number of shares which the Director was entitled to purchase on the day preceding the day on which the Director ceased to be a director.

(iii) if the Director ceases to be a director of the Company because of removal for Cause, the Option shall immediately terminate on the date of the Director's removal; and

(iv) in the event of the Director's Disability or death while serving as a director of the Company, or the Director's death within three months after the Director ceases to be a director (other than by reason of removal for Cause, Retirement or failure to be nominated by the Board of Directors for re-election), the Option shall terminate upon the earlier to occur of (A) 12 months after the date of the Director's death or Disability, or (B) the Option's expiration date. The Option shall be exercisable during such period after the Director's death or Disability with respect to the number of shares as to which the Option shall have been exercisable on the date preceding the Director's death or Disability, as the case may be."

2. Ratification of Grant Agreement. Except as expressly modified by this Amendment, all other terms and provisions of the Grant Agreement shall remain in full force and effect, unmodified and unrevoked, and the same are hereby reaffirmed and ratified by the Director and the Company as if fully set forth herein.

3. Counterparts. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Company has caused this Amendment to be duly executed by its duly authorized officer and said Director has hereunto signed this Amendment on the Director's own behalf, thereby representing that the Director has carefully read and understands this Amendment and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and
Chief Financial Officer

AMENDMENT NO. 1 TO NON-QUALIFIED STOCK OPTION GRANT AGREEMENT

THIS AMENDMENT NO. 1 TO NON-QUALIFIED STOCK OPTION GRANT AGREEMENT (the "Amendment") is made as of the __ day of January, 2009 (the "Effective Date"), by and between **KINDRED HEALTHCARE, INC.**, a Delaware corporation (the "Company"), and _______________ (the "Director").

WHEREAS, in order to promote effective Board processes consistent with good corporate governance, the Executive Compensation Committee of the Board of Directors of the Company (the "Committee") has amended and restated the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (as amended and restated, the "Plan") to permit non-employee directors who are in good standing with the Company to maintain their proprietary interests in the Company after they retire or otherwise do not stand for re-election to the Board of Directors.

WHEREAS, the Plan provides for the grant to non-employee directors of non-qualified stock options to purchase shares of common stock of the Company, par value $.25 per share (the "Common Stock").

WHEREAS, the Committee previously granted to the Director non-qualified stock options to purchase shares of Common Stock pursuant to a Non-Qualified Stock Option Grant Agreement dated ____ __, ____ (the "Grant Agreement").

WHEREAS, the Company and the Director desire to amend the Grant Agreement pursuant to the terms of this Amendment.

WHEREAS, the Company and the Director agree that the terms and provisions of the Grant Agreement shall continue except as specifically amended herein.

NOW, THEREFORE, in consideration of the premises and the respective covenants and agreements contained herein, and intending to be legally bound hereby, the Company and the Director agree as follows:

1. Amendment to Section 6. As of the Effective Date, Section 6 of the Grant Agreement shall be revised in its entirety to read as follows:

"6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, the Option shall expire on _____ __, ____. In addition, the following shall apply to the Option:

(i) if the Non-Employee Director ceases to be a director of the Company for any reason other than failure to be nominated by the Board of Directors for re-election, death, Disability, Retirement or removal for Cause, the Option shall terminate three months after the Non-Employee Director ceases to be a director of the Company (unless the Non-Employee Director dies during such period), or on the Option's expiration date, if earlier, and shall be exercisable during such three-month period only

with respect to the number of shares which the Non-Employee Director was entitled to purchase on the day preceding the day on which the Non-Employee Director ceased to be a director;

(ii) if the Non-Employee Director ceases to be a director of the Company because of removal for Cause, the Option shall immediately terminate;

(iii) if the Non-Employee Director ceases to be a director of the Company because of failure to be nominated by the Board of Directors for re-election, the Option shall terminate on the Option's expiration date and shall be exercisable until the Option's expiration date only with respect to the number of shares which the Non-Employee Director was entitled to purchase on the day preceding the day on which the Non-Employee Director ceased to be a director; and

(iv) in the event of the Non-Employee Director's Retirement, Disability or death while serving as a director of the Company, or the Non-Employee Director's death within three months after the Non-Employee Director ceases to be a director (other than by reason of removal for Cause), the Option shall immediately vest in full and shall be exercisable until the Option's expiration date."

2. **Ratification of Grant Agreement**. Except as expressly modified by this Amendment, all other terms and provisions of the Grant Agreement shall remain in full force and effect, unmodified and unrevoked, and the same are hereby reaffirmed and ratified by the Director and the Company as if fully set forth herein.

3. **Counterparts**. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the Company has caused this Amendment to be duly executed by its duly authorized officer and said Director has hereunto signed this Amendment on the Director's own behalf, thereby representing that the Director has carefully read and understands this Amendment and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By:	Richard A. Lechleiter
Title:	Executive Vice President and Chief Financial Officer

EXHIBIT 21

REGISTRANT'S SUBSIDIARIES

DECEMBER 31, 2008

Corporations and Limited Liability Companies

Cornerstone Insurance Company, a Cayman Islands corporation

Kindred Healthcare Operating, Inc., a Delaware corporation

Homestead Health and Rehabilitation Center, L.L.C., a Delaware limited liability company

Kindred Development 27, L.L.C., a Delaware limited liability company

Kindred Development 29, L.L.C., a Delaware limited liability company

Kindred Hospitals East, L.L.C., a Delaware limited liability company

Goddard Nursing, L.L.C., a Delaware limited liability company

Kindred Braintree Hospital, L.L.C., a Delaware limited liability company

Kindred Hospital Palm Beach, L.L.C., a Delaware limited liability company

Kindred Hospital-Pittsburgh-North Shore, L.L.C., a Delaware limited liability company

Kindred Hospital-Springfield, L.L.C., a Delaware limited liability company

Kindred Hospital-Toledo, L.L.C., a Delaware limited liability company

Kindred Development 15, L.L.C., a Delaware limited liability company

Kindred Development 17, L.L.C., a Delaware limited liability company

Springfield Park View Hospital, L.L.C., a Delaware limited liability company

Kindred Hospitals West, L.L.C., a Delaware limited liability company

Kindred Nursing Centers East, L.L.C., a Delaware limited liability company

Avery Manor Nursing, L.L.C., a Delaware limited liability company

Braintree Nursing, L.L.C., a Delaware limited liability company

Country Estates Nursing, L.L.C., a Delaware limited liability company

Forestview Nursing, L.L.C., a Delaware limited liability company

Greens Nursing and Assisted Living, L.L.C., a Delaware limited liability company

Harborlights Nursing, L.L.C., a Delaware limited liability company

Highgate Nursing, L.L.C., a Delaware limited liability company

Highlander Nursing, L.L.C., a Delaware limited liability company

Kindred Development Holdings 3, L.L.C., a Delaware limited liability company

Kindred Development Holdings 5, L.L.C., a Delaware limited liability company

Kindred Development 7, L.L.C., a Delaware limited liability company

Kindred Development 8, L.L.C., a Delaware limited liability company

Kindred Development 9, L.L.C., a Delaware limited liability company

Kindred Development 10, L.L.C., a Delaware limited liability company

Kindred Development 11, L.L.C., a Delaware limited liability company

Kindred Development 12, L.L.C., a Delaware limited liability company

Kindred Development 13, L.L.C., a Delaware limited liability company

Laurel Lake Health and Rehabilitation, L.L.C., a Delaware limited liability company

Massachusetts Assisted Living, L.L.C., a Delaware limited liability company

Meadows Nursing, L.L.C., a Delaware limited liability company

Tower Hill Nursing, L.L.C., a Delaware limited liability company

Kindred Nursing Centers West, L.L.C., a Delaware limited liability company

Kindred Development 4, L.L.C., a Delaware limited liability company

Maine Assisted Living, L.L.C., a Delaware limited liability company

California Nursing Centers, L.L.C., a Delaware limited liability company

Bayberry Care Center, L.L.C., a Delaware limited liability company

Care Center of Rossmoor, L.L.C., a Delaware limited liability company

Greenbrae Care Center, L.L.C., a Delaware limited liability company

Medical Hill Rehab Center, L.L.C., a Delaware limited liability company

Pacific Coast Care Center, L.L.C., a Delaware limited liability company

Siena Care Center, L.L.C., a Delaware limited liability company

Smith Ranch Care Center, L.L.C., a Delaware limited liability company

Ygnacio Valley Care Center, L.L.C., a Delaware limited liability company

Kindred Nursing Centers South, L.L.C., a Delaware limited liability company

Kindred Nursing Centers North, L.L.C., a Delaware limited liability company

Kindred Nevada, L.L.C., a Delaware limited liability company

Kindred Holdings, L.L.C., a Delaware limited liability company

Kindred Systems, Inc., a Delaware corporation

Kindred Healthcare Services, Inc., a Delaware corporation

Ledgewood Health Care Corporation, a Massachusetts corporation (1)

Kindred Rehab Services, Inc., a Delaware corporation

Rehab Staffing, L.L.C., a Delaware limited liability company

People*first* Virginia, L.L.C., a Delaware limited liability company

Kindred Hospice Services, L.L.C., a Delaware limited liability company

Peoplefirst HomeCare & Hospice of Colorado, L.L.C., a Delaware limited liability company

Peoplefirst HomeCare & Hospice of Indiana, L.L.C., a Delaware limited liability company

Peoplefirst HomeCare & Hospice of Massachusetts, L.L.C., a Delaware limited liability company

Peoplefirst HomeCare & Hospice of Ohio, L.L.C., a Delaware limited liability company

Peoplefirst HomeCare & Hospice of Utah, L.L.C., a Delaware limited liability company

PF Development 13, L.L.C., a Delaware limited liability company

PF Development 14, L.L.C., a Delaware limited liability company

PF Development 15, L.L.C., a Delaware limited liability company

PF Development 5, L.L.C., a Delaware limited liability company

PF Development 6, L.L.C., a Delaware limited liability company

PF Development 7, L.L.C., a Delaware limited liability company

PF Development 8, L.L.C., a Delaware limited liability company

PF Development 9, L.L.C., a Delaware limited liability company

PF Development 10, L.L.C., a Delaware limited liability company

KND Development 50, L.L.C., a Delaware limited liability company

KND Development 51, L.L.C., a Delaware limited liability company

KND Development 52, L.L.C., a Delaware limited liability company

KND Development 53, L.L.C., a Delaware limited liability company

KND Development 54, L.L.C., a Delaware limited liability company

KND Development 55, L.L.C., a Delaware limited liability company

KND Development 56, L.L.C., a Delaware limited liability company

KND Development 57, L.L.C., a Delaware limited liability company

KND Development 58, L.L.C., a Delaware limited liability company

KND Development 59, L.L.C., a Delaware limited liability company

KND Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Hospital Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Real Estate 8, L.L.C., a Delaware limited liability company

KND Real Estate 9, L.L.C., a Delaware limited liability company

KND Real Estate 14, L.L.C., a Delaware limited liability company

KND Real Estate 21, L.L.C., a Delaware limited liability company

KND Real Estate 22, L.L.C., a Delaware limited liability company

KND Real Estate 23, L.L.C., a Delaware limited liability company

KND Real Estate 24, L.L.C., a Delaware limited liability company

KND Real Estate 25, L.L.C., a Delaware limited liability company

KND Real Estate 26, L.L.C., a Delaware limited liability company

KND Real Estate 27, L.L.C., a Delaware limited liability company

KND Real Estate 28, L.L.C., a Delaware limited liability company

KND Real Estate 29, L.L.C., a Delaware limited liability company

KND Real Estate 30, L.L.C., a Delaware limited liability company

KND SNF Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Real Estate 1, L.L.C., a Delaware limited liability company

KND Real Estate 2, L.L.C., a Delaware limited liability company

KND Real Estate 3, L.L.C., a Delaware limited liability company

KND Real Estate 4, L.L.C., a Delaware limited liability company

KND Real Estate 5, L.L.C., a Delaware limited liability company

KND Real Estate 6, L.L.C., a Delaware limited liability company

KND Real Estate 7, L.L.C., a Delaware limited liability company

KND Real Estate 10, L.L.C., a Delaware limited liability company

KND Real Estate 11, L.L.C., a Delaware limited liability company

KND Real Estate 12, L.L.C., a Delaware limited liability company

KND Real Estate 13, L.L.C., a Delaware limited liability company

KND Real Estate 15, L.L.C., a Delaware limited liability company

KND Real Estate 16, L.L.C., a Delaware limited liability company

KND Real Estate 17, L.L.C., a Delaware limited liability company

KND Real Estate 18, L.L.C., a Delaware limited liability company

KND Real Estate 19, L.L.C., a Delaware limited liability company

KND Real Estate 20, L.L.C., a Delaware limited liability company

KND Real Estate 31, L.L.C., a Delaware limited liability company

KND Real Estate 32, L.L.C., a Delaware limited liability company

KND Real Estate 33, L.L.C., a Delaware limited liability company

KND Real Estate 34, L.L.C., a Delaware limited liability company

KND Real Estate 35, L.L.C., a Delaware limited liability company

KND Real Estate 36, L.L.C., a Delaware limited liability company

KND Real Estate 37, L.L.C., a Delaware limited liability company

KND Real Estate 38, L.L.C., a Delaware limited liability company

KND Real Estate 39, L.L.C., a Delaware limited liability company

KND Real Estate 40, L.L.C., a Delaware limited liability company

KND Rehab Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Real Estate 41, L.L.C., a Delaware limited liability company

KND Real Estate 42, L.L.C., a Delaware limited liability company

KND Real Estate 43, L.L.C., a Delaware limited liability company

KND Real Estate 44, L.L.C., a Delaware limited liability company

KND Real Estate 45, L.L.C., a Delaware limited liability company

Helian Health Group, Inc., a Delaware corporation

Helian ASC of Northridge, Inc., a California corporation

MedEquities, Inc., a California corporation

Lafayette Health Care Center, Inc., a Georgia corporation

PersonaCare of Connecticut, Inc., a Connecticut corporation

Courtland Gardens Health Center, Inc., a Connecticut corporation

Homestead Health Center, Inc., a Connecticut corporation

PersonaCare of Georgia, Inc., a Delaware corporation

PersonaCare of Huntsville, Inc., a Delaware corporation

PersonaCare of Ohio, Inc., a Delaware corporation

PersonaCare of Pompano East, Inc., a Delaware corporation

PersonaCare of Reading, Inc., a Delaware corporation

PersonaCare of Shreveport, Inc., a Delaware corporation

PersonaCare of Warner Robbins, Inc., a Delaware corporation

PersonaCare of Wisconsin, Inc., a Delaware corporation

Tucker Nursing Center, Inc., a Georgia corporation

Specialty Healthcare Services, Inc., a Delaware corporation

Southern California Specialty Care, Inc., a California corporation

Specialty Hospital of Cleveland, Inc., an Ohio corporation

Specialty Hospital of Philadelphia, Inc., a Pennsylvania corporation

Specialty Hospital of South Carolina, Inc., a South Carolina corporation

Caribbean Behavioral Health Systems, Inc., a Nevada corporation

JB Thomas Hospital, Inc., a Massachusetts corporation

THC—Chicago, Inc., an Illinois corporation

THC—North Shore, Inc., an Illinois corporation

THC—Houston, Inc., a Texas corporation

THC—Orange County, Inc., a California corporation

THC—Seattle, Inc., a Washington corporation

Transitional Hospitals Corporation of Indiana, Inc., an Indiana corporation

Transitional Hospitals Corporation of Louisiana, Inc., a Louisiana corporation

Transitional Hospitals Corporation of New Mexico, Inc., a New Mexico corporation

Transitional Hospitals Corporation of Nevada, Inc., a Nevada corporation

Transitional Hospitals Corporation of Tampa, Inc., a Florida corporation

Transitional Hospitals Corporation of Texas, Inc., a Texas corporation

Transitional Hospitals Corporation of Wisconsin, Inc., a Wisconsin corporation

Partnerships

Kindred Hospitals Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Central Limited Partnership, a Delaware limited partnership

Foothill Nursing Company Partnership, a California general partnership

Fox Hill Village Partnership, a Massachusetts general partnership (1)

Starr Farm Partnership, a Vermont general partnership (1)

Hillhaven-MSC Partnership, a California general partnership

Northridge Surgery Center, Ltd., a California limited partnership (2)

Northridge Surgery Center Development Ltd., a California limited partnership (3)

(1) Only fifty percent (50%) is owned by one of the Registrant's subsidiaries

(2) Only forty-eight percent (48%) is owned by one or more of the Registrant's subsidiaries

(3) Only forty-three percent (43%) is owned by one of the Registrant's subsidiaries

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-59598, 333-62022, 333-88086, 333-116755, and 333-151580) and the Registration Statement on Form S-3 (No. 333-69646) of Kindred Healthcare, Inc. of our report dated February 25, 2009 relating to the consolidated financial statements, financial statement schedules and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

Louisville, Kentucky
February 25, 2009

Certification Required By Rules 13a-14(a) and 15d-14(a)
under the Securities Exchange Act of 1934

I, Paul J. Diaz, certify that:

1. I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2009

/s/ Paul J. Diaz
Paul J. Diaz
President and Chief Executive Officer

Certification Required By Rules 13a-14(a) and 15d-14(a)
under the Securities Exchange Act of 1934

I, Richard A. Lechleiter, certify that:

1. I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2009

/s/ Richard A. Lechleiter
Richard A. Lechleiter
Executive Vice President and Chief Financial Officer

Section 1350 Certifications
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), each of the undersigned officers of Kindred Healthcare, Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Annual Report on Form 10-K for the year ended December 31, 2008 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2009

/s/ Paul J. Diaz
Paul J. Diaz
President and Chief Executive Officer

Date: February 25, 2009

/s/ Richard A. Lechleiter
Richard A. Lechleiter
Executive Vice President and Chief Financial Officer

2007 Kindred Healthcare, Inc 10K

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

Commission File Number: 001-14057

KINDRED HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**61-1323993** (I.R.S. Employer Identification Number)
680 South Fourth Street **Louisville, Kentucky** (Address of principal executive offices)	**40202-2412** (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, par value $0.25 per share	New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment of this Annual Report on Form 10-K. ☐

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

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐

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

The aggregate market value of the shares of the Registrant held by non-affiliates of the Registrant, based on the closing price of such stock on the New York Stock Exchange on June 29, 2007, was approximately $915,415,000. For purposes of the foregoing calculation only, all directors and executive officers of the Registrant have been deemed affiliates.

As of January 31, 2008, there were 38,343,534 shares of the Registrant's common stock, $0.25 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 22, 2008 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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PART I

Item 1. *Business*

GENERAL

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States. At December 31, 2007, our hospital division operated 84 long-term acute care ("LTAC") hospitals (6,567 licensed beds) in 24 states. Our health services division operated 228 nursing centers (29,106 licensed beds) in 27 states. We also operated a contract rehabilitation services business that provides rehabilitative services primarily in long-term care settings. All references in this Annual Report on Form 10-K to "Kindred," "Company," "we," "us," or "our" mean Kindred Healthcare, Inc. and, unless the context otherwise requires, our consolidated subsidiaries.

All financial and statistical information presented in this Annual Report on Form 10-K reflects the continuing operations of our businesses for all periods presented unless otherwise indicated.

Spin-Off Transaction. On July 31, 2007, we completed the spin-off of our former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. Immediately after the Spin-off Transaction, our stockholders and the stockholders of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from our balance sheet effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in our operating results. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in our historical continuing operations.

In addition to the pharmacy services contracts noted above, we also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters.

Commonwealth Transaction. In February 2006, we acquired the operations of the LTAC hospitals, nursing centers and assisted living facilities operated by Commonwealth Communities Holdings LLC and certain of its affiliates (collectively, "Commonwealth") for a total purchase price of $124 million in cash (the "Commonwealth Transaction").

The Commonwealth Transaction included five freestanding LTAC hospitals and one hospital-in-hospital with a total of 421 hospital beds. Three of these hospitals also operate co-located sub-acute units and skilled nursing units with a total of 168 beds. In addition, we acquired the operations of nine nursing centers containing 1,316 beds and four assisted living facilities with a total of 215 beds. Two of these assisted living facilities share campuses with a Commonwealth nursing center. In the transaction, we also acquired the right to develop 95 additional LTAC hospital beds in Massachusetts. All of these facilities are located in Massachusetts except for two freestanding assisted living facilities located in Maine.

Spin-off from Ventas. On May 1, 1998, Ventas, Inc. ("Ventas") completed the spin-off of its healthcare operations to its stockholders through the distribution of our former common stock. Ventas retained ownership of substantially all of its real property and leases a portion of such real property to us. In anticipation of the spin-off from Ventas, we were incorporated on March 27, 1998 as a Delaware corporation. For accounting purposes, the consolidated historical financial statements of Ventas became our historical financial statements following the spin-off.

Risk Factors. This Annual Report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). See "Item 1A – Risk Factors."

Discontinued Operations

In recent years, we have completed certain strategic divestitures to improve our future operating results. In June 2007, we purchased for resale 21 nursing centers and one LTAC hospital (collectively, the "Ventas Facilities") previously leased from Ventas for $171.5 million (the "Facility Acquisitions"). In addition, we paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax losses of approximately $4 million for 2007 and $10 million each for 2006 and 2005.

During 2007, we sold 14 of the Ventas Facilities for approximately $67 million. We intend to complete the divestiture of the remaining Ventas Facilities during 2008. We expect to generate between $13 million and $23 million in proceeds from the sale of the remaining Ventas Facilities and the related operations. We recorded a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to these planned divestitures.

In January 2007, we acquired from Health Care Property Investors, Inc. ("HCP") the real estate related to 11 unprofitable leased nursing centers operated by us for resale in exchange for the real estate related to three hospitals previously owned by us (the "HCP Transaction"). As part of the HCP Transaction, we continue to operate these hospitals under a long-term lease arrangement with HCP. In addition, we paid HCP a one-time cash payment of approximately $36 million. We also amended our existing master lease with HCP to (1) terminate the current annual rent of approximately $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of approximately $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022.

During 2007, we sold all of the nursing centers acquired in the HCP Transaction and received proceeds of $77.9 million. These 11 nursing centers, which contained 1,754 licensed beds, generated pretax losses of approximately $4 million for 2007, $1 million for 2006 and $4 million for 2005. In addition, we terminated a nursing center lease with another landlord during 2007. We recorded a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

During 2005, we disposed of three unprofitable leased nursing centers, designated two owned nursing centers as held for sale and closed one nursing center. The pretax loss associated with these transactions totaled $6.6 million ($4.1 million net of income taxes).

For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2007 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

HEALTHCARE OPERATIONS

We are organized into three operating divisions: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing centers. The rehabilitation division provides rehabilitation services primarily in long-term care settings. We believe that the independent focus of each division on the unique aspects of its business enhances its ability to attract patients, residents and non-affiliated customers, improve the quality of its operations and achieve operating efficiencies.

HOSPITAL DIVISION

Our hospital division provides long-term acute care services to medically complex patients through the operation of a national network of 84 hospitals with 6,567 licensed beds located in 24 states as of December 31, 2007. We operate the largest network of LTAC hospitals in the United States based upon fiscal 2007 revenues of approximately $1.8 billion (before eliminations). As a result of our commitment to the LTAC hospital business, we have developed a comprehensive program of care for medically complex patients which allows us to deliver high quality care in a cost-effective manner.

A number of the hospital division's hospitals also provide skilled nursing, sub-acute and outpatient services. Outpatient services may include diagnostic services, rehabilitation therapy, CT scanning, one-day surgery, laboratory and X-ray.

In our hospitals, we treat medically complex patients, including the critically ill, suffering from multiple organ system failures, most commonly of the cardiovascular, pulmonary, kidney, gastro-intestinal and cutaneous (skin) systems. In particular, we have a core competency in treating patients with cardio-pulmonary disorders, skin and wound conditions, and life-threatening infections. Prior to being admitted to our hospitals, many of our patients have undergone a major surgical procedure or developed a neurological disorder following head and spinal cord injury, cerebral vascular incident or metabolic instability. Our expertise lies in the ability to simultaneously deliver comprehensive and coordinated medical interventions directed at all affected organ systems, while maintaining a patient-centered, integrated care plan. Medically complex patients are characteristically dependent on technology for continued life support, including mechanical ventilation, total parenteral nutrition, respiratory or cardiac monitors and kidney dialysis machines. During 2007, the average length of stay for patients in our hospitals was approximately 32 days. Approximately 62% of our hospital patients are over 65 years old.

Our hospital division patients generally have conditions that require a high level of monitoring and specialized care, yet may not need the services of a traditional intensive care unit. Due to their severe medical conditions, these patients are not clinically appropriate for admission to other post-acute settings and their medical conditions are periodically or chronically unstable. By providing a range of services required for the care of medically complex patients, we believe that our LTAC hospitals provide our patients with high quality, cost-effective care.

Our LTAC hospitals employ a comprehensive program of care for their patients which draws upon the talents of interdisciplinary teams, including physician specialists. The teams evaluate patients upon admission to determine treatment programs. Our hospital division has developed specialized treatment programs focused on the needs of medically complex patients. In addition to traditional medical services, most of our patients receive individualized treatment plans in rehabilitation, skin integrity management and clinical pharmacology. Where appropriate, the treatment programs may involve the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

Effective July 1, 2004, we reorganized substantially all of our hospital pharmacy and rehabilitation departments by transferring the related personnel and operations to our former pharmacy division and our

rehabilitation division, respectively (the "Hospital Services Reorganization"). The historical operating results of our hospital, pharmacy and rehabilitation services segments were not restated to conform with this business realignment.

Regulatory Developments

The Medicare, Medicaid and SCHIP Extension Act of 2007 (the "SCHIP Extension Act") became effective for cost reporting periods after December 29, 2007. This legislation provides for, among other things:

(1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria;

(2) enhanced medical necessity review of LTAC hospital cases;

(3) a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development;

(4) a three-year moratorium on an increase in the number of beds at a LTAC hospital or satellite facility, subject to exceptions for states where there is only one other LTAC hospital or upon request following the closure or decrease in the number of beds at a LTAC hospital within the state;

(5) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under the Long-Term Acute Care Prospective Payment System ("LTAC PPS");

(6) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 11, 2007;

(7) a three-year moratorium on the application of the so-called "25 Percent Rule" to freestanding LTAC hospitals;

(8) a three-year period during which LTAC hospitals that are co-located within another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS;

(9) a three-year period during which LTAC hospitals that are co-located with an urban single hospital or a hospital that generates more than 25% of the Medicare discharges in a metropolitan statistical area ("MSA Dominant hospital") may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS; and

(10) the elimination of the July 1, 2007 market basket increase in the standard federal payment rate of 0.71%, effective for discharges occurring on or after April 1, 2008.

The SCHIP Extension Act also extends the Medicare Part B therapy cap exception process until June 30, 2008. See "– Governmental Regulation – Rehabilitation Division – Overview of Rehabilitation Division Reimbursement."

On May 1, 2007, the Centers for Medicare and Medicaid Services ("CMS") issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the "2007 Final Rule") that became effective for discharges occurring on or after July 1, 2007. The 2007 Final Rule was amended on June 29, 2007 by revising the high cost outlier threshold. The 2007 Final Rule projected an overall decrease in payments to all Medicare certified LTAC hospitals of approximately 1.2%. Included in the 2007 Final Rule were (1) an increase to the standard federal payment rate of 0.71% (eliminated for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) revisions to payment methodologies impacting short-stay outliers, which reduce payments by 0.9% (currently subject to a three-year moratorium pursuant to the SCHIP Extension Act); (3) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.5%; (4) an increase in the high cost outlier threshold per discharge to $20,738, resulting in projected reductions of 0.4%; and (5) an extension of the policy known as the "25 Percent Rule" to all LTAC

hospitals, with a three-year phase-in, which CMS projects will not result in payment reductions for the first year of implementation (also currently subject to a three-year moratorium pursuant to the SCHIP Extension Act).

The 2007 Final Rule reduced our hospital Medicare revenues by approximately $21 million in the second half of 2007, including the effect of a lower than expected market basket increase.

The 2007 Final Rule expanded the so-called "25 Percent Rule" to all LTAC hospitals, regardless of whether they are co-located within another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid the LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon short-term acute care hospital rates. However, as set forth above, the SCHIP Extension Act has placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals. In addition, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals that are co-located within another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS. See "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

On August 1, 2007, CMS issued final regulations regarding Medicare hospital inpatient payments to short-term acute care hospitals as well as certain provisions affecting LTAC hospitals. These regulations adopt a new system for classifying patients into diagnostic categories called Medicare Severity Diagnosis Related Groups or more specifically, for LTAC hospitals, "MS-LTC-DRGs." This new MS-LTC-DRG system replaces the previous diagnostic related group system for LTAC hospitals and became effective for discharges occurring on or after October 1, 2007. The MS-LTC-DRG system creates additional severity-adjusted categories for most diagnoses, resulting in an expansion of the aggregate number of diagnostic groups from 538 to 745. CMS states that MS-LTC-DRG weights were developed in a budget neutral manner and as such, the estimated aggregate payments under LTAC PPS would be unaffected by the annual recalibration of MS-LTC-DRG payment weights. For more information regarding reimbursement for our hospitals, see "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

Hospital Division Strategy

Our goal is to be the leading operator of LTAC hospitals in terms of both quality of care and operating efficiency. Our strategies for achieving this goal include:

Maintaining High Quality of Care. The hospital division differentiates its hospitals through its ability to care for medically complex patients in a high-quality, cost-effective setting. We are committed to maintaining and improving the quality of our patient care by dedicating appropriate resources at each facility and continuing to refine our clinical initiatives and objectives. We continue to take steps to improve our quality indicators and maintain the quality of care at our hospitals, including:

- attracting and retaining high quality professional staff within each market. The hospital division believes that its future success will depend in part upon its continued ability to hire and retain qualified healthcare personnel and to promote leadership and development training,
- maintaining an integrated quality assurance and improvement program, administered by our chief medical officer and senior vice president of clinical operations, which encompasses utilization review, quality improvement, infection control and risk management,
- promoting best practices through our hospitals and standardizing products and services to promote better care,

- maintaining a strategic outcomes program, which includes a concurrent review of all of our patient population against quality screenings, outcomes reporting and patient and family satisfaction surveys,
- maintaining a program whereby our hospitals are reviewed by internal quality auditors for compliance with standards of the Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals (the "Joint Commission"),
- engaging quality councils at the divisional, group, district and hospital levels to analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division,
- incorporating the clinical advice of our chief medical officer, medical advisory board and other physicians into our operational procedures, and
- implementing an integrated risk management plan to improve quality and expand existing patient safety initiatives.

Improving Operating Efficiency. The hospital division is continually focused on improving operating efficiency and controlling costs while maintaining quality patient care. Our hospital division seeks to improve operating efficiencies and control costs by standardizing key operating procedures and optimizing the skill mix of its staff based upon the clinical needs of each hospital's patients. The initiatives we have undertaken to control our costs and improve efficiency include:

- managing labor costs by adjusting staffing to patient acuity and fluctuations in census,
- increasing the standardization of operating processes, procedures and equipment,
- improving physician participation in resource consumption, medical record documentation and intensity of service management,
- managing pharmacy costs through the use of a medication control program and evaluating medical utilization through our pharmacy and therapeutic committees in each hospital,
- centralizing administrative functions such as accounting, payroll, legal, reimbursement, compliance, tax and information systems, and
- utilizing management information technology to aid in financial and clinical reporting as well as billing and collections.

Growing Through Business Development and Acquisitions. Our growth strategy is focused on the development and expansion of our services:

- Freestanding Hospitals – At December 31, 2007, we operated 67 freestanding hospitals (5,845 licensed beds). During 2007, we opened four new freestanding hospitals and one replacement hospital which added a total of 261 LTAC hospital beds and 39 sub-acute beds. We currently have five freestanding hospitals under development which will add 249 LTAC hospital beds and 30 sub-acute beds. Pursuant to the SCHIP Extension Act, a three-year moratorium has been imposed on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development. All of the freestanding hospitals that we currently have under development are exempt from the three-year moratorium established by the SCHIP Extension Act.
- Growing Through Selective Acquisitions – We seek growth opportunities through strategic acquisitions in selected target markets. In 2006, we completed the Commonwealth Transaction, which added six hospitals in Massachusetts with a total of 646 licensed beds.
- Sub-Acute Development – We are well positioned to develop sub-acute units in several of our hospitals to promote higher quality care and take advantage of unused capacity. We currently operate five

sub-acute units with 212 beds and we have three hospital-based sub-acute units with 118 beds currently under development.

- Cluster Market Development – We are increasingly focused on the opportunities available to us in markets where we operate multiple hospitals or which have affiliated nursing centers. These cluster markets present opportunities to collaborate between our hospitals and nursing centers by sharing clinical expertise and sales and marketing resources. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.
- Hospital-in-Hospital – We have contracts with non-Kindred short-term acute care and other hospitals to operate LTAC hospitals within the host hospital ("HIH"). Under these arrangements, we lease space and purchase certain ancillary services from the host hospital and provide it with the option to discharge a portion of its clinically appropriate patients into the care of our hospital. These HIHs also receive patients from general short-term acute care hospitals other than the host hospital. At December 31, 2007, we operated 17 HIHs with 722 licensed beds. We have two HIHs under development which will add 79 licensed beds, which are exempt from the three-year moratorium established by the SCHIP Extension Act.

Expanding Program Development. We are a leading provider of long-term acute care to patients with pulmonary dysfunctions. In addition, we have developed and continue to expand other inpatient and outpatient service areas such as wound care, post-surgical care, acute rehabilitation and pain management where we believe opportunities exist to position our hospitals as centers of excellence in given markets. We intend to broaden our expertise beyond pulmonary services and to leverage our leadership position in pulmonary care to expand our market strength to other clinical services. We also intend to expand our sub-acute programs in selected markets.

Increasing Patient Volume, Particularly Commercial Patients. We have expanded our sales and marketing efforts to grow same-store admissions and take advantage of available capacity. We generally receive higher reimbursement rates from commercial insurers as a group than from the Medicare and Medicaid programs. As a result, we work to expand relationships with insurers to increase commercial patient volume. Each of our hospitals employs specialized staff to focus on patient admissions and the patient referral process.

Improving Relationships with Referring Providers. Substantially all of the acute and medically complex patients admitted to our hospitals are transferred to us by other healthcare providers such as general short-term acute care hospitals, intensive care units, managed care programs, physicians, nursing centers and home care settings. Accordingly, we are focused on maintaining strong relationships with these providers. In order to maintain these relationships, we employ clinical liaisons that are responsible for coordinating admissions and assessing the nature of services necessary for the proper care of the patient. The clinical liaisons also are responsible for educating healthcare professionals at the referral sources about the unique nature of the services provided by our LTAC hospitals.

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Selected Hospital Division Operating Data

The following table sets forth certain operating and financial data for the hospital division (dollars in thousands, except statistics):

	Year ended December 31, 2007	2006	2005
Revenues	$ 1,772,272	$ 1,710,670	$ 1,592,998
Operating income	$ 362,199	$ 384,745	$ 416,423
Hospitals in operation at end of period	84	80	73
Licensed beds at end of period	6,567	6,199	5,474
Admissions	42,876	41,008	37,861
Patient days	1,382,201	1,306,511	1,148,818
Revenues per admission	$ 41,335	$ 41,715	$ 42,075
Revenues per patient day	$ 1,282	$ 1,309	$ 1,387
Average daily census	3,787	3,579	3,147
Average length of stay	32.2	31.9	30.3
Occupancy %	64.9	64.5	60.4
Assets at end of period	$ 846,429	$ 762,943	$ 560,767

The term "operating income" is defined as earnings before interest, income taxes, depreciation, amortization, rent and corporate overhead. A reconciliation of "operating income" to our consolidated results of operations is included in note 8 of the notes to consolidated financial statements. The term "licensed beds" refers to the maximum number of beds permitted in a facility under its license regardless of whether the beds are actually available for patient care. "Patient days" refers to the total number of days of patient care provided for the periods indicated. "Average daily census" is computed by dividing each facility's patient days by the number of calendar days in the respective period. "Average length of stay" is computed by dividing each facility's patient days by the number of admissions in the respective period. "Occupancy %" is computed by dividing average daily census by the number of operational licensed beds, adjusted for the length of time each facility was in operation during each respective period.

Sources of Hospital Revenues

The hospital division receives payment for its hospital services from third party payors, including government reimbursement programs such as Medicare and Medicaid and non-government sources such as Medicare Advantage, commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. Patients covered by non-government payors generally are more profitable to the hospital division than those covered by the Medicare and Medicaid programs. The following table sets forth the approximate percentages of our hospital admissions, patient days and revenues derived from the payor sources indicated:

Year ended	Medicare			Medicaid			Medicare Advantage (a)			Commercial insurance and other		
December 31,	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues	Admissions	Patient days	Revenues
2007	68%	60%	58%	10%	15%	10%	4%	4%	4%	18%	21%	28%
2006	71	63	61	10	15	10				19	22	29
2005	75	70	67	9	10	6				16	20	27

(a) Data not available prior to April 1, 2007.

For the year ended December 31, 2007, revenues of the hospital division totaled approximately $1.8 billion or 39% of our total revenues (before eliminations). For more information regarding the reimbursement for our

hospital services, see "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement."

Hospital Facilities

The following table lists by state the number of hospitals and related licensed beds we operated as of December 31, 2007:

		Number of facilities			
State	Licensed beds	Owned by us	Leased from Ventas (2)	Leased from other parties	Total
Arizona	217	–	2	2	4
California	885	5	5	1	11
Colorado	68	–	1	–	1
Florida (1)	615	–	6	2	8
Georgia (1)	72	–	–	1	1
Illinois (1)	545	–	4	1	5
Indiana	119	–	1	1	2
Kentucky (1)	414	–	1	1	2
Louisiana	168	–	1	–	1
Massachusetts (1)	755	–	2	6	8
Missouri (1)	265	–	2	1	3
Nevada	184	1	1	1	3
New Jersey (1)	117	–	–	3	3
New Mexico	61	–	1	–	1
North Carolina (1)	124	–	1	–	1
Ohio	250	–	–	3	3
Oklahoma	93	–	1	1	2
Pennsylvania	393	2	2	3	7
South Carolina (1)	59	–	–	1	1
Tennessee (1)	109	–	1	1	2
Texas	852	2	6	4	12
Virginia (1)	60	–	–	1	1
Washington (1)	80	1	–	–	1
Wisconsin	62	–	–	1	1
Totals	6,567	11	38	35	84

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."
(2) See "– Master Lease Agreements."

Quality Assessment and Improvement

The hospital division maintains a clinical outcomes program which includes a review of its patient population measured against utilization and quality standards, as well as clinical outcomes data collection and patient and family satisfaction surveys. In addition, our hospitals have integrated quality assessment and improvement programs administered by a director of quality management which encompasses quality improvement, infection control and risk management. The objective of these programs is to ensure that patients are managed appropriately in our hospitals and that quality healthcare is provided in a cost-effective manner.

The hospital division has implemented a program whereby its hospitals are reviewed by internal quality auditors for compliance with standards of the Joint Commission. The purposes of this internal review process are to (1) ensure ongoing compliance with industry recognized standards for hospitals, (2) assist management in analyzing each hospital's operations and (3) provide consulting and educational programs for each hospital to identify opportunities to improve patient care.

Hospital Division Management and Operations

Each of our hospitals has a fully credentialed, multi-specialty medical staff to meet the needs of the medically complex, long-term acute patient. Our hospitals offer a broad range of physician services including

pulmonology, internal medicine, infectious diseases, neurology, nephrology, cardiology, radiology and pathology. In addition, our hospitals have a multi-disciplinary team of healthcare professionals including a professional nursing staff trained to care for long-term acute patients, respiratory, physical, occupational and speech therapists, pharmacists, registered dietitians and social workers, to address the needs of medically complex patients.

Each hospital utilizes a pre-admission assessment system to evaluate clinical needs and other information in determining the appropriateness of each potential patient admission. After admission, each patient's case is reviewed by the hospital's interdisciplinary team to determine a care plan. Where appropriate, the care plan may involve the services of several disciplines, such as pulmonary medicine, infectious disease and physical medicine.

A hospital chief executive officer or administrator supervises and is responsible for the day-to-day operations at each of our hospitals. Each hospital or network of hospitals also employs a chief financial officer who monitors the financial matters of the hospital or network. Within selected markets having a significant concentration of hospitals, administrative functions such as billing and collections may be shared to improve efficiency. In addition, each hospital or network of hospitals employs a chief clinical officer to oversee the clinical operations and a director of quality management to oversee our quality assurance programs. We provide centralized services in the areas of information systems design and development, training, reimbursement expertise, legal advice, tax, technical accounting support, purchasing and facilities management to each of our hospitals. We believe that this centralization improves efficiency and allows hospital staff to focus more attention on patient care.

A division president and a chief financial officer manage the hospital division. The operations of the hospitals are divided into an east group and a west group, each headed by an executive vice president of the division who reports to the division president. The clinical issues and quality concerns of the hospital division are managed by the division's chief medical officer and senior vice president of clinical operations.

Hospital Division Competition

In each geographic market that we serve, there are generally several competitors that provide similar services to those provided by our hospital division. In addition, several of the markets in which the hospital division operates have other LTAC hospitals that provide services comparable to those offered by our hospitals. Certain competing hospitals are operated by not-for-profit, non-taxpaying or governmental agencies, which can finance capital expenditures on a tax-exempt basis and receive funds and charitable contributions unavailable to our hospital division.

Competition for patients covered by non-government reimbursement sources is intense. The primary competitive factors in the LTAC hospital business include quality of services, charges for services and responsiveness to the needs of patients, families, payors and physicians. Other companies have entered the LTAC market with licensed hospitals that compete with our hospitals. The competitive position of any hospital also is affected by the ability of its management to negotiate contracts with purchasers of group healthcare services, including managed care companies, preferred provider organizations and health maintenance organizations. Such organizations attempt to obtain discounts from established hospital charges. The importance of obtaining contracts with preferred provider organizations, health maintenance organizations and other organizations which finance healthcare, and its effect on a hospital's competitive position, vary from market to market, depending on the number and market strength of such organizations.

HEALTH SERVICES DIVISION

Our health services division provides quality, cost-effective care through the operation of a national network of 228 nursing centers (29,106 licensed beds) located in 27 states. We are the largest publicly held operator of

nursing centers in the United States based upon our fiscal 2007 revenues of approximately $2.0 billion (before eliminations). Through our nursing centers, we provide patients and residents with long-term care services, a full range of pharmacy, medical and clinical services and routine services, including daily dietary, social and recreational services.

Consistent with industry trends, patients and residents admitted to our nursing centers are increasingly more acutely ill and require a more extensive level of care. This is particularly true with our Medicare population. To appropriately care for a more frail and unstable population, we are taking steps to improve the delivery of the clinical and hospitality services offered to our patients and residents by adjusting the level of clinical and hospitality staffing, assisting physician oversight through the selective use of nurse practitioners and improving clinical case management through the employment of clinical case managers.

At a number of our nursing centers, we offer specialized programs for residents suffering from Alzheimer's disease and other dementias through our Reflections units. We have developed specific certification criteria for these units. These are discrete units operated by teams of professionals that are dedicated to addressing the unique problems experienced by residents with Alzheimer's disease or other dementias. We believe that we are a leading provider of nursing care to residents with Alzheimer's disease and dementia based upon the specialization and size of our program. We also have developed transitional care units at several of our facilities. These discrete units typically consist of 12 to 36 beds offering skilled nursing services and physical, occupational and speech therapy to patients recovering from conditions such as joint replacement surgery and cardiac and respiratory ailments.

We also monitor and enhance the quality of care and customer service at our nursing centers through the use of performance improvement committees as well as family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Physicians serve on these committees as medical directors and advise on healthcare policies and practices. We regularly conduct surveys of residents and their families, and these surveys are reviewed by our performance improvement committees at each facility to promote quality care and customer service.

Substantially all of our nursing centers are certified to provide services under the Medicare and Medicaid programs. Our nursing centers have been certified because the quality of our services, accommodations, equipment, safety, personnel, physical environment and policies and procedures meet or exceed the standards of certification set by those programs.

Effective January 1, 2004, we reorganized our rehabilitation services business into a separate operating division by transferring our internal rehabilitation personnel from our nursing centers and consolidating them with our external rehabilitation business (the "Rehabilitation Services Reorganization"). The historical operating results of our nursing center and rehabilitation services segments were not restated to conform with this business realignment.

Health Services Division Strategy

Our goal is to become the provider of choice in the markets we serve, which we believe will allow us to increase our census and enhance our payor mix. We have employed several initiatives to improve the quality of our services and to address the needs of a more acute patient population. The principal elements of our health services division strategy are:

Providing Quality, Clinical-Based Services. The health services division is focused on qualitative and quantitative clinical performance indicators with the goal of providing quality care under the cost containment objectives imposed by government and private payors. In an effort to continually improve the quality of our services and enhance our ability to care for complex and higher acuity residents, we pursue initiatives to:

- improve recruitment, retention, management development, succession planning and employee satisfaction,

- expand the involvement of our medical directors and increase the use of nurse practitioners,
- expand our therapy services, wound care, complex medical care and palliative care programs to improve our ability to care for a more acute patient population,
- improve our processes to monitor and promote our resident care objectives and align financial incentives with quality care and customer service goals,
- increase the number of our transitional care and sub-acute units to treat patients with rehabilitation and complex medical needs,
- improve our Reflections units to care for residents with Alzheimer's disease and other dementias,
- maximize quality outcomes by implementing the collaborative advice and recommendations of the chief medical officer, senior nursing staff and rehabilitation therapists, and
- implement recommendations of our performance improvement committees established at the division, regional and district levels that analyze data, set quality goals and oversee all quality assurance and quality improvement activities throughout the division.

Enhancing Sales and Marketing Programs. We conduct our nursing center marketing efforts, which focus on the quality of care provided at our facilities, at the local market level through our nursing center executive directors, clinical liaisons, admissions coordinators and/or other facility-based sales and marketing personnel. The marketing efforts of our nursing center personnel are supplemented by strategies provided by our divisional, regional and district marketing staffs. To better promote our services we are:

- concentrating our sales and marketing resources toward our transitional care, sub-acute and Alzheimer's units,
- working to improve our relationships with existing local referral sources and identifying and developing new referral sources and promoting our value proposition,
- expanding the number of clinical liaisons and admission coordinators and implementing community outreach programs,
- focusing on improving the recruiting, training and retention of sales and marketing personnel, and
- increasingly focusing on the opportunities available to us in markets where we operate multiple nursing centers or which have affiliated hospitals. These cluster markets present opportunities to collaborate between our nursing centers and hospitals by sharing clinical expertise and sales and marketing resources. We believe a more market focused approach will increase admissions over time, better educate the marketplace on our ability to care for post-acute patients and enhance our capabilities to care for patients across various post-acute settings.

Increasing Operating Efficiency. The health services division continually seeks to improve operating efficiency with a view to maintaining high-quality care. We believe that operating efficiency is critical to maintaining our position as a leading provider of nursing center services in the United States. To improve operating efficiency we strive to:

- increase our average occupancy levels, which leverages our revenues over the fixed costs associated with operating our nursing centers,
- centralize administrative functions such as accounting, payroll, legal, reimbursement, compliance and information systems,
- enhance our quality assurance, risk management and liability claims defense initiatives to address professional liability and worker's compensation costs, and

- continue to upgrade our management information systems to aid in financial and clinical reporting and improve billing and collections.

Repositioning Nursing Center Assets. The health services division continually seeks ways to improve its existing portfolio. To reposition our nursing center portfolio, we have:

- divested 34 nursing centers with approximately 5,000 beds in the last three years,
- plans to divest in 2008 the remaining seven under-performing nursing centers acquired as part of the Facility Acquisitions,
- entered into new leases for eight nursing centers, containing 910 licensed beds, in the San Francisco market, and acquired one nursing center/ assisted living facility containing 160 skilled nursing beds and 82 assisted living beds in 2007,
- acquired 11 nursing centers concentrated in Massachusetts as part of the Commonwealth Transaction in 2006,
- expanded our sub-acute and transitional care units, and
- made significant capital investments to improve our existing facilities.

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Selected Health Services Division Operating Data

The following table sets forth certain operating and financial data for the health services division (dollars in thousands, except statistics):

	Year ended December 31,		
	2007	2006	2005
Revenues	$ 2,014,786	$ 1,819,320	$ 1,645,130
Operating income	$ 296,749	$ 241,852	$ 210,943
Nursing centers in operation at end of period:			
Owned or leased	224	215	204
Managed	4	5	5
Licensed beds at end of period:			
Owned or leased	28,621	27,568	25,804
Managed	485	605	605
Patient days (a)	9,095,099	8,761,111	8,203,089
Revenues per patient day (a)	$ 222	$ 208	$ 201
Average daily census (a)	24,918	24,003	22,474
Occupancy % (a)	87.8	88.3	87.1
Assets at end of period	$ 550,525	$ 427,376	$ 385,864

(a) Excludes managed facilities.

Sources of Nursing Center Revenues

Nursing center revenues are derived principally from the Medicare and Medicaid programs and from private and other payors. Consistent with the nursing center industry, changes in the mix of the patient and resident population among these three categories significantly affect the profitability of our nursing center operations. Although higher acuity patients and residents generally produce the most revenue per patient day, profitability with respect to higher acuity patients is impacted by the costs associated with the higher level of nursing care and other services generally required. In addition, these patients usually have a significantly shorter length of stay.

The following table sets forth the approximate percentages of nursing center patient days and revenues derived from the payor sources indicated:

	Medicare		Medicaid		Private and other	
Year ended December 31,	Patient days	Revenues	Patient days	Revenues	Patient days	Revenues
2007	17%	34%	63%	44%	20%	22%
2006	17	34	64	46	19	20
2005	17	34	66	48	17	18

For the year ended December 31, 2007, revenues of the health services division totaled approximately $2.0 billion or 44% of our total revenues (before eliminations). For more information regarding the reimbursement for our nursing center services, see "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

Nursing Center Facilities

The following table lists by state the number of nursing centers and related licensed beds we operated as of December 31, 2007:

		Number of facilities				
State	Licensed beds	Owned by us	Leased from Ventas (2)	Leased from other parties	Managed	Total
Alabama (1)	474	–	2	1	–	3
Arizona	723	–	4	1	–	5
California	2,825	4	9	11	–	24
Colorado	464	–	4	–	–	4
Connecticut (1)	736	–	6	–	–	6
Georgia (1)	549	–	4	–	–	4
Idaho	767	1	7	–	–	8
Indiana	3,726	7	13	4	–	24
Kentucky (1)	1,595	1	10	2	–	13
Maine (1)	751	–	8	–	–	8
Massachusetts (1)	4,961	–	26	12	3	41
Missouri (1)	240	–	–	2	–	2
Montana (1)	331	–	2	–	–	2
Nevada	180	–	2	–	–	2
New Hampshire (1)	512	–	3	–	–	3
North Carolina (1)	2,169	–	16	3	–	19
Ohio (1)	1,870	2	9	2	–	13
Oregon (1)	254	–	2	–	–	2
Pennsylvania	103	–	1	–	–	1
Rhode Island (1)	201	–	2	–	–	2
Tennessee (1)	1,065	–	3	5	–	8
Utah	620	–	5	–	–	5
Vermont (1)	310	–	1	–	1	2
Virginia (1)	629	–	4	–	–	4
Washington (1)	678	–	7	–	–	7
Wisconsin (1)	1,922	–	11	1	–	12
Wyoming	451	–	4	–	–	4
Totals	29,106	15	165	44	4	228

(1) These states have certificate of need regulations. See "– Governmental Regulation – Federal, State and Local Regulation."
(2) See "– Master Lease Agreements."

Health Services Division Management and Operations

Each of our nursing centers is managed by a state-licensed executive director who is supported by other professional personnel, including a director of nursing, nursing assistants, licensed practical nurses, staff development coordinator, activities director, social services director, admissions coordinator and business office manager. The directors of nursing are state-licensed nurses who supervise our nursing staffs that include registered nurses, licensed practical nurses and nursing assistants. Staff size and composition vary depending on the size and occupancy of each nursing center and on the type of care provided by the nursing center. The nursing centers contract with physicians who provide medical director services and serve on performance improvement committees. We provide our facilities with centralized information systems, federal and state reimbursement expertise, state licensing and certification maintenance, as well as legal, finance, accounting, purchasing and facilities management support. The centralization of these services improves operating efficiencies and permits facility staff to focus on the delivery of quality care.

Our health services division is managed by a division president and a chief financial officer. Our nursing center operations are divided into three geographic regions, each of which is headed by an operational senior vice president. These three operational senior vice presidents report to the division president. The clinical issues and quality concerns of the health services division are overseen by the division's chief medical officer and senior vice president of clinical operations with assistance from our regional and district teams. The sales and marketing efforts for the division are led by our senior vice president of sales and marketing with assistance from our regional and district teams. Divisional, regional and/or district staff also support the health services division in the areas of nursing, dietary services, federal and state reimbursement, human resources management, maintenance, and financial services.

Quality Assessment and Improvement

Quality of care is monitored and enhanced by our clinical operations personnel as well as our performance improvement committees and family satisfaction surveys. Our performance improvement committees oversee resident healthcare needs and resident and staff safety. Additionally, physicians serve on these committees as medical directors and advise on healthcare policies and practices. Regional and district nursing professionals visit our nursing centers periodically to review practices and recommend improvements where necessary in the level of care provided and to ensure compliance with requirements under applicable Medicare and Medicaid regulations. Surveys of residents' families are conducted on a regular basis which provide an opportunity for families to rate various aspects of service and the physical condition of the nursing centers. These surveys are reviewed by performance improvement committees at each facility to promote and improve quality resident care.

The health services division provides training programs for nursing center executive directors, business office and other department managers, nurses and nursing assistants. These programs are designed to maintain high levels of quality patient and resident care, with an orientation towards regulatory compliance.

Substantially all of our nursing centers are certified to provide services under the Medicare and Medicaid programs. A nursing center's qualification to participate in such programs depends upon many factors, such as accommodations, equipment, clinical services, safety, personnel, physical environment and adequacy of policies and procedures.

Health Services Division Competition

Our nursing centers compete with other nursing centers and similar long-term care facilities primarily on the basis of quality of care, reputation, location and physical appearance and, in the case of private payment residents, the charges for our services. Our nursing centers also compete on a local and regional basis with other nursing centers as well as with facilities providing similar services, including hospitals, extended care centers, assisted living facilities, home health agencies and similar institutions. Some competitors may operate newer facilities and may provide services that we do not offer. Our competitors include government-owned, religious organization-owned, secular not-for-profit and for-profit institutions. Many of these competitors have greater financial and other resources than we do. Although there is limited, if any, price competition with respect to Medicare and Medicaid residents (since revenues received for services provided to such residents are based generally on fixed rates), there is substantial price competition for private payment residents.

REHABILITATION DIVISION

Our rehabilitation division provides rehabilitative services primarily in long-term care settings, but our customers also include hospitals, school districts, outpatient clinics, home health agencies, assisted living facilities and hospice providers, including the hospitals and nursing centers that we operate. We provide rehabilitative services to 502 nursing centers, 87 hospitals and 55 other locations in 40 states under the name "People*first* Rehabilitation." Approximately 68% of the rehabilitation division's revenues in 2007 were generated from contracts with our hospitals and nursing centers.

Our rehabilitation division employs approximately 7,600 therapists and had revenues of approximately $352 million (before eliminations) in 2007. We are organized into four geographic regions.

Our rehabilitation division provides contract therapy services, including physical, occupational and speech therapies, to residents and patients of nursing centers, assisted living facilities and hospitals. In addition to the standard physical, occupational and speech therapies, we provide specialized rehabilitation programs designed to meet the specific needs of the residents and patients we serve. Our specialized care programs are designed to address dementias and Alzheimer's disease, wound care, pain management and pulmonary rehabilitation therapies. Other programs we offer include fall prevention and continence improvement.

We provide our customers with the clinical expertise necessary to facilitate positive outcomes for their residents and patients. Rehabilitation services provided to our customers include therapy record completion and documentation review, clinical audit processes, updates regarding regulatory changes and clinical care strategies. We also offer our customers various management services to strengthen their rehabilitation programs, including invoicing systems and a claims tracking system.

We believe that outsourcing therapy services allows our customers to fulfill the continuing need for the recruitment and retention of full-time and part-time therapists and offers our customers the ability to improve the quality of care provided to their residents and patients.

On January 1, 2004, we reorganized our rehabilitation services business into a separate operating division by completing the Rehabilitation Services Reorganization. On July 1, 2004, the rehabilitation division began providing services to our hospital division as part of the Hospital Services Reorganization. Internal personnel from the hospital division were transferred to the rehabilitation division in conjunction with the Hospital Services Reorganization. The historical operating results of our nursing center, hospital and rehabilitation services segments have not been restated to conform with these business realignments.

Rehabilitation Division Strategy

Our goals are to be the leading contract rehabilitation services provider and employer of choice in the markets we serve and to increase our market share and name recognition through the expansion of our rehabilitation programs, quality initiatives, and clinical, compliance and recruiting efforts. Our strategies for achieving these goals include:

Maintaining Quality Care and Customer Satisfaction. Our rehabilitation division is committed to providing effective and efficient care to the residents and patients of the nursing centers, hospitals and assisted living facilities that we serve. In this regard, we have taken the following measures to improve the operating efficiency of our customers and to enhance and maintain the quality of care provided to their residents and patients:

- We have specialized programs to promote the quality initiatives of our customers, including Alzheimer's disease and other dementia programs, pain management and orthopedic and neuro rehabilitation.
- We promote the competencies of our therapists by providing extensive training and implementing best practices.
- We take an integrated approach of delivering our services as a key member of the customer's interdisciplinary care team and work to enhance our customer's quality objectives.
- We have developed a proprietary nationwide rehabilitation information system that allows us to access management and clinical reports which provide quality assurance measures, identify industry trends, track patient outcomes and streamline invoicing and reporting.
- We have developed technology enhancements which enable our therapists to be more efficient and to improve our compliance with regulations pertaining to documentation.

Effective Recruiting and Retention of Qualified Therapists. The healthcare industry is facing a shortage of qualified therapists. In order to provide the most effective and efficient care to the patients and residents we serve we must recruit and retain qualified therapists. We offer competitive incentive and recognition programs for our therapists and have increased our recruiting infrastructure to reduce open positions, decrease contract labor and improve productivity. We also promote continuing education opportunities to improve patient care and to enhance the personal knowledge, growth and satisfaction of our therapists and encourage their participation in a culture of quality and customer service.

Growing Through Business Development and External Contract Sales. Our growth strategy is focused on the expansion of rehabilitation programs for the customers we currently serve and the development of additional external business in markets where we have a significant presence or where we believe appropriate demand exists for our services. We also believe opportunities exist for new program development in the sub-acute and wound care areas. We plan to increase our market share by demonstrating our value proposition that the quality clinical care and strong customer service provided by People*first* Rehabilitation will enhance the quality and clinical objectives of our customers. We will continue to promote greater brand recognition of our People*first* services by expanding our sales and marketing strategies and through the use of our People*first* website.

Growing Through Selective Acquisitions. We seek growth opportunities through strategic acquisitions in selected target markets. On October 1, 2007, we acquired a rehabilitation services business operating in the states of Maryland and Virginia which had 22 customer contracts under service and generated approximately $7 million in annual revenues.

Selected Rehabilitation Division Operating Data

The following table sets forth certain operating and financial data for the rehabilitation division (dollars in thousands):

	Year ended December 31,		
	2007	2006	2005
Revenues:			
Company-operated	$ 239,740	$ 225,936	$ 200,187
Non-affiliated	112,657	74,170	62,586
	$ 352,397	$ 300,106	$ 262,773
Operating income	$ 34,526	$ 30,362	$ 32,052
Number of customer contracts:			
Company-operated	326	330	317
Non-affiliated	318	229	209
Assets at end of period	$ 30,751	$ 10,621	$ 7,124

Sources of Rehabilitation Division Revenues

The rehabilitation division receives payment for its services provided to residents and patients of the nursing centers, hospitals and assisted living facilities that we serve. The payments are based upon negotiated patient per diem rates or a negotiated fee schedule based upon the types of services rendered. For the year ended December 31, 2007, revenues of the rehabilitation division totaled approximately $352 million or 8% of our total revenues (before eliminations). As a provider of services to other healthcare providers, trends and developments in healthcare reimbursement will impact our revenues and growth. Changes in the reimbursement provided by Medicare or Medicaid to our customers can impact the demand and price for our services. For more information regarding the reimbursement for our rehabilitation services, see "– Governmental Regulation – Rehabilitation Division – Overview of Rehabilitation Division Reimbursement," "– Governmental Regulation – Hospital Division – Overview of Hospital Division Reimbursement," and "– Governmental Regulation – Health Services Division – Overview of Health Services Division Reimbursement."

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Geographic Coverage

The following table lists by state the number of hospitals, nursing centers and other rehabilitation customer contracts we serviced as of December 31, 2007:

	Hospitals		Nursing centers		Other	Total	
State	Company operated	Non-affiliated	Company operated	Non-affiliated	Non-affiliated	Company operated	Non-affiliated
Alabama	–	–	4	–	–	4	–
Arizona	4	–	6	2	–	10	2
California	11	–	25	3	–	36	3
Colorado	1	–	4	7	–	5	7
Connecticut	–	–	6	9	–	6	9
Delaware	–	–	–	1	–	–	1
Florida	8	–	–	47	5	8	52
Georgia	1	–	5	–	–	6	–
Iowa	–	–	–	1	–	–	1
Idaho	–	–	8	1	9	8	10
Illinois	5	–	–	19	3	5	22
Indiana	2	–	24	4	9	26	13
Kentucky	2	–	13	15	4	15	19
Louisiana	1	–	–	–	–	1	–
Maine	–	–	10	4	–	10	4
Maryland	–	–	–	11	–	–	11
Massachusetts	8	–	43	10	5	51	15
Michigan	1	–	–	–	–	1	–
Missouri	3	–	2	1	–	5	1
Montana	–	–	2	–	2	2	2
Nebraska	–	–	1	–	–	1	–
Nevada	3	–	2	2	1	5	3
New Hampshire	–	–	3	–	–	3	–
New Jersey	2	–	–	–	–	2	–
New Mexico	1	1	–	–	–	1	1
North Carolina	1	–	22	43	3	23	46
Ohio	3	1	13	20	6	16	27
Oklahoma	2	–	–	–	–	2	–
Oregon	–	–	2	–	–	2	–
Pennsylvania	7	–	1	10	–	8	10
Rhode Island	–	–	2	2	–	2	2
South Carolina	1	–	–	–	–	1	–
Tennessee	1	–	9	14	–	10	14
Texas	12	2	–	13	4	12	19
Utah	–	–	5	–	–	5	–
Vermont	–	–	2	3	–	2	3
Virginia	1	–	4	13	–	5	13
Washington	1	–	9	2	3	10	5
Wisconsin	1	–	12	2	–	13	2
Wyoming	–	–	4	–	1	4	1
Totals	83	4	243	259	55	326	318

Sales and Marketing

The rehabilitation division's marketing and sales strategy focuses on the outsourcing needs of long-term care facilities and hospitals by emphasizing the broad range of rehabilitation programs, clinical expertise, and competitive pricing that we can provide. The rehabilitation division's new business efforts are led by the vice president of business development and five directors of business development in geographically defined regions.

Rehabilitation Division Management and Operations

We have five nursing center and four hospital regions determined predominantly by geography. Each of our rehabilitation programs has an on-site program manager who reports to an area rehabilitation director. The area director is responsible for the overall management of eight to 12 on-site managers. The area directors report to regional rehabilitation directors who report to their respective senior vice president or vice president of rehabilitation operations.

We provide our program staff with centralized information systems, federal and state reimbursement expertise, licensing support, as well as legal, finance, accounting and purchasing support. The centralization of these services improves operating efficiencies and permits program staff to focus on the delivery of high quality, medically appropriate rehabilitation services.

A division president and a chief financial officer manage our rehabilitation division. A vice president of rehabilitation clinical services manages the clinical education and quality issues for the division.

Rehabilitation Division Competition

In each geographic market that we serve, there are national, regional and local rehabilitation service providers that provide rehabilitation services comparable to those offered by us. Some of our competitors may have greater financial and other resources than us and may be more established in the markets in which we compete. In addition, many long-term care facilities and hospitals may not elect to outsource rehabilitation services thereby reducing our potential customer base. While there are several large rehabilitation providers, the market generally is highly fragmented and is primarily comprised of smaller independent providers.

We believe our rehabilitation division generally competes on its reputation for providing quality service, pricing and clinical expertise.

MASTER LEASE AGREEMENTS

At December 31, 2007, we leased from Ventas and its affiliates 38 LTAC hospitals and 165 nursing centers under four master lease agreements (as amended, the "Master Lease Agreements"). Under the Master Lease Agreements, Ventas has a right to sever properties from the existing leases in order to create additional leases, a device adopted to facilitate its financing flexibility. In such circumstances, our aggregate lease obligations remain unchanged.

In April 2007, we entered into agreements with Ventas to purchase the Ventas Facilities and to renew the leases for an additional five years for 49 nursing centers (approximately 5,844 licensed beds) and eight LTAC hospitals (approximately 635 licensed beds) (collectively, the "Renewal Facilities") that were scheduled to expire in April 2008. The existing rent payments and the annual escalators were not affected by the renewals. Ventas also agreed that it would not contest the Spin-off Transaction.

We completed the purchase of the Ventas Facilities for $171.5 million in June 2007. In addition, we paid Ventas a lease termination fee of $3.5 million. The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax losses of approximately $4 million for 2007 and $10 million each for 2006 and 2005.

In connection with the purchase of the Ventas Facilities, we and Ventas agreed to amend the Master Lease Agreements, which became effective immediately. As amended, the Master Lease Agreements include, among other things, the following amendments:

- We have an ongoing right to de-license 35% of the hospital beds in any hospital and 10% of the hospital beds in any Master Lease Agreement for conversion into skilled nursing care beds.

- We are permitted to de-license 912 beds in 70 nursing centers, which will allow us to reduce multiple bed rooms and enhance the quality of life for our residents and improve the marketability of these facilities to Medicare, managed care and private pay patients and residents.
- Insurance provisions have been modified (1) to expand the number of third party insurers that are permitted to insure our professional liability exposure and (2) to provide a one-time right for us to commute certain insurance policies that may result in the refund of insurance premiums for prior years.
- Two lease renewal bundles contained in Master Lease Agreement No. 3 were combined.
- Ventas obtained enhanced reporting and inspection rights.

The following summary description of the Master Lease Agreements is qualified in its entirety by reference to the Master Lease Agreements as filed with the Securities and Exchange Commission (the "SEC").

Term and Renewals

Each Master Lease Agreement includes land, buildings, structures and other improvements on the land, easements and similar appurtenances to the land and improvements, and permanently affixed equipment, machinery and other fixtures relating to the operation of the leased properties. There are several bundles of leased properties under each Master Lease Agreement, with each bundle containing approximately six to 20 leased properties. Under the Master Lease Agreements, the leases for 87 nursing centers and 22 LTAC hospitals (which are contained in ten renewal bundles) are scheduled to expire in April 2010 (the "2010 Leases") and the leases for 29 nursing centers and eight LTAC hospitals (which are contained in four renewal bundles) are scheduled to expire in April 2013 (the "2013 Leases"). As noted above, the base term for the Renewal Facilities was initially set to expire in April 2008, but was renewed for an additional five-year term.

At our option, the 2010 Leases and 2013 Leases may be extended for one five-year renewal term beyond the base term at the then existing rental rate plus the then existing escalation amount per annum. If we elect to renew, all, but not less than all, of the facilities in a renewal bundle must be renewed.

After the first renewal, we may further extend the term of the 2010 Leases, the 2013 Leases and the Renewal Facilities for two additional five-year renewal terms beyond the first renewal term at the greater of the then existing rental rate plus the then existing escalation amount per annum or the then fair market value rental rate. The rental rate during the first renewal term and any additional renewal term in which rent due is based upon the then existing rental rate will escalate each year during such term(s) at the applicable escalation rate.

We may not extend the Master Lease Agreements beyond the base term or any previously exercised renewal term if, at the time we seek such extension and at the time such extension takes effect, (1) an event of default has occurred and is continuing or (2) a Medicare/Medicaid event of default (as described below) and/or a licensed bed event of default (as described below) has occurred and is continuing with respect to three or more leased properties subject to a particular Master Lease Agreement. The base term and renewal term of each Master Lease Agreement are subject to termination upon default by us (subject to certain exceptions) and certain other conditions described in the Master Lease Agreements.

Rental Amounts and Escalators

Each Master Lease Agreement is commonly known as a triple-net lease or an absolute-net lease. Accordingly, in addition to rent, we are required to pay the following: (1) all insurance required in connection with the leased properties and the business conducted on the leased properties, (2) certain taxes levied on or with respect to the leased properties (other than taxes on the net income of Ventas) and (3) all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties.

Under the Master Lease Agreements, the annual aggregate base rent owed by us currently approximates $235 million. We paid rents to Ventas (including amounts classified as discontinued operations) approximating $238 million for the year ended December 31, 2007, $214 million for the year ended December 31, 2006 and $188 million for the year ended December 31, 2005. In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements which increased the aggregate annual rents by approximately $33 million (including the Ventas Facilities) and became effective retroactively to July 19, 2006. The new aggregate annual rents were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under each of the Master Lease Agreements. As required, Ventas paid us a reset fee of approximately $4.6 million that will be amortized as a reduction of rent expense over the remaining original terms of the Master Lease Agreements. In connection with the exercise of the rent reset, the new annual rents were allocated among the facilities subject to the Master Lease Agreements in accordance with the determinations made by the final appraisers during the rent reset process.

Each Master Lease Agreement provides for rent escalations each May 1 if the patient revenues for the leased properties meet certain criteria as measured using the preceding calendar year revenues as compared to the base period. All annual rent escalators are payable in cash. In connection with the exercise of the rent reset by Ventas, the rent escalations were modified. The new contingent annual rent escalator is 2.7% for Master Lease Agreements Nos. 1, 3 and 4. The new contingent annual rent escalator for Master Lease Agreement No. 2 is based upon the Consumer Price Index with a floor of 2.25% and a ceiling of 4%. Prior to the rent reset, the contingent annual Ventas rent escalator under each Master Lease Agreement was 3.5%.

Use of the Leased Property

The Master Lease Agreements require that we utilize the leased properties solely for the provision of healthcare services and related uses and as Ventas may otherwise consent. We are responsible for maintaining or causing to be maintained all licenses, certificates and permits necessary for the leased properties to comply with various healthcare and other regulations. We also are obligated to operate continuously each leased property as a provider of healthcare services.

Events of Default

Under each Master Lease Agreement, an "Event of Default" will be deemed to occur if, among other things:

- we fail to pay rent or other amounts within five days after notice,
- we fail to comply with covenants, which failure continues for 30 days or, so long as diligent efforts to cure such failure are being made, such longer period (not over 180 days) as is necessary to cure such failure,
- certain bankruptcy or insolvency events occur, including filing a petition of bankruptcy or a petition for reorganization under the bankruptcy code,
- an event of default arises from our failure to pay principal or interest on any indebtedness exceeding $50 million,
- the maturity of any indebtedness exceeding $50 million is accelerated,
- we cease to operate any leased property as a provider of healthcare services for a period of 30 days,
- a default occurs under any guaranty of any lease or the indemnity agreements with Ventas,
- we or our subtenant lose any required healthcare license, permit or approval or fail to comply with any legal requirements as determined by a final unappealable determination,
- we fail to maintain insurance,
- we create or allow to remain certain liens,

- we breach any material representation or warranty,
- a reduction occurs in the number of licensed beds in a facility, generally in excess of 10% (or less than 10% if we have voluntarily "banked" licensed beds) of the number of licensed beds in the applicable facility on the commencement date (a "licensed bed event of default"),
- Medicare or Medicaid certification with respect to a participating facility is revoked and re-certification does not occur for 120 days (plus an additional 60 days in certain circumstances) (a "Medicare/Medicaid event of default"),
- we become subject to regulatory sanctions as determined by a final unappealable determination and fail to cure such regulatory sanctions within the specified cure period for any facility,
- we fail to cure a breach of any permitted encumbrance within the applicable cure period and, as a result, a real property interest or other beneficial property right of Ventas is at material risk of being terminated, or
- we fail to cure the breach of any of the obligations of Ventas as lessee under any existing ground lease within the applicable cure period and, if such breach is a non-monetary, non-material breach, such existing ground lease is at material risk of being terminated.

Remedies for an Event of Default

Except as noted below, upon an Event of Default under one of the Master Lease Agreements, Ventas may, at its option, exercise the following remedies:

(1) after not less than ten days notice to us, terminate the Master Lease Agreement to which such Event of Default relates, repossess any leased property, relet any leased property to a third party and require that we pay to Ventas, as liquidated damages, the net present value of the rent for the balance of the term, discounted at the prime rate,

(2) without terminating the Master Lease Agreement to which such Event of Default relates, repossess the leased property and relet the leased property with us remaining liable under such Master Lease Agreement for all obligations to be performed by us thereunder, including the difference, if any, between the rent under such Master Lease Agreement and the rent payable as a result of the reletting of the leased property, and

(3) seek any and all other rights and remedies available under law or in equity.

In addition to the remedies noted above, under the Master Lease Agreements, in the case of a facility-specific event of default, Ventas may terminate a Master Lease Agreement as to the leased property to which the Event of Default relates, and may, but need not, terminate the entire Master Lease Agreement. Each of the Master Lease Agreements includes special rules relative to Medicare/Medicaid events of default and a licensed bed event of default. In the event a Medicare/Medicaid event of default and/or a licensed bed event of default occurs and is continuing (a) with respect to not more than two properties at the same time under a Master Lease Agreement that covers 41 or more properties and (b) with respect to not more than one property at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, Ventas may not exercise termination or dispossession remedies against any property other than the property or properties to which the event of default relates. Thus, in the event Medicare/Medicaid events of default and licensed bed events of default would occur and be continuing (a) with respect to one property under a Master Lease Agreement that covers less than 20 properties, (b) with respect to two or more properties at the same time under a Master Lease Agreement that covers 21 to and including 40 properties, or (c) with respect to three or more properties at the same time under a Master Lease Agreement that covers 41 or more properties, then Ventas would be entitled to exercise all rights and remedies available to it under the Master Lease Agreements.

Assignment and Subletting

Except as noted below, the Master Lease Agreements provide that we may not assign, sublease or otherwise transfer any leased property or any portion of a leased property as a whole (or in substantial part), including by virtue of a change of control, without the consent of Ventas, which may not be unreasonably withheld if the proposed assignee (1) is a creditworthy entity with sufficient financial stability to satisfy its obligations under the related Master Lease Agreement, (2) has not less than four years experience in operating healthcare facilities for the purpose of the applicable facility's primary intended use, (3) has a favorable business and operational reputation and character, and (4) has all licenses, permits, approvals and authorizations to operate the facility and agrees to comply with the use restrictions in the related Master Lease Agreement. The obligation of Ventas to consent to a subletting or assignment is subject to the reasonable approval rights of any mortgagee and/or the lenders under its credit agreement. We may sublease up to 20% of each leased property for restaurants, gift shops and other stores or services customarily found in hospitals or nursing centers without the consent of Ventas, subject, however, to there being no material alteration in the character of the leased property or in the nature of the business conducted on such leased property.

In addition, each Master Lease Agreement allows us to assign or sublease (a) without the consent of Ventas, 10% of the nursing center facilities in each Master Lease Agreement and (b) with Ventas's consent (which consent will not be unreasonably withheld, delayed or conditioned), two hospitals in each Master Lease Agreement, if either (i) the applicable regulatory authorities have threatened to revoke our Medicaid or Medicare certification or an authorization necessary to operate such leased property or (ii) we cannot profitably operate such leased property. Any such proposed assignee/sublessee must satisfy the requirements listed above and it must have all licenses, permits, approvals and other authorizations required to operate the leased properties in accordance with the applicable permitted use. With respect to any assignment or sublease made under this provision, Ventas agrees to execute a nondisturbance and attornment agreement with such proposed assignee or subtenant. Upon any assignment or subletting, we will not be released from our obligations under the applicable Master Lease Agreement.

Subject to certain exclusions, we must pay to Ventas 80% of any consideration received by us on account of an assignment and 80% (50% in the case of existing subleases) of sublease rent payments (approximately equal to revenue net of specified allowed expenses attributable to a sublease, and specifically defined in the Master Lease Agreements), provided that Ventas's right to such payments will be subordinate to that of our lenders.

Ventas will have the right to approve the purchaser at a foreclosure of one or more of our leasehold mortgages by our lenders. Such approval will not be unreasonably withheld so long as such purchaser is creditworthy, reputable and has four years experience in operating healthcare facilities. Any dispute regarding whether Ventas has unreasonably withheld its consent to such purchaser will be subject to expedited arbitration.

GOVERNMENTAL REGULATION

Medicare and Medicaid

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over and certain disabled persons. Medicaid is a medical assistance program administered by each state pursuant to which healthcare benefits are available to certain indigent patients. Within the Medicare and Medicaid statutory framework, there are substantial areas subject to administrative rulings, interpretations and discretion that may affect payments made under Medicare and Medicaid. A substantial portion of our revenues are derived from patients covered by the Medicare and Medicaid programs. See "– Hospital Division – Sources of Hospital Revenues," "– Health Services Division – Sources of Nursing Center Revenues" and "– Rehabilitation Division – Sources of Rehabilitation Division Revenues."

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We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. In addition, we cannot assure you that the facilities operated by us, or the provision of goods and services offered by us, will meet the requirements for participation in such programs. In addition, we cannot assure you that future healthcare legislation or other changes in the administration or interpretation of governmental healthcare programs will not have a material adverse effect on our financial position, results of operations and liquidity. See "Item 1A – Risk Factors – Changes in the reimbursement rates or methods of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins."

Federal, State and Local Regulation

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities, allowable costs, services and prices for services, facility staffing requirements, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients the cost of whose care will be paid by Medicare or other governmental programs. Sanctions for violating these anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations. We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bars on Medicare and Medicaid payments for new admissions and civil monetary penalties. Such sanctions could have a material adverse effect on our financial position, results of operations and liquidity. We vigorously contest such sanctions where appropriate; however, these cases can involve significant legal expense and consume our resources.

Section 1877 of the Social Security Act, commonly known as "Stark I," states that a physician who has a financial relationship with a clinical laboratory generally is prohibited from referring patients to that laboratory. The Omnibus Budget Reconciliation Act of 1993 contains provisions, commonly known as "Stark II," amending Section 1877 to expand greatly the scope of Stark I. Effective January 1995, Stark II broadened the referral limitations of Stark I to include, among other designated health services, inpatient and outpatient hospital services. Under Stark I and Stark II, a "financial relationship" is defined as an ownership interest or a compensation arrangement. If such a financial relationship exists, the entity generally is prohibited from claiming payment for services under the Medicare or Medicaid programs. Compensation arrangements generally are exempted from Stark I and Stark II if, among other things, the compensation to be paid is set in advance, does not exceed fair market value and is not determined in a manner that takes into account the volume or value of any referrals or other business generated between the parties. The U.S. Department of Health and Human Services has issued regulations that describe some of the conduct and business relationships permissible under the anti-kickback amendments. The fact that a given business arrangement does not fall within one of these safe harbors does not render the arrangement per se illegal. Business arrangements of healthcare service providers that fail to satisfy the applicable criteria, however, risk increased scrutiny and possible sanctions by enforcement authorities. These laws and regulations, however, are complex, and there is limited judicial or regulatory interpretation.

We believe that business practices of providers and financial relationships between providers have become subject to increased scrutiny as healthcare reform efforts continue on the federal and state levels. Many states have adopted or are considering similar legislative proposals, some of which extend beyond the Medicaid program, to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of the source of payment for the care. While we do not believe our arrangements are in violation of these prohibitions, we cannot assure you that governmental officials charged with the responsibility for enforcing the provisions of these prohibitions will not assert that one or more of our arrangements are in violation of the provisions of such laws and regulations.

The Balanced Budget Act of 1997 (the "Balanced Budget Act") also includes a number of anti-fraud and abuse provisions. The Balanced Budget Act contains additional civil monetary penalties for violations of the anti-kickback amendments discussed above and imposes an affirmative duty on healthcare providers to ensure that they do not employ or contract with persons excluded from the Medicare program. The Balanced Budget Act also provides a minimum ten-year period for exclusion from participation in federal healthcare programs for persons or entities convicted of a prior healthcare offense.

Various states in which we operate hospitals and nursing centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals, including nurses, certified nurse's assistants and other staff. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

HIPAA. The federal Health Insurance Portability and Accountability Act of 1996, commonly known as "HIPAA," broadens the scope of existing fraud and abuse laws to include all health plans, whether or not they are reimbursed under federal programs. In addition, HIPAA also mandates the adoption of regulations aimed at standardizing transaction formats and billing codes for documenting medical services, dealing with claims submissions and protecting the privacy and security of individually identifiable health information. HIPAA regulations that standardize transactions and code sets require standard formatting for healthcare providers, like us, that submit claims electronically.

The HIPAA privacy regulations apply to "protected health information," which is defined generally as individually identifiable health information transmitted or maintained in any form or medium, excluding certain education records and student medical records. The privacy regulations seek to limit the use and disclosure of most paper and oral communications, as well as those in electronic form, regarding an individual's past, present or future physical or mental health or condition, or relating to the provision of healthcare to the individual or payment for that healthcare, if the individual can or may be identified by such information. HIPAA provides for the imposition of civil and/or criminal penalties if protected health information is improperly disclosed.

HIPAA's security regulations require us to ensure the confidentiality, integrity, and availability of all electronic protected health information that we create, receive, maintain or transmit. We must protect against reasonably anticipated threats or hazards to the security of such information and the unauthorized use or disclosure of such information. The HIPAA unique health identifier standards require us to obtain and use national provider identifiers.

We believe we are in substantial compliance with the HIPAA regulations. Sanctions for failing to comply with HIPAA health information practices provisions include criminal penalties and/or civil sanctions. We cannot assure you that our compliance with the HIPAA regulations will not have a material adverse effect on our financial position, results of operations and liquidity.

Certificates of Need and State Licensing. Certificate of need, or CON, regulations control the development and expansion of healthcare services and facilities in certain states. Certain states also require regulatory approval prior to certain changes in ownership of a hospital or nursing center. Certain states that do not have CON programs may have other laws or regulations that limit or restrict the development or expansion of healthcare facilities. We operate hospitals in 12 states and nursing centers in 18 states that require state approval for the expansion of our facilities and services under CON programs. To the extent that CONs or other similar approvals are required for expansion of the operations of our hospitals or nursing centers, either through facility acquisitions, expansion or provision of new services or other changes, such expansion could be affected adversely by the failure or inability to obtain the necessary approvals, changes in the standards applicable to such approvals or possible delays and expenses associated with obtaining such approvals.

We are required to obtain state licenses to operate each of our hospitals and nursing centers and to ensure their participation in government programs. Once a hospital or nursing center becomes licensed and operational, it must continue to comply with federal, state and local licensing requirements in addition to local building and life-safety codes. All of our hospitals and nursing centers have the necessary licenses.

Hospital Division

General Regulations. The hospital division is subject to various federal and state regulations. In order to receive Medicare reimbursement, each hospital must meet the applicable conditions of participation set forth by the U.S. Department of Health and Human Services relating to the type of hospital, its equipment, personnel and standard of medical care, as well as comply with state and local laws and regulations. We have developed a management system to facilitate our compliance with these various standards and requirements. Among other things, each hospital employs a person who is responsible for an ongoing quality assessment and improvement program. Hospitals undergo periodic on-site Medicare certification surveys, which generally are limited in frequency if the hospital is accredited by the Joint Commission. As of December 31, 2007, 82 hospitals operated by the hospital division were certified as Medicare LTAC providers, one hospital was certified as a Medicare short-term acute care provider and one hospital has a pending Medicare certification. In addition, 72 hospitals also were certified by their respective state Medicaid programs. A loss of certification could affect adversely a hospital's ability to receive payments from the Medicare and Medicaid programs.

As noted above, the hospital division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed above. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Accreditation by the Joint Commission. Hospitals may receive accreditation from the Joint Commission, a national commission that establishes standards relating to the physical plant, administration, quality of patient care and operation of medical staffs of hospitals. Generally, hospitals and certain other healthcare facilities are required to have been in operation at least four months in order to be eligible for accreditation by the Joint Commission. After conducting on-site surveys, the Joint Commission awards accreditation for up to three years to hospitals found to be in substantial compliance with Joint Commission standards. Accredited hospitals also are periodically resurveyed, at the option of the Joint Commission, upon a major change in facilities or organization and after merger or consolidation. As of December 31, 2007, all of the hospitals operated by the hospital division were accredited by the Joint Commission or were in the process of seeking accreditation. The hospital division intends to seek and obtain Joint Commission accreditation for any additional facilities it may operate in the future.

Peer Review. Federal regulations provide that admission to and utilization of hospitals by Medicare and Medicaid patients must be reviewed by peer review organizations or quality improvement organizations in order to ensure efficient utilization of hospitals and services. A quality improvement organization may conduct such review either prospectively or retroactively and may, as appropriate, recommend denial of payments for services provided to a patient. The review is subject to administrative and judicial appeals. Each of the hospitals operated by our hospital division employs a clinical professional to administer the hospital's integrated quality assurance and improvement program. Denials by quality improvement organizations historically have not had a material adverse effect on the hospital division's operating results.

Overview of Hospital Division Reimbursement

Medicare Reimbursement of Short-term Acute Care Hospitals – Medicare reimburses general short-term acute care hospitals under a prospective payment system. Under the short-term acute care prospective payment system, Medicare inpatient costs are reimbursed based upon a fixed payment amount per discharge using medical severity diagnostic related groups ("MS-DRGs"). The MS-DRG payment under the short-term prospective payment system is based upon the national average cost of treating a Medicare patient's condition. Although the average length of stay varies for each MS-DRG, the average stay for all Medicare patients subject to the short-term prospective payment system is approximately six days. An additional outlier payment is made for patients with higher treatment costs but these payments are designed only to cover marginal costs. Hospitals that are certified by Medicare as LTAC hospitals are excluded from the short-term prospective payment system.

Medicare Reimbursement of Long-term Acute Care Hospitals – Since October 2002, the Medicare payment system for LTAC hospitals has been based upon a prospective payment system specifically for LTAC hospitals. Prior to October 2002, LTAC hospitals were reimbursed on a reasonable cost-based payment system.

LTAC PPS is based upon discharged-based MS-LTC-DRGs similar to the system used to pay short-term acute care hospitals. While the clinical system which groups procedures and diagnoses is identical to the prospective payment system for short-term acute care hospitals, LTAC PPS utilizes different rates and formulas. Three types of payments are used in this system: (a) short-stay outlier payment, which provides for patients whose length of stay is less than 5/6th of the geometric mean length of stay for that MS-LTC-DRG, based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) a blend of an amount comparable to what would otherwise be paid under the short-term acute care inpatient payment system ("IPPS") computed as a per diem, capped at the full IPPS MS-DRG comparable payment amount and a per diem based upon the average payment for that MS-LTC-DRG under LTAC PPS; (b) MS-LTC-DRG fixed payment which provides a single payment for all patients with a given MS-LTC-DRG, regardless of length of stay, cost of care or place of discharge; and (c) high cost outlier that will provide a partial coverage of costs for patients whose cost of care far exceeds the MS-LTC-DRG reimbursement. For patients in the high cost outlier category, Medicare will reimburse 80% of the costs incurred above the MS-LTC-DRG reimbursement plus a fixed cost outlier threshold per discharge.

For discharges occurring on or after July 1, 2007 and before December 29, 2007, certain short-stay outlier cases having a length of stay less than or equal to a predetermined IPPS threshold were reimbursed based upon the lesser of (1) a per diem based upon the average payment for that MS-LTC-DRG, (2) the estimated costs, (3) the full MS-LTC-DRG payment, or (4) an amount comparable to what would otherwise be paid under IPPS. These very short-stay payment provisions were suspended for three years beginning with discharges on or after December 29, 2007, pursuant to the SCHIP Extension Act.

LTAC PPS provides for an adjustment for differences in area wages resulting from salary and benefit variations. There also are additional rules for payment for patients who are transferred from a LTAC hospital to another healthcare setting and are subsequently re-admitted to the LTAC hospital. The LTAC PPS payment rates also are subject to annual adjustments.

LTAC PPS maintains LTAC hospitals as a distinct provider type, separate from short-term acute care hospitals. Only providers certified as LTAC hospitals may be paid under this system. To maintain certification under LTAC PPS, the average length of stay of Medicare patients must be at least 25 days. Under the previous system, compliance with the 25-day average length of stay threshold was based upon all patient discharges.

The SCHIP Extension Act became effective for cost reporting periods after December 29, 2007. This legislation provides for, among other things:

(1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria;

(2) enhanced medical necessity review of LTAC hospital cases;

(3) a three-year moratorium on the establishment of a LTAC hospital or satellite facility, subject to exceptions for facilities under development;

(4) a three-year moratorium on an increase in the number of beds at a LTAC hospital or satellite facility, subject to exceptions for states where there is only one other LTAC hospital or upon request following the closure or decrease in the number of beds at a LTAC hospital within the state;

(5) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS;

(6) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 11, 2007;

(7) a three-year moratorium on the application of the so-called "25 Percent Rule" to freestanding LTAC hospitals;

(8) a three-year period during which LTAC hospitals that are co-located within another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS;

(9) a three-year period during which LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS; and

(10) the elimination of the July 1, 2007 market basket increase in the standard federal payment rate of 0.71%, effective for discharges occurring on or after April 1, 2008.

The SCHIP Extension Act also extends the Medicare Part B therapy cap exception process until June 30, 2008. See "– Governmental Regulation – Rehabilitation Division – Overview of Rehabilitation Division Reimbursement."

On May 1, 2007, CMS issued the 2007 Final Rule that became effective for discharges occurring on or after July 1, 2007. The 2007 Final Rule was amended on June 29, 2007 by revising the high cost outlier threshold. The 2007 Final Rule projected an overall decrease in payments to all Medicare certified LTAC hospitals of approximately 1.2%. Included in the 2007 Final Rule were (1) an increase to the standard federal payment rate of 0.71% (eliminated for discharges occurring on or after April 1, 2008 by the SCHIP Extension Act); (2) revisions to payment methodologies impacting short-stay outliers, which reduce payments by 0.9% (currently subject to a three-year moratorium pursuant to the SCHIP Extension Act); (3) adjustments to the wage index component of the federal payment resulting in projected reductions in payments of 0.5%; (4) an increase in the high cost outlier threshold per discharge to $20,738, resulting in projected reductions of 0.4%; and (5) an extension of the policy known as the "25 Percent Rule" to all LTAC hospitals, with a three-year phase-in, which CMS projects will not result in payment reductions for the first year of implementation (also currently subject to a three-year moratorium pursuant to the SCHIP Extension Act).

The 2007 Final Rule reduced our hospital Medicare revenues by approximately $21 million in the second half of 2007, including the effect of a lower than expected market basket increase.

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The 2007 Final Rule expanded the so-called "25 Percent Rule" to all LTAC hospitals, regardless of whether they are co-located within another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon short-term acute care hospital rates. However, as set forth above, the SCHIP Extension Act has placed a three-year moratorium on the expansion of the "25 Percent Rule" to freestanding hospitals.

Under the 2007 Final Rule, the 25% threshold was to be phased in over three years. Hospitals having fiscal years beginning on or after July 1, 2007 and before July 1, 2008, including most of our hospitals, had their admission cap initially established at the lesser of 75% of Medicare referrals or the actual percentage of Medicare referrals received from a primary referral source for that hospital in the base year of 2005. For most of our hospitals, this initial first year cap began on September 1, 2007. Beginning on September 1, 2008, the cap would have been reduced to the lesser of 50% of Medicare referrals or the actual percentage of Medicare referrals for that hospital in the 2005 base year. The fully phased-in cap of 25% would have applied to most of our hospitals after September 1, 2009.

CMS has regulations governing payments to LTAC hospitals that are co-located within another hospital, such as a HIH. The rules generally limit Medicare payments to the HIH if the Medicare 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, urban single and MSA Dominant hospitals. Admissions that exceed this "25 Percent Rule" are paid using IPPS. Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non-host hospital, are eligible for the full payment under LTAC PPS. If the HIH's admissions from the host hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of (1) the amount payable under LTAC PPS or (2) an amount equivalent to what Medicare would otherwise pay under IPPS.

Effective December 29, 2007, the SCHIP Extension Act provides for a three-year period during which (1) LTAC hospitals that are co-located within another hospital may admit up to 50% of their patients from their host hospitals and still be paid according to LTAC PPS, and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single or MSA Dominant hospital and still be paid according to LTAC PPS.

On August 1, 2007, CMS issued final regulations regarding Medicare hospital inpatient payments to short-term acute care hospitals as well as certain provisions affecting LTAC hospitals. These regulations adopt a new system for classifying patients into diagnostic categories called "MS-LTC-DRGs" for LTAC hospitals. This new MS-LTC-DRG system replaces the previous diagnostic related group system for LTAC hospitals and became effective for discharges occurring on or after October 1, 2007. The MS-LTC-DRG system creates additional severity-adjusted categories for most diagnoses, resulting in an expansion of the aggregate number of diagnostic groups from 538 to 745. CMS states that MS-LTC-DRG weights were developed in a budget neutral manner and as such, the estimated aggregate payments under LTAC PPS would be unaffected by the annual recalibration of MS-LTC-DRG payment weights.

On May 2, 2006, CMS issued final regulatory changes regarding Medicare reimbursement to LTAC hospitals (the "2006 Hospital Medicare Rule") that significantly reduced Medicare revenues to our hospitals associated with short-stay outliers and high cost outliers. The 2006 Hospital Medicare Rule also eliminated the annual market basket adjustment. The 2006 Hospital Medicare Rule became effective for discharges occurring after June 30, 2006. The 2006 Hospital Medicare Rule also extended until July 1, 2008 CMS's authority to impose a one-time prospective budget neutrality adjustment to LTAC hospital rates.

On August 1, 2005, CMS published the final rules related to the LTAC DRG weights and the geometric length-of-stay thresholds that took effect for hospital Medicare discharges occurring on or after October 1, 2005. In connection with the final rules, CMS estimated that these changes could result in an aggregate reduction in payments to LTAC hospitals of approximately 4.2%.

Under LTAC PPS, a provider will choose one of two methods of receiving interim cash payments: (1) by billing each patient at the earlier of the time of discharge or 60 days from the time of admission or (2) by electing a periodic interim payment methodology which estimates the total annual LTAC PPS reimbursement by hospital and converts that amount into a bi-weekly cash payment. We have elected the periodic interim payment method. In addition, each hospital must comply with regulations established by CMS regarding the timing and accuracy of claims submissions to maintain its eligibility to receive periodic interim payments.

We cannot predict the ultimate long-term impact of LTAC PPS. This payment system is subject to significant change. Slight variations in patient acuity could significantly change Medicare revenues generated under LTAC PPS. In addition, our hospitals may not be able to appropriately adjust their operating costs as patient acuity levels change or to changes in reimbursement rates. In addition, we cannot assure you that LTAC PPS will not have a material adverse effect on revenues from non-government third party payors. Various factors, including a reduction in average length of stay, have negatively impacted revenues from non-government third party payors.

Medicaid Reimbursement of Long-term Acute Care Hospitals – The Medicaid program is designed to provide medical assistance to individuals unable to afford care. Medicaid payments are made under a number of different systems, which include cost-based reimbursement, prospective payment systems or programs that negotiate payment levels with individual hospitals. Medicaid programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by state agencies and certain government funding limitations, all of which may increase or decrease the level of payments to our hospitals.

Private Payment – The hospital division seeks to maximize the number of private payment patients admitted to its hospitals, including those covered under commercial insurance and managed care health plans. Private payment patients typically have financial resources (including insurance coverages) to pay for their services and do not rely on government programs for support.

Health Services Division

General Regulations. The development and operation of nursing centers and the provision of healthcare services are subject to federal, state and local laws relating to the adequacy of medical care, equipment, personnel, operating policies, fire prevention, rate-setting and compliance with building codes and environmental laws. Nursing centers are subject to periodic inspection by governmental and other authorities to ensure continued compliance with various standards, continued licensing under state law, certification under the Medicare and Medicaid programs and continued participation in the Veterans Administration program. The failure to obtain, maintain or renew any required regulatory approvals or licenses could adversely affect nursing center operations including their financial results.

As noted above, the health services division also is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the anti-kickback amendments discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers and some states prohibit business corporations from providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties. These laws vary considerably from state to state.

In certain circumstances, federal law mandates that conviction for certain abusive or fraudulent behavior with respect to one nursing center may subject other facilities under common control or ownership to disqualification from participation in the Medicare and Medicaid programs. In addition, some regulations provide that all nursing centers under common control or ownership within a state are subject to being delicensed if any one or more of such facilities are delicensed.

Licensure and Requirements for Participation. The nursing centers operated and managed by the health services division are licensed either on an annual or bi-annual basis and generally are certified annually for participation in Medicare and Medicaid programs through various regulatory agencies that determine compliance with federal, state and local laws. These legal requirements relate to compliance with the laws and regulations governing the operation of nursing centers including the quality of nursing care, the qualifications of the administrative and nursing personnel, and the adequacy of the physical plant and equipment. Federal regulations determine the survey process for nursing centers that is followed by state survey agencies. The state survey agencies recommend to CMS the imposition of federal sanctions and impose state sanctions on facilities for noncompliance with certain requirements. Available sanctions include, but are not limited to, imposition of civil monetary penalties, temporary suspension of payment for new admissions, appointment of a temporary manager, suspension of payment for eligible patients and suspension or decertification from participation in the Medicare and Medicaid programs.

We believe that substantially all of our nursing centers are in substantial compliance with applicable Medicare and Medicaid requirements of participation. In the ordinary course of business, however, the nursing centers periodically receive statements of deficiencies from regulatory agencies. In response, the nursing centers implement plans of correction to address the alleged deficiencies. In most instances, the regulatory agency accepts the nursing center's plan of correction and places the nursing center back into compliance with regulatory requirements. In some cases, the regulatory agency may take a number of adverse actions against the nursing center, including the imposition of fines, temporary suspension of admission of new residents to the nursing center, decertification from participation in the Medicaid and/or Medicare programs and, in extreme circumstances, revocation of the nursing center's license.

Overview of Health Services Division Reimbursement

Medicare – The Medicare Part A program provides reimbursement for extended care services furnished to Medicare beneficiaries who are admitted to nursing centers after at least a three-day stay in an acute care hospital. Covered services include supervised nursing care, room and board, social services, physical, speech and occupational therapies, pharmaceuticals, supplies and other necessary services provided by nursing centers. Medicare payments to our nursing centers are based upon certain resource utilization grouping ("RUG") payment rates developed by CMS that provide various levels of reimbursement based upon patient acuity.

The Balanced Budget Act established a Medicare prospective payment system ("PPS") for nursing centers for cost reporting periods beginning on or after July 1, 1998. The payments received under PPS cover substantially all services for Medicare residents including all ancillary services, such as respiratory therapy, physical therapy, occupational therapy, speech therapy and certain covered pharmaceuticals.

Prior to the implementation of PPS, the costs of ancillary services were reimbursed under cost-based reimbursement rules. Various legislative and regulatory actions provided a measure of relief from the impact of the Balanced Budget Act. In April 2000, the Balanced Budget Refinement Act (the "BBRA") implemented a 20% upward adjustment in the payment rates for the care of higher acuity patients. The 20% upward adjustment in the payment rates for the care of higher acuity patients under the BBRA remained in effect until a revised RUGs payment system was established by CMS. Nursing center revenues associated with the 20% upward adjustment approximated $35 million for the year ended December 31, 2005. On July 28, 2005, CMS published the final rules related to the revised RUGs payment system for nursing centers. Among other things, these rules provided for a 3.1% inflation update to all RUGs categories effective October 1, 2005. In addition, effective January 1, 2006, these rules increased the indexing of RUG categories, expanded the total RUG categories from 44 to 53 and eliminated the 20% payment add-on for the care of higher acuity patients that had been in effect since 2000 under the BBRA.

In December 2000, the Medicare, Medicaid, and State Child Health Insurance Program Benefits Improvement and Protection Act of 2000 ("BIPA") was enacted. Among other things, BIPA extended the

two-year moratorium on an outpatient therapy cap for nursing center patients under the BBRA through December 31, 2002. Except for the period from September 2003 through December 2003, the implementation of the therapy cap was delayed through calendar year 2005. On February 1, 2006, Congress passed the budget reconciliation package, or the Deficit Reduction Act of 2005. This legislation allows, among other things, an annual $1,740 Medicare Part B outpatient therapy cap that was effective on January 1, 2006. CMS subsequently increased the therapy cap to $1,780 on January 1, 2007 and to $1,810 on January 1, 2008. The legislation also required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. The exception process, which was set to expire on January 1, 2007, was included in the Tax Relief and Health Care Act of 2006 and continued to function as an exception to the Medicare Part B outpatient therapy cap until January 1, 2008. The SCHIP Extension Act further extended the Medicare Part B outpatient therapy cap until June 30, 2008.

On January 1, 2006, Medicare Part D implemented a major expansion of the Medicare program through the introduction of a prescription drug benefit. Under Medicare Part D, dual eligible patients have their outpatient prescription drug costs covered by this new Medicare benefit, subject to certain limitations. Most of our nursing center patients whose drug costs were previously covered by state Medicaid programs are dual eligible patients who qualify for the Medicare drug benefit. Accordingly, Medicaid is no longer a primary payor for the pharmacy services provided to these residents.

Medicaid – Medicaid is a state-administered program financed by state funds and matching federal funds. The program provides for medical assistance to the indigent and certain other eligible persons. Although administered under broad federal regulations, states are given flexibility to construct programs and payment methods consistent with their individual goals. Accordingly, these programs differ in many respects from state to state.

The health services division provides to eligible individuals Medicaid-covered services consisting of nursing care, room and board and social services. In addition, states may at their option cover other services such as physical, occupational and speech therapies and pharmaceuticals. Medicaid programs also are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by the state agencies and certain government funding limitations, all of which may materially increase or decrease the level of program payments to nursing centers operated by the health services division. We believe that the payments under many of these programs may not be sufficient on an overall basis to cover the costs of serving certain patients participating in these programs. In addition, budgetary pressures impacting state fiscal budgets may further reduce Medicaid payments to our nursing centers from current levels.

There continue to be legislative and regulatory proposals that would impose further limitations on government and private payments to providers of healthcare services. The Balanced Budget Act eased existing impediments on the ability of states to reduce their Medicaid reimbursement levels. Many states are considering or have enacted measures that are designed to reduce their Medicaid expenditures and to make certain changes to private healthcare insurance. As states face budgetary issues, we anticipate further pressure on Medicaid rates that could negatively impact payments to our nursing center operations.

In addition, some states seek to increase the levels of funding contributed by the federal government to their Medicaid programs through a mechanism known as a provider tax. Under these programs, states levy a tax on providers, which increases the amount of state revenue available to expend on the Medicaid program. This increase in program revenues increases the payment made by the federal government to the state in the form of matching funds. Consequently, the state then has more funds available to support Medicaid rates for providers of Medicaid covered services. Provider tax plans are subject to approval by the federal government and were included as a provision in the Tax Relief and Health Care Act of 2006, codifying the maximum Medicaid provider tax rate at 5.5% through fiscal year 2011. Although these plans have been approved in the past, we cannot assure you that such plans will be approved by the federal government in the future.

Private Payment – The health services division seeks to maximize the number of private payment residents admitted to our nursing centers, including those covered under private insurance and managed care health plans. Private payment residents typically have financial resources (including insurance coverages) to pay for their monthly services and do not rely on government programs for support.

Rehabilitation Division

General Regulations. The rehabilitation division is subject to various federal and state regulations. Therapists and other healthcare professionals we employ are required to be individually licensed or certified under applicable state law. We take measures to ensure that our therapists and other healthcare professionals are properly licensed or certified. In addition, we require our therapists and other employees to participate in continuing education programs. The failure to obtain, maintain or renew required licenses or certifications by our therapists or our other healthcare professionals could adversely affect our operations, including our financial results.

As noted above, the rehabilitation division is subject to federal and state laws that govern financial and other arrangements between healthcare providers. These laws prohibit, among other things, certain direct and indirect payments or fee-splitting arrangements between healthcare providers that are designed to induce or encourage the referral of patients to, or the recommendation of, a particular provider for medical products and services. Such laws include the antifraud and anti-kickback laws discussed previously. In addition, some states restrict certain business relationships between physicians and ancillary service providers. Some states also prohibit for-profit corporations from practicing therapy services through therapists directly employed by the corporation or otherwise providing, or holding themselves out as a provider of, medical care. Possible sanctions for violation of any of these restrictions or prohibitions include loss of eligibility to contract with long-term care facilities, hospitals and other providers participating in Medicare, Medicaid and other federal healthcare programs as well as civil and criminal penalties. These laws vary considerably from state to state.

Overview of Rehabilitation Division Reimbursement

The rehabilitation division receives payment for its services provided to patients and residents of the nursing centers, hospitals and assisted living facilities that we serve. The payments are based upon negotiated patient per diem rates or a negotiated fee schedule based upon the type of service rendered.

As noted above, various federal and state laws and regulations govern reimbursement to long-term care facilities, hospitals and other healthcare providers participating in Medicare, Medicaid and other federal healthcare programs. Though these laws and regulations are generally not applicable to our rehabilitation division, they are applicable to our customers. If our customers fail to comply with these laws and regulations they could be subject to possible sanctions, including loss of licensure or eligibility to participate in reimbursement programs as well as civil and criminal penalties, which could adversely affect our operations, including our financial results. In addition, there continue to be legislative and regulatory proposals to contain healthcare costs by imposing further limitations on government and private payments to providers of healthcare services.

On February 1, 2006, Congress passed the Deficit Reduction Act of 2005. This legislation allows, among other things, an annual $1,740 Medicare Part B outpatient therapy cap that was effective on January 1, 2006. CMS subsequently increased the therapy cap to $1,780 on January 1, 2007 and to $1,810 on January 1, 2008. The legislation also required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. The exception process, which was set to expire on January 1, 2007, was included in the Tax Relief and Health Care Act of 2006 and continued to function as an exception to the Medicare Part B outpatient therapy cap until January 1, 2008. The SCHIP Extension Act further extended the Medicare Part B outpatient therapy cap until June 30, 2008.

Reductions in the reimbursement provided to our customers by Medicare or Medicaid could negatively impact the demand and price for our services and could have a material adverse effect on our rehabilitation revenues and growth prospects.

ADDITIONAL INFORMATION

Employees

As of December 31, 2007, we had approximately 38,200 full-time and 14,300 part-time and per diem employees. We had approximately 2,900 unionized employees under 22 collective bargaining agreements as of December 31, 2007.

The healthcare industry currently is facing a shortage of qualified personnel, such as nurses, certified nurse's assistants, nurse's aides, therapists and other important providers of healthcare services. As a result, we are experiencing challenges in recruiting and retaining qualified staff due to this high demand. Our hospitals and nursing centers are particularly dependent on nurses for patient care. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract nursing and therapy personnel. We may continue to experience increases in our labor costs primarily due to higher wages and benefit costs required to attract and retain qualified healthcare personnel. Our ability to control labor costs will significantly affect our future operating results.

Professional and General Liability Insurance

Our healthcare operations are primarily insured for professional and general liability risks by our wholly owned limited purpose insurance subsidiary, Cornerstone Insurance Company ("Cornerstone"). Cornerstone insures initial losses up to specified coverage levels per occurrence and in the aggregate. On a per claim basis, coverages for losses in excess of those insured by Cornerstone are maintained through unaffiliated commercial insurance carriers. Effective January 1, 2003, Cornerstone insures all claims in all states up to a per occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk.

We believe that our insurance is adequate in amount and coverage. There can be no assurance that in the future such insurance will be available at a reasonable price or that we will be able to maintain adequate levels of professional and general liability insurance coverage.

Where You Can Find More Information

We file annual, quarterly and special reports, proxy statements and other information with the SEC under the Exchange Act.

You also may read or obtain copies of this information in person or by mail from the SEC's Public Reference Room, 100 F Street, NE, Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our filings with the SEC also are available to the public on the SEC website at *http://www.sec.gov*, which contains reports, proxy and information statements and other information. You also may inspect reports, proxy statements and other information about us at the office of the NASD, Inc. at 1735 K Street, N.W., Washington, D.C. 20006.

Our filings with the SEC, including our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments thereto, are available free of charge on our website, through a link to the SEC's website, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. In addition, our corporate governance guidelines, code of conduct, and charters for our audit, compliance and quality, executive compensation, and nominating and governance committees of our board of directors are available on our website and upon request of our Corporate Secretary. Our website is *www.kindredhealthcare.com*. Information made available on our website is not a part of this document.

In addition, you may request a copy of our SEC filings (excluding exhibits) at no cost by writing or telephoning us at the following address or telephone number:

Kindred Healthcare, Inc.
680 South Fourth Street
Louisville, KY 40202
Attention: Investor Relations
(502) 596-7300

Item 1A. ***Risk Factors***

Certain statements made in this Annual Report on Form 10-K and the documents we incorporate by reference in this Annual Report on Form 10-K include forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements regarding our 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 you must recognize that actual results may differ materially from our expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based upon management's current expectations and include known and unknown risks, uncertainties and other factors, many of which we are unable to predict or control, that may cause our 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 our filings with the SEC. Factors that may affect our plans or results include, without limitation:

- our ability to operate pursuant to the terms of our debt obligations and the Master Lease Agreements,
- our ability to meet our rental and debt service obligations,
- adverse developments with respect to our results of operations or liquidity,
- our ability to attract and retain key executives and other healthcare personnel,
- increased operating costs due to shortages in qualified nurses, therapists and other healthcare personnel,
- the effects of healthcare reform and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry,
- changes in the reimbursement rates or methods of payment from third party payors, including the Medicare and Medicaid programs, changes arising from and related to LTAC PPS, including potential changes in the Medicare payment rules, Medicare Part D and changes in Medicare and Medicaid reimbursements for our nursing centers,
- the impact of the SCHIP Extension Act, including the ability of our hospitals to adjust to potential LTAC certification and the three-year moratorium on future hospital development,
- national and regional economic conditions, including their effect on the availability and cost of labor, materials and other services,
- our ability to control costs, particularly labor and employee benefit costs,
- our ability to successfully pursue our development activities and successfully integrate new operations, including the realization of anticipated revenues, economies of scale, cost savings and productivity gains associated with such operations,

- the increase in the costs of defending and insuring against alleged professional liability claims and our ability to predict the estimated costs related to such claims,
- our ability to successfully reduce (by divestiture of operations or otherwise) our exposure to professional liability claims,
- our ability to successfully dispose of unprofitable facilities, including the Ventas Facilities, and
- our ability to ensure and maintain an effective system of internal controls over financial reporting.

Many of these factors are beyond our control. We caution you that any forward-looking statements made by us are not guarantees of future performance. We disclaim 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.

Changes in the reimbursement rates or methods of payment from third party payors, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our revenues and operating margins.

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for substantially all of our revenues. For the year ended December 31, 2007, we derived approximately 66% of our total revenues from the Medicare and Medicaid programs and approximately 34% from private third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers. The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Item 1 – Business."

Private third party payors are continuing their efforts to control healthcare costs through direct contracts with healthcare providers, increased utilization review and greater enrollment in managed care programs and preferred provider organizations. These private payors increasingly are demanding discounted fee structures and the assumption by healthcare providers of all or a portion of the financial risk.

We could be affected adversely by the continuing efforts of governmental and private third party payors to contain healthcare costs. We cannot assure you that reimbursement payments under governmental and private third party payor programs, including Medicare supplemental insurance policies, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. Future changes in third party payor reimbursement rates or methods, including the Medicare and Medicaid programs, or the implementation of other measures to reduce reimbursement for our services and products could result in a substantial reduction in our net operating revenues. Our operating margins may continue to be under pressure because of deterioration in pricing flexibility, changes in payor mix and growth in operating expenses in excess of increases in payments by third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients is limited.

Healthcare reform could adversely affect the liquidity of our customers which would have an adverse effect on their ability to make timely payments to us for our products and services.

Healthcare reform and legislation may have an adverse effect on our business through decreasing funds available to our customers. Limitations or restrictions on Medicare and Medicaid payments to our customers could adversely impact the liquidity of our customers, resulting in their inability to pay us, or to timely pay us, for our products and services. This inability could have a material adverse effect on our financial position, results of operations and liquidity.

Further consolidation of managed care organizations and other third party payors may adversely affect our profits.

Managed care organizations and other third party payors have continued to consolidate in order to enhance their ability to influence the delivery of healthcare services. Consequently, the healthcare needs of a large percentage of the U.S. population are increasingly served by a small number of managed care organizations. These organizations generally enter into service agreements with a limited number of providers for needed services. In addition, private payors, including managed care payors, increasingly are demanding discounted fee structures. To the extent that these organizations terminate us as a preferred provider, engage our competitors as a preferred or exclusive provider or demand discounted fee structures, our business could be materially and adversely affected.

Our failure to pay rent or otherwise comply with the provisions of any of our Master Lease Agreements could materially adversely affect our financial position, results of operations and liquidity.

We currently lease 38 of our hospitals and 165 of our nursing centers from Ventas under our Master Lease Agreements. Our failure to pay the rent or otherwise comply with the provisions of any of our Master Lease Agreements would result in an "Event of Default" under such Master Lease Agreement. Upon an Event of Default, remedies available to Ventas include, without limitation, terminating such Master Lease Agreement, repossessing and reletting the leased properties and requiring us to remain liable for all obligations under such Master Lease Agreement, including the difference between the rent under such Master Lease Agreement and the rent payable as a result of reletting the leased properties, or requiring us to pay the net present value of the rent due for the balance of the term of such Master Lease Agreement. The exercise of such remedies would have a material adverse effect on our financial position, results of operations and liquidity. See "Item 1 – Business – Master Lease Agreements."

We have limited operational and strategic flexibility since we lease a substantial number of our facilities.

We lease a substantial number of our facilities from Ventas and other third parties. Under our leases, we generally are required to operate continuously our leased properties as a provider of healthcare services. In addition, these leases generally limit or restrict our ability to assign the lease to another party. Our failure to comply with these lease provisions would result in an event of default under the leases and subject us to material damages, including potential defaults under our revolving credit facility. Given these restrictions, we may be forced to continue operating unprofitable facilities to avoid defaults under our leases. See "Item 1 – Business – Master Lease Agreements."

Significant legal actions could subject us to increased operating costs and substantial uninsured liabilities, which could materially and adversely affect our financial position, results of operations and liquidity.

We incur significant costs for professional liability claims, particularly in our nursing center and hospital operations. In addition to large compensatory claims, plaintiffs' attorneys increasingly are seeking significant punitive damages and attorney's fees. As a result, our professional liability costs are significant and can be unpredictable.

We insure a substantial portion of our professional liability risks primarily through a wholly owned limited purpose insurance subsidiary. The limited purpose insurance subsidiary insures initial losses up to specified coverage levels per occurrence and in the aggregate. On a per claim basis, coverages for losses in excess of those insured by the limited purpose insurance subsidiary are maintained through unaffiliated commercial insurance carriers. Effective January 1, 2003, the limited purpose insurance subsidiary insures all claims in all states up to a per occurrence limit without the benefit of any aggregate coverage limit through unaffiliated commercial insurance carriers, thereby increasing our financial risk. We maintain professional and general liability insurance in amounts and coverage that management believes are sufficient for our operations. However, our insurance

may not cover all claims against us or the full extent of our liability nor continue to be available at a reasonable cost. Moreover, the cost of insurance coverage maintained with unaffiliated commercial insurance carriers has increased significantly and may continue to increase. If we are unable to maintain adequate insurance coverage or are required to pay punitive damages that are uninsured, we may be exposed to substantial liabilities.

In our rehabilitation division contracts, we generally indemnify our customers from claim denials associated with our services. From time to time, we may be subject to indemnification obligations under these contracts.

We also are subject to lawsuits under the federal False Claims Act and comparable state laws for submitting fraudulent bills for services to the Medicare and Medicaid programs. These lawsuits, which may be initiated by whistleblowers, can involve significant monetary damages, fines, attorney fees and the award of bounties to private plaintiffs who successfully bring these suits and to the government programs.

We could experience significant increases to our operating costs due to shortages of qualified nurses, therapists and other healthcare professionals.

The market for qualified nurses, therapists and other healthcare professionals is highly competitive. We, like other healthcare providers, have experienced difficulties in attracting and retaining qualified personnel such as nurses, certified nurse's assistants, nurse's aides, therapists and other important providers of healthcare services. Our hospitals and nursing centers are particularly dependent on nurses for patient care. The difficulty we have experienced in hiring and retaining qualified personnel has increased our average wage rates and may force us to increase our use of contract personnel. We may continue to experience increases in our labor costs primarily due to higher wages and greater benefits required to attract and retain qualified healthcare personnel. Salaries, wages and benefits were approximately 57% of our consolidated revenues for the year ended December 31, 2007. Our ability to control labor costs will significantly affect our future operating results.

Various states in which we operate hospitals and nursing centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. The implementation of these staffing requirements in some states is not contingent upon any additional appropriation of state funds in any budget act or other statute. Our ability to satisfy such staffing requirements will depend upon our ability to attract and retain qualified healthcare professionals. Failure to comply with such minimum staffing requirements may result in the imposition of fines or other sanctions. If states do not appropriate sufficient additional funds (through Medicaid program appropriations or otherwise) to pay for any additional operating costs resulting from such minimum staffing requirements, our profitability may be materially adversely affected.

We may not be able to meet our substantial rent and debt service requirements.

A substantial portion of our cash flows from operations is dedicated to the payment of rents related to our leased properties as well as principal and interest obligations on our outstanding indebtedness, including our revolving credit facility. Subject to certain restrictions, we also have the ability to incur substantial additional borrowings under our revolving credit facility. If we are unable to generate sufficient funds to meet our obligations, we may be required to refinance, restructure or otherwise amend some or all of such obligations, sell assets or raise additional cash through the sale of our equity. We cannot assure you that such restructuring activities, sales of assets or issuances of equity can be accomplished or, if accomplished, would raise sufficient funds to meet these obligations. In addition, our capital structure and our revolving credit facility:

- require us to dedicate a substantial portion of our cash flow to payments on our rent and interest obligations, thereby reducing the availability of cash flow to fund working capital, capital expenditures and other general corporate activities,
- require us to pledge as collateral substantially all of our assets, and
- require us to maintain a financial ratio at a specified level, thereby reducing our financial flexibility.

These provisions:

- could have a material adverse effect on our ability to withstand competitive pressures or adverse economic conditions (including adverse regulatory changes),

- could affect adversely our ability to make material acquisitions, obtain future financing or take advantage of business opportunities that may arise, and
- could increase our vulnerability to a downturn in general economic conditions or in our business.

We conduct business in a heavily regulated industry, and changes in regulations or violations of regulations may result in increased costs or sanctions that reduce our revenues and profitability.

In the ordinary course of our business, we are subject regularly to inquiries, investigations and audits by federal and state agencies that oversee applicable healthcare program participation and payment regulations.

The extensive federal, state and local regulations affecting the healthcare industry include, but are not limited to, regulations relating to licensure, conduct of operations, ownership of facilities, addition of facilities, allowable costs, services and prices for services, facility staffing requirements, and the confidentiality and security of health-related information. In particular, various laws including anti-kickback, anti-fraud and abuse amendments codified under the Social Security Act prohibit certain business practices and relationships that might affect the provision and cost of healthcare services reimbursable under Medicare and Medicaid, including the payment or receipt of remuneration for the referral of patients whose care will be paid by Medicare or other governmental programs. Sanctions for violating the anti-kickback, anti-fraud and abuse amendments under the Social Security Act include criminal penalties, civil sanctions, fines and possible exclusion from government programs such as Medicare and Medicaid. See "Item 1 – Business – Governmental Regulation."

We believe that the regulatory environment surrounding most segments of the healthcare industry remains intense. Federal and state governments continue to impose intensive enforcement policies resulting in a significant number of inspections, citations of regulatory deficiencies and other regulatory sanctions including demands for refund of overpayments, terminations from the Medicare and Medicaid programs, bans on Medicare and Medicaid payments for new admissions and civil monetary penalties. If we fail to comply with the extensive laws and regulations applicable to our businesses, we could become ineligible to receive government program reimbursement, suffer civil or criminal penalties or be required to make significant changes to our operations. In addition, we could be forced to expend considerable resources responding to an investigation or other enforcement action under these laws or regulations. Furthermore, should we lose licenses for a number of our facilities as a result of regulatory action or otherwise, we could be in default under our Master Lease Agreements and our revolving credit facility.

We are unable to predict the future course of federal, state and local regulation or legislation, including Medicare and Medicaid statutes and regulations, or the intensity of federal and state enforcement actions. Changes in the regulatory framework and sanctions from various enforcement actions could have a material adverse effect on our financial position, results of operations and liquidity.

Acquisitions, investments and strategic alliances that we have made or may make in the future may use significant resources, may be unsuccessful and could expose us to unforeseen liabilities.

We intend to selectively pursue strategic acquisitions of, investments in, and strategic alliances with LTAC hospitals, nursing centers, rehabilitation operations and other related healthcare operations. Acquisitions may involve significant cash expenditures, debt incurrence, additional operating losses, amortization of certain intangible assets of acquired companies, dilutive issuances of equity securities and expenses that could have a material adverse effect on our financial position, results of operations and liquidity. Acquisitions, investments and strategic alliances involve numerous risks, including:

- difficulties integrating acquired operations, personnel and information systems, and in realizing projected efficiencies and cost savings,
- diversion of management's time from existing operations,

- potential loss of key employees or customers of acquired companies,
- inaccurate assessment of assets and liabilities and exposure to undisclosed or unforeseen liabilities of acquired companies, including liabilities for failure to comply with healthcare laws,
- difficulty in obtaining financing for acquisitions at a reasonable cost, or that such financing will not contain restrictive covenants that limit our operating flexibility or ability to access additional capital when needed, and
- inability to operate acquired facilities profitably or succeed in achieving improvements in their financial performance.

We continue to seek acquisitions and other strategic opportunities for each of our businesses that may impact our financial position, results of operations and liquidity.

We continue to seek acquisitions and other strategic opportunities for each of our businesses. Accordingly, we are often engaged in evaluating potential transactions and other strategic alternatives. In addition, from time to time, we engage in preliminary discussions that may result in one or more transactions. Although there is uncertainty that any of these discussions will result in definitive agreements or the completion of any transactions, our short-term and long-term financial position, results of operations and liquidity may be impacted if we complete any such transactions. Moreover, although we would enter into transactions to enhance shareholder value, our ability to achieve this objective would be subject to integration risks, the ability to retain and attract key personnel, the ability to realize synergies and other risks.

If we fail to attract patients and residents and compete effectively with other healthcare providers, our revenues and profitability may decline.

The long-term healthcare services industry is highly competitive. Our hospitals face competition from healthcare providers that provide services comparable to those offered by our hospitals. Many competing hospitals are larger and more established than our hospitals. We may experience increased competition from existing hospitals as well as hospitals converted, in whole or in part, to specialized care facilities. Our nursing centers compete on a local and regional basis with other nursing centers and other long-term healthcare providers. Some of our competitors operate newer facilities and may offer services not provided by us or are operated by entities having greater financial and other resources than us. Our rehabilitation division competes with national, regional and local rehabilitation service providers within our markets. Several of these competitors may have greater financial and other resources than us and may be more established in the markets in which we compete. We cannot assure you that increased competition in the future will not adversely affect our financial position, results of operations and liquidity.

The inability or failure of management in the future to conclude that we maintain effective internal controls over financial reporting, or the inability of our independent auditor to issue a report of our internal controls over financial reporting, could have a material adverse effect on our financial position, results of operations and liquidity.

Under the Sarbanes-Oxley Act of 2002, our management is required to report in our Annual Report on Form 10-K on the effectiveness of our internal controls over financial reporting, and our independent auditor is also required to audit the effectiveness of our internal controls over financial reporting. Significant resources are required to establish that we are in full compliance with the financial reporting controls and procedures. If we fail to have, or management or our independent auditor is unable to conclude that we maintain, effective internal controls and procedures for financial reporting, we could be unable to provide timely and reliable financial information which could have a material adverse effect on our financial position, results of operations and liquidity.

Following the Spin-off Transaction, we are more highly leveraged and as a result, our ability to borrow and to invest our cash flows may be limited.

As a result of the Spin-off Transaction, we are a more highly leveraged business and have fewer financial resources as a result of the loss of the earnings associated with the KPS business. Our ability to satisfy our obligations and maintain profitability is solely dependent upon the performance of our three remaining businesses since we are not able to rely upon the financial resources of KPS.

If the Spin-off Transaction does not qualify as a tax-free transaction, tax could be imposed on us and our shareholders.

As a condition to closing the Spin-off Transaction, we received a private letter ruling from the Internal Revenue Service (the "IRS") that the spin-off of KPS and the subsequent merger of KPS and distribution of PharMerica common stock qualifies for tax-free treatment to holders of our common stock (except with respect to cash received in lieu of a fractional share) and, generally, to us.

Though the IRS ruling has been received, the ruling does not address all of the issues that are relevant to determining whether the Spin-off Transaction will qualify for tax-free treatment because the IRS will not rule on certain issues. As a condition to closing, we received an opinion of counsel that the Spin-off Transaction generally qualifies for tax-free treatment to us and our shareholders. The opinion of counsel is intended to address certain of those matters that the ruling does not. The IRS ruling and opinion of counsel do not address, however, state, local or foreign tax consequences of the spin-off, merger and distribution of PharMerica common stock.

The IRS ruling and the opinion of counsel relied on representations, assumptions and undertakings made by us and PharMerica (and its subsidiaries), including representations and undertakings from PharMerica regarding the conduct of its business and other matters after the closing of the Spin-off Transaction. If such representations, assumptions or undertakings are incorrect, neither the IRS ruling nor the opinion of counsel would be valid. In addition, current law generally creates a presumption that the spin-off of KPS in the Spin-off Transaction would be taxable to us, but not to our shareholders, if PharMerica or its shareholders were to engage in certain transactions that result in a change in ownership of its stock during the four-year period beginning two years before the spin-off, unless it is established that the spin-off and such transactions were not part of a plan or series of related transactions to effect a change in ownership of the stock of PharMerica.

Furthermore, notwithstanding the IRS private letter ruling and the opinion of counsel, the IRS could determine that the Spin-off Transaction should be treated as a taxable transaction to us and our shareholders if it determines that any of the representations, assumptions or undertakings that were included in the request for the private letter ruling are false or have been violated or if it disagrees with the conclusions in the opinion of counsel that are not covered by the IRS ruling. If the spin-off of KPS in the Spin-off Transaction fails to qualify for tax-free treatment, the deemed receipt of shares of KPS will be treated as a taxable distribution to our shareholders. In addition, events occurring after the distribution of common stock of PharMerica could cause us to recognize a gain on the spin-off of KPS.

We may be required to satisfy certain indemnification obligations to PharMerica or may not be able to collect on indemnification rights from PharMerica.

Under the terms of the Spin-off Transaction, we indemnified PharMerica, and PharMerica indemnified us, for certain damages, liabilities and expenses resulting from a breach by the other of certain covenants contained in a master transaction agreement and other agreements entered into as part of the Spin-off Transaction.

These indemnification obligations could be significant and we cannot presently determine the amount, if any, of indemnification obligations for which we might be liable or for which we might seek payment. Our ability to satisfy these obligations will depend upon our future financial performance and other factors. Similarly, the ability of PharMerica to satisfy any such obligations to us will depend on its future financial performance and other factors. We cannot assure you that we will have the ability to satisfy any obligations to PharMerica or that PharMerica will have the ability to satisfy any obligations to us.

Item 1B. ***Unresolved Staff Comments***

Not applicable.

Item 2. ***Properties***

For information concerning the hospitals and nursing centers operated by us, see "Item 1 – Business – Hospital Division – Hospital Facilities," "Item 1 – Business – Health Services Division – Nursing Center Facilities," and "Item 1 – Business – Master Lease Agreements." We believe that our facilities are adequate for our future needs in such locations.

Our corporate headquarters is located in a 287,000 square foot building in Louisville, Kentucky.

We are subject to various federal, state and local laws and regulations governing the use, discharge and disposal of hazardous materials, including medical waste products. Compliance with these laws and regulations is not expected to have a material adverse effect on us. It is possible, however, that environmental issues may arise in the future which we cannot now predict.

Item 3. ***Legal Proceedings***

We are a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions arising in the ordinary course of our business. We cannot predict the ultimate outcome of pending litigation and regulatory and other government investigations. The U.S. Department of Justice, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to our businesses in the future which may, either individually or in the aggregate, have a material adverse effect on our financial position, operating results and liquidity.

Item 4. ***Submission of Matters to a Vote of Security Holders***

Not applicable.

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EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names, ages (as of January 1, 2008) and present and past positions of our current executive officers:

Name	Age	Position
Edward L. Kuntz	62	Executive Chairman of the Board
Paul J. Diaz	46	President and Chief Executive Officer
Richard A. Lechleiter	49	Executive Vice President and Chief Financial Officer
Frank J. Battafarano	57	Executive Vice President and President, Hospital Division
Lane M. Bowen	57	Executive Vice President and President, Health Services Division
Richard E. Chapman	59	Executive Vice President and Chief Administrative and Information Officer
William M. Altman	48	Senior Vice President, Strategy and Public Policy
Benjamin A. Breier	37	President, People*first* Rehabilitation Division
Joseph L. Landenwich	43	Senior Vice President of Corporate Legal Affairs and Corporate Secretary
Gregory C. Miller	38	Senior Vice President, Corporate Development and Financial Planning
M. Suzanne Riedman	56	Senior Vice President and General Counsel

Edward L. Kuntz has served as our Executive Chairman of the Board since January 1, 2004. Mr. Kuntz served as our Chairman of the Board and Chief Executive Officer from January 1999 to December 31, 2003. He also served as our President from November 1998 to January 2002. He served as our Chief Operating Officer and a director from November 1998 to January 1999.

Paul J. Diaz has served as one of our directors since May 2002, as our Chief Executive Officer since January 1, 2004 and as our President since January 2002. Mr. Diaz served as our Chief Operating Officer from January 2002 to December 31, 2003.

Richard A. Lechleiter, a certified public accountant, has served as our Executive Vice President and Chief Financial Officer since February 2005. He served as Senior Vice President and Chief Financial Officer from February 2002 to February 2005. He served as Treasurer from July 1998 to December 2003 and also served as Vice President, Finance and Corporate Controller from April 1998 to February 2002. Mr. Lechleiter served as Vice President, Finance and Corporate Controller of our predecessor from November 1995 to April 1998. From June 1995 to November 1995, he was Director of Finance for our predecessor.

Frank J. Battafarano has served as our Executive Vice President since February 2005 and as President, Hospital Division since November 1998. He served as our Vice President of Operations from April 1998 to November 1998. He held the same position with our predecessor from February 1998 to April 1998. From May 1996 to January 1998, Mr. Battafarano served as Senior Vice President of the central regional office of our predecessor. From January 1992 to April 1996, he served as an executive director and hospital administrator for our predecessor.

Lane M. Bowen has served as our Executive Vice President since February 2005 and as President, Health Services Division since October 2002. He served as the Senior Vice President, Pacific Region of the Health Services Division from September 2001 to October 2002. From January 2001 to September 2001, Mr. Bowen served as Senior Vice President, South Region of the Health Services Division.

Richard E. Chapman has served as our Executive Vice President and Chief Administrative and Information Officer since February 2005. He served as Chief Administrative and Information Officer and Senior Vice President from January 2001 to February 2005. From April 1998 to January 2001, he served as our Senior Vice President and Chief Information Officer. Mr. Chapman served as Senior Vice President and Chief Information Officer of our predecessor from October 1997 to April 1998.

William M. Altman, an attorney, has served as our Senior Vice President, Strategy and Public Policy since January 1, 2008. He served as Senior Vice President, Compliance and Government Programs from April 2002 to December 2007 and previously served as Vice President of Compliance and Government Programs from October 1999 to April 2002. He served as Operations Counsel in our law department from April 1998 to September 1999. He held the same position with our predecessor from June 1996 through April 1998.

Benjamin A. Breier has served as our President, People*first* Rehabilitation division since August 2005. Prior to joining us, Mr. Breier served as Senior Vice President, Operations for Concentra, Inc., a leading provider of workers' compensation and occupational health services, from December 2003 to August 2005, and as Vice President, Western Operations, from June 2001 to November 2003.

Joseph L. Landenwich, an attorney and certified public accountant, has served as our Senior Vice President of Corporate Legal Affairs and Corporate Secretary since December 2003. Mr. Landenwich served as Vice President of Corporate Legal Affairs and Corporate Secretary from November 1999 to December 2003. He served as Corporate Counsel from April 1998 to November 1999 and as Assistant Secretary from February 1999 to November 1999. Mr. Landenwich also was Corporate Counsel with our predecessor from September 1996 to April 1998.

Gregory C. Miller has served as our Senior Vice President, Corporate Development and Financial Planning since January 2005. He served as our Vice President, Corporate Development and Financial Planning from January 2004 to January 2005. Prior to joining us, Mr. Miller served in various positions, most recently as Senior Vice President, for Houlihan Lokey Howard & Zukin, an investment bank, from March 1998 to January 2004.

M. Suzanne Riedman, an attorney, has served as our Senior Vice President and General Counsel since August 1999. She served as our Vice President and Associate General Counsel from April 1998 to August 1999. Ms. Riedman held the same positions with our predecessor from January 1997 to April 1998. She joined our predecessor as counsel in September 1995 and became Associate General Counsel in January 1996.

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PART II

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

MARKET PRICE FOR COMMON STOCK AND DIVIDEND HISTORY

Our common stock is quoted on the New York Stock Exchange (the "NYSE") under the ticker symbol "KND." The prices in the table below, for the calendar quarters indicated, represent the high and low sale prices for our common stock as reported on the NYSE.

	Sales price of common stock			
2007		**High**		**Low**
First quarter	$	34.44	$	24.46
Second quarter	$	36.67	$	30.56
Third quarter	$	31.80	$	17.35
Fourth quarter	$	26.02	$	17.35
2006		**High**		**Low**
First quarter	$	29.50	$	19.70
Second quarter	$	27.40	$	22.76
Third quarter	$	32.07	$	24.91
Fourth quarter	$	29.99	$	24.95

On July 31, 2007, we completed the Spin-off Transaction. Immediately after the Spin-off Transaction, our stockholders and the stockholders of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

Our revolving credit facility contains covenants that limit, among other things, our ability to pay dividends. Any determination to pay dividends in the future will be dependent upon our results of operations, financial position, contractual restrictions, restrictions imposed by applicable laws and other factors deemed relevant by our Board of Directors. We have not paid any cash dividends on our common stock.

As of January 31, 2008, there were 492 holders of record of our common stock.

See "Part III – Item 12 – Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters," for disclosures regarding our equity compensation plans.

As required by Section 303A.12 of the NYSE listing standards, on June 8, 2007, Paul J. Diaz, our President and Chief Executive Officer, certified that he was not aware of any violation by us of NYSE corporate governance listing standards. The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are included as exhibits to this Annual Report on Form 10-K.

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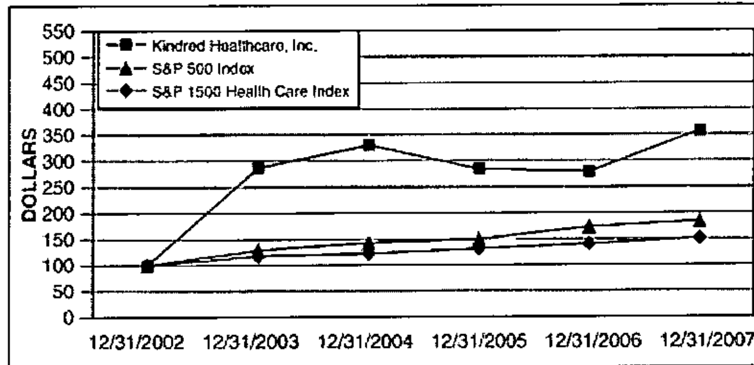
PERFORMANCE GRAPH

The following graph summarizes the cumulative total return to shareholders of the Company's common stock from December 31, 2002 to December 31, 2007, compared to the cumulative total return on the Standard & Poor's 500 Stock Index (the "S&P 500 Index") and the Standard & Poor's 1500 Health Care Index (the "S&P 1500 Health Care Index"). The graph assumes an investment of $100 in each of the Company's common stock, the S&P 500 Index, and the S&P 1500 Health Care Index on December 31, 2002, and also assumes the reinvestment of all cash dividends. In accordance with SEC rules, the July 31, 2007 distribution of the KPS shares to our shareholders in connection with the Spin-off Transaction is treated for purposes of the graph as a special stock dividend in calculating shareholder return and prior period prices have been adjusted accordingly.



	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
Kindred Healthcare, Inc.	$ 100.00	$ 286.38	$ 330.01	$ 283.84	$ 278.22	$ 357.00
S&P 500 Index	100.00	128.68	142.69	149.70	173.34	182.87
S&P 1500 Health Care Index	100.00	117.63	121.56	130.67	139.77	150.98

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Item 6. *Selected Financial Data*

KINDRED HEALTHCARE, INC.
SELECTED FINANCIAL DATA
(In thousands, except per share amounts)

	Year ended December 31,				
	2007	2006	2005	2004	2003
Statement of Operations Data:					
Revenues	$ 4,220,266	$ 4,130,052	$ 3,718,499	$ 3,288,078	$ 2,973,204
Salaries, wages and benefits	2,386,702	2,243,106	1,987,239	1,818,042	1,676,363
Supplies	550,987	676,326	560,981	462,128	406,812
Rent	347,560	297,663	250,479	235,486	226,780
Other operating expenses	754,041	669,482	598,693	535,440	499,147
Other income	(7,701)	–	–	–	–
Depreciation and amortization	121,767	117,422	97,304	84,311	73,927
Interest expense	17,044	13,920	8,096	12,814	10,312
Investment income	(16,155)	(14,495)	(11,034)	(6,422)	(6,116)
	4,154,245	4,003,424	3,491,758	3,141,799	2,887,225
Income from continuing operations before reorganization items and income taxes	66,021	126,628	226,741	146,279	85,979
Reorganization items	–	–	(1,639)	(304)	(1,010)
Income from continuing operations before income taxes	66,021	126,628	228,380	146,583	86,989
Provision for income taxes	31,301	49,965	91,384	59,924	36,379
Income from continuing operations	34,720	76,663	136,996	86,659	50,610
Discontinued operations, net of income taxes:					
Income (loss) from operations	(4,569)	2,080	9,294	(257)	(46,533)
Loss on divestiture of operations	(77,021)	(32)	(1,381)	(15,822)	(79,413)
Net income (loss)	$ (46,870)	$ 78,711	$ 144,909	$ 70,580	$ (75,336)
Earnings (loss) per common share:					
Basic:					
Income from continuing operations	$ 0.90	$ 1.96	$ 3.67	$ 2.42	$ 1.45
Discontinued operations:					
Income (loss) from operations	(0.12)	0.05	0.25	(0.01)	(1.33)
Loss on divestiture of operations	(1.99)	–	(0.04)	(0.44)	(2.28)
Net income (loss)	$ (1.21)	$ 2.01	$ 3.88	$ 1.97	$ (2.16)
Diluted:					
Income from continuing operations	$ 0.87	$ 1.87	$ 3.03	$ 2.04	$ 1.45
Discontinued operations:					
Income (loss) from operations	(0.11)	0.05	0.20	–	(1.33)
Loss on divestiture of operations	(1.93)	–	(0.03)	(0.37)	(2.27)
Net income (loss)	$ (1.17)	$ 1.92	$ 3.20	$ 1.67	$ (2.15)
Shares used in computing earnings (loss) per common share:					
Basic	38,791	39,108	37,328	35,774	34,880
Diluted	39,983	40,923	45,239	42,403	35,047
Financial Position:					
Working capital	$ 383,705	$ 386,450	$ 312,281	$ 273,905	$ 237,807
Assets	2,079,552	2,016,127	1,760,561	1,593,293	1,585,414
Long-term debt	275,814	130,090	26,323	32,544	139,397
Stockholders' equity	862,124	995,578	870,536	719,785	597,565

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operation***

You should read the following discussion together with the selected financial data in Item 6 and our consolidated financial statements and the notes thereto included in this Annual Report on Form 10-K. All financial and operating data presented in Items 6 and 7 reflects the continuing operations of our business for all periods presented unless otherwise indicated.

Overview

We are a healthcare services company that through our subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States. At December 31, 2007, our hospital division operated 84 LTAC hospitals with 6,567 licensed beds in 24 states. Our health services division operated 228 nursing centers with 29,106 licensed beds in 27 states. We also operated a contract rehabilitation services business which provides rehabilitative services primarily in long-term care settings.

On July 31, 2007, we completed the Spin-off Transaction. See "Item 1 – Business – General – Spin-off Transaction" and note 2 of the notes to consolidated financial statements.

In recent years, we have completed several strategic divestitures to improve our future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2007 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See notes 3 and 4 of the notes to consolidated financial statements.

The operating results of acquired businesses are included in the accompanying consolidated statement of operations since the respective acquisition dates.

Critical Accounting Policies

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates and judgments that affect the reported amounts and related disclosures of commitments and contingencies. We rely on historical experience and on various other assumptions that we believe to be reasonable under the circumstances to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

We believe the following critical accounting policies, among others, affect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

We have agreements with third party payors that provide for payments to each of our operating divisions. These payment arrangements may be based upon prospective rates, reimbursable costs, established charges, discounted charges or per diem payments. Net patient service revenue is recorded at the estimated net realizable amounts from Medicare, Medicaid, other third party payors and individual patients for services rendered. Retroactive adjustments that are likely to result from future examinations by third party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods based upon new information or final settlements.

Favorable settlements of prior year hospital Medicare cost reports aggregated $3 million in 2007, $8 million in 2006 and $63 million in 2005. In addition, we recorded approximately $13 million of income in 2005 related to prior year retroactive nursing center Medicaid rate increases in Indiana.

In the fourth quarter of 2007, we recorded a pretax credit of approximately $3 million to reflect a change in estimate for hospital Medicare in-house accounts receivable and a pretax credit of approximately $4 million to adjust certain nursing center Medicaid revenues.

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

	Year ended December 31,		
	2007	2006	2005
Medicare	$ 1,892,580	$ 1,923,372	$ 1,619,968
Medicaid	1,100,443	1,061,711	1,132,148
Private and other	1,552,543	1,497,621	1,271,010
	4,545,566	4,482,704	4,023,126
Eliminations:			
Rehabilitation	(239,740)	(215,537)	(185,516)
Pharmacy	(85,560)	(137,115)	(119,111)
	(325,300)	(352,652)	(304,627)
	$ 4,220,266	$ 4,130,052	$ 3,718,499

Collectibility of accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, we consider a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of the change.

The provision for doubtful accounts totaled $27 million for 2007, $31 million for 2006 and $12 million for 2005. In the fourth quarter of 2007, we recorded a $7 million charge related to accounts receivable for certain hospitals acquired in 2006. In the fourth quarter of 2005, we recorded a $3 million favorable change in estimate related to the provision for doubtful accounts in our former pharmacy division.

Allowances for insurance risks

We insure a substantial portion of our professional liability risks and workers compensation risks through a wholly owned limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including third party actuarially determined estimates.

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 liabilities 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 subsequent expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited.

Provisions for loss for professional liability risks retained by our limited purpose insurance subsidiary have been discounted based upon third party actuarial estimates of claim payment patterns using a discount rate of 5% in each of the last three years. Amounts equal to the discounted loss provision are funded annually. We do 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. The allowance for professional liability risks aggregated $251 million at December 31, 2007 and $250 million at December 31, 2006. If we did not discount any of the allowances for professional liability risks, these balances would have approximated $264 million at December 31, 2007 and $263 million at December 31, 2006.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $37 million in 2007, $34 million in 2006 and $30 million in 2005 from our limited purpose insurance subsidiary.

Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between our estimated and ultimate actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. For example, a 1% variance in the allowance for professional liability risks at December 31, 2007 would impact our operating income by approximately $3 million.

The provision for professional liability risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $37 million for 2007, $53 million for 2006 and $64 million for 2005. Changes in estimates for prior year professional liability costs reduced professional liability costs by approximately $35 million, $24 million and $10 million in 2007, 2006 and 2005, respectively. While we expect that professional liability costs for 2008 may be higher than the costs recorded over the last three years, we believe that our professional liability costs appear to be moderating.

With respect to our discontinued operations, we recorded a pretax charge aggregating $2 million for 2007 and favorable pretax adjustments of $19 million and $42 million for 2006 and 2005, respectively, resulting from a change in estimate for professional liability reserves related to prior years.

Provisions for loss for workers compensation risks retained by our limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually. The allowance for workers compensation risks aggregated $89 million at December 31, 2007 and $85 million at December 31, 2006. The provision for workers compensation risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $39 million for 2007, $36 million for 2006 and $45 million for 2005.

See notes 4 and 10 of the notes to consolidated financial statements.

Accounting for income taxes

The provision for income taxes is based upon our estimate of annual taxable income or loss for each respective accounting period. We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. We also recognize as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these

deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

In November 2004, the IRS proposed certain adjustments to our 2000 and 2001 federal income tax returns which we contested. The principal proposed adjustment related to the manner of reduction of our tax attributes, primarily our net operating loss carryforwards, in connection with the emergence of our subsidiaries and us from proceedings under the bankruptcy code. In 2006, we reached a settlement with the IRS related to all disputed federal income tax issues for fiscal 2000 and 2001. In connection with the settlement, we paid approximately $3 million of employer payroll taxes to the IRS in 2007. At December 31, 2006, we reflected the impact of the settlement in our consolidated balance sheet by increasing certain net deferred tax assets by approximately $16 million, reducing currently payable income taxes by approximately $70 million and increasing stockholders' equity by approximately $86 million. Because of fresh-start accounting rules related to our reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

Our effective income tax rate was 47.4% in 2007, 39.5% in 2006 and 40.0% in 2005. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction. We recorded favorable income tax adjustments in 2007 and 2006 related to the resolution of certain income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million and $3 million, respectively.

In July 2006, the Financial Accounting Standards Board (the "FASB") issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." We adopted the provisions of FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material impact on our financial position, results of operations or liquidity.

There are significant uncertainties with respect to capital loss and net operating loss carryforwards that could affect materially the realization of certain deferred tax assets. Accordingly, we have recognized deferred tax assets to the extent it is more likely than not they will be realized and a valuation allowance is provided for deferred tax assets to the extent that it is uncertain that the deferred tax asset will be realized. We recognized net deferred tax assets totaling $174 million at December 31, 2007 and $159 million at December 31, 2006.

After our emergence from bankruptcy, the realization of pre-reorganization deferred tax assets and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of approximately $3 million in 2007, $80 million in 2006 and $18 million in 2005 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability.

We are 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. While we believe our tax positions are appropriate, we cannot assure you that the various authorities engaged in the examination of our income tax returns will not challenge our positions.

See note 9 of the notes to consolidated financial statements.

Valuation of long-lived assets and goodwill

We regularly review the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

In assessing the carrying values of long-lived assets, we estimate 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 facility 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 our ability to renew the lease or divest a particular property), we define the group of facilities under 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 are aggregated for purposes of evaluating the carrying values of long-lived assets.

In accordance with SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," we are required to perform an impairment test for goodwill and indefinite lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. We perform our annual impairment test at the end of each year. No impairment charge was recorded in each of the last three years in connection with our annual impairment test.

Our other intangible assets with finite lives are amortized under SFAS 142 using the straight-line method over their estimated useful lives ranging from one to five years.

Recently Issued Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS 141R"), "Business Combinations," which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at acquisition date and expensing acquisition and restructuring costs. SFAS 141R is effective for business combinations which occur during fiscal years beginning after December 15, 2008. At this time, we cannot determine the impact that SFAS 141R will have on our financial position, results of operations or liquidity; however, our accounting for all business combinations after January 1, 2009 will comply with SFAS 141R.

In December 2007, the FASB issued SFAS No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements," which will change the accounting and reporting for minority interests. SFAS 160 will recharacterize minority interests as noncontrolling interests and will be classified as a component of stockholders' equity. The new consolidation method will significantly change the accounting for transactions with minority-interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on our financial position, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 157 ("SFAS 157"), "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 generally accepted accounting principles. SFAS 157 was effective for fiscal years beginning after November 15, 2007. In November 2007, the FASB deferred the effective date of SFAS 157 to be for fiscal years beginning after November 15, 2008 for nonfinancial assets and liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The adoption of SFAS 157 is not expected to have a material impact on our financial position, results of operations or liquidity.

In July 2006, the FASB issued FIN 48 which clarifies the accounting for uncertain income tax issues recognized in an entity's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 became effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on our financial position, results of operations or liquidity.

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Impact of Medicare and Medicaid Reimbursement

We depend on reimbursement from third party payors, including the Medicare and Medicaid programs, for substantially all of our revenues. For the year ended December 31, 2007, we derived approximately 66% of our total revenues from the Medicare and Medicaid programs and approximately 34% from private third party payors, such as commercial insurance companies, health maintenance organizations, preferred provider organizations and contracted providers.

The Medicare and Medicaid programs are highly regulated and subject to frequent and substantial changes. See "Part I – Item 1 – Business – Governmental Regulation" for an overview of the reimbursement systems impacting our businesses and "Part I – Item 1A – Risk Factors."

Results of Operations – Continuing Operations

For the years ended December 31, 2007, 2006 and 2005

A summary of our operating data follows (dollars in thousands, except statistics):

	Year ended December 31,		
	2007	2006	2005
Revenues:			
Hospital division	$ 1,772,272	$ 1,710,670	$ 1,592,998
Health services division	2,014,786	1,819,320	1,645,130
Rehabilitation division	352,397	300,106	262,773
Pharmacy division	406,111	652,608	522,225
	4,545,566	4,482,704	4,023,126
Eliminations:			
Rehabilitation	(239,740)	(215,537)	(185,516)
Pharmacy	(85,560)	(137,115)	(119,111)
	(325,300)	(352,652)	(304,627)
	$ 4,220,266	$ 4,130,052	$ 3,718,499
Operating income (loss):			
Hospital division	$ 362,199	$ 384,745	$ 416,423
Health services division	296,749	241,852	210,943
Rehabilitation division	34,526	30,362	32,052
Pharmacy division	17,557	48,461	56,837
Corporate:			
Overhead	(167,717)	(157,157)	(134,514)
Insurance subsidiary	(7,077)	(7,125)	(10,155)
	(174,794)	(164,282)	(144,669)
Reorganization items	–	–	1,639
	$ 536,237	$ 541,138	$ 573,225

Operating data (Continued):

	Year ended December 31,		
	2007	2006	2005
Hospital data:			
End of period data:			
Number of hospitals	84	80	73
Number of licensed beds	6,567	6,199	5,474
Revenue mix %:			
Medicare	58	61	67
Medicaid	10	10	6
Medicare Advantage (a)	4		
Commercial insurance and other	28	29	27
Admissions:			
Medicare	29,262	29,322	28,588
Medicaid	4,275	3,985	3,222
Medicare Advantage	1,687		
Commercial insurance and other	7,652	7,701	6,051
	42,876	41,008	37,861
Admissions mix %:			
Medicare	68	71	75
Medicaid	10	10	9
Medicare Advantage	4		
Commercial insurance and other	18	19	16
Patient days:			
Medicare	823,827	830,254	807,355
Medicaid	213,175	193,071	115,174
Medicare Advantage	55,208		
Commercial insurance and other	289,991	283,186	226,289
	1,382,201	1,306,511	1,148,818
Average length of stay:			
Medicare	28.2	28.3	28.2
Medicaid	49.9	48.4	35.7
Medicare Advantage	32.7		
Commercial insurance and other	37.9	36.8	37.4
Weighted average	32.2	31.9	30.3
Revenues per admission:			
Medicare	$ 35,058	$ 35,524	$ 37,237
Medicaid	43,109	42,456	30,619
Medicare Advantage	43,107		
Commercial insurance and other	63,956	64,908	71,033
Weighted average	41,335	41,715	42,075
Revenues per patient day:			
Medicare	$ 1,245	$ 1,255	$ 1,319
Medicaid	865	876	857
Medicare Advantage	1,317		
Commercial insurance and other	1,688	1,765	1,899
Weighted average	1,282	1,309	1,387
Medicare case mix index (discharged patients only)	1.10	1.10	1.19
Average daily census	3,787	3,579	3,147
Occupancy %	64.9	64.5	60.4

(a) Data not available prior to April 1, 2007.

Operating data (Continued):

	Year ended December 31,		
	2007	2006	2005
Nursing center data:			
End of period data:			
Number of nursing centers:			
Owned or leased	224	215	204
Managed	4	5	5
	228	220	209
Number of licensed beds:			
Owned or leased	28,621	27,568	25,804
Managed	485	605	605
	29,106	28,173	26,409
Revenue mix %:			
Medicare	34	34	34
Medicaid	44	46	48
Private and other	22	20	18
Patient days (a):			
Medicare	1,552,930	1,495,554	1,401,646
Medicaid	5,693,398	5,638,641	5,391,434
Private and other	1,848,771	1,626,916	1,410,009
	9,095,099	8,761,111	8,203,089
Patient day mix %:			
Medicare	17	17	17
Medicaid	63	64	66
Private and other	20	19	17
Revenues per patient day:			
Medicare Part A	$ 411	$ 384	$ 354
Total Medicare (including Part B)	447	420	396
Medicaid	155	148	147
Private and other	236	219	210
Weighted average	222	208	201
Average daily census	24,918	24,003	22,474
Occupancy %	87.8	88.3	87.1
Rehabilitation data:			
Revenue mix %:			
Company-operated	68	75	76
Non-affiliated	32	25	24

(a) Excludes managed facilities.

The Year in Review

Fiscal 2007 was a year in which we positioned the Company for future growth while creating value for our patients and their families, our employees and our shareholders. Our most significant accomplishments in 2007 included the following:

- we successfully operated each of our three businesses with a continued emphasis on our employees, patients, residents and their families;
- we completed agreements with Ventas to acquire for resale 22 under-performing assets and to eliminate out-of-market lease provisions related to insurance requirements and facility bed management restrictions;
- we completed the Spin-off Transaction, creating value for our shareholders on a tax-free basis and allowing us to better focus on growth in our retained businesses;
- we acquired $50 million of our common stock in open market purchases;
- we amended our revolving credit facility to provide more financial flexibility and better pricing; and
- we continued our development activities by adding four hospitals, nine nursing centers and a rehabilitation services company to our portfolio.

Our hospital division continued to operate under a difficult reimbursement environment in which we were challenged by significant Medicare cuts. In response to these reimbursement reductions, our strategy has focused upon volume growth through managed care (including Medicare Advantage) and commercial insurance sources to better leverage our unused capacity. Despite overall same-store volume growth of 2% in 2007, hospital operating income declined 6% primarily due to reimbursement rate pressures and growth in wage rates.

In our health services division, fiscal 2007 was a year in which our continued investments in quality and customer service began to produce improvements in our operating results. These investments over the past several years have included, among other things, improved staffing and clinical resource development, reduced contract labor utilization, investments in physical plant and equipment and expansion of services to effectively care for higher acuity Medicare and managed care patients. We also have continued to execute on our risk management initiatives, which have provided a more stable environment to improve our clinical processes and resolve quality issues as they arise. In addition, these quality investments have enhanced our capabilities to better serve higher acuity patients and residents, many of whom required extensive rehabilitation therapy services. Our 2007 operating results in this division were encouraging, with solid growth in revenues, Medicare and managed care mix and operating income compared to 2006. We believe that there are additional opportunities to improve our nursing center results in the future by continuing to execute our strategy of providing cost-effective care to higher acuity patients and residents.

In People*first* Rehabilitation, we made significant progress in 2007 to grow beyond the Kindred nursing center and hospital portfolio that currently comprises more than half of its revenues. People*first* has developed an effective therapist recruitment and retention program and its name recognition and reputation for clinical excellence is expanding in the marketplace. As the labor market for therapists becomes more competitive, People*first* is well positioned to grow through a program of external contract development and higher levels of productivity. Over the longer term, we believe that People*first* has opportunities to succeed and grow in a regulatory environment that is generally favorable to providing more rehabilitation therapy services in lower cost settings, particularly nursing centers.

In June 2007, we entered into an agreement with Ventas under which we purchased for resale 22 under-performing facilities for $175 million. In addition, the out-of-market lease provisions related to insurance requirements and facility bed management issues were modified to provide more operating flexibility.

In July 2007, we completed the Spin-off Transaction. At the time of the closing, our shareholders received approximately 50% of the common stock of PharMerica on a tax-free basis. We believe that the business prospects underlying the combination of the institutional pharmacy operations of KPS and AmerisourceBergen, including the operational synergies and economies of scale that can be realized over the long term, will provide additional value to our shareholders. Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us.

In connection with the Spin-off Transaction, we realigned our corporate and divisional overhead structure to more efficiently support our three remaining businesses. We also are leveraging our information technology infrastructure by providing information systems support to PharMerica for a five-year period.

In connection with the Spin-off Transaction, we successfully amended our revolving credit facility. Among other things, the amendment (1) increased the amount of the credit to $500 million, (2) provided for further increases in the amount of the credit under certain conditions, (3) allowed for higher levels of capital investments and restricted payments such as share repurchases and dividends and (4) reduced borrowing costs by approximately 75 basis points.

During 2007, we added four hospitals (286 licensed beds), nine nursing centers (1,152 licensed beds) and a rehabilitation services company with 22 nursing center customers. We also opened a new replacement hospital in Indianapolis, Indiana that increased our capacity in that market. In addition, we acquired eight nursing centers and one hospital that were previously leased for approximately $113 million.

Our acquisition and development activities have strengthened our existing market positions and expanded our services into new markets. Our ongoing development activities will focus on the completion of seven new hospital projects already underway, as well as selective opportunities to broaden our nursing center and People*first* Rehabilitation businesses.

As we continue to position the Company for the future, we see more opportunities to improve the working environment for our employees and the care of our patients and residents. We believe that the link between taking care of our employees, quality and profitability has never been clearer.

Hospital Division

Revenues increased 4% in 2007 to $1.8 billion and 7% in 2006 to $1.7 billion. During each of the past two years, revenues have grown through increases in same-store volumes, expansion of services, ongoing development of new hospitals and acquisitions. Despite growth in patient volumes and services, revenues have been negatively impacted by significant reductions in Medicare reimbursement and pricing pressures from commercial insurance and managed care payors. See "Part I – Item 1 – Business – Governmental Regulation" for a discussion of the reductions in hospital Medicare reimbursement.

On a same-store basis, aggregate admissions rose 1% in both 2007 and 2006, while non-government same-store admissions increased 17% in both 2007 and 2006.

Hospital operating margins have declined in each of the past two years primarily because growth in wage and benefit costs have exceeded overall revenue growth. Hospital wage and benefit costs increased 6% to $800 million in 2007 and increased 11% to $755 million in 2006 compared to $679 million in 2005. Average hourly wage rates grew 3% in 2007 and 2% in 2006, while employee benefit costs increased 7% in 2007 and 9% in 2006.

Professional liability costs were $12 million in 2007, $19 million in 2006 and $20 million in 2005. The decline in professional liability costs in 2007 and 2006 was primarily the result of changes in estimates for prior years and our ongoing quality improvement and risk management programs.

Revenues associated with the Commonwealth Transaction approximated $100 million in 2007 and $95 million in 2006. Operating losses associated with the Commonwealth Transaction approximated $6 million for 2007 compared to operating income of $6 million for 2006. The operating loss for the Commonwealth hospitals in 2007 was primarily attributable to a decline in average daily census and a change in estimate of $7 million related to the provision for doubtful accounts.

Health Services Division

Revenues increased 11% in 2007 to $2.0 billion and 11% in 2006 to $1.8 billion. Revenue growth in each of the past two years was primarily attributable to reimbursement rate increases and acquisitions. While overall nursing center occupancy has remained relatively unchanged, growth in higher acuity Medicare and managed care volumes have favorably impacted revenue growth.

On a same-store basis, aggregate patient days were relatively unchanged in 2007 and increased 1% in 2006 compared to prior periods.

Nursing center operating margins improved in each of the past two years primarily due to same-store growth in Medicare and managed care volumes, the favorable impact of acquired nursing centers and reductions in professional liability costs. Nursing center wage and benefit costs increased 9% to $1.1 billion in 2007 and increased 11% to $961 million in 2006 compared to $868 million in 2005. Average hourly wage rates increased 5% in 2007 and 4% in 2006, while employee benefit costs increased 9% in 2007 and 7% in 2006.

Professional liability costs were $24 million in 2007, $33 million in 2006 and $43 million in 2005. The decline in professional liability costs in 2007 and 2006 was primarily the result of changes in estimates for prior years and our ongoing quality improvement and risk management programs.

Revenues associated with acquisitions, including the Commonwealth Transaction, aggregated $218 million in 2007 and $104 million in 2006. Operating income associated with acquisitions approximated $37 million in 2007 and $10 million in 2006.

Rehabilitation Division

Revenues increased 17% to $352 million in 2007 and 14% to $300 million in 2006. The increase in revenues in both periods was primarily attributable to growth in both new customers and the volume of services provided to existing customers. Revenues derived from unaffiliated customers aggregated $112 million in 2007, $74 million in 2006 and $63 million in 2005.

While revenues have grown significantly in both 2007 and 2006, operating margins have declined primarily due to wage pressures resulting from an increasingly competitive marketplace for therapists and start-up costs associated with external customer growth. Operating income for 2006 included a pretax charge of approximately $3 million related primarily to revisions to prior estimates for accrued contract labor costs.

Pharmacy Division

The Spin-off Transaction was completed on July 31, 2007. As a result, our consolidated operating results for 2007 included the results of our former pharmacy division for seven months. For accounting purposes, the pharmacy division will not be treated as a discontinued operation in our historical consolidated financial statements. See note 2 of the notes to consolidated financial statements.

Corporate Overhead

Operating income for our operating divisions excludes allocations of corporate overhead. These costs aggregated $168 million in 2007, $157 million in 2006 and $135 million in 2005. As a percentage of

consolidated revenues, corporate overhead totaled 4.0% in 2007, 3.8% in 2006 and 3.6% in 2005. Excluding the items discussed in the quarterly consolidated financial information, corporate overhead totaled $145 million in 2007, $147 million in 2006 and $127 million in 2005 and as a percentage of consolidated revenues, corporate overhead totaled 3.4% in 2007, 3.5% in 2006 and 3.4% in 2005.

The increase in corporate overhead in 2006 was primarily attributable to increases in stock-based compensation and certain incentive compensation costs. We began to recognize compensation expense prospectively in our consolidated financial statements for non-vested stock options outstanding at December 31, 2005 and for all future stock option grants under SFAS No. 123 (revised 2004) ("SFAS 123R"), "Share-Based Payment." The adoption of SFAS 123R increased corporate overhead by approximately $7 million in 2006.

Corporate expenses included the operating losses from our limited purpose insurance subsidiary of $7 million in both 2007 and 2006, and $10 million in 2005.

Capital Costs

Rent expense increased 17% to $347 million in 2007 and 19% to $298 million in 2006. A substantial portion of the increase in both periods resulted from the Ventas rent reset under the Master Lease Agreements, contractual inflation, contingent rent increases, growth in the number of leased facilities, and acquisition and development activities.

In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements. These new aggregate annual rents of approximately $239 million (including the Ventas Facilities) became effective retroactively to July 19, 2006 and were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under the Master Lease Agreements. Aggregate annual Ventas rents prior to the rent reset approximated $206 million (including the Ventas Facilities). Aggregate Ventas rent expense totaled $230 million in 2007, $198 million in 2006 and $175 million in 2005.

Depreciation and amortization expense increased to $122 million in 2007 from $117 million in 2006 and $97 million in 2005. The increase was primarily a result of our ongoing capital expenditure program and our acquisition and development activities.

Interest expense aggregated $17 million in 2007 compared to $14 million in 2006 and $8 million in 2005. The increase in 2007 and 2006 was primarily attributable to increased borrowings under our revolving credit facility related to our acquisition and development activities.

Investment income related primarily to our insurance subsidiary investments totaled $16 million in 2007 compared to $15 million in 2006 and $11 million in 2005.

Income Taxes

The provision for income taxes is based upon our estimate of annual taxable income or loss for each respective accounting period and includes the effect of certain non-taxable and non-deductible items. Our effective income tax rate was 47.4% in 2007, 39.5% in 2006 and 40.0% in 2005. The effective income tax rate in 2007 was negatively impacted by $5 million of non-deductible expenses associated with the Spin-off Transaction. We recorded favorable income tax adjustments in 2007 and 2006 related to the resolution of certain income tax contingencies from prior years that reduced the provision for income taxes by approximately $2 million and $3 million, respectively.

We have reduced our net deferred tax assets by a valuation allowance to the extent we do not believe it is "more likely than not" that the asset ultimately will be realizable.

In 2006, we reached a settlement with the IRS related to all disputed federal tax issues for fiscal 2000 and 2001. In connection with the settlement, we paid approximately $3 million of employer payroll taxes to the IRS in 2007. At December 31, 2006, we reflected the impact of the settlement in our consolidated balance sheet by increasing certain net deferred tax assets by approximately $16 million, reducing currently payable income taxes by approximately $70 million and increasing stockholders' equity by approximately $86 million. Because of fresh-start accounting rules related to our reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

Our aggregate net operating loss carryforwards aggregated $10 million and $9 million at December 31, 2007 and 2006, respectively. These carryforwards expire in various amounts through 2026.

Consolidated Results

Income from continuing operations before income taxes declined 48% to $66 million in 2007 from $127 million in 2006 and declined 45% in 2006 from $228 million in 2005. Net income from continuing operations declined 55% to $35 million in 2007 and declined 44% in 2006 to $77 million.

Fourth Quarter Operating Results – Continuing Operations

Operating results for the fourth quarter of 2007 included a pretax charge of $1 million for costs incurred in connection with the Spin-off Transaction, a pretax charge of $0.4 million for employee severance costs, a pretax charge of $2 million for professional fees associated with our strategic planning process and a pretax gain of $1 million from an asset sale. In addition, the provision for income taxes included a net charge of $0.4 million related to income tax items associated with the Spin-off Transaction.

We also recorded certain adjustments in the fourth quarter of 2007, including a pretax charge of approximately $7 million related to accounts receivable for certain hospitals acquired in 2006, a pretax credit of approximately $3 million to reflect a change in estimate for hospital Medicare in-house accounts receivable and a pretax credit of approximately $4 million to adjust certain nursing center Medicaid revenues. The aggregate effect of these changes in estimate did not have a material effect on our consolidated fourth quarter 2007 results of operations.

Operating results for the fourth quarter of 2006 included pretax income of $2 million related to favorable settlements of prior year hospital Medicare cost reports, pretax income of $1 million from insurance recoveries related to hurricane costs, a pretax charge of $4 million to adjust certain estimated institutional pharmacy Medicare Part D revenues recorded in the first nine months of 2006, a pretax charge of $3 million to adjust the accounts receivable of an acquired institutional pharmacy, and a pretax charge of $5 million for professional fees and other costs incurred in connection with the Spin-off Transaction and the rent reset issue with Ventas. We also recorded favorable income tax adjustments in the fourth quarter of 2006 that increased net income by $3 million.

Results of Operations – Discontinued Operations

Net loss from discontinued operations aggregated $5 million in 2007 compared to net income from discontinued operations of $2 million in 2006 and $9 million in 2005. Discontinued operations included a pretax charge of approximately $2 million ($1 million net of income taxes) in 2007 and favorable pretax adjustments of $19 million ($12 million net of income taxes) and $42 million ($26 million net of income taxes) in 2006 and 2005, respectively, resulting from a change in estimate for professional liability reserves related to prior years.

During 2007, we recorded a pretax loss on divestiture of operations of $113 million ($69 million net of income taxes) related to the acquisition and the planned divestiture of the Ventas Facilities. During 2007, we also recorded a pretax loss on divestiture of operations related to the HCP Transaction of $13 million ($8 million net of income taxes).

During 2005, we disposed of three unprofitable leased nursing centers, designated two owned nursing centers as held for sale and closed one nursing center. The pretax loss associated with these transactions totaled $7 million ($4 million net of income taxes).

See notes 3, 4 and 10 of the notes to consolidated financial statements.

Liquidity

Operating cash flows and capital spending

Cash flows provided by operations (including discontinued operations) aggregated $163 million for 2007, $130 million for 2006 and $263 million for 2005. During each year we maintained sufficient liquidity to fund our ongoing capital expenditure program and finance our ongoing hospital development expenditures as well as our acquisition and strategic divestiture activities.

Our operating cash flows in 2007 and 2006 declined from the level reported in 2005 primarily as a result of growth in accounts receivable and higher income tax payments. Prior to 2006, our federal income tax payments were significantly reduced primarily as a result of certain income tax benefits arising in connection with our 2001 reorganization, including the utilization of net operating loss carryforwards. Federal income tax payments totaled $17 million in 2007, $55 million in 2006 and $5 million in 2005. In addition, operating cash flows in 2007 were negatively impacted by the Spin-off Transaction. Operating cash flows in 2005 also included $48 million related to favorable settlements of prior year hospital Medicare cost reports.

Cash and cash equivalents totaled $33 million at December 31, 2007 compared to $21 million at December 31, 2006. Our long-term debt and capital lease obligations at December 31, 2007 aggregated $292 million (including $275 million of borrowings under our revolving credit facility). Based upon our existing cash levels, expected operating cash flows and capital spending (including planned acquisition and development activities), and the availability of borrowings under our revolving credit facility, we believe that we have the necessary financial resources to satisfy our expected short-term and long-term liquidity needs.

In November 2007, we entered into a 20-year capital lease obligation related to a newly constructed replacement hospital. In January 2008, we exercised a purchase option for this hospital and we expect to complete the transaction in the second quarter of 2008. The purchase price, which is based upon project costs, is expected to approximate $17 million.

Revolving credit facility and financing activities

In July 2007, we completed certain amendments to our revolving credit facility. Under the terms of the revolving credit facility as amended, the aggregate amount of the credit was increased to $500 million and may be further increased to $600 million at our option if certain conditions are met. The term of the revolving credit facility was extended by an additional three years until July 2012. The revolving credit facility also establishes permitted acquisitions and certain investments by us at $500 million in the aggregate and allows for up to $150 million of certain restricted payments including, among other things, the repurchase of common stock and payment of cash dividends. The revolving credit facility also allowed for the consummation of the Spin-off Transaction.

Interest rates under the revolving credit facility are based, at our option, upon (a) LIBOR plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. The applicable margin in the revolving credit facility represents a decrease of 75 basis points from the previous pricing. The revolving credit facility is collateralized by substantially all of our assets including certain owned real property and is guaranteed by substantially all of our subsidiaries. The revolving credit facility constitutes a working capital facility for general corporate purposes and permitted acquisitions and investments in healthcare facilities and companies up to certain limits. The terms of our revolving credit facility include certain financial covenants and covenants which limit acquisitions and annual capital expenditures. We were in compliance with the terms of our revolving credit facility at December 31, 2007.

As a result of improved professional liability underwriting results of our limited purpose insurance subsidiary, we received distributions of $37 million in 2007, $34 million in 2006 and $30 million in 2005 from our limited purpose insurance subsidiary. These proceeds were used primarily to repay borrowings under our revolving credit facility.

Strategic divestitures

Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to us. We used these proceeds to reduce outstanding borrowings under our revolving credit facility.

In June 2007, we paid approximately $176 million to purchase the Ventas Facilities with borrowings under our revolving credit facility. During 2007, we sold 14 of the Ventas Facilities for approximately $67 million. We intend to complete the divestiture of the remaining Ventas Facilities during 2008. We expect to generate between $13 million and $23 million in proceeds from the sale of the remaining Ventas Facilities and the related operations. See note 3 of the notes to consolidated financial statements.

In January 2007, we paid $37 million as part of the consideration to complete the HCP Transaction. We also divested the 11 nursing centers acquired in the HCP Transaction during 2007 and received proceeds of $78 million, which were used to repay borrowings under our revolving credit facility.

Equity transactions

In August 2007, our Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, we expended $50 million to purchase approximately 2.6 million shares of our common stock. We intend to finance any additional repurchases from operating cash flows or from borrowings under our revolving credit facility. The authorization includes both open market purchases as well as private transactions.

In connection with the exercise of our Series A warrants and Series B warrants in April 2006, we issued approximately 10.1 million shares of common stock and received net proceeds of approximately $142 million. These proceeds were used to repurchase approximately 5.8 million shares of our common stock in the open market in 2006.

In August 2005, our Board of Directors authorized the repurchase of up to $100 million in common stock and warrants. During 2005, we repurchased approximately 1.8 million shares of our common stock at an aggregate cost of $48 million. During 2006, we repurchased approximately 2 million shares of our common stock in the open market at an aggregate cost of $52 million, thereby completing the 2005 share repurchase program. We financed these repurchases from both operating cash flows and borrowings under our revolving credit facility.

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Debt and lease obligations

Future payments of principal and interest due under long-term debt agreements and lease obligations as of December 31, 2007 follows (in thousands):

	Payments due by period						
				Non-cancelable operating leases			
Year	Revolving credit facility (a)	Capital lease obligation	Other long-term debt	Ventas (b)	Other	Subtotal	Total
2008	$ 18,872	$ 1,898	$ 127	$ 234,652	$ 72,845	$ 307,497	$ 328,394
2009	18,820	1,627	127	234,652	65,044	299,696	320,270
2010	18,820	1,627	128	154,491	61,110	215,601	236,176
2011	18,820	1,627	128	114,411	57,307	171,718	192,293
2012	285,313	1,627	127	114,411	52,873	167,284	454,351
Thereafter	–	24,130	520	38,136	319,965	358,101	382,751
	$ 360,645	$ 32,536	$ 1,157	$ 890,753	$ 629,144	$ 1,519,897	$ 1,914,235

(a) Revolving credit facility interest is based upon the weighted average interest rate of 6.8% as of December 31, 2007.

(b) See "Part I – Business – Master Lease Agreements – Rental Amounts and Escalators."

As previously discussed, we adopted the provisions of FIN 48 on January 1, 2007. As of December 31, 2007, we had approximately $9 million of total gross unrecognized tax benefits and $2 million of accrued interest related to uncertain tax positions. Because future cash outflows related to these unrecognized tax benefits are uncertain, they are excluded from the table above.

Capital Resources

Excluding acquisitions, capital expenditures totaled $186 million in 2007, $151 million in 2006 and $126 million in 2005. Excluding acquisitions, capital expenditures (including hospital development) could approximate $175 million to $200 million in 2008. We believe that our capital expenditure program is adequate to improve and equip existing facilities. Capital expenditures in each of the last three years were financed primarily through internally generated funds. At December 31, 2007, the estimated cost to complete and equip construction in progress approximated $95 million.

During 2007, we acquired eight nursing centers and one hospital that were previously leased for approximately $113 million. Annual rents associated with these facilities approximated $10 million. These transactions were financed through borrowings under our revolving credit facility.

In July 2007, we acquired a combined nursing center and assisted living facility for $20 million. The purchase price was financed through borrowings under our revolving credit facility.

In February 2007, we entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8 million.

In February 2006, we completed the Commonwealth Transaction for a total purchase price of $124 million in cash and the assumption of certain operating lease obligations. The acquisition was financed primarily with borrowings under our revolving credit facility.

We expended $11 million and $103 million during 2006 and 2005, respectively, for acquisitions in our former pharmacy division. In addition, during 2005 we expended $12 million to acquire two hospital properties for development. We financed these acquisitions primarily through the use of operating cash flows.

At December 31, 2007, the remaining permitted acquisition amount under our revolving credit facility aggregated $364 million.

Other Information

Effects of Inflation and Changing Prices

We derive a substantial portion of our revenues from the Medicare and Medicaid programs. Congress and certain state legislatures have enacted or may enact additional significant cost containment measures limiting our ability to recover our cost increases through increased pricing of our healthcare services. Medicare revenues in LTAC hospitals and nursing centers are subject to fixed payments under the Medicare prospective payment systems. Medicaid reimbursement rates in many states in which we operate nursing centers also are based upon fixed payment systems. Generally, these rates are adjusted annually for inflation. However, these adjustments may not reflect the actual increase in the costs of providing healthcare services.

We believe that our operating margins may continue to be under pressure as the growth in operating expenses, particularly professional liability, labor and employee benefits costs, exceeds payment increases from third party payors. In addition, as a result of competitive pressures, our ability to maintain operating margins through price increases to private patients is limited.

See "Part I – Item 1 – Business – Governmental Regulation" for a detailed discussion of Medicare and Medicaid reimbursement regulations.

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Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

The following discussion of our exposure to market risk contains "forward-looking statements" that involve risks and uncertainties. The information presented has been prepared utilizing certain assumptions considered reasonable in light of information currently available to us. Given the unpredictability of interest rates as well as other factors, actual results could differ materially from those projected in such forward-looking information.

Our exposure to market risk relates to changes in the prime rate, federal funds rate and the London Interbank Offered Rate which affect the interest paid on certain borrowings.

The following table provides information about our financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted average interest rates by expected maturity date.

Interest Rate Sensitivity
Principal (Notional) Amount by Expected Maturity
Average Interest Rate
(Dollars in thousands)

	Expected maturities							Fair value 12/31/07
	2008	2009	2010	2011	2012	Thereafter	Total	
Liabilities:								
Long-term debt, including amounts due within one year:								
Fixed rate	$ 76	$ 81	$ 86	$ 91	$ 96	$ 460	$ 890	$ 878
Average interest rate	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%		
Variable rate (a)	$ –	$ –	$ –	$ –	$ 275,000	$ –	$ 275,000	$ 275,000

(a) Interest on borrowings under our revolving credit facility is payable, at our option, at (1) the London Interbank Offered Rate plus an applicable margin ranging from 1.25% to 2.00% or (2) the applicable margin ranging from 0.25% to 1.00% plus the higher of the prime rate or 0.5% over the federal funds rate. The applicable margin is based upon our average daily excess availability as defined in our revolving credit facility.

Item 8. *Financial Statements and Supplementary Data*

The information required by this Item 8 is included in appendix pages F-2 through F-39 of this Annual Report on Form 10-K.

Item 9. *Changes in and Disagreements With Accountants on Accounting and Financial Disclosure*

Not applicable.

Item 9A. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting

We have carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon our evaluation, the Chief

Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2007, the disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required.

There has been no change in our internal control over financial reporting during the quarter ended December 31, 2007, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.*

Based upon our assessment and those criteria, management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2007.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, who also audited our consolidated financial statements included in our Annual Report on Form 10-K, as stated in their report which appears in our consolidated financial statements.

Item 9B. ***Other Information***

Not applicable.

PART III

Item 10. *Directors, Executive Officers and Corporate Governance*

The information required by this Item, other than the information set forth above under "Part I – Executive Officers of the Registrant," is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 11. *Executive Compensation*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 13. *Certain Relationships and Related Transactions, and Director Independence*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

Item 14. *Principal Accounting Fees and Services*

The information required by this Item is omitted because we are filing a definitive proxy statement, which includes the required information, pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The required information contained in our proxy statement is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a)(1) and (a)(2) Index to Consolidated Financial Statements and Financial Statement Schedules:

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Report of Independent Registered Public Accounting Firm	F-2
Consolidated Financial Statements:	
Consolidated Statement of Operations for the years ended December 31, 2007, 2006 and 2005	F-3
Consolidated Balance Sheet, December 31, 2007 and 2006	F-4
Consolidated Statement of Stockholders' Equity for the years ended December 31, 2007, 2006 and 2005	F-5
Consolidated Statement of Cash Flows for the years ended December 31, 2007, 2006 and 2005	F-6
Notes to Consolidated Financial Statements	F-7
Quarterly Consolidated Financial Information (Unaudited)	F-36
Financial Statement Schedule (a):	
Schedule II – Valuation and Qualifying Accounts for the years ended December 31, 2007, 2006 and 2005	F-39

(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

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(a)(3) Index to Exhibits:

Exhibit number	Description of document
2.1	Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code. Exhibit 2.1 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.2	Order Confirming the Fourth Amended Joint Plan of Reorganization of Vencor, Inc. and Affiliated Debtors under Chapter 11 of the Bankruptcy Code, as entered by the United States Bankruptcy Court for the District of Delaware on March 16, 2001. Exhibit 2.2 to the Current Report on Form 8-K of the Company dated March 19, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.3	Purchase and Sale Agreement by and among those entities listed on Schedule P thereto as buying entities, those entities listed on Schedule P thereto as selling entities and Jeffrey A. Goldshine, Douglas B. Noble, and Mary Catherine Rumsey, and solely for purposes of Article III thereof and the Guaranty, Kindred Healthcare Operating, Inc., dated as of October 24, 2005. Exhibit 2.1 to the Company's Current Report on Form 8-K dated October 24, 2005 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.4*	Master Transaction Agreement, dated as of October 25, 2006, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.5	Amendment No. 1 To Master Transaction Agreement, dated as of June 4, 2007, among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., Safari Holding Corporation, Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 4, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
2.6*	Amendment No. 2 To Master Transaction Agreement, dated as of July 31, 2007, among AmerisourceBergen Corporation, PharMerica Long-Term Care, Inc. (formerly named PharMerica, Inc.), Kindred Healthcare, Inc., Kindred Healthcare Operating, Inc., Kindred Pharmacy Services, Inc., PharMerica Corporation (formerly named Safari Holding Corporation), Hippo Merger Corporation and Rhino Merger Corporation. Exhibit 2.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.1	Amended and Restated Certificate of Incorporation of the Company. Exhibit 4.1 to the Company's Registration Statement on Form S-3 filed August 31, 2001 (Comm. File No. 333-68838) is hereby incorporated by reference.
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation. Exhibit 3.1 to the Company's Form 10-Q for the quarterly period ended March 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
3.3	Amended and Restated Bylaws of the Company. Exhibit 3.1 to the Company's Current Report on Form 8-K dated February 19, 2008 (Comm. File No. 001-14057) is hereby incorporated by reference.
4.1	Articles IV, IX, X and XII of the Restated Certificate of Incorporation of the Company is included in Exhibit 3.1.

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Exhibit number	Description of document
10.1	Second Amended and Restated Credit Agreement dated as of July 18, 2007 among the Company, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent, J.P. Morgan Securities Inc., as Sole Bookrunner and Sole Lead Arranger, Citicorp USA, Inc., as Syndication Agent, and General Electric Capital Corporation, The CIT Group/Business Credit, Inc. and Wells Fargo Foothill, as Co-Documentation Agents. Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.2	Tax Allocation Agreement dated as of April 30, 1998 by and between Vencor, Inc. and Ventas, Inc. Exhibit 10.9 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.3	Agreement of Indemnity-Third Party Leases dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.4	Agreement of Indemnity-Third Party Contracts dated as of April 30, 1998 by and between Vencor, Inc. and its subsidiaries and Ventas, Inc. Exhibit 10.12 to the Company's Form 10-Q for the quarterly period ended June 30, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.5	Form of Indemnification Agreement between the Company and certain of its officers and employees. Exhibit 10.31 to the Ventas, Inc. Form 10-K for the year ended December 31, 1995 (Comm. File No. 1-10989) is hereby incorporated by reference.
10.6	Form of Indemnification Agreement between the Company and each member of its Board of Directors dated October 29, 2001. Exhibit 10.21 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.7**	Kindred Deferred Compensation Plan, Second Amendment and Restatement effective as of January 1, 2005. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended September 30, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.8	Tax Refund Escrow Agreement and First Amendment to the Tax Allocation Agreement made and entered into as of the 20th of April 2001 by and between the Company and each of its subsidiaries and Ventas, Inc., Ventas Realty Limited Partnership and Ventas LP Realty, L.L.C. Exhibit 10.31 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.9**	Vencor, Inc. Supplemental Executive Retirement Plan dated January 1, 1998, as amended. Exhibit 10.27 to the Company's Registration Statement on Form S-4 (Reg. No. 333-57953) is hereby incorporated by reference.
10.10**	Amendment No. Two to Supplemental Executive Retirement Plan dated as of January 15, 1999. Exhibit 10.48 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.11**	Amendment No. Three to Supplemental Executive Retirement Plan dated as of December 31, 1999. Exhibit 10.49 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.12**	Amendment No. 4 to the Vencor, Inc. Supplemental Executive Retirement Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended March 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.13**	Amendment No. 5 to Supplemental Executive Retirement Plan. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended September 30, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.14**	Company's 2000 Long-Term Incentive Plan, dated effective as of January 1, 2001. Exhibit 10.46 to the Company's Form 10-K for the year ended December 31, 2000 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.15**	Amendment No. One to the Company's Long-Term Incentive Plan, dated effective as of June 21, 2001. Exhibit 10.12 to the Company's Form 10-Q for the quarterly period ended June 30, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.16**	Amendment No. Two to the Company's Long-Term Incentive Plan, dated effective as of December 16, 2003. Exhibit 10.37 to the Company's Form 10-K for the year ended December 31, 2003 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.17**	Kindred Healthcare, Inc. Short-Term Incentive Plan. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended March 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.18**	Form of Kindred Healthcare Operating, Inc. Change-in-Control Severance Agreement. Exhibit 10.28 to the Company's Registration Statement on Form S-4 (Reg. No. 333-57953) is hereby incorporated by reference.
10.19**	Employment Agreement dated as of February 22, 2007 by and between Kindred Healthcare, Inc. and Edward L. Kuntz. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended March 31, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.20**	Change-in-Control Severance Agreement dated as of February 22, 2006 by and between Kindred Healthcare Operating, Inc. and Edward L. Kuntz. Exhibit 10.2 to the Company's Current Report on Form 8-K dated February 22, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.21**	Employment Agreement dated as of October 28, 2003 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.41 to the Company's Form 10-K for the year ended December 31, 2003 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.22**	Change-in-Control Severance Agreement dated as of January 28, 2002 by and between Kindred Healthcare Operating, Inc. and Paul J. Diaz. Exhibit 10.7 to the Company's Form 10-Q for the quarterly period ended March 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.23**	Employment Agreement dated as of July 28, 1998 between Vencor Operating, Inc. and Richard E. Chapman. Exhibit 10.58 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.24**	Amendment No. 1 to the Employment Agreement dated December 21, 2001 by and between Kindred Healthcare Operating, Inc. and Richard E. Chapman. Exhibit 10.43 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.25**	Employment Agreement dated as of July 28, 1998 between Vencor Operating, Inc. and Frank J. Battafarano. Exhibit 10.63 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.26**	Amendment to Employment Agreement dated as of September 28, 1998 between Vencor Operating, Inc. and Frank J. Battafarano. Exhibit 10.64 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.27**	Amendment No. 2 to Employment Agreement dated as of November 5, 1999 between Vencor Operating, Inc. and Frank J. Battafarano. Exhibit 10.65 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.

Exhibit number	Description of document
10.28**	Amendment No. 3 to the Employment Agreement dated December 21, 2001 by and between Kindred Healthcare Operating, Inc. and Frank J. Battafarano. Exhibit 10.50 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.29**	Employment Agreement dated as of July 28, 1998 between Vencor Operating, Inc. and M. Suzanne Riedman. Exhibit 10.67 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.30**	Amendment to Employment Agreement dated as of September 28, 1998 between Vencor Operating, Inc. and M. Suzanne Riedman. Exhibit 10.68 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.31**	Amendment No. 2 to Employment Agreement dated as of November 5, 1999 between Vencor Operating, Inc. and M. Suzanne Riedman. Exhibit 10.69 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.32**	Amendment No. 3 to Employment Agreement dated December 21, 2001 by and between Kindred Healthcare Operating, Inc. and M. Suzanne Riedman. Exhibit 10.56 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.33**	Employment Agreement dated as of July 28, 1998 between Vencor Operating, Inc. and Richard A. Lechleiter. Exhibit 10.70 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.34**	Amendment to Employment Agreement dated as of September 28, 1998 between Vencor Operating, Inc. and Richard A. Lechleiter. Exhibit 10.71 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.35**	Amendment No. 2 to Employment Agreement dated as of November 5, 1999 between Vencor Operating, Inc. and Richard A. Lechleiter. Exhibit 10.72 to the Company's Form 10-K for the year ended December 31, 1999 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.36**	Amendment No. 3 to Employment Agreement dated December 21, 2001 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.60 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.37**	Employment Agreement dated as of December 21, 2001 between Kindred Healthcare Operating, Inc. and William M. Altman. Exhibit 10.61 to the Company's Form 10-K for the year ended December 31, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.38**	Employment Agreement dated as of October 28, 2002 by and among Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.74 to the Company's Form 10-K for the year ended December 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.39**	Change-in-Control Severance Agreement dated as of October 28, 2002 by and between Kindred Healthcare Operating, Inc. and Lane M. Bowen. Exhibit 10.75 to the Company's Form 10-K for the year ended December 31, 2002 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.40**	Employment Agreement dated as of February 25, 2003 by and among Kindred Healthcare Operating, Inc. and Joseph L. Landenwich. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended March 31, 2003 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.41**	Change-in-Control Severance Agreement dated as of February 25, 2003 by and between Kindred Healthcare Operating, Inc. and Joseph L. Landenwich. Exhibit 10.7 to the Company's Form 10-Q for the quarterly period ended March 31, 2003 (Comm. File No. 001-14057) is hereby incorporated by reference.

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Exhibit number	Description of document
10.42**	Employment Agreement dated as of August 1, 2005 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier. Exhibit 99.2 to the Company's Current Report on Form 8-K dated August 1, 2005 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.43**	Change-in-Control Severance Agreement dated as of August 1, 2005 by and between Kindred Healthcare Operating, Inc. and Benjamin A. Breier. Exhibit 99.3 to the Company's Current Report on Form 8-K dated August 1, 2005 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.44**	Employment Agreement dated as of January 1, 2006 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller. Exhibit 10.1 to the Company's Current Report on Form 8-K dated January 1, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.45**	Change-in-Control Severance Agreement dated as of January 1, 2006 by and between Kindred Healthcare Operating, Inc. and Gregory C. Miller. Exhibit 10.2 to the Company's Current Report on Form 8-K dated January 1, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.46	Second Amended and Restated Master Lease Agreement No. 1 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.3 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.47	Amendment to Memorandum of Lease and Specific Property Lease Amendment dated as of June 8, 2007 by and between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant.
10.48	Second Amended and Restated Master Lease Agreement No. 2 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.4 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.49	Second Amended and Restated Master Lease Agreement No. 3 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.5 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.50	Second Amended and Restated Master Lease Agreement No. 4 dated as of April 27, 2007 for Lease Executed by Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.51	Amendment to Master Lease and Memorandum of Lease dated as of August 7, 2007 by and among Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc. as Tenant.
10.52	Master Lease among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated May 16, 2001. Exhibit 10.11 to the Company's Form 10-Q for the quarterly period ended June 30, 2001 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.53	First Amendment to Master Lease dated effective August 1, 2001 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee.

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Exhibit number	Description of document
10.54	Second Amendment to Master Lease dated as of November 18, 2003 by and among Health Care Property Investors, Inc., Health Care Property Partners and Indiana HCP, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee.
10.55	Third Amendment to Master Lease dated and effective as of June 30, 2004 by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee.
10.56	Fourth Amendment to Master Lease by and among Health Care Property Investors, Inc. and Health Care Property Partners, collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C. and Kindred Nursing Centers Limited Partnership, collectively, as Lessee, dated February 26, 2006. Exhibit 10.71 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.57	Fifth Amendment to Master Lease by and among Health Care Property Investors, Inc., Health Care Property Partners, Texas HCP Holding, L.P., collectively, as Lessor and Kindred Nursing Centers East, L.L.C., Kindred Nursing Centers West, L.L.C., Kindred Nursing Centers Limited Partnership and Transitional Hospitals Corporation of Wisconsin, Inc., collectively, as Lessee, dated January 31, 2007. Exhibit 10.72 to the Company's Form 10-K for the year ended December 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.58	Master Lease Agreement dated as of February 28, 2006 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant. Exhibit 10.6 to the Company's Form 10-Q for the quarterly period ended March 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.59	First Amendment to Master Lease Agreement dated as of June 20, 2007 by and between HCRI Massachusetts Properties Trust II, as Lessor and Kindred Nursing Centers East, L.L.C., as Tenant.
10.60	Master Lease Agreement dated as of February 28, 2006 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant. Exhibit 10.7 to the Company's Form 10-Q for the quarterly period ended March 31, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.61	First Amendment to Master Lease Agreement dated as of July 25, 2007 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant.
10.62	Second Amendment to Master Lease Agreement dated as of December 5, 2007 by and between HCRI Massachusetts Properties Trust and HCRI Massachusetts Properties Trust II, as Lessor and Kindred Hospitals East, L.L.C., as Tenant.
10.63	Agreement and Plan of Reorganization between the Company and Ventas, Inc. Exhibit 10.1 to the Company's Form 10, as amended, dated April 27, 1998 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.64**	The Company's 2000 Stock Option Plan. Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.65**	The Company's Restricted Share Plan. Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Reg. No. 333-59598) is hereby incorporated by reference.
10.66**	Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated. Exhibit 10.2 to the Company's Form 10-Q for the quarterly period ended September 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.

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Exhibit number	Description of document
10.67**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.68**	Form of Kindred Healthcare, Inc. Incentive Stock Option Grant Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.69**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.70**	Form of Kindred Healthcare, Inc. Stock Bonus Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.71**	Form of Kindred Healthcare, Inc. Performance Unit Award Agreement under the 2001 Stock Incentive Plan, Amended and Restated.
10.72**	Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors (Amended and Restated). Exhibit 10.1 to the Company's Form 10-Q for the quarterly period ended June 30, 2007 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.73**	Form of Kindred Healthcare, Inc. Non-Qualified Stock Option Grant Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.74**	Form of Kindred Healthcare, Inc. Restricted Share Award Agreement under the 2001 Equity Plan for Non-Employee Directors (Amended and Restated).
10.75	Tax Matters Agreement, by and among AmerisourceBergen Corporation, PharMerica, Inc., Kindred Healthcare, Inc., Kindred Pharmacy Services, Inc. and Safari Holding Corporation, in each case on behalf of itself and its Affiliates. Exhibit 10.2 to the Company's Current Report on Form 8-K dated October 25, 2006 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.76	Other Debt Instruments – Copies of debt instruments for which the related debt is less than 10% of total assets will be furnished to the SEC upon request.
21	List of Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
31	Rule 13a-14(a)/15d-14(a) Certifications.
32	Section 1350 Certifications.

* The Company will furnish supplementally to the SEC upon request a copy of any omitted exhibit or annex.

** Compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(b) of this Annual Report on Form 10-K.

(b) Exhibits.

The response to this portion of Item 15 is submitted as a separate section of this Annual Report on Form 10-K.

(c) Financial Statement Schedules.

The response to this portion of Item 15 is included in appendix page F-39 of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 28, 2008

KINDRED HEALTHCARE, INC.

By: /s/ Paul J. Diaz

Paul J. Diaz
President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Ann C. Berzin **Ann C. Berzin**	Director	February 28, 2008
/s/ Thomas P. Cooper, M.D. **Thomas P. Cooper, M.D.**	Director	February 28, 2008
/s/ Michael J. Embler **Michael J. Embler**	Director	February 28, 2008
/s/ Garry N. Garrison **Garry N. Garrison**	Director	February 28, 2008
/s/ Isaac Kaufman **Isaac Kaufman**	Director	February 28, 2008
/s/ John H. Klein **John H. Klein**	Director	February 28, 2008
/s/ Eddy J. Rogers, Jr. **Eddy J. Rogers, Jr.**	Director	February 28, 2008
/s/ Edward L. Kuntz **Edward L. Kuntz**	Executive Chairman of the Board	February 28, 2008
/s/ Paul J. Diaz **Paul J. Diaz**	President and Chief Executive Officer (Principal Executive Officer)	February 28, 2008
/s/ Richard A. Lechleiter **Richard A. Lechleiter**	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	February 28, 2008
/s/ John J. Lucchese **John J. Lucchese**	Senior Vice President and Corporate Controller (Principal Accounting Officer)	February 28, 2008

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(a) All other schedules have been omitted because the required information is not present or not present in material amounts.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of Kindred Healthcare, Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Kindred Healthcare, Inc. and its subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, appearing in Management's Annual Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 of the Notes to Consolidated Financial Statements, the Company began recognizing compensation expense for the fair value of non-vested stock-based compensation awards effective January 1, 2006.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

Louisville, Kentucky
February 28, 2008

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	Year ended December 31,		
	2007	2006	2005
Revenues	$ 4,220,266	$ 4,130,052	$ 3,718,499
Salaries, wages and benefits	2,386,702	2,243,106	1,987,239
Supplies	550,987	676,326	560,981
Rent	347,560	297,663	250,479
Other operating expenses	754,041	669,482	598,693
Other income	(7,701)	–	–
Depreciation and amortization	121,767	117,422	97,304
Interest expense	17,044	13,920	8,096
Investment income	(16,155)	(14,495)	(11,034)
	4,154,245	4,003,424	3,491,758
Income from continuing operations before reorganization items and income taxes	66,021	126,628	226,741
Reorganization items	–	–	(1,639)
Income from continuing operations before income taxes	66,021	126,628	228,380
Provision for income taxes	31,301	49,965	91,384
Income from continuing operations	34,720	76,663	136,996
Discontinued operations, net of income taxes:			
Income (loss) from operations	(4,569)	2,080	9,294
Loss on divestiture of operations	(77,021)	(32)	(1,381)
Net income (loss)	$ (46,870)	$ 78,711	$ 144,909
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	$ 0.90	$ 1.96	$ 3.67
Discontinued operations:			
Income (loss) from operations	(0.12)	0.05	0.25
Loss on divestiture of operations	(1.99)	–	(0.04)
Net income (loss)	$ (1.21)	$ 2.01	$ 3.88
Diluted:			
Income from continuing operations	$ 0.87	$ 1.87	$ 3.03
Discontinued operations:			
Income (loss) from operations	(0.11)	0.05	0.20
Loss on divestiture of operations	(1.93)	–	(0.03)
Net income (loss)	$ (1.17)	$ 1.92	$ 3.20
Shares used in computing earnings (loss) per common share:			
Basic	38,791	39,108	37,328
Diluted	39,983	40,923	45,239

See accompanying notes.

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KINDRED HEALTHCARE, INC.
CONSOLIDATED BALANCE SHEET
(In thousands, except per share amounts)

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,877	$ 20,857
Cash–restricted	5,360	5,757
Insurance subsidiary investments	231,693	227,865
Accounts receivable less allowance for loss of $33,305 – 2007 and $62,064 – 2006	598,108	588,166
Inventories	22,035	49,533
Deferred tax assets	59,936	62,512
Income taxes	43,128	10,652
Other	20,510	28,106
	1,013,647	993,448
Property and equipment, at cost:		
Land	45,768	31,457
Buildings	588,145	430,013
Equipment	499,417	479,885
Construction in progress	92,781	85,757
	1,226,111	1,027,112
Accumulated depreciation	(542,773)	(475,882)
	683,338	551,230
Goodwill	69,100	107,852
Intangible assets less accumulated amortization of $1,095 – 2007 and $6,925 – 2006	79,956	117,345
Assets held for sale	15,837	9,113
Insurance subsidiary investments	49,166	52,977
Deferred tax assets	113,854	96,252
Other	54,654	87,910
	$ 2,079,552	$ 2,016,127
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 180,367	$ 158,085
Salaries, wages and other compensation	261,608	280,039
Due to third party payors	41,980	27,784
Professional liability risks	64,740	65,497
Other accrued liabilities	80,663	75,522
Long-term debt and capital lease obligation due within one year	584	71
	629,942	606,998
Long-term debt	275,814	130,090
Capital lease obligation	15,760	–
Professional liability risks	186,652	184,749
Deferred credits and other liabilities	109,260	98,712
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.25 par value; authorized 1,000 shares; none issued and outstanding	–	–
Common stock, $0.25 par value; authorized 175,000 shares; issued 38,339 shares – 2007 and 39,978 shares – 2006	9,585	9,994
Capital in excess of par value	790,367	793,054
Accumulated other comprehensive income	1,250	1,246
Retained earnings	60,922	191,284
	862,124	995,578
	$ 2,079,552	$ 2,016,127

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)

	Shares of common stock	Par value common stock	Capital in excess of par value	Deferred compensation	Accumulated other comprehensive income/(loss)	Retained earnings	Total
Balances, December 31, 2004	37,189	$ 9,297	$ 636,015	$ (7,353)	$ 468	$ 81,358	$ 719,785
Comprehensive income:							
Net income						144,909	144,909
Net unrealized investment losses, net of income taxes					(528)		(528)
Comprehensive income							144,381
Grant of non-vested restricted stock	521	130	16,224	(16,354)			-
Issuance of common stock in connection with employee benefit plans	550	137	8,610			(218)	8,529
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(184)	(46)	(3,262)			(3,647)	(6,955)
Issuance of common stock in connection with warrant exercises	1,008	253	16,091				16,344
Repurchase of common stock, at cost	(1,753)	(438)	(27,257)			(20,269)	(47,964)
Stock-based compensation amortization				9,470			9,470
Pre-emergence deferred tax valuation allowance adjustment			18,186				18,186
Income tax benefit in connection with the issuance of common stock under employee benefit plans			9,107				9,107
Other			(356)	9			(347)
Balances, December 31, 2005	37,331	9,333	673,358	(14,228)	(60)	202,133	870,536
Comprehensive income:							
Net income						78,711	78,711
Net unrealized investment gains, net of income taxes					1,124		1,124
Comprehensive income							79,835
Conversion to SFAS 123R (as defined) as of January 1, 2006			(14,228)	14,228			-
Grant of non-vested restricted stock	343	86	(86)				-
Issuance of common stock in connection with employee benefit plans	111	27	1,560				1,587
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(124)	(31)	(2,549)			(765)	(3,345)
Issuance of common stock in connection with warrant exercises	8,795	2,198	140,115				142,313
Cashless warrant exercise	1,351	338	21,455			(21,793)	-
Repurchase of common stock, at cost	(7,829)	(1,957)	(125,351)			(67,002)	(194,310)
Stock-based compensation amortization			18,557				18,557
Pre-emergence deferred tax valuation allowance adjustment			79,832				79,832
Income tax benefit in connection with the issuance of common stock under employee benefit plans			391				391
Other					182		182
Balances, December 31, 2006	39,978	9,994	793,054	-	1,246	191,284	995,578
Comprehensive loss:							
Net loss						(46,870)	(46,870)
Net unrealized investment gains, net of income taxes					349		349
Comprehensive loss							(46,521)
Grant of non-vested restricted stock	437	109	(109)				-
Issuance of common stock in connection with employee benefit plans	597	150	10,457			(142)	10,465
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(114)	(28)	(2,564)			(293)	(2,885)
Spin-off Transaction (as defined)						(80,220)	(80,220)
Repurchase of common stock, at cost	(2,559)	(640)	(46,520)			(2,837)	(49,997)
Stock-based compensation amortization			31,222				31,222
Pre-emergence income tax liability adjustment			2,950				2,950
Income tax benefit in connection with the issuance of common stock under employee benefit plans			1,877				1,877
Other					(345)		(345)
Balances, December 31, 2007	38,339	$ 9,585	$ 790,367	$ -	$ 1,250	$ 60,922	$ 862,124

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)

	Year ended December 31,		
	2007	2006	2005
Cash flows from operating activities:			
Net income (loss)	$ (46,870)	$ 78,711	$ 144,909
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	124,280	124,042	104,506
Amortization of stock-based compensation costs	31,222	18,557	9,470
Provision for doubtful accounts	30,093	35,149	14,867
Deferred income taxes	(9,148)	(1,976)	50,286
Loss on divestiture of discontinued operations	77,021	32	1,381
Reorganization items	–	–	(1,639)
Other	(4,022)	(7,826)	(2,687)
Change in operating assets and liabilities:			
Accounts receivable	(97,292)	(141,220)	(70,555)
Inventories and other assets	18,123	(10,713)	(3,509)
Accounts payable	6,804	20,805	4,413
Income taxes	11,477	(12,875)	37,254
Due to third party payors	14,196	1,142	(7,268)
Other accrued liabilities	7,499	26,156	(18,295)
Net cash provided by operating activities	163,383	129,984	263,133
Cash flows from investing activities:			
Purchase of property and equipment	(186,488)	(151,074)	(126,063)
Acquisitions	(351,097)	(135,086)	(114,818)
Sale of assets	148,490	13,644	17,199
Purchase of insurance subsidiary investments	(142,897)	(215,969)	(336,391)
Sale of insurance subsidiary investments	151,725	230,830	334,820
Net change in insurance subsidiary cash and cash equivalents	(6,246)	(12,583)	1,899
Net change in other investments	1,514	1,668	3,344
Other	4,982	(5,860)	(215)
Net cash used in investing activities	(380,017)	(274,430)	(220,225)
Cash flows from financing activities:			
Proceeds from borrowings under revolving credit	1,746,600	1,459,900	667,400
Repayment of borrowings under revolving credit	(1,600,800)	(1,330,700)	(667,400)
Repayment of long-term debt	(71)	(3,311)	(5,282)
Payment of deferred financing costs	(3,059)	(1,177)	(702)
Proceeds from borrowing related to Spin-off Transaction	125,000	–	–
Issuance of common stock	10,465	143,900	24,873
Repurchase of common stock	(49,997)	(194,310)	(47,964)
Other	516	7,581	459
Net cash provided by (used in) financing activities	228,654	81,883	(28,616)
Change in cash and cash equivalents	12,020	(62,563)	14,292
Cash and cash equivalents at beginning of period	20,857	83,420	69,128
Cash and cash equivalents at end of period	$ 32,877	$ 20,857	$ 83,420
Supplemental information:			
Interest payments	$ 15,961	$ 10,689	$ 6,274
Income tax payments	23,402	65,453	9,662
Rental payments to Ventas, Inc.	237,860	213,523	187,748

See accompanying notes.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ACCOUNTING POLICIES

Reporting entity

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates hospitals, nursing centers and a contract rehabilitation services business across the United States (collectively, "Kindred" or the "Company").

Basis of presentation

The consolidated financial statements include all subsidiaries. Significant intercompany transactions have been eliminated. Investments in affiliates in which the Company has a 50% or less interest are accounted for by either the equity or cost method.

On July 31, 2007, the Company completed the Spin-off Transaction (as defined). See Note 2.

In recent years, the Company has completed several transactions related to the divestiture of unprofitable hospitals, nursing centers and other healthcare businesses to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. Assets not sold at December 31, 2007 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet. See Notes 3 and 4.

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

Impact of recent accounting pronouncements

In December 2007, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141 (revised 2007) ("SFAS 141R"), "Business Combinations," which significantly changes the accounting for business combinations, including, among other changes, new accounting concepts in determining the fair value of assets and liabilities acquired, recording the fair value of contingent considerations and contingencies at acquisition date and expensing acquisition and restructuring costs. SFAS 141R is effective for business combinations which occur during fiscal years beginning after December 15, 2008. At this time, the Company has not determined the impact that SFAS 141R will have on its financial position, results of operations or liquidity; however, the Company's accounting for all business combinations after January 1, 2009 will comply with SFAS 141R.

In December 2007, the FASB issued SFAS No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements," which will change the accounting and reporting for minority interests. SFAS 160 will recharacterize minority interests as noncontrolling interests and will be classified as a component of stockholders' equity. The new consolidation method will significantly change the accounting for transactions with minority-interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

In September 2006, the FASB issued SFAS No. 157 ("SFAS 157"), "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 generally accepted accounting principles. SFAS 157 was effective for

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Impact of recent accounting pronouncements (Continued)

fiscal years beginning after November 15, 2007. In November 2007, the FASB deferred the effective date of SFAS 157 to be for fiscal years beginning after November 15, 2008 for nonfinancial assets and liabilities that are recognized or disclosed at fair value on a nonrecurring basis. The adoption of SFAS 157 is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

In July 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." The interpretation clarifies the accounting for uncertain income tax issues recognized in an entity's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 became effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on the Company's financial position, results of operations or liquidity.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation. These changes did not have any impact on the Company's financial position, results of operations or liquidity.

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 and other third party payors.

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

	Year ended December 31,		
	2007	2006	2005
Medicare	$ 1,892,580	$ 1,923,372	$ 1,619,968
Medicaid	1,100,443	1,061,711	1,132,148
Private and other	1,552,543	1,497,621	1,271,010
	4,545,566	4,482,704	4,023,126
Eliminations:			
Rehabilitation	(239,740)	(215,537)	(185,516)
Pharmacy	(85,560)	(137,115)	(119,111)
	(325,300)	(352,652)	(304,627)
	$ 4,220,266	$ 4,130,052	$ 3,718,499

Cash and cash equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less when purchased.

Insurance subsidiary investments

The Company maintains investments, consisting principally of money market funds, asset backed securities, corporate bonds, commercial paper, equities and U.S. Treasury notes for the payment of claims and expenses

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Insurance subsidiary investments (Continued)

related to professional liability and workers compensation risks. These investments have been categorized as available-for-sale and are reported at fair value. The fair value of publicly traded debt and equity securities are based upon quoted market prices. The Company's insurance subsidiary investments are classified in the accompanying consolidated balance sheet based upon their expected maturities. Expected maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations prior to the stated maturity date.

The Company follows the guidance provided by Emerging Issues Task Force No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" to assess whether the Company's investments with unrealized loss positions are other than temporarily impaired. Unrealized gains and losses, net of deferred income taxes, are reported as a component of accumulated other comprehensive income. Realized gains and losses and declines in value judged to be other than temporary are determined using the specific identification method and are reported in the Company's statement of operations. See Note 11.

Accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies and individual patients and customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions.

Inventories

Inventories consist primarily of pharmaceutical and medical supplies and are stated at the lower of cost (first-in, first-out) or market.

Property and equipment

Depreciation expense, computed by the straight-line method, was $117.3 million for 2007, $112.2 million for 2006 and $95.1 million for 2005. Depreciation rates for buildings range generally from 20 to 45 years. Leasehold improvements are depreciated over their estimated useful lives or the remaining lease term, whichever is shorter. Estimated useful lives of equipment vary from five to 15 years. Depreciation expense is not recorded for property and equipment classified as held for sale.

Interest costs incurred during the construction period related to the Company's development projects are capitalized. Capitalized interest for the years ended December 31, 2007 and 2006 was $2.6 million and $0.9 million, respectively. Capitalized interest for the year ended December 31, 2005 was immaterial.

Goodwill and other intangible assets

Intangible assets are comprised primarily of goodwill, certificates of need, customer relationship assets and non-compete agreements primarily originating from business combinations accounted for as purchase transactions. In accordance with SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," the Company is required to perform an impairment test for goodwill and indefinite lived intangible assets at least

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. The Company performs its annual impairment test at the end of each year. No impairment charge was recorded in each of the last three years in connection with the annual impairment test.

A summary of goodwill follows (in thousands):

	Hospital division	Health services division	Rehabilitation division	Pharmacy division	Total
Balances, December 31, 2005	$ 29,862	$ –	$ –	$ 40,017	$ 69,879
Commonwealth Transaction (as defined)	32,751	–	–	–	32,751
Acquisitions	–	–	–	3,725	3,725
Other	–	–	–	1,497	1,497
Balances, December 31, 2006	62,613	–	–	45,239	107,852
Commonwealth Transaction	4,985	–	–	–	4,985
Acquisitions	–	639	863	580	2,082
Spin-off Transaction	–	–	–	(45,819)	(45,819)
Balances, December 31, 2007	$ 67,598	$ 639	$ 863	$ –	$ 69,100

The Company's other intangible assets include both finite and indefinite lived intangible assets. The Company's other intangible assets with finite lives are amortized under SFAS 142 using the straight-line method over their estimated useful lives ranging from one to five years. A summary of intangible assets at December 31 follows (in thousands):

	2007				2006			
	Cost	Accumulated amortization	Carrying value	Weighted average life	Cost	Accumulated amortization	Carrying value	Weighted average life
Current:								
Trademark	$ –	$ –	$ –		$ 400	$ (400)	$ –	
Employment contract	37	(21)	16	1 year	375	(73)	302	1 year
	37	(21)	16		775	(473)	302	
Non-current:								
Certificates of need (indefinite life)	77,080	–	77,080		75,880	–	75,880	
Customer relationship assets	1,044	(62)	982	4 years	43,355	(5,851)	37,504	11 years
Non-compete agreements	2,927	(1,033)	1,894	5 years	5,035	(1,074)	3,961	5 years
	81,051	(1,095)	79,956		124,270	(6,925)	117,345	
	$ 81,088	$ (1,116)	$ 79,972		$ 125,045	$ (7,398)	$ 117,647	

Amortization expense computed by the straight-line method totaled $4.5 million for 2007, $5.2 million for 2006 and $2.2 million for 2005. Amortization expense for intangible assets transferred to PharMerica (as

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Goodwill and other intangible assets (Continued)

defined) in connection with the Spin-off Transaction totaled $2.4 million for 2007, $3.4 million for 2006 and $2.2 million for 2005.

Estimated annual amortization expense for intangible assets at December 31, 2007 will approximate $0.9 million, $0.8 million, $0.8 million, $0.3 million and $0.1 million for the years 2008, 2009, 2010, 2011 and 2012, respectively.

Long-lived assets

The Company regularly reviews the carrying value of certain long-lived assets and identifiable intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

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 facility 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 as the lowest level for which there are independent, identifiable cash flows. Accordingly, the estimated cash flows of all facilities within a master lease are aggregated for purposes of evaluating the carrying values of long-lived assets.

Insurance risks

Provisions for loss for professional liability risks and workers compensation risks are based upon management's best available information including third party actuarially determined estimates. The provisions for loss related to professional liability risks retained by the Company's wholly owned limited purpose insurance subsidiary have been discounted based upon management's estimate of long-term investment yields and third party actuarial estimates of claim payment patterns. Provisions for loss for workers compensation risks retained by the limited purpose insurance subsidiary are not discounted. To the extent that subsequent expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited. See Notes 4 and 10.

Earnings (loss) per common share

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of warrants, stock options and non-vested restricted stock.

Stock option accounting

The Company adopted SFAS No. 123 (revised 2004) ("SFAS 123R"), "Share-Based Payment," on January 1, 2006 and began to recognize compensation expense prospectively in its consolidated financial statements using a Black-Scholes option valuation model for non-vested stock options. Prior to the adoption of

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 – ACCOUNTING POLICIES (Continued)

Stock option accounting (Continued)

SFAS 123R, the Company followed Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its employee stock options.

The adoption of SFAS 123R reduced net income by $12.4 million and $6.2 million for the years ended December 31, 2007 and 2006, respectively. The reduction in net income for the year ended December 31, 2007 included $8.8 million of charges related to the adjustment of stock options in connection with the Spin-off Transaction.

In December 2005, the Company accelerated the vesting of approximately 944,000 non-vested stock options awarded to employees and officers which had exercise prices greater than the closing price at December 14, 2005 of $26.48 per share. The acceleration of the vesting of these stock options increased the pro forma stock-based employee compensation expense in 2005 by $13.2 million ($8.3 million net of income taxes or $0.18 per diluted share). The decision to accelerate the vesting of the outstanding underwater stock options was made primarily to reduce compensation expense that otherwise would be recorded in future periods following the adoption of SFAS 123R, to enhance management's focus on increasing shareholder returns and to improve employee morale and retention.

Pro forma information regarding net income and earnings per share determined as if the Company had accounted for its employee stock options granted under the fair value method of SFAS 123 beginning January 1, 2005 follows (in thousands, except per share amounts):

	Year ended December 31, 2005
Net income, as reported	$ 144,909
Adjustments:	
Stock-based employee compensation expense included in reported net income	5,844
Stock-based employee compensation expense determined under fair value based method	(21,436)
Pro forma net income	$ 129,317
Earnings per common share:	
As reported:	
Basic	$ 3.88
Diluted	$ 3.20
Pro forma:	
Basic	$ 3.46
Diluted	$ 2.83

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 2 – SPIN-OFF TRANSACTION

On July 31, 2007, the Company completed the spin-off of its former institutional pharmacy business, Kindred Pharmacy Services, Inc. ("KPS"), and the immediate subsequent combination of KPS with the former institutional pharmacy business of AmerisourceBergen Corporation ("AmerisourceBergen") to form a new, independent, publicly traded company named PharMerica Corporation ("PharMerica") (the "Spin-off Transaction"). Immediately prior to the Spin-off Transaction, KPS incurred $125 million of bank debt, the proceeds of which were distributed to the Company. Immediately after the Spin-off Transaction, the stockholders of the Company and of AmerisourceBergen each held approximately 50 percent of the outstanding common stock of PharMerica.

For accounting purposes, the assets and liabilities of KPS were eliminated from the balance sheet of the Company effective at the close of business on July 31, 2007, and beginning August 1, 2007, the future operating results of KPS were no longer included in the operating results of the Company. In accordance with SFAS No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets," the historical operating results of KPS are not reported as a discontinued operation of the Company because of the significance of the expected continuing cash flows between PharMerica and the Company under pharmacy services contracts for services to be provided by PharMerica to the Company's hospitals and nursing centers. Accordingly, for periods prior to August 1, 2007, the historical operating results of KPS are included in the historical continuing operations of the Company.

In addition to the pharmacy services contracts noted above, the Company also entered into new agreements with PharMerica for information systems services, transition services and certain tax matters. The Company recorded $7.7 million in other income in 2007 related to the information systems and transition services agreements.

A summary of the net assets of KPS which were transferred to PharMerica in the Spin-off Transaction follows (in thousands):

Assets:		
Current assets	$ 140,934	
Property and equipment, net	24,008	
Goodwill	45,819	
Intangible assets, net	35,655	
Other long-term assets	19,370	$ 265,786
Liabilities:		
Current liabilities	$ 56,024	
Long-term debt	125,000	
Other long-term liabilities	4,542	185,566
		$ 80,220

The net assets transferred by the Company were recorded as a reduction to retained earnings in 2007.

NOTE 3 – DIVESTITURES

In recent years, the Company has completed certain strategic divestitures to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying consolidated statement of operations for all periods presented. See Note 4.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 – DIVESTITURES (Continued)

2007 divestitures

In June 2007, the Company purchased for resale 21 nursing centers and one long-term acute care ("LTAC") hospital (collectively, the "Ventas Facilities") previously leased from Ventas, Inc. ("Ventas") for $171.5 million (the "Facility Acquisitions"). In addition, the Company paid Ventas a lease termination fee of $3.5 million.

The Ventas Facilities, which contained 2,634 licensed nursing center beds and 220 licensed hospital beds, generated pretax losses of approximately $4 million for 2007 and $10 million each for 2006 and 2005.

During 2007, the Company sold 14 of the Ventas Facilities for approximately $67 million. The Company intends to complete the divestiture of the remaining Ventas Facilities during 2008. The Company expects to generate between $13 million and $23 million in proceeds from the sale of the remaining Ventas Facilities and the related operations. The Company recorded a pretax loss of $112.7 million ($69.3 million net of income taxes) during 2007 related to these planned divestitures.

In January 2007, the Company acquired from Health Care Property Investors, Inc. ("HCP") the real estate related to 11 unprofitable leased nursing centers operated by the Company for resale in exchange for the real estate related to three hospitals previously owned by the Company (the "HCP Transaction"). As part of the HCP Transaction, the Company continues to operate these hospitals under a long-term lease arrangement with HCP. In addition, the Company paid HCP a one-time cash payment of approximately $36 million. The Company also amended its existing master lease with HCP to (1) terminate the current annual rent of approximately $9.9 million on the 11 nursing centers, (2) add the three hospitals to the master lease with a current annual rent of approximately $6.3 million and (3) extend the initial expiration date of the master lease until January 31, 2017 except for one hospital which has an expiration date of January 31, 2022. During 2007, the Company sold all of the nursing centers acquired in the HCP Transaction and received proceeds of $77.9 million. These 11 nursing centers, which contained 1,754 licensed beds, generated pretax losses of approximately $4 million for 2007, $1 million for 2006 and $4 million for 2005. In addition, the Company terminated a nursing center lease with another landlord during 2007. The Company recognized a pretax loss related to these divestitures of $13.4 million ($8.3 million net of income taxes) in 2007.

In accordance with SFAS 144, assets not sold at December 31, 2007 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying consolidated balance sheet.

2005 divestitures

During 2005, the Company disposed of three unprofitable leased nursing centers, designated two owned nursing centers as held for sale and closed one nursing center. The pretax loss associated with these transactions totaled $6.6 million ($4.1 million net of income taxes).

NOTE 4 – DISCONTINUED OPERATIONS

In accordance with SFAS 144, the divestiture of unprofitable businesses discussed in Notes 1 and 3 have been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the losses or impairments related to these divestitures have been classified as discontinued operations, net of income taxes, in the accompanying consolidated statement of operations. At December 31, 2007, the Company held for sale seven nursing centers and one LTAC hospital.

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KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

Discontinued operations included a pretax charge of approximately $1.5 million ($0.9 million net of income taxes) for 2007 and favorable pretax adjustments of $19.3 million ($11.8 million net of income taxes) and $42.3 million ($26.0 million net of income taxes) for 2006 and 2005, respectively, resulting from a change in estimate for professional liability reserves related to prior years.

A summary of discontinued operations follows (in thousands):

	Year ended December 31,		
	2007	2006	2005
Revenues	$ 157,910	$ 243,226	$ 284,348
Salaries, wages and benefits	90,104	132,066	157,928
Supplies	9,957	15,229	19,195
Rent	6,248	22,746	27,230
Other operating expenses	56,516	63,193	58,088
Depreciation	2,513	6,620	7,202
Interest expense	6	1	9
Investment income	(5)	(11)	(416)
	165,339	239,844	269,236
Income (loss) from operations before income taxes	(7,429)	3,382	15,112
Income tax provision (benefit)	(2,860)	1,302	5,818
Income (loss) from operations	(4,569)	2,080	9,294
Loss on divestiture of operations, net of income taxes	(77,021)	(32)	(1,381)
	$ (81,590)	$ 2,048	$ 7,913

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	Year ended December 31,		
	2007	2006	2005
Revenues:			
Hospital division:			
Hospitals	$ 14,873	$ 19,228	$ 27,185
Ancillary services	–	2	14
	14,873	19,230	27,199
Health services division	143,037	223,996	257,149
Pharmacy division	–	–	–
	$ 157,910	$ 243,226	$ 284,348
Operating income (loss):			
Hospital division:			
Hospitals	$ 2,535	$ 3,868	$ 2,363
Ancillary services	–	1	29
	2,535	3,869	2,392
Health services division	(1,202)	28,869	46,735
Pharmacy division	–	–	10
	$ 1,333	$ 32,738	$ 49,137
Rent:			
Hospital division:			
Hospitals	$ 545	$ 1,583	$ 2,013
Ancillary services	–	–	2
	545	1,583	2,015
Health services division	5,703	21,163	25,215
Pharmacy division	–	–	–
	$ 6,248	$ 22,746	$ 27,230
Depreciation:			
Hospital division:			
Hospitals	$ 198	$ 838	$ 783
Ancillary services	–	–	–
	198	838	783
Health services division	2,315	5,782	6,419
Pharmacy division	–	–	–
	$ 2,513	$ 6,620	$ 7,202

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	December 31,	
	2007	2006
Long-term assets:		
Property and equipment, net	$ 15,595	$ 8,802
Other	242	311
	15,837	9,113
Current liabilities (included in other accrued liabilities)	(717)	(1,376)
	$ 15,120	$ 7,737

NOTE 5 – ACQUISITIONS

The following is a summary of the Company's significant acquisition activities. The operating results of these acquired businesses have been included in the accompanying consolidated financial statements of the Company since the respective acquisition dates. The purchase price of these 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.

2007 acquisitions

During 2007, the Company acquired eight nursing centers and one hospital that were previously leased for $112.5 million. Annual rents associated with these facilities approximated $9.6 million. These transactions were financed through borrowings under the Company's revolving credit facility.

In July 2007, the Company acquired a combined nursing center and assisted living facility for $20.3 million. Goodwill and identifiable intangible assets recorded in connection with the acquisition aggregated $0.8 million.

In February 2007, the Company entered into new leases for eight nursing centers, the aggregate annual rents for which approximated $8.1 million.

Commonwealth Transaction

In February 2006, the Company acquired the operations of the LTAC hospitals, nursing centers and assisted living facilities operated by Commonwealth Communities Holdings LLC and certain of its affiliates (the "Commonwealth Transaction"). The Commonwealth Transaction was financed primarily through the use of the Company's revolving credit facility. Goodwill recorded in connection with the Commonwealth Transaction aggregated $37.7 million. The purchase price also included identifiable intangible assets of $75.9 million related to the value of acquired certificates of need with indefinite lives and other intangible assets of $5.2 million which will be amortized over approximately three years. The net cash paid through December 31, 2007 includes approximately $1.3 million of contingent consideration to be held in escrow through February 2008 in accordance with the acquisition agreement. During 2007, a portion of the contingent consideration previously held in escrow was settled, resulting in an increase of $6 million in goodwill. The Company has asserted various claims against the sellers under the acquisition agreement that may result in changes in the allocation of the purchase price.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 – ACQUISITIONS (Continued)

Commonwealth Transaction (Continued)

A summary of the Commonwealth Transaction follows (in thousands):

Fair value of assets acquired, including goodwill and other intangible assets	$	130,453
Fair value of liabilities assumed		(6,763)
Net cash paid through December 31, 2006		123,690
Additional payment of transaction costs		12
Net cash paid through December 31, 2007	$	123,702

The pro forma effect of the Commonwealth Transaction assuming the transaction occurred on January 1, 2006 and January 1, 2005 follows (in thousands, except per share amounts):

	Year ended December 31,			
	2006		2005	
Revenues	$	4,169,843	$	3,952,138
Income from continuing operations		76,690		142,169
Net income		78,738		150,082
Earnings per common share:				
Basic:				
Income from continuing operations	$	1.96	$	3.81
Net income	$	2.01	$	4.02
Diluted:				
Income from continuing operations	$	1.87	$	3.14
Net income	$	1.92	$	3.32

Pro forma financial data has been derived by combining the historical financial results of the Company and the operations acquired in the Commonwealth Transaction for the periods presented.

Pharmacy acquisitions

During 2006, the Company acquired three institutional pharmacy businesses for an aggregate cost of $15.3 million. During 2005, the Company acquired three institutional pharmacy businesses for an aggregate cost of $99.3 million.

NOTE 6 – REORGANIZATION ITEMS

Transactions related to the Company's emergence from bankruptcy on April 20, 2001 and related plan of reorganization have been classified separately in the accompanying consolidated statement of operations. Operating results for 2005 included income of $1.6 million resulting from changes in estimates for accrued professional and administrative costs related to these activities.

NOTE 7 – EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings (loss) per common share includes the dilutive effect of warrants, stock options and non-vested restricted stock.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 – EARNINGS (LOSS) PER SHARE (Continued)

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

	Year ended December 31,		
	2007	2006	2005
Earnings (loss):			
Income from continuing operations	$ 34,720	$76,663	$136,996
Discontinued operations, net of income taxes:			
Income (loss) from operations	(4,569)	2,080	9,294
Loss on divestiture of operations	(77,021)	(32)	(1,381)
Net income (loss)	$(46,870)	$78,711	$144,909
Shares used in the computation:			
Weighted average shares outstanding – basic computation	38,791	39,108	37,328
Dilutive effect of certain securities:			
Warrants	–	1,119	6,548
Employee stock options	767	450	927
Non-vested restricted stock	425	246	436
Adjusted weighted average shares outstanding – diluted computation	39,983	40,923	45,239
Earnings (loss) per common share:			
Basic:			
Income from continuing operations	$ 0.90	$ 1.96	$ 3.67
Discontinued operations:			
Income (loss) from operations	(0.12)	0.05	0.25
Loss on divestiture of operations	(1.99)	–	(0.04)
Net income (loss)	$ (1.21)	$ 2.01	$ 3.88
Diluted:			
Income from continuing operations	$ 0.87	$ 1.87	$ 3.03
Discontinued operations:			
Income (loss) from operations	(0.11)	0.05	0.20
Loss on divestiture of operations	(1.93)	–	(0.03)
Net income (loss)	$ (1.17)	$ 1.92	$ 3.20
Number of antidilutive stock options and non-vested restricted stock excluded from shares used in the diluted earnings (loss) per share computation	149	2,179	23

NOTE 8 – BUSINESS SEGMENT DATA

At December 31, 2007, the Company operated three business segments: the hospital division, the health services division and the rehabilitation division. The hospital division operates LTAC hospitals. The health services division operates nursing centers. The rehabilitation division provides rehabilitation services primarily in long-term care settings. The Company defines operating income as earnings before interest, income taxes, depreciation, amortization and rent. Operating income reported for each of the Company's business segments excludes the allocation of corporate overhead.

The Spin-off Transaction was completed on July 31, 2007. As a result, the Company's consolidated operating results for 2007 included the results of the Company's former pharmacy division for seven months. For accounting purposes, the pharmacy division will not be treated as a discontinued operation in the Company's historical consolidated financial statements.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – BUSINESS SEGMENT DATA (Continued)

The Company identifies its segments in accordance with the aggregation provisions of SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This information is consistent with information used by the Company in managing its businesses and aggregates businesses with similar economic characteristics.

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

	Year ended December 31,		
	2007	2006	2005
Revenues:			
Hospital division	$ 1,772,272	$ 1,710,670	$ 1,592,998
Health services division	2,014,786	1,819,320	1,645,130
Rehabilitation division	352,397	300,106	262,773
Pharmacy division	406,111	652,608	522,225
	4,545,566	4,482,704	4,023,126
Eliminations:			
Rehabilitation	(239,740)	(215,537)	(185,516)
Pharmacy	(85,560)	(137,115)	(119,111)
	(325,300)	(352,652)	(304,627)
	$ 4,220,266	$ 4,130,052	$ 3,718,499
Income from continuing operations:			
Operating income (loss):			
Hospital division	$ 362,199	$ 384,745	$ 416,423
Health services division	296,749	241,852	210,943
Rehabilitation division	34,526	30,362	32,052
Pharmacy division	17,557	48,461	56,837
Corporate:			
Overhead	(167,717)	(157,157)	(134,514)
Insurance subsidiary	(7,077)	(7,125)	(10,155)
	(174,794)	(164,282)	(144,669)
Reorganization items	–	–	1,639
Operating income	536,237	541,138	573,225
Rent	(347,560)	(297,663)	(250,479)
Depreciation and amortization	(121,767)	(117,422)	(97,304)
Interest, net	(889)	575	2,938
Income before income taxes	66,021	126,628	228,380
Provision for income taxes	31,301	49,965	91,384
	$ 34,720	$ 76,663	$ 136,996

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 8 – BUSINESS SEGMENT DATA (Continued)

	Year ended December 31,		
	2007	2006	2005
Rent:			
Hospital division	$ 143,718	$ 121,086	$ 98,989
Health services division	194,547	167,013	142,953
Rehabilitation division	4,641	3,697	3,243
Pharmacy division	4,325	5,554	4,935
Corporate	329	313	359
	$ 347,560	$ 297,663	$ 250,479
Depreciation and amortization:			
Hospital division	$ 42,304	$ 46,285	$ 40,165
Health services division	50,662	38,251	27,567
Rehabilitation division	1,176	533	231
Pharmacy division	6,510	8,835	5,751
Corporate	21,115	23,518	23,590
	$ 121,767	$ 117,422	$ 97,304
Capital expenditures, excluding acquisitions (including discontinued operations):			
Hospital division	$ 95,084	$ 70,154	$ 45,303
Health services division	46,940	41,229	50,346
Rehabilitation division	2,037	603	653
Pharmacy division	4,115	9,851	6,963
Corporate:			
Information systems	24,431	28,146	20,404
Other	13,881	1,091	2,394
	$ 186,488	$ 151,074	$ 126,063

	December 31, 2007	December 31, 2006
Assets at end of period:		
Hospital division	$ 846,429	$ 762,943
Health services division	550,525	427,376
Rehabilitation division	30,751	10,621
Pharmacy division	–	225,684
Corporate	651,847	589,503
	$ 2,079,552	$ 2,016,127
Goodwill:		
Hospital division	$ 67,598	$ 62,613
Health services division	639	–
Rehabilitation division	863	–
Pharmacy division	–	45,239
	$ 69,100	$ 107,852

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INCOME TAXES

The provision for income taxes is based upon management's estimate of annual taxable income or loss for each respective accounting period. The Company recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Company also recognizes as deferred tax assets the future tax benefits from net operating and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

Provision for income taxes consists of the following (in thousands):

	Year ended December 31,		
	2007	2006	2005
Current:			
Federal	$ 34,265	$ 45,543	$ 39,725
State	5,572	9,158	6,458
	39,837	54,701	46,183
Deferred	(8,536)	(4,736)	45,201
	$ 31,301	$ 49,965	$ 91,384

Reconciliation of federal statutory tax expense to the provision for income taxes follows (in thousands):

	Year ended December 31,		
	2007	2006	2005
Income tax expense at federal rate	$ 23,107	$ 44,320	$ 79,933
State income tax expense, net of federal income tax expense	2,311	4,432	7,993
Spin-off Transaction costs	4,829	–	–
Prior year contingencies	(2,296)	(2,697)	1,014
Other items, net	3,350	3,910	2,444
	$ 31,301	$ 49,965	$ 91,384

A summary of net deferred income tax assets by source included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2007	2006
Property and equipment	$ 27,601	$ 14,602
Insurance	48,608	42,502
Accounts receivable allowances	25,567	42,207
Compensation	38,279	36,320
Net operating losses	3,956	3,602
Assets held for sale	14,009	833
Other	27,098	30,026
	185,118	170,092
Valuation allowance	(11,328)	(11,328)
	$ 173,790	$ 158,764

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INCOME TAXES (Continued)

Deferred income taxes totaling $59.9 million and $62.5 million at December 31, 2007 and 2006, respectively, were classified as current assets, and deferred income taxes totaling $113.9 million and $96.3 million at December 31, 2007 and 2006, respectively, were classified as noncurrent assets.

In November 2004, the Internal Revenue Service (the "IRS") proposed certain adjustments to the Company's 2000 and 2001 federal income tax returns which were contested. The principal proposed adjustment related to the manner of reducing tax attributes, primarily net operating loss carryforwards ("NOLs"), in connection with the emergence of the Company and its subsidiaries from proceedings under the bankruptcy code. In 2006, the Company reached a settlement with the IRS related to all disputed federal income tax issues for fiscal 2000 and 2001. In connection with the settlement, the Company paid $2.9 million of employer payroll taxes to the IRS in 2007. At December 31, 2006, the Company reflected the impact of the settlement in its consolidated balance sheet by increasing certain net deferred tax assets by $16.4 million, reducing currently payable income taxes by $69.7 million and increasing stockholders' equity by $86.1 million. Because of fresh-start accounting rules related to the Company's reorganization in 2001, the settlement of these pre-reorganization income tax matters had no impact on earnings in 2006.

After the Company's emergence from bankruptcy, the realization of pre-reorganization deferred tax assets (amounts which had been considered "more likely than not" to be realized by the Company) and the resolution of certain income tax contingencies eliminated in full the goodwill recorded in connection with fresh-start accounting. After the fresh-start accounting goodwill was eliminated in full, the excess of $3.0 million in 2007, $79.8 million in 2006 and $18.2 million in 2005 was treated as an increase to capital in excess of par value and a reduction in the pre-emergence deferred tax valuation allowance and pre-emergence income tax liability.

In connection with the Company's emergence from bankruptcy, the Company realized a gain from the extinguishment of certain indebtedness. This gain was not taxable since the gain resulted from the reorganization under the bankruptcy code. However, the Company is required, beginning with its 2002 taxable year, to reduce certain tax attributes including (a) NOLs, (b) certain tax credits and (c) tax bases in assets in an amount equal to such gain on extinguishment.

The Company had NOLs of $10.3 million and $9.4 million (after the conclusion of the Company's 2000 and 2001 federal tax examinations and the reductions in the attributes discussed above) at December 31, 2007 and 2006, respectively. A deferred tax valuation allowance of $2.3 million related to NOLs was recorded at December 31, 2007 and 2006. The NOLs expire in various amounts through 2026.

FIN 48

In July 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes" which clarifies the accounting for uncertain income tax issues recognized in an entity's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 – INCOME TAXES (Continued)

FIN 48 (Continued)

The Company adopted the provisions of FIN 48 on January 1, 2007. As of the date of adoption, the Company's unrecognized tax benefits were $7.4 million. A reconciliation of the 2007 activity related to unrecognized tax benefits follows (in thousands):

Balance, January 1, 2007	$	7,419
Additions related to prior period tax filings		4,715
Reductions due to lapses of applicable statute of limitations		(2,921)
Balance, December 31, 2007	$	9,213

The Company records accrued interest and penalties associated with uncertain tax positions as income tax expense in the consolidated statement of operations. Accrued interest related to uncertain tax provisions totaled $2.1 million as of January 1, 2007 and $1.5 million as of December 31, 2007.

To the extent the unrecognized income tax benefits become realized or the related accrued interest is no longer necessary, the Company's provision for income taxes would be favorably impacted. The amount, if recognized, that would favorably impact the Company's results of operations approximates $4.6 million. The remaining balance of unrecognized income tax benefits of $4.6 million, if recognized, would increase stockholders' equity.

The federal statute of limitations remains open for tax years 2004 through 2007. The IRS is currently examining the 2004 and 2005 tax years.

State jurisdictions generally have statutes of limitations for tax returns ranging from three to five years. The state income tax impact of federal income tax changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company currently has various state income tax returns under examination.

During 2008, the statutes of limitations associated with certain state income tax filing positions will expire and may decrease the amount of unrecognized income tax benefits. A reduction in the Company's income tax liability of up to approximately $2 million for unrecognized income tax benefits and up to $1 million of accrued interest is reasonably possible and may favorably impact the Company's financial position and results of operations. In addition, due to the expiration of statutes of limitations associated with certain states, it is reasonably possible that approximately $4.6 million of unrecognized income tax benefits would result in an increase to stockholders' equity for unrecognized income benefits resulting from the Company's emergence from bankruptcy.

NOTE 10 – INSURANCE RISKS

The Company insures a substantial portion of its professional liability risks and workers compensation risks through a wholly owned limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management's best available information including third party actuarially determined estimates.

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 liabilities 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 subsequent expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited. See Note 4.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE RISKS (Continued)

The provision for loss for insurance risks, including the cost of coverage maintained with unaffiliated commercial insurance carriers, follows (in thousands):

	Year ended December 31,		
	2007	2006	2005
Professional liability:			
Continuing operations	$ 36,992	$ 52,949	$ 64,058
Discontinued operations	12,368	(2,713)	(22,715)
Workers compensation:			
Continuing operations	$ 38,366	$ 35,808	$ 44,502
Discontinued operations	2,196	3,490	5,263

A summary of the assets and liabilities related to insurance risks included in the accompanying consolidated balance sheet at December 31 follows (in thousands):

	2007			2006		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$ 127,017	$ 104,676	$ 231,693	$ 158,245	$ 69,620	$ 227,865
Reinsurance recoverables	4,334	–	4,334	2,291	–	2,291
	131,351	104,676	236,027	160,536	69,620	230,156
Non-current:						
Insurance subsidiary investments	49,166	–	49,166	52,977	–	52,977
Reinsurance recoverables	4,530	–	4,530	8,565	–	8,565
Deposits	6,250	1,455	7,705	7,250	1,507	8,757
Other	–	261	261	–	275	275
	59,946	1,716	61,662	68,792	1,782	70,574
	$ 191,297	$ 106,392	$ 297,689	$ 229,328	$ 71,402	$ 300,730
Liabilities:						
Allowance for insurance risks:						
Current	$ 64,740	$ 26,144	$ 90,884	$ 65,497	$ 27,920	$ 93,417
Non-current	186,652	63,132	249,784	184,749	56,971	241,720
	$ 251,392	$ 89,276	$ 340,668	$ 250,246	$ 84,891	$ 335,137

Provisions for loss for professional liability risks retained by the limited purpose insurance subsidiary have been discounted based upon third party actuarial estimates of claim payment patterns using a discount rate of 5% in each of the last three years. 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 $263.8 million at December 31, 2007 and $262.9 million at December 31, 2006.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 – INSURANCE RISKS (Continued)

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

NOTE 11 – INSURANCE SUBSIDIARY INVESTMENTS

The amortized cost and estimated fair value of the Company's insurance subsidiary investments at December 31 follow (in thousands):

	2007				2006			
	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents	$ 149,212	$ –	$ –	$ 149,212	$ 142,966	$ –	$ –	$ 142,966
Asset backed securities	52,098	444	(33)	52,509	50,901	28	(328)	50,601
Corporate bonds	35,824	126	(215)	35,735	31,210	23	(130)	31,103
Commercial paper	20,912	15	–	20,927	31,072	–	(11)	31,061
Equities	14,498	2,278	(886)	15,890	12,944	1,966	(141)	14,769
U.S. Treasury notes	6,141	445	–	6,586	10,112	294	(64)	10,342
	$ 278,685	$ 3,308	$ (1,134)	$ 280,859	$ 279,205	$ 2,311	$ (674)	$ 280,842

The fair value of available-for-sale investments of the Company's insurance subsidiary at December 31, 2007 follows. Expected maturities may differ from contractual maturities as issuers may have the right to call or prepay obligations prior to the stated maturity date.

(In thousands)	Expected maturities	Contractual maturities
Within one year	$ 231,693	$ 229,319
One year to five years	46,067	48,441
After five years	3,099	3,099
	$ 280,859	$ 280,859

Net investment income earned by the Company's insurance subsidiary investments follows (in thousands):

	Year ended December 31,		
	2007	2006	2005
Interest income	$ 12,405	$ 10,894	$ 8,108
Net amortization of premium and accretion of discount	818	864	399
Gains on sale of investments	1,350	846	673
Losses on sale of investments	(106)	(249)	(830)
Investment expenses	(263)	(222)	(256)
	$ 14,204	$ 12,133	$ 8,094

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

The available-for-sale investments of the Company's insurance subsidiary which have unrealized losses at December 31, 2007 are shown below. The investments are categorized by the length of time that individual securities have been in a continuous unrealized loss position at December 31, 2007.

	Less than one year		One year or greater		Total	
(In thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Asset backed securities	$ 1,811	$ 10	$ 12,725	$ 23	$ 14,536	$ 33
Corporate bonds	15,264	198	9,688	17	24,952	215
Commercial paper	–	–	–	–	–	–
Equities	4,955	792	753	94	5,708	886
U.S. Treasury notes	–	–	–	–	–	–
	$ 22,030	$ 1,000	$ 23,166	$ 134	$ 45,196	$ 1,134

As of December 31, 2007, the unrealized losses on asset backed securities and corporate bonds totaling $0.2 million were due to changes in interest rates. The unrealized losses on equities totaling $0.9 million were due to market fluctuations. Accordingly, the Company believes these unrealized losses are the result of temporary interest rate and market fluctuations.

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 generate cash to fund the underwriting needs of its insurance subsidiary. This ability to hold securities allows sufficient time for recovery of temporary declines in market value of equity securities and par value of debt securities as of their stated maturity date.

Because the Company considers the unrealized losses at December 31, 2007 to be temporary, and due to its investment policy guidelines and ability to hold investments for a period of time sufficient to allow for any anticipated recovery in market value, the Company has not recorded any impairment loss related to these securities.

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KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12 – LEASES

The Company leases real estate and equipment under cancelable and non-cancelable arrangements. The following table sets forth rent expense by business segment (in thousands):

	Year ended December 31,		
	2007	2006	2005
Hospital division:			
Buildings:			
Ventas	$ 84,358	$ 71,171	$ 61,207
Other landlords	32,968	24,601	14,827
Equipment	26,392	25,314	22,955
	143,718	121,086	98,989
Health services division:			
Buildings:			
Ventas	145,916	127,263	113,723
Other landlords	45,697	36,965	26,530
Equipment	2,934	2,785	2,700
	194,547	167,013	142,953
Rehabilitation division:			
Buildings	84	74	72
Equipment	4,557	3,623	3,171
	4,641	3,697	3,243
Pharmacy division:			
Buildings	3,705	4,739	4,147
Equipment	620	815	788
	4,325	5,554	4,935
Corporate:			
Buildings	285	277	326
Equipment	44	36	33
	329	313	359
	$ 347,560	$ 297,663	$ 250,479

Future minimum payments under non-cancelable operating leases are as follows (in thousands):

	Minimum payments		
	Ventas	Other	Total
2008	$ 234,652	$ 72,845	$ 307,497
2009	234,652	65,044	299,696
2010	154,491	61,110	215,601
2011	114,411	57,307	171,718
2012	114,411	52,873	167,284
Thereafter	38,136	319,965	358,101

At December 31, 2007, the Company leased from Ventas and its affiliates 38 LTAC hospitals and 165 nursing centers under four Master Lease Agreements (the "Master Lease Agreements").

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 12 – LEASES (Continued)

In October 2006, Ventas exercised a one-time right to reset rent under each of the Master Lease Agreements. These new aggregate annual rents of approximately $239 million (including the Ventas Facilities) became effective retroactively to July 19, 2006 and were determined as fair market rentals by the final independent appraisers engaged in connection with the rent reset process under the Master Lease Agreements. Aggregate annual Ventas rents prior to the rent reset approximated $206 million (including the Ventas Facilities). As required, Ventas paid the Company a reset fee of approximately $4.6 million that will be amortized as a reduction of rent expense over the remaining original terms of the Master Lease Agreements. In connection with the exercise of the rent reset, the new annual rents were allocated among the facilities subject to the Master Lease Agreements in accordance with the determinations made by the final appraisers during the rent reset process. The new contingent annual rent escalator is 2.7% for Master Lease Agreements Nos. 1, 3 and 4. The new contingent annual rent escalator for Master Lease Agreement No. 2 is based upon the Consumer Price Index with a floor of 2.25% and a ceiling of 4%. Prior to the rent reset, the contingent annual Ventas rent escalator under each Master Lease Agreement was 3.5%.

NOTE 13 – LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION

Capitalization

A summary of long-term debt and capital lease obligation at December 31 follows (in thousands):

	2007	2006
Revolving credit facility due 2012 (LIBOR plus 1.25% to 2.00%)	$ 275,000	$ 129,200
Capital lease obligation due 2027 (8.04% discount rate)	16,268	–
Other	890	961
Total debt, average life of 5 years (weighted average rate 6.8%)	292,158	130,161
Amounts due within one year	(584)	(71)
Long-term debt and capital lease obligation	$ 291,574	$ 130,090

In July 2007, the Company completed certain amendments to its revolving credit facility. Under the terms of the revolving credit facility as amended, the aggregate amount of the credit was increased to $500 million and may be further increased to $600 million at the Company's option if certain conditions are met. The term of the revolving credit facility was extended by an additional three years until July 2012. The revolving credit facility also establishes permitted acquisitions and certain investments by the Company at $500 million in the aggregate and allows for up to $150 million of certain restricted payments including, among other things, the repurchase of common stock and payment of cash dividends. The revolving credit facility also allowed for the consummation of the Spin-off Transaction.

Interest rates under the revolving credit facility are based, at the Company's option, upon (a) LIBOR plus the applicable margin or (b) the applicable margin plus the higher of the prime rate or 0.5% over the federal funds rate. The applicable margin in the revolving credit facility represents a decrease of 75 basis points from the previous pricing.

The revolving credit facility is collateralized by substantially all of the Company's assets including certain owned real property and is guaranteed by substantially all of the Company's subsidiaries. The revolving credit facility constitutes a working capital facility for general corporate purposes and permitted acquisitions and investments in healthcare facilities and companies up to certain limits. The terms of the revolving credit facility include certain financial covenants and covenants which limit acquisitions and annual capital expenditures. The Company was in compliance with the terms of the revolving credit facility at December 31, 2007.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13 – LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION (Continued)

Capitalization (Continued)

In November 2007, the Company entered into a 20-year capital lease obligation related to a newly constructed replacement hospital. In January 2008, the Company exercised a purchase option for this hospital and expects to complete the transaction in the second quarter of 2008. The purchase price, which is based upon project costs, is expected to approximate $17 million.

Other Information

The following table summarizes scheduled maturities of long-term debt for the years 2008 through 2012 (in thousands):

	Revolving credit facility	Other	Total
2008	$ –	$ 76	$ 76
2009	–	81	81
2010	–	86	86
2011	–	91	91
2012	275,000	96	275,096

The estimated fair value of the Company's long-term debt at December 31, 2007 and 2006 approximated the respective carrying amounts.

The following table summarizes scheduled maturities of the capital lease obligation (in thousands):

	Principal	Interest	Total
2008	$ 508	$ 1,390	$ 1,898
2009	373	1,254	1,627
2010	404	1,223	1,627
2011	438	1,189	1,627
2012	475	1,152	1,627
Thereafter	14,070	10,060	24,130
	$ 16,268	$ 16,268	$ 32,536

NOTE 14 – CONTINGENCIES

Management continually evaluates contingencies based upon the best available information. In addition, allowances for loss are provided currently for disputed items that have continuing significance, such as certain third party reimbursements and deductions that continue to be claims 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 programs. The Company is contesting certain issues raised in audits of prior year cost reports.

Professional liability risks – The Company has provided for loss for professional liability risks based upon management's best available information including third party actuarially determined estimates. Ultimate claims costs may differ from the provisions for loss. See Notes 4 and 10.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 14 – CONTINGENCIES (Continued)

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. In addition, the Company is a party to a tax matters agreement with PharMerica with respect to the Company's rights and obligations related to taxes for periods before and after the Spin-off Transaction.

Litigation – The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions in the ordinary course of business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. The U.S. Department of Justice (the "DOJ"), the Centers for Medicare and Medicaid Services ("CMS") or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company's businesses in the future which may, either individually or in the aggregate, have a material adverse effect on the Company's financial position, results of operations and liquidity.

Other indemnifications – In the ordinary course of business, the Company enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction such as a disposal of an operating facility. These indemnifications may cover claims related to employment-related matters, governmental regulations, environmental issues and tax matters, as well as patient, third party payor, supplier and contractual relationships. Obligations under these indemnities generally are initiated by a breach of the terms of a contract or by a third party claim or event.

NOTE 15 – CAPITAL STOCK

In April 2002, the shareholders of the Company approved an increase in the number of authorized shares of common stock from 39 million to 175 million. The shareholders also approved an additional 3.2 million shares of common stock in May 2004 and 2.4 million shares of common stock in April 2002 that could be issued under the Company's incentive compensation plans.

Plan descriptions

The Company maintains plans under which approximately eight million restricted stock awards and options to purchase common stock may be granted to directors, officers and other key employees. Exercise provisions vary, but most stock options are exercisable in whole or in part beginning one to four years after grant and ending seven to ten years after grant. Shares of common stock available for future grants were 1,309,470, 1,663,490 and 2,730,841 at December 31, 2007, 2006 and 2005, respectively.

Stock options

As discussed in Note 1, the Company adopted SFAS 123R as of January 1, 2006. The fair value of each stock option is estimated at the date of grant using a Black-Scholes option valuation model with the following weighted average assumptions:

	Year ended December 31,		
	2007	2006	2005
Risk-free interest rate	4.46%	4.62%	4.14%
Expected dividend yield	None	None	None
Expected term	6 years	5 years	6 years
Expected volatility	47%	51%	53%
Weighted average fair value at grant date	$12.51	$11.03	$16.16

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15 – CAPITAL STOCK (Continued)

Stock options (Continued)

The expected term represents the period of time that stock options granted are estimated to be outstanding. The expected volatility is based upon the historical prices of the Company's common stock. As required by SFAS 123R, an estimate of expected forfeitures was determined and compensation expense was recognized only for those stock options expected to vest.

At December 31, 2007, unearned compensation costs related to non-vested stock options aggregated $3.1 million. These costs will be expensed over the remaining weighted average vesting period of approximately three years. Compensation expense related to stock options approximated $16.1 million for the year ended December 31, 2007 and $7.4 million for the year ended December 31, 2006. Compensation expense for the year ended December 31, 2007 included $11.7 million related to the adjustment of stock options in connection with the Spin-off Transaction.

Activity in the various plans is summarized below:

	Shares under option	Option price per share	Weighted average exercise price
Balances, December 31, 2006	3,386,869	$ 6.39 to $37.17	$ 22.40
Granted	35,000	25.38	25.38
Exercised	(565,669)	6.39 to 31.14	18.19
Canceled	(52,502)	7.97 to 31.14	21.71
Balances, July 31, 2007	2,803,698	6.39 to 37.17	23.30
Issued in connection with the Spin-off Transaction	864,614	4.89 to 28.41	17.81
Granted	10,000	20.55 to 23.66	22.11
Exercised	(40,947)	4.89 to 22.55	12.10
Canceled	(75,013)	4.89 to 23.80	16.11
Balances, December 31, 2007	3,562,352	$ 4.89 to $28.41	$ 17.93

As a result of the Spin-off Transaction, adjustments to outstanding stock options as of July 31, 2007 were made in accordance with IRS guidelines which resulted in changes to both the number of shares subject to the stock option and the exercise price.

The intrinsic value of the stock options exercised during 2007, 2006 and 2005 approximated $9.1 million, $1.2 million and $11.9 million, respectively. Cash received from stock option exercises in 2007, 2006 and 2005 totaled $10.5 million, $1.6 million and $8.5 million, respectively.

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15 – CAPITAL STOCK (Continued)

Stock options (Continued)

A summary of stock options outstanding at December 31, 2007 follows:

	Options outstanding			Options exercisable	
Range of exercise prices	Number outstanding at December 31, 2007	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at December 31, 2007	Weighted average exercise price
$4.89 to $8.44	351,967	5 years	$ 7.97	351,967	$ 7.97
$12.16 to $15.29	760,583	4 years	13.76	760,583	13.76
$16.81 to $22.72	1,475,472	6 years	18.55	870,311	19.05
$23.25 to $28.41	974,330	5 years	23.84	969,330	23.84
	3,562,352	5 years	17.93	2,952,191	17.94

The intrinsic value of the stock options outstanding and stock options that are exercisable as of December 31, 2007 approximated $25.2 million and $20.8 million, respectively.

Restricted stock

At December 31, 2007, unearned compensation costs related to non-vested restricted stock aggregated $11.8 million. These costs will be expensed over the remaining weighted average vesting period of approximately three years. Compensation expense related to these awards approximated $15.1 million for the year ended December 31, 2007, $11.2 million for the year ended December 31, 2006 and $9.4 million for the year ended December 31, 2005. Compensation expense for the year ended December 31, 2007 included $3.9 million in connection with the Spin-off Transaction.

A summary of non-vested restricted shares follows:

	Non-vested restricted shares	Weighted average fair value at date of grant
Balances, December 31, 2006	830,697	$ 26.87
Granted	482,998	34.79
Vested	(324,452)	26.61
Canceled	(46,463)	28.23
Balances, December 31, 2007	942,780	$ 30.95

The fair value of restricted shares vested during 2007, 2006 and 2005 was $9.0 million, $10.8 million and $20.9 million, respectively.

Stock repurchases

In August 2007, the Company's Board of Directors authorized up to $100 million in common stock repurchases. The authorization allowed for the repurchase of up to $50 million of common stock during 2007 and the remainder during 2008. During 2007, the Company expended $50 million to purchase approximately

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 15 – CAPITAL STOCK (Continued)

Stock repurchases (Continued)

2.6 million shares of its common stock. The Company intends to finance any additional repurchases from operating cash flows or from borrowings under its revolving credit facility. The authorization includes both open market purchases as well as private transactions.

In August 2005, the Company's Board of Directors authorized the repurchase of up to $100 million in common stock and warrants. During 2005, the Company repurchased approximately 1.8 million shares of its common stock at an aggregate cost of $48.0 million. During 2006, the Company repurchased approximately 2 million shares of its common stock in the open market at an aggregate cost of $52.0 million, thereby completing the 2005 share repurchase program. The Company financed these repurchases from both operating cash flows and borrowings under its revolving credit facility.

Common stock repurchases are accounted for as constructive retirements in accordance with the allocation method under paragraph 12 of Accounting Principles Board Opinion No. 6, "Status of Accounting Research Bulletins," which provides that any excess of the purchase price over par value may be allocated between capital surplus and retained earnings.

Warrants

In connection with the exercise of the Company's Series A warrants and Series B warrants in April 2006, the Company issued approximately 10.1 million shares of common stock and received net proceeds of $142.3 million. These proceeds were used to repurchase approximately 5.8 million shares of the Company's common stock in the open market in 2006.

NOTE 16 – EMPLOYEE BENEFIT PLANS

The Company maintains defined contribution retirement plans covering employees who meet certain minimum eligibility requirements. Benefits are determined as a percentage of a participant's contributions and generally are vested based upon length of service. Retirement plan expense was $9.5 million for 2007, $10.8 million for 2006 and $8.6 million for 2005. Amounts equal to retirement plan expense are funded annually.

NOTE 17 – ACCRUED LIABILITIES

A summary of other accrued liabilities at December 31 follows (in thousands):

	2007	2006
Patient accounts	$ 37,131	$ 31,357
Taxes other than income	26,234	27,244
Other	17,298	16,921
	$ 80,663	$ 75,522

KINDRED HEALTHCARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 18 – FAIR VALUE OF FINANCIAL INSTRUMENTS

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.

	2007		2006	
(In thousands)	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	$ 32,877	$ 32,877	$ 20,857	$ 20,857
Cash–restricted	5,360	5,360	5,757	5,757
Insurance subsidiary investments	280,859	280,859	280,842	280,842
Tax refund escrow investments	213	213	230	230
Long-term debt, including amounts due within one year	275,890	275,878	130,161	130,148

NOTE 19 – LITIGATION

The Company is a party to various legal actions (some of which are not insured), and regulatory and other government investigations and sanctions arising in the ordinary course of its business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory and other government investigations. 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 which may, either individually or in the aggregate, have a material adverse effect on the Company's financial position, operating results and liquidity.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)
(In thousands, except per share amounts)

	2007 (a)			
	First	Second	Third	Fourth
Revenues	$ 1,108,989	$ 1,096,245	$ 1,009,459	$ 1,005,573
Net income (loss):				
Income (loss) from continuing operations	16,525	9,643	(9,058)	17,610
Discontinued operations, net of income taxes:				
Loss from operations	(1,426)	(1,874)	(4)	(1,265)
Loss on divestiture of operations	(7,266)	(69,702)	–	(53)
Net income (loss)	7,833	(61,933)	(9,062)	16,292
Earnings (loss) per common share:				
Basic:				
Income (loss) from continuing operations	0.42	0.24	(0.23)	0.47
Discontinued operations:				
Loss from operations	(0.03)	(0.05)	–	(0.03)
Loss on divestiture of operations	(0.19)	(1.76)	–	–
Net income (loss)	0.20	(1.57)	(0.23)	0.44
Diluted:				
Income (loss) from continuing operations	0.41	0.24	(0.23)	0.46
Discontinued operations:				
Loss from operations	(0.03)	(0.05)	–	(0.03)
Loss on divestiture of operations	(0.18)	(1.71)	–	–
Net income (loss)	0.20	(1.52)	(0.23)	0.43
Shares used in computing earnings (loss) per common share:				
Basic	39,212	39,591	39,013	37,365
Diluted	39,997	40,645	39,013	38,366
Market prices (b):				
High	34.44	36.67	31.80	26.02
Low	24.46	30.56	17.35	17.35

	2006 (a)			
	First	Second	Third	Fourth
Revenues	$ 997,124	$ 1,040,814	$ 1,024,144	$ 1,067,970
Net income:				
Income from continuing operations	24,249	26,464	4,564	21,386
Discontinued operations, net of income taxes:				
Income (loss) from operations	(447)	3,517	(1,752)	762
Gain (loss) on divestiture of operations	157	(308)	126	(7)
Net income	23,959	29,673	2,938	22,141
Earnings per common share:				
Basic:				
Income from continuing operations	0.66	0.64	0.12	0.55
Discontinued operations:				
Income (loss) from operations	(0.01)	0.08	(0.05)	0.02
Gain (loss) on divestiture of operations	–	(0.01)	–	–
Net income	0.65	0.71	0.07	0.57
Diluted:				
Income from continuing operations	0.59	0.62	0.11	0.54
Discontinued operations:				
Income (loss) from operations	(0.01)	0.08	(0.04)	0.02
Gain (loss) on divestiture of operations	–	(0.01)	–	–
Net income	0.58	0.69	0.07	0.56
Shares used in computing earnings per common share:				
Basic	36,576	41,695	39,014	39,120
Diluted	41,091	42,956	39,769	39,784
Market prices:				
High	29.50	27.40	32.07	29.99
Low	19.70	22.76	24.91	24.95

(a) See accompanying discussion of certain quarterly items.

(b) On July 31, 2007, the Company completed the Spin-off Transaction. Immediately after the Spin-off Transaction, stockholders of the Company held approximately 50% of the outstanding common stock of PharMerica.

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED) (Continued)

SIGNIFICANT QUARTERLY ADJUSTMENTS

The following is a description of significant quarterly adjustments recorded during each quarter of 2007 and 2006:

Fourth quarter 2007

Operating results for the fourth quarter of 2007 included a pretax charge of $1.1 million for costs incurred in connection with the Spin-off Transaction, a pretax charge of $0.4 million for employee severance costs, a pretax charge of $1.7 million for professional fees associated with the Company's strategic planning process and a pretax gain of $0.6 million from an asset sale. In addition, the provision for income taxes included a net charge of $0.4 million related to income tax items associated with the Spin-off Transaction.

The Company also recorded certain adjustments in the fourth quarter of 2007, including a pretax charge of approximately $6.6 million related to accounts receivable for certain hospitals acquired in 2006, a pretax credit of approximately $2.6 million to reflect a change in estimate for hospital Medicare in-house accounts receivable and a pretax credit of approximately $3.7 million to adjust certain nursing center Medicaid revenues. The aggregate effect of these changes in estimates did not have a material effect on the Company's consolidated fourth quarter 2007 results of operations.

Third quarter 2007

Operating results for the third quarter of 2007 included a non-cash pretax charge of $17.7 million for compensation costs resulting from the Spin-off Transaction (primarily related to the adjustment of stock options adjusted in the Spin-off Transaction and the vesting of certain stock-based and other compensation), a pretax charge of $3.9 million for professional fees and other costs incurred in connection with the Spin-off Transaction and a pretax charge of $0.9 million for employee severance costs. In addition, the provision for income taxes included a net charge of $2.2 million related to income tax items associated with the Spin-off Transaction and the favorable resolution of certain income tax contingencies for prior years.

Second quarter 2007

Operating results for the second quarter of 2007 included a pretax charge of $2.8 million for professional fees and other costs incurred in connection with the Spin-off Transaction and a pretax charge of $3.4 million for employee severance costs. The Company also recorded a pretax charge of $4.6 million related to an unfavorable judgment rendered in connection with a civil dispute with a hospital vendor. In addition, operating results for the second quarter of 2007 included pretax income of $5.5 million related to a favorable settlement of a rehabilitation therapy contract dispute from prior years.

First quarter 2007

Operating results for the first quarter of 2007 included a pretax charge of $4.1 million for professional fees and other costs incurred in connection with the Spin-off Transaction.

Fourth quarter 2006

Operating results for the fourth quarter of 2006 included pretax income of $2.3 million related to favorable settlements of prior year hospital Medicare cost reports, pretax income of $1.5 million from insurance recoveries related to hurricane losses, a pretax charge of $4.2 million to adjust certain estimated institutional pharmacy

KINDRED HEALTHCARE, INC.
QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED) (Continued)

SIGNIFICANT QUARTERLY ADJUSTMENTS (Continued)

Fourth quarter 2006 (Continued)

Medicare Part D revenues recorded in the first nine months of 2006, a pretax charge of $3.1 million to adjust the accounts receivable of an acquired institutional pharmacy, and a pretax charge of $5.3 million for professional fees and other costs incurred in connection with the Spin-off Transaction and the rent reset issue with Ventas. The Company also recorded favorable income tax adjustments that increased net income by $3.5 million.

Third quarter 2006

Operating results for the third quarter of 2006 included pretax income of $1.3 million related to an insurance recovery and a favorable adjustment of a prior year tax dispute, and a pretax charge of $3.5 million for costs incurred in connection with the Spin-off Transaction and professional fees incurred in connection with the Ventas rent reset issue. Third quarter 2006 results also included a charge of $0.6 million related to a change in estimate of the Company's annual effective income tax rate.

Second quarter 2006

Operating results for the second quarter of 2006 included pretax income of $4.3 million related to favorable settlements of prior year hospital Medicare cost reports, a pretax charge of $3.3 million in connection with the settlement of a prior year tax dispute and a pretax charge of $1 million for investment banking services and costs related to the rent reset issue with Ventas.

First quarter 2006

Operating results for the first quarter of 2006 included pretax income of $1.8 million related to the favorable settlement of prior year hospital Medicare cost reports, a $1.3 million pretax gain from an institutional pharmacy joint venture transaction, a pretax charge of $2.7 million related primarily to revisions to prior estimates for accrued contract labor costs in the Company's rehabilitation division, and a pretax charge of $1.3 million for investment banking services and costs related to the rent reset issue with Ventas.

KINDRED HEALTHCARE, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
FOR THE YEARS ENDED DECEMBER 31, 2007, 2006 AND 2005
(In thousands)

	Balance at beginning of period	Additions		Deductions		Balance at end of period
		Charged to costs and expenses	Acquisitions	Deductions or payments	Spin-off Transaction	
Allowance for loss on accounts receivable:						
Year ended December 31, 2005	$ 60,320	$ 14,867	$ 9,892	$ (23,001)	$ –	$ 62,078
Year ended December 31, 2006	62,078	35,149	509	(35,672)	–	62,064
Year ended December 31, 2007	62,064	30,093	149	(43,315)	(15,686)	33,305
Allowance for deferred taxes:						
Year ended December 31, 2005	$ 137,749	$ –	$ –	$ (11,571)	$ –	$ 126,178
Year ended December 31, 2006	126,178	–	–	(114,850)	–	11,328
Year ended December 31, 2007	11,328	–	–	–	–	11,328

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**AMENDMENT TO MEMORANDUM OF LEASE
AND SPECIFIC PROPERTY LEASE AMENDMENT**

THIS FIRST AMENDMENT TO MEMORANDUM OF LEASE AND SPECIFIC PROPERTY LEASE AMENDMENT (hereinafter this "Amendment") is dated as of the 8th day of June, 2007, and is between VENTAS REALTY, LIMITED PARTNERSHIP, a Delaware limited partnership (together with its successors and assigns, "Lessor") having an office at 10350 Ormsby Park Place, Suite 300, Louisville, Kentucky 40223, and KINDRED HEALTHCARE, INC., a Delaware corporation formerly known as Vencor, Inc. ("Kindred"), and KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation formerly known as Vencor Operating, Inc. ("Operator"; Operator, jointly and severally with Kindred and permitted successors and assignees of Operator and Kindred, "Tenant"), both having an office at 680 South 4th Avenue, Louisville, Kentucky 40202.

RECITALS

A. Lessor and Tenant have heretofore entered into (i) a certain Second Amended and Restated Master Lease Agreement No. 1 dated as of April 27, 2007 (as the same may have been or may hereafter be amended, amended and restated, supplemented, modified, renewed, extended or replaced, the "Lease") demising to Tenant, among other properties, the real property described in Exhibit A attached hereto and made a part hereof, together with the improvements thereon (the "Premises"), and (ii) a Memorandum of Lease (the "Memorandum") dated as of April 20, 2001, and recorded on April 27, 2001, in the Official Records of Clay County, Florida, Book 1934, Page 1858, which Memorandum provides record notice of the Lease, as it applies to the Premises.

B. Contemporaneously herewith, the City of Green Cove Springs is purchasing a portion of the Premises legally described in Exhibit B attached hereto and made a part hereof (the "Parcel").

C. Lessor and Tenant desire to amend the Lease, as it relates to the Premises, and to amend the Memorandum.

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the parties hereby agree as follows:

1. Effective as of 6-8-07, the Memorandum, and the Lease as it applies to the Premises, are amended: (a) to terminate the Memorandum and the Lease as they apply to the Parcel, and (b) to confirm and adopt, as the revised legal description for the Premises, the amended legal description (the "Amended Premises") that is attached hereto and made a part hereof as Exhibit C.

2. This Amendment is being executed solely to give notice of the Lease, as it relates to the Amended Premises, and to amend the Memorandum and the Lease as they apply to the Amended Premises, and is not intended to amend the Lease in any respect other than as expressly provided in Paragraph 1 above. Without limitation of the foregoing, Lessor and Tenant acknowledge and agree that the Lease relates to the Amended Premises and multiple

other properties and that, as provided in the Lease, the Lease demises all of such properties as a unified commercial operating lease and Lessor is not obligated, and may not be required, to lease less than all of such properties pursuant to the Lease.

3. This Amendment may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto were upon the same instrument.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed these presents the day and year first above written.

TENANT:

KINDRED HEALTHCARE, INC., a Delaware corporation

By: /s/ John Cowgill

Name: John Cowgill

Title: VP.

KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation

By: /s/ John Cowgill

Name: John Cowgill

Title: VP.

LESSOR:

VENTAS REALTY, LIMITED PARTNERSHIP, a Delaware limited partnership

By: Ventas, Inc., a Delaware corporation, its general partner

By: /s/ T. Richard Riney

T. Richard Riney, Executive Vice President, General Counsel and Secretary

Acknowledgments

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On June 7, 2007, before me, Patricia Burkhead personally appeared John Cowgill, the V.P. of Facilities Management of KINDRED HEALTHCARE, INC., a Delaware corporation, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature /s/ Patricia A. Burkhead
(This area for official seal)

Patricia A. Burkhead
Notary Public, State at Large, KY
My commission expires Oct. 29, 2007

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On June 7, 2007, before me, Patricia Burkhead personally appeared John Cowgill, the V.P. of Facilities Management of KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation, personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he/she executed the same in his/her authorized capacity, and that by his/her signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

WITNESS my hand and official seal.

Signature /s/ Patricia A. Burkhead
(This area for official seal)

Patricia A. Burkhead
Notary Public, State at Large, KY
My commission expires Oct. 29, 2007

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

On June 7, 2007, before me, Barbara F. Thompson personally appeared T. Richard Riney, who is personally known to me (or proved to me on the basis of satisfactory evidence) to be the person whose name is subscribed to the within instrument and acknowledged to me that he executed the same in his authorized capacity, as the Executive Vice President, General Counsel and Secretary of Ventas, Inc., a Delaware corporation, in its capacity as the general partner of Ventas Realty, Limited Partnership, a. Delaware limited partnership, and that by his signature on the instrument the aforesaid corporation executed the instrument, as the general partner and on behalf of the aforesaid limited partnership.

WITNESS my hand and official seal.

Signature /s/ Barbara F. Thompson

Notary Public, State at Large, KY

(This area for official seal) My Commission expires: December 9, 2010.

EXHIBIT A

Premises

PARCEL A:

Lots 1, 5, 6, 7 and 8 of GOLFAIR, according to plat thereof recorded in Plat Book 6, Page 23 of the Public Records of Clay County, Florida.

PARCEL B:

Lots 2, 3, 4 and 9, GOLFAIR, according to plat thereof recorded in Plat Book 6, Page 23 of the Public Records of Clay County, Florida.

PARCEL C:

A portion of Block 54, PALMER AND FERRIS TRACT, Green Cove Springs, Clay County, Florida, according to Plat Book 2, Page 1, Public Records of said county, being more particularly described as follows:

For a Point of Beginning commence at a point where the West line of Claude Street intersects the South line of Golfair Street according to Plat Book 6, Page 23 of the Public Records of Clay County and run thence North 72°45' East 246.0 feet; run thence South 17°15' East 124.0 feet to a point; thence North 72°45' East 420.0 feet to a point; thence South 17°15' East 56 feet to a point; thence South 72°45' West 1282.94 feet to a point; thence South 19°42'36" East 40.04 feet to a point; thence South 70°17'24" West 273.50 feet to a point on the Easterly line of the Railroad right-of-way as per Deed Book 68, Page 217, Public Records of Clay County, Florida; thence North along the Easterly right-of-way of said Railroad right-of-way to a point which intersects the Southerly right-of-way of Oak Street; thence North 72°45' East 698.91 feet along the Southerly right-of-way of Oak Street to a point; thence south 17°15' East 420.0 feet along the Westerly right-of-way line of Claude Street to the point of Beginning, EXCEPTING THEREFROM that portion conveyed to Green Cove Springs Public Health Authority in O.R. Volume 350, Page 627.

PARCEL D:

A parcel of land located in Block 54 (said Block being known as the "Golf Course"), Green Cove Springs, Florida, according to plat recorded in Plat Book 2, Page 1, Public Records of Clay County, Florida, more particularly described as follows:

Commence at the intersection of the Southern terminus of the center line of Green Street and the south line of Oak Street; run thence East along the southerly boundary line of Oak Street 210 feet; thence turn at right angle and run South 544 feet; thence turn at right angle and run West 420 feet; thence turn at right angle and run North 544 feet; thence turn at right angle and run East along the southerly line of Oak Street 210 feet to the Point of Beginning.

PARCEL E:

A parcel of land situated in Block 54, Palmer Ferris Tract, Green Cove Springs, Clay County, Florida, according to Plat Book 2, page 1 of the Public Records of said county, said parcel being more particularly described as follows:

Begin at the intersection of the Westerly line of Palmetto Avenue with the Southerly line of Golfair Street according to Plat Book 6, Page 2 of said Public Records; thence on last said line run South 72°45" West 747.70 feet; thence South 17°15' East 300.00 feet; thence North 72°45' East 748.40 feet to the Westerly line of said Palmetto Avenue; thence on last said line North 17°23' West 37.00 feet; thence South 72°45' West 210.00 feet; thence North 17°23' West 210.00 feet; thence North 72°45' East 210.00 feet to the Westerly line of said Palmetto Avenue; thence on last said line North 17°23' West 53.00 feet to the Point of Beginning.

PARCEL F:

Lots 2, 3, 4, 5, 6, 7 and 8, a Replat of Borden Oaks Subdivision as recorded in Plat Book 6, Page 2 of the Public Records of Clay County, Florida.

EXHIBIT B

Parcel

PARCEL C:

A portion of Block 54, Palmer and Ferris Tract, Green Cove Springs, Clay County, Florida, according to Plat Book 2, page 1, public records of said county, being more particularly described as follows:

For a Point of Beginning commence at a point where the West line of Claude Street intersects the South line of Golfair Street according to Plat Book 6, page 23 of the public records of Clay County and run thence North 72 degrees 45 minutes East 246.00 feet; run thence South 17 degrees 15 minutes East 124.00 feet to a point; thence North 72 degrees 45 minutes East 420.00 feet to a point; thence South 17 degrees 15 minutes East 56.00 feet to a point; thence South 72 degrees 45 minutes West 1282.94 feet to a point; thence South 19 degrees 42 minutes 36 seconds East 40.04 feet to a point; thence South 70 degrees 17 minutes 24 seconds West 272.93 feet to a point on the Easterly line of the Railroad right-of-way as per Deed Book 68, page 217, Public Records of Clay County, Florida; Thence on said Easterly line of said Railroad right-of-way run the following 2 courses: 1) Northerly on the arc of a curve concave to the Easterly and having a radius of 1935.00 feet, a chord distance of 291.94 feet, the bearing of said chord being North 03 degrees 29 minutes 21 Seconds West; 2) North 00 degrees 50 minutes 14 seconds East 387.29 feet to a point which intersects the Southerly right-of-way of Oak Street; thence North 72 degrees 45 minutes East 298.22 feet along the Southerly right-of-way of Oak Street to the Westerly line of lands described in Official Records Book 350, page 627, of said Public Records; Thence on last said line South 17 degrees 15 minutes 00 seconds East 550.00 feet to the Southerly line thereof; Thence on last said line North 72 degrees 45 minutes 00 seconds East 400.00 feet to the Easterly line thereof; Thence on last said line North 17 degrees 15 minutes 00 seconds West 130.00 feet to the Point of Beginning, being 7.72 acres, more or less, in area, and being the same lands as those described in Official Records Book 1763, page 767, of said Public Records.

PARCEL D-South:

All that portion of those lands described as Parcel "D", as recorded in Official Records Book 1763, page 767, of the Public Records of Clay County, Florida, lying Southerly of that certain 15 foot wide Perpetual Wastewater Easement as recorded in Official Records Book 310, page 63, of said Public Records, said portion being described as:

A Parcel of land located in Block 54 (said Block being known as the "Golf Course"), Green Cove Springs, Florida, according to Plat recorded in Plat Book 2, page 1, Public Records of Clay County, Florida, more particularly described as follows:

Commence at the intersection of the Southern terminus of the center line of Green Street and the South line of Oak Street; run thence North 72 degrees 45 minutes 00 seconds East along the Southerly boundary line of Oak Street 210.00 feet to the Easterly line of said Parcel D; Thence on last said line run the following 2 courses: 1) South 17 degrees 15 minutes 00 seconds East 420.00 feet to the Southerly line of said Perpetual Wastewater Easement and the Point of Beginning; 2) South 17 degrees 15 minutes 00 seconds East 124.00 feet to the Southerly line of said Parcel "D"; Thence on last said line run South 72 degrees 45 minutes 00 seconds West 420.00 feet to the Westerly line thereof; Thence on last said line run North 17 degrees 15 minutes 00 seconds West 124.00 feet to said Southerly line of said Perpetual Wastewater Easement; Thence on last said line run North 72 degrees 45 minutes 00 seconds East 420.00 feet to the Point of Beginning, being 1.20 acres, more or less, in area.

PARCEL E:

A parcel of land situated in Block 54, Palmer and Ferris Tract, Green Cove Springs, Clay County, Florida, according to Plat Book 2, page 1 of the public records of said county, said parcel being more particularly described as follows:

Begin at the intersection of the Westerly line of Palmetto Avenue with the Southerly line of Golfair Street according to Plat Book 6, page 2 of said public records; thence on last said line run South 72 degrees 45 minutes West 747.70 feet; thence South 17 degrees 15 minutes East 300.00 feet; thence North 72 degrees 45 minutes East 748.40 feet to the Westerly line of said Palmetto Avenue; thence on last said line North 17 degrees 23 minutes West 37.00 feet; thence South 72 degrees 45 minutes West 210.00 feet; thence North 17 degrees 23 minutes West 210.00 feet; thence North 72 degrees 45 minutes East 210.00 feet to the Westerly line of said Palmetto Avenue; thence on last said line North 17 degrees 23 minutes West 53.00 feet to the Point of Beginning, being 4.14 acres, more or less, in area.

EXHIBIT C

Amended Premises

PARCEL A:

Lots 1, 5, 6, 7 and 8 of GOLFAIR, according to plat thereof recorded in Plat Book 6, Page 23 of the Public Records of Clay County, Florida.

PARCEL B:

Lots 2, 3, 4 and 9, GOLFAIR, according to plat thereof recorded in Plat Book 6, Page 23 of the Public Records of Clay County, Florida.

PARCEL D:

A Parcel of land located in Block 54 (said Block being known as the "Golf Course"), Green Cove Springs, Florida, according to Plat recorded in Plat Book 2, Page 1, Public Records of Clay County, Florida, more particularly described as follows:

Commence at the intersection of the Southern terminus of the center line of Green Street and the South line of Oak Street; run thence North 72 degrees 45 minutes 00 seconds East along the Southerly boundary line of Oak Street 210.00 feet to the Easterly line of said Parcel "D"; Thence on last said line run South 17 degrees 15 minutes 00 seconds East 420.00 feet to the Southerly line of said Perpetual Wastewater Easement; Thence on last said line run South 72 degrees 45 minutes 00 seconds West 420.00 feet to the Westerly line thereof; Thence on last said line run North 17 degrees 15 minutes 00 seconds West 420.00 feet to the South line of Oak Street; Thence on last said line run North 72 degrees 45 minutes 00 seconds East 210.00 feet to the Point of Beginning.

PARCEL F:

Lots 2, 3, 4, 5, 6, 7 and 8, a Replat of Borden Oaks Subdivision as recorded in Plat Book 6, Page 2 of the Public Records of Clay County, Florida.

After recording, this document
should be returned to:

Thomas H. Page
Barack Ferrazzano Kirschbaum
& Nagelberg LLP
200 West Madison Street, Suite 3900
Chicago, Illinois 60606

This document was prepared by:
T. Richard Riney, Esq.
10350 Ormsby Park Place
Suite 300
Louisville, Kentucky 40223

T. Richard Riney, Esq.

AMENDMENT TO MASTER LEASE AND MEMORANDUM OF LEASE

BY AND AMONG

KINDRED HEALTHCARE, INC.
(f/k/a Vencor, Inc.),

KINDRED HEALTHCARE OPERATING, INC.
(f/k/a Vencor Operating, Inc.),

AND

VENTAS REALTY, LIMITED PARTNERSHIP

Facility No.: KY-277
Property Address: 550 High Street
Bowling Green, Kentucky
(Warren County)

AMENDMENT TO MASTER LEASE
AND MEMORANDUM OF LEASE

THIS AMENDMENT TO MASTER LEASE AND MEMORANDUM OF LEASE (hereinafter this "Amendment") is dated as of the 7th day of August, 2007 (the "Effective Date"), and is by and among **VENTAS REALTY, LIMITED PARTNERSHIP**, a Delaware limited partnership (together with its successors and assigns, "Lessor") having an office at 10350 Ormsby Park Place, Suite 300, Louisville, Kentucky 40223, **KINDRED HEALTHCARE, INC.**, a Delaware corporation (f/k/a Vencor, Inc.) ("Kindred"), and **KINDRED HEALTHCARE OPERATING, INC.**, a Delaware corporation (f/k/a Vencor Operating, Inc.) ("Operator"; Operator, jointly and severally with Kindred and permitted successors and assignees of Operator and Kindred, "Tenant"), both having an office at 680 South 4th Avenue, Louisville, Kentucky 40202.

RECITALS

A. Lessor and Tenant heretofore entered into that certain Amended and Restated Master Lease Agreement No. 4 dated as of April 20, 2001 (the "Original Lease"), demising to Tenant (i) the real property described on Exhibit A attached hereto and made a part hereof, together with the improvements thereon (the "Original Premises"), and (ii) multiple other properties.

B. A Memorandum of Lease (the "Memorandum") relating to the Original Lease as it affects the Original Premises was heretofore filed for record on April 26, 2001 in the office of the County Clerk for Warren County, Kentucky as document no. 374950 at Book D820, Page 765.

C. Lessor and Tenant heretofore entered into that certain Second Amended and Restated Master Lease Agreement No. 4 (the "Amended and Restated Lease") dated as of April 27, 2007, pursuant to which the Original Lease was amended and restated in its entirety.

D. Lessor and Tenant desire to amend the Memorandum and the Amended and Restated Lease with respect to the Original Premises, in accordance with the terms and conditions of this Amendment.

NOW, THEREFORE, in consideration of the premises and other good and valuable consideration, the parties hereby amend the Memorandum and the Amended and Restated Lease as follows:

1. For all purposes of the Amended and Restated Lease and the Memorandum, the legal description for the Premises shall be amended and restated in its entirety to read as set forth in Exhibit B attached hereto and made a part hereof (the "Revised Premises").

2. In addition to the other properties demised pursuant to the Amended and Restated Lease, Lessor hereby leases to Tenant, and Tenant takes and leases from Lessor, the Revised Premises pursuant to the terms and conditions of the Amended and Restated Lease.

3. Tenant shall have and hold the Revised Premises for a term that, unless sooner terminated as otherwise provided in the Amended and Restated Lease, shall expire on April 30,

2010. Thereafter, the term, as it relates to the Revised Premises, may be extended by Tenant for up to three (3) additional extended terms of five (5) years each, subject to the terms of the Amended and Restated Lease.

4. Lessor and Tenant agree that the party obligated to cause or pay for any maintenance, repair, replacements, alterations or improvements to the Revised Premises shall not permit any lien to be filed against the Revised Premises as a result of such activities. To the extent recognized by applicable law, no lien arising as a result of Tenant's activities shall affect Lessor's interest in the Revised Premises, and no lien arising as a result of Lessor's activities shall affect or take priority over Tenant's interest in the Revised Premises as created by the Amended and Restated Lease.

5. Lessor and Tenant acknowledge and agree that the Amended and Restated Lease relates to the Revised Premises and multiple other properties and that, as provided in the Amended and Restated Lease, the Amended and Restated Lease demises all of such properties as a unified commercial operating lease and Lessor is not obligated, and may not be required, to lease less than all of such properties pursuant to the Amended and Restated Lease.

6. This Amendment and any amendment hereto may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto were upon the same instrument.

7. Tenant has no present right or option to purchase the Revised Premises; provided, however, that a possible option to purchase the Revised Premises in favor of Tenant is available to Tenant upon the occurrence of certain defaults under the Amended and Restated Lease on the terms and subject to the conditions more specifically set forth in Section 16.12 of the Amended and Restated Lease. In any event any option to purchase in favor of Tenant relative to the Revised Premises shall expire upon the expiration or termination of the Amended and Restated Lease as it applies to the Revised Premises, which date shall in all events occur not later than the expiration date of the Amended and Restated Lease as it relates to the Revised Premises (taking into account any extension options relative to the Revised Premises that are duly exercised by Tenant), as described in Paragraph 3 above.

[Signature Page Follows]

IN WITNESS WHEREOF, the parties hereto have executed these presents the day and year first above written.

TENANT:
KINDRED HEALTHCARE, INC., a Delaware corporation formerly known as Vencor, Inc.

By:	/s/ Douglas Curnutte
Name:	Douglas Curnutte
Title:	Vice President of Facilities and Real Estate Development

TENANT:
KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation formerly known as Vencor Operating, Inc.

By:	/s/ Douglas Curnutte
Name:	Douglas Curnutte
Title:	Vice President of Facilities and Real Estate Development

LESSOR:
VENTAS REALTY, LIMITED PARTNERSHIP, a Delaware limited partnership

By:	Ventas, Inc., a Delaware corporation, its general partner	
	By:	/s/ T. Richard Riney
		T. Richard Riney, Executive Vice President, General Counsel and Secretary

Rosewood Health Care
Amendment to Master Lease and Memorandum of Lease v2

Acknowledgments

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

The foregoing instrument was acknowledged before me this 23 day of October, 2007, by Douglas Curnutte, as Vice President of Facilities and Real Estate Development of KINDRED HEALTHCARE, INC., a Delaware corporation, on behalf of such corporation.

/s/ Sondra L. Staten

Notary Public
[Seal, if any, of notarial officer]
My Commission Expires:
05/25/08

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

The foregoing instrument was acknowledged before me this 23 day of October, 2007, by Douglas Curnutte, as Vice President of Facilities and Real Estate Development of KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation, on behalf of such corporation.

/s/ Sondra L. Staten

Notary Public
[Seal, if any, of notarial officer]
My Commission Expires:
05/25/08

STATE OF Kentucky)
) ss
COUNTY OF Jefferson)

The foregoing instrument was acknowledged before me this 25th day of Oct, 2007, by T. Richard Riney, as the Executive Vice President, General Counsel and Secretary of VENTAS, INC., a Delaware corporation, on behalf of such corporation, in its capacity as the general partner of VENTAS REALTY, LIMITED PARTNERSHIP, a Delaware limited partnership, and on behalf of such limited partnership.

/s/ Terre Parker

Notary Public
[Seal, if any, of notarial officer]
My Commission Expires:
Jan 6, 2009

Rosewood Health Care
Amendment to Master Lease and Memorandum of Lease v2

EXHIBIT A

The Original Premises

A certain tract of land located on Fairview Avenue at its intersection with High Street in the City of Bowling Green in Warren County, Kentucky.

Beginning at a point in the east right-of-way line of Fairview Avenue on a corner common to the subject property and a property conveyed to Fairview Development Corporation in Deed Book 475, Page 806; thence with the line of Fairview Avenue North 48° 07 minutes 55 seconds West 227.38 feet, thence along a chord 40.40 feet with a radius of 27.50 feet to a point North 02° 34 minutes 43 seconds East, thence North 47° 09 minutes 13 seconds East 56.33 feet, thence North 42° 50 minutes 47 seconds West 2.50 feet to a steel pin in the right-of-way line of High Street; thence along said right-of-way line North 47° 09 minutes 13 seconds East 458.86 feet to a concrete monument at a corner common to the subject property and the right-of-way lines of High Street and Fifth Street; thence South 42° 14 minutes 47 seconds East 216.30 feet; thence South 42° 39 minutes 13 seconds West, to the point of beginning.

Being a portion of the property conveyed to Ventas Realty, Limited Partnership, a Delaware Limited Partnership, by Deed dated September 25, 1998 and recorded in Deed Book 776, Page 126, in the Office of the Clerk of Warren County, Kentucky.

EXHIBIT B

The Revised Premises

Parcel 1:

A certain tract of land located on Fairview Avenue at its intersection with High Street in the City of Bowling Green in Warren County, Kentucky.

Beginning at a point in the east right-of-way line of Fairview Avenue on a corner common to the subject property and a property conveyed to Fairview Development Corporation in Deed Book 475, Page 806; thence with the line of Fairview Avenue North 48° 07 minutes 55 seconds West 227.38 feet, thence along a chord 40.40 feet with a radius of 27.50 feet to a point North 02° 34 minutes 43 seconds East, thence North 47° 09 minutes 13 seconds East 56.33 feet, thence North 42° 50 minutes 47 seconds West 2.50 feet to a steel pin in the right-of-way line of High Street; thence along said right-of-way line North 47° 09 minutes 13 seconds East 458.86 feet to a concrete monument at a corner common to the subject property and the right-of-way lines of High Street and Fifth Street; thence South 42° 14 minutes 47 seconds East 216.30 feet; thence South 42° 39 minutes 13 seconds West, to the point of beginning.

Being a portion of the property conveyed to Ventas Realty, Limited Partnership, a Delaware Limited Partnership, by Deed dated September 25, 1998 and recorded in Deed Book 776, Page 126, in the Office of the Clerk of Warren County, Kentucky.

Parcel 2:

Lot 17 in George Shields Addition to the City of Bowling Green according to the plat thereof recorded in Plat Book 1, Page 12, as revised by Revision of Lots 17, 18, 19, 20, 21 and 22 George Shields Addition to the City of Bowling Green recorded on August 7, 2007 in Plat Book 38, Page 151, in the Office of the Clerk of Warren County, Kentucky.

Being a portion of the property conveyed to Ventas Realty, Limited Partnership, a Delaware Limited Partnership, by Deed dated September 25, 1998 and recorded in Deed Book 776, Page 126, in the Office of the Clerk of Warren County, Kentucky, as the same was added to as a result of the alley closure adopted by Bowling Green Ordinance No. BG 2005—54 which is referenced in the plat revision which is referenced in the description of Parcel 2.

FIRST AMENDMENT TO MASTER LEASE

THIS FIRST AMENDMENT TO MASTER LEASE (the "Amendment") is made and entered into and effective as of August 1, 2001 (the "Effective Date"), by and among HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation ("HCPI"), HEALTH CARE PROPERTY PARTNERS, a California general partnership ("HCPP"), and INDIANA HCP, L.P., a Delaware limited partnership ("Indiana HCP") (collectively and jointly and severally, "Lessor"), KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company, KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company, KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership (collectively, and jointly and severally, "Lessee"), with respect to the following:

RECITALS

A. Lessor is the "Lessor" and Lessee is the "Lessee" pursuant to that certain Master Lease dated as of May 16, 2001 (the "Lease"), covering the Land, Leased Improvements, Related Rights and Fixtures of twenty-two (22) separate health care Facilities, all as more particularly described in the Lease. HCPI transferred its interests in the Facility located in the State of Indiana to Indiana HCP on or about December 21, 2001, and in connection therewith HCPI assigned to and Indiana assumed HCPI's rights and obligations in, to and under the Master Lease (and all guarantees, indemnities or other rights relating thereto) with respect to such Facility pursuant to that certain Partial Assignment and Assumption of Master Lease dated December 21, 2001, by and between HCPI and Indiana HCP.

B. The obligations of Lessee under the Master Lease are guaranteed by Kindred Healthcare, Inc., a Delaware corporation, and Kindred Operating, Inc., a Delaware corporation (collectively and jointly and severally, "Guarantors"), pursuant to that certain written Guaranty of Obligations executed by Guarantors as of May 16, 2001.

C. Lessee desires to amend the Lease to effect a reallocation of the Initial Annual and Monthly Allocated Minimum Rent for the Facilities located in the State of Ohio. Lessor is willing to agree to the same, but only upon the terms and subject to the conditions set forth in this Amendment.

AGREEMENT

IN CONSIDERATION OF the foregoing Recitals and the mutual promises and covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Lessor and Lessee agree as follows:

1. Replacement of Exhibit B. Exhibit B attached to the Lease is hereby replaced, in its entirety, with Exhibit B attached to this Amendment.

2. Effective Date. This Amendment shall be effective as of the Effective Date specified above, notwithstanding any later execution and delivery hereof by Lessor and Lessee.

3. Reimbursement of Costs. Upon execution and delivery of this Amendment, Lessee shall pay to Lessor, as an Additional Charge under the Lease, as hereby amended, the sum of $500.00, as a reimbursement to Lessor for Lessor's legal fees and expenses incurred in the preparation of this Amendment.

4. Defined Terms. All terms used in this Amendment with initial capital letters and not defined herein shall have the meanings given to such terms in the Lease.

5. Leases in Effect. Lessor and Lessee acknowledge and agree that the Lease, as hereby amended, remains in full force and effect in accordance with its terms.

6. Counterparts. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute a single instrument. Delivery of an executed counterpart of a signature page to this Amendment via telephone facsimile transmission shall be as effective as delivery of a manually executed counterpart of this Agreement.

[Signature Page Follows]

IN WITNESS WHEREOF, Lessor and Lessee have executed this First Amendment to Master Lease as of the Effective Date.

"LESSOR"

HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President, General Counsel and Corporate Secretary

"HCPI"

HEALTH CARE PROPERTY PARTNERS, a California general partnership

By: HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation, its Managing General Partner

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President, General Counsel and Corporate Secretary

"HCPP"

INDIANA HCP, L.P., a Delaware corporation

By: INDIANA HCP GP, INC., a Delaware corporation, its General Partner

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President

"INDIANA HCP"

"LESSEE"

KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company

By: /s/ James H. Gillenwater, Jr.
Its: Senior VP

By: /s/ Joseph L. Landenwich
Its: VP of Corporate Legal Affairs

KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company

By: /s/ James H. Gillenwater, Jr.
Its: Senior VP
By: /s/ Joseph L. Landenwich
Its: VP of Corporate Legal Affairs

KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership

By: /s/ James H. Gillenwater, Jr.
Its: Senior VP

By: /s/ Joseph L. Landenwich
Its: VP of Corporate Legal Affairs

CONSENT AND REAFFIRMATION OF GUARANTORS

The undersigned Guarantors hereby consent to the foregoing First Amendment to Master Lease and reaffirm to Lessor that their obligations under the Guaranty remains in full force and effect with respect the Lease, as amended hereby.

KINDRED HEALTHCARE, INC., a Delaware corporation

By: /s/ James H. Gillenwater, Jr.

Its: Senior VP

By: /s/ Joseph L. Landenwich

Its: VP of Corporate Legal Affairs

KINDRED OPERATING, INC., a Delaware corporation

By: /s/ James H. Gillenwater, Jr.

Its: Senior VP

By: /s/ Joseph L. Landenwich

Its: VP of Corporate Legal Affairs

EXHIBIT B

List Of Facilities, Facility Groups, Number Of Licensed And Operating Beds For Each Facility And Initial Annual And Monthly Allocated Minimum Rent For The Facilities

Kindred Facility #	City/St. Location	Group	# of Avail Beds	# of Licensed Beds	Initial Annual Allocated Minimum Rent	Initial Monthly Allocated Minimum Rent
	Group 1					
0171	Bolivar TN	1	136	136	720,000	60,000.00
0174	Camden TN	1	185	189	500,000	41,666.67
0175	Jefferson City TN	1	185	186	1,000,000	83,333.33
0177	Loudon TN	1	190	192	900,000	75,000.00
0178	Memphis TN	1	246	246	1,460,000	121,666.67
0179	Huntingdon TN	1	196	196	575,000	47,916.67
0183	Ripley TN	1	182	182	625,000	52,083.33
0184	Blountville TN	1	173	173	680,000	56,666.67
0187	Maryville TN	1	187	189	1,100,000	91,666.67
0189	Maryville TN	1	75	75	440,000	36,666.67
	Group 2					
0237	Newark OH	2	300	300	1,395,348	116,279.00
0287	Vincennes IN	2	205	216	1,100,000	91,666.67
0271	Mayfield KY	2	100	100	585,000	48,750.00
0295	Whitehouse OH	2	88	94	449,760	37,480.00
0870	Marion OH	2	110	110	509,892	42,491.00
0861	Kansas City, MO (beds)	2	180	180	850,000	70,833.33
	(units/beds)		96	96		
	Group 3					
0849	Denver CO	3	172	180	1,060,000	88,333.33
0531	Fairhaven, MA	3	106	107	378,000	31,500.00
0540	West Roxbury, MA	3	141	141	441,000	36,750.00
0205	Livermore, CA	3	80	83	346,500	28,875.00
0197	Oshkosh,WI	3	182	184	454,000	37,833.33
0541	Westborough, MA	3	122	123	559,500	46,625.00
					16,129,000	1,344,083

SECOND AMENDMENT TO MASTER LEASE

THIS SECOND AMENDMENT TO MASTER LEASE (the "Amendment") is made and entered into as of November 18, 2003 and effective as of July 1, 2003 (the "Effective Date"), by and among HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation ("HCPI"), HEALTH CARE PROPERTY PARTNERS, a California general partnership ("HCPP"), and INDIANA HCP, L.P., a Delaware limited partnership ("Indiana HCP") (collectively and jointly and severally, "Lessor"), KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company, KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company, KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership (collectively, and jointly and severally, "Lessee"), with respect to the following:

RECITALS

A. Lessor is the "Lessor" and Lessee is the "Lessee" pursuant to that certain Master Lease dated as of May 16, 2001 (the "Original Lease"), as amended by that certain First Amendment to Master Lease dated as of August 1, 2001 (the "First Amendment"). The Lease covers the Land, Leased Improvements, Related Rights and Fixtures of twenty-two (22) separate health care Facilities, all as more particularly described in the Lease. The Original Lease together with the First Amendment are collectively referred to herein as the "Lease."

B. The obligations of Lessee under the Lease are guaranteed by Kindred Healthcare, Inc., a Delaware corporation, and Kindred Healthcare Operating, Inc., a Delaware corporation (collectively and jointly and severally, "Guarantors"), pursuant to that certain written Guaranty of Obligations executed by Guarantors as of May 16, 2001 (the "Guaranty"). The Guaranty was mistakenly executed under the name of "Kindred Operating, Inc., a Delaware corporation," instead of Kindred Healthcare Operating, Inc., a Delaware corporation.

C. Lessor and Lessee desire to, among other things, retroactively adjust the monthly Allocated Minimum Rent payable by Lessee for each Facility, but only upon the terms and conditions set forth in this Amendment.

AGREEMENT

IN CONSIDERATION OF the foregoing Recitals and the mutual promises and covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Lessor and Lessee agree as follows:

1. Allocated Minimum Rent. Notwithstanding any later execution and delivery of this Amendment, Lessor and Lessee acknowledge and agree as follows:

(a) The Allocated Minimum Rent payable by Lessee for each Facility from July 1, 2003 through July 31,2003 shall be equal to the amount set forth opposite such Facility on Exhibit A attached hereto and incorporated herein by this reference.

(b) Commencing August 1, 2003 (i.e., the commencement of the third (3rd) Lease Year) the Allocated Minimum Rent payable by Lessee for each Facility shall be equal to the amount set forth opposite such Facility on Exhibit B attached hereto and incorporated herein by this reference. Such Allocated Minimum Rent shall be subject to increase at the times and in the amounts set forth in Section 3.1 of the Original Lease.

(c) After giving effect to the retroactive adjustments in the Allocated Minimum Rent pursuant to subsections (a) and (b) above and the payments made by Lessee on account of Minimum Rent through September 30, 2003, Lessee owed Lessor an additional Forty- Seven Thousand Five Hundred Thirty-One and 24/100 Dollars ($47,531.24) (the "Adjustment Rent"). Lessor acknowledges that it has received the Adjustment Rent from Lessee.

2. Use of the Leased Property. Notwithstanding anything to the contrary contained in Exhibit B to the Lease, the number of licensed and operating beds for each Facility shall be equal to the numbers set forth opposite such Facility on Exhibit C attached hereto and incorporated herein by this reference.

3. General Insurance Requirements. Notwithstanding anything to the contrary contained in the Lease, Lessee shall be allowed to maintain a claims made policy form of insurance insuring against the risks set forth in Section 13.1.5 of the Original Lease, provided that such claims made policy must include therein the right to purchase a "tail" that insures against so-called "incurred but not reported claims" for a period of not less than three (3) years following the expiration of such claims made policy. Upon the expiration of any such claims made policy, Lessee shall either (i) purchase a three (3) year "tail" policy covering any so-called "incurred but not reported claims" during the prior policy period or (ii) provide other insurance covering "incurred but not reported claims" for such prior policy period for a period of not less than three (3) years thereafter in form satisfactory to Lessor.

4. Defined Terms. All terms used in this Amendment with initial capital letters and not defined herein shall have the meanings given to such terms in the Lease.

5. Lease in Effect. Lessor and Lessee acknowledge and agree that the Lease, as hereby amended, remains in full force and effect in accordance with its terms.

6. Counterparts. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute a single instrument. Delivery of an executed counterpart of a signature page to this Amendment via telephone facsimile transmission shall be as effective as delivery of a manually executed counterpart of this Amendment.

7. Payment of Expenses Lessee shall be responsible for the payment of its own legal, accounting and other expenses incurred in connection with the preparation and negotiation of this Amendment and each of Lessor and Lessee shall be responsible for the payment of one-half (1/2) of Lessor's legal, accounting and other expenses incurred in connection with the preparation and negotiation of this Amendment.

[Signature Page Follows]

IN WITNESS WHEREOF, Lessor and Lessee have executed this Amendment as of the Effective Date.

"LESSOR"

HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President, General Counsel and Corporate Secretary

"HCPI"

HEALTH CARE PROPERTY PARTNERS, a California general partnership

By: HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation, its Managing General Partner

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President, General Counsel and Corporate Secretary

"HCPP"

INDIANA HCP, L.P., a Delaware corporation

By: INDIANA HCP GP, INC., a Delaware corporation, its General Partner

By: /s/ Edward J. Henning
Edward J. Henning
Senior Vice President

"INDIANA HCP"

"LESSEE"

KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company

By: /s/ Lane Bowen
Its: President, HSD

By: /s/ Joseph L. Landenwich
Its: V.P. of Corporate Legal Affairs

KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company

By: /s/ Lane Bowen
Its: President, HSD
By: /s/ Joseph L. Landenwich
Its: V.P. of Corporate Legal Affairs

KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership

By: Kindred Healthcare Operating, Inc., its general partner

By: /s/ Lane Bowen
Its: President, HSD

By: /s/ Joseph L. Landenwich
Its: V.P. of Corporate Legal Affairs

CONSENT AND REAFFIRMATION OF GUARANTORS

The undersigned Guarantors hereby consent to the foregoing Second Amendment to Master Lease and reaffirm to Lessor that their obligations under the Guaranty remain in full force and effect with respect the Lease, as amended hereby.

In addition, Kindred Healthcare Operating, Inc. hereby acknowledges that the Guaranty, and Guarantor's consent and reaffirmation of that certain First Amendment to Master Lease dated as of August 1, 2001, were mistakenly executed under the name of "Kindred Operating, Inc., a Delaware corporation," and that Kindred Healthcare Operating, Inc. is jointly and severally liable for all obligations of "Guarantors" under the Guaranty, as the same may have been amended or supplemented from time to time.

KINDRED HEALTHCARE, INC., a Delaware corporation

By: /s/ Lane Bowen

Its: President, HSD

By: /s/ Joseph L. Landenwich

Its: V.P. of Corporate Legal Affairs

KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation

By: /s/ Lane Bowen

Its: President, HSD

By: /s/ Joseph L. Landenwich

Its: V.P. of Corporate Legal Affairs

EXHIBIT A

List of Facilities, Facility Groups and Annual and Monthly Allocated Minimum Rent for the Facilities

(July 1, 2003 – July 31, 2003)

Kindred Facility #	City. St. Location	Group		Annual Allocated Minimum Rent		Monthly Allocated Minimum Rent
0171	Bolivar TN	1	$	730,988	$	61,087.50
0174	Camden TN	1	$	511,156	$	45,947.92
0175	Jefferson City TN	1	$	1,016,500	$	86,083.33
0177	Loudon TN	1	$	914,438	$	77,062.50
0178	Memphis TN	1	$	1,483,119	$	124,710.42
0179	Huntingdon TN	1	$	587,938	$	52,947.92
0183	Ripley TN	1	$	637,937	$	56,427.08
0184	Blountville TN	1	$	690,481	$	57,797.92
0187	Maryville TN	1	$	1,116,688	$	93,229.17
0189	Maryville TN	1	$	446,600	$	37,216.67
	Group 2					
0237	Newark OH	2	$	1,416,278	$	118,023.19
0287	Vincennes IN	2	$	1,116,500	$	93,041.67
0271	Mayfield KY	2	$	593,775	$	49,481.25
0295	Whitehouse OH	2	$	456,506	$	38,042.20
0870	Marion OH	2	$	517,540	$	43,128.37
0861	Kansas City MO	2	$	543,533	$	45,294.38
0861	Kansas City MO	2	$	319,217	$	26,601.45
	Group 3					
0849	Denver CO	3	$	1,075,900	$	89,658.33
0531	Fairhaven MA	3	$	383,670	$	31,972.50
0540	West Roxbury MA	3	$	447,615	$	37,301.25
0205	Livermore CA	3	$	351,698	$	29,308.13
0197	Oshkosh WI	3	$	460,810	$	38,400.83
0541	Westborough MA	3	$	567,893	$	47,324.38
			$	16,386,779	$	1,380,088.36

EXHIBIT B

List of Facilities, Facility Groups and Annual and Monthly Allocated Minimum Rent for the Facilities

(August 1, 2003 – July 31, 2004)

Kindred Facility #	City. St. Location	Group		Annual Allocated Minimum Rent		Monthly Allocated Minimum Rent
0171	Bolivar TN	1	$	748,470	$	62,372.49
0174	Camden TN	1	$	562,083	$	46,840.27
0175	Jefferson City TN	1	$	1,054,416	$	87,868.04
0177	Loudon TN	1	$	944,025	$	78,668.74
0178	Memphis TN	1	$	1,527,793	$	127,316.09
0179	Huntingdon TN	1	$	647,690	$	53,974.13
0183	Ripley TN	1	$	690,510	$	57,542.52
0184	Blountville TN	1	$	708,138	$	59,011.52
0187	Maryville TN	1	$	1,142,308	$	95,192.35
0189	Maryville TN	1	$	456,023	$	38,001.94
	Group 2					
0237	Newark OH	2	$	1,446,162	$	120,513.48
0287	Vincennes IN	2	$	1,140,058	$	95,004.85
0271	Mayfield KY	2	$	606,304	$	50,525.30
0295	Whitehouse OH	2	$	466,139	$	38,844.89
0870	Marion OH	2	$	528,461	$	44,038.38
0861	Kansas City MO	2	$	555,001	$	46,250.09
0861	Kansas City MO	2	$	325,953	$	27,162.74
	Group 3					
0849	Denver CO	3	$	1,098,601	$	91,550.12
0531	Fairhaven MA	3	$	391,765	$	32,647.12
0540	West Roxbury MA	3	$	457,060	$	38,088.31
0205	Livermore CA	3	$	359,118	$	29,926.53
0197	Oshkosh WI	3	$	470,533	$	39,211.09
0541	Westborough MA	3	$	579,875	$	48.322.92
			$	16,906,487	$	1,408,873,91

EXHIBIT C

Number of Licensed and Operating Beds for Each Facility

Kindred Facility #	City. State Location	# of Available Beds	# of Licensed Beds
0171	Bolivar TN	134	134
0174	Camden TN	150	150
0175	Jefferson City TN	170	170
0177	Loudon TN	182	182
0178	Memphis TN	233	233
0179	Huntingdon TN	150	150
0183	Ripley TN	144	144
0184	Blountville TN	170	170
0187	Maryville TN	187	187
0189	Maryville TN	75	75
	Group 2		
0237	Newark OH	300	300
0287	Vincennes IN	205	216
0271	Mayfield KY	100	100
0295	Whitehouse OH	88	94
0870	Marion OH	110	110
0861	Kansas City MO	180	180
0861	Kansas City MO	96	96
	Group 3		
0849	Denver CO	172	180
0531	Fairhaven MA	106	107
0540	West Roxbury MA	141	141
0205	Livermore CA	80	83
0197	Oshkosh WI	182	184
0541	Westborough MA	122	123

EXHIBIT 10.55

Added Facility:
Carthage, Tennessee

Removed Facilities:
Kansas City, Missouri
West Roxbury, Massachusetts
Oshkosh, Wisconsin

THIRD AMENDMENT TO MASTER LEASE

THIS THIRD AMENDMENT TO MASTER LEASE (the "Amendment") is made and entered into and effective as of June 30, 2004 (the "Effective Date"), by and among HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation ("HCP") and HEALTH CARE PROPERTY PARTNERS, a California general partnership ("HCPP") (collectively, and jointly and severally, "Lessor"), KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company, KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company, and KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership (collectively, and jointly and severally, "Lessee"), with respect to the following:

RECITALS

A. Lessor is the "Lessor" and Lessee is the "Lessee" pursuant to that certain Master Lease dated as of May 16, 2001 (the "Original Lease"), as amended by that certain First Amendment to Master Lease dated as of August 1, 2001 (the "First Amendment") and that certain Second Amendment to Master Lease dated as of November 18, 2003 (the "Second Amendment"). The Original Lease together with the First Amendment and Second Amendment are collectively referred to herein as the "Lease." The Lease covers the Land, Leased Improvements, Related Rights and Fixtures of twenty-two (22) separate health care Facilities, all as more particularly described in the Lease.

B. The obligations of Lessee under the Lease are guaranteed by Kindred Healthcare, Inc., a Delaware corporation, and Kindred Healthcare Operating, Inc., a Delaware corporation (collectively and jointly and severally, "Guarantors"), pursuant to that certain written Guaranty of Obligations executed by Guarantors as of May 16, 2001 (as the same may have been amended, modified and/or reaffirmed from time to time in accordance with the terms thereof, the "Guaranty").

C. On or about December 21, 2001, HCP transferred its interests in the Facility located in the State of Indiana to Indiana HCP, L.P., a Delaware limited partnership ("Indiana HCP"), and in connection therewith HCP assigned to and Indiana HCP assumed HCP's rights and obligations in, to and under the Lease (and all guaranties, indemnities and other rights relating thereto) with respect to such Facility pursuant to that certain Partial Assignment and Assumption of Master Lease dated December 21, 2001, by and between HCP and Indiana HCP. On or about March 3, 2004, Indiana HCP was merged with and into HCP and the separate existence of Indiana HCP ceased.

D. Kindred Healthcare Operating, Inc., a Delaware corporation ("Kindred Operating"), as Buyer, and HCP or HCPP, as applicable, as Seller, are also parties to those certain Purchase and Sale Agreements and Joint Escrow Instructions of even date herewith (each,

a "Purchase Agreement" and collectively, the "Purchase Agreements"), pursuant to which HCP or HCPP, as applicable, has agreed to sell and Kindred Operating has agreed to purchase the Kansas City, Missouri Facility, the West Roxbury, Massachusetts Facility and the Oshkosh, Wisconsin Facility (each, a "Sale Property" and collectively, the "Sale Properties"), as applicable, in accordance with the terms of the respective Purchase Agreements. The closing of the transaction contemplated by each Purchase Agreement, if at all, with respect to each applicable Sale Property, shall be referred to herein as a "Sale Property Closing," and the date thereof shall be referred to herein as a "Sale Property Closing Date."

E. In connection with each Sale Property Closing, Lessor and Lessee desire effective as of the Sale Property Closing Date to remove the applicable Sale Property from the Leased Property covered by the Lease and to terminate the Lease with respect thereto.

F. HCP, as Buyer, and Kindred Nursing Centers Limited Partnership, a Delaware limited partnership, as Seller, are also parties to that certain Contract of Acquisition of even date herewith (the "Carthage Contract of Acquisition"), pursuant to which HCP is purchasing and acquiring on the Closing Date as defined in the Carthage Contract of Acquisition (the "Carthage Closing Date") certain real and personal property situated in the City of Carthage, County of Smith, State of Tennessee, comprising a 128-bed skilled nursing facility (the "Carthage Facility"), all as more particularly described in the Carthage Contract of Acquisition. A legal description of the Land associated with the Carthage Facility is attached hereto as Exhibit A-23 and incorporated herein by this reference.

G. Effective immediately upon the Carthage Closing Date, if at all, Lessor desires to add to the Leased Property and lease to Lessee and Lessee desires to lease and hire from Lessor, the Carthage Facility.

H. Lessor and Lessee desire to amend the Lease to reflect the foregoing removal of the Sale Properties from and the addition of the Carthage Facility to the Leased Property, but only upon the terms and conditions set forth herein.

AGREEMENT

IN CONSIDERATION OF the foregoing Recitals and the mutual promises and covenants contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Lessor and Lessee agree as follows:

1. Termination of Lease with Respect to Sale Properties. Effective as of each Sale Property Closing Date, if at all, the following shall apply:

(a) Termination. The Lease, as hereby amended, shall be terminated as to the applicable Sale Property, but not as to any other Facility, and the Lease, as hereby amended, shall continue in full force and effect with respect to each such other Facility, except that the total monthly Allocated Minimum Rent payable under the Lease, as hereby amended, shall be reduced effective as of such Sale Property Closing Date by the amount of the monthly Allocated Minimum Rent for such Sale Property. The provisions of Section 18 of the Original Lease shall have no application to the termination of the Lease, as hereby amended, with respect

to any Sale Property. Following each Sale Property Closing, the parties shall execute a memorandum confirming the Sale Property Closing Date for purposes of this Amendment.

(b) Leased Property; Facilities. The defined term "Leased Property" shall no longer include the applicable Sale Property and all references in the Lease, as hereby amended, to a "Facility" or "Facilities" shall mean each Facility (as defined in the Lease) other than such Sale Property.

(c) Reservations. Notwithstanding the termination of the Lease, as hereby amended, as to any Sale Property, the following obligations of Lessee under the Lease and Guarantors under the Guaranty with respect to each such Sale Property shall be reserved and continue in favor of Lessor subsequent to the applicable Sale Property Closing Date and shall not be merged with the deed delivered by HCP or HCPP, as applicable, at the Sale Property Closing:

(i) Lessee and Guarantors shall remain responsible for all Rents accrued but not paid, whether or not billed, applicable to such Sale Property through (but not including) each Sale Property Closing Date (prorated for the month in which such Sale Property Closing Date occurs based upon a thirty (30) day month);

(ii) Lessee and Guarantors shall remain responsible for all indemnification and hold harmless obligations of Lessee under the Lease and/or Guarantors under the Guaranty under the terms set forth therein with respect to such Sale Property whether arising out of events or circumstances on, before or after the applicable Sale Property Closing Date and whether such obligations occur or accrue on, or before or after the applicable Sale Property Closing Date; and

(iii) Lessee shall continue to observe any other covenant or agreement of Lessee in the Lease with respect to such Sale Property which is intended to or expressly provides that it shall survive the termination of the Lease with respect to such Sale Property, as set forth in Sections 40.3 and 40.8 of the Lease. Guarantors shall continue to observe any other covenant or agreement of Guarantor under the Guaranty with respect to such Sale Property which is intended to or expressly provides that it shall survive the termination of the Lease with respect to such Sale Property.

2. Leasing of Carthage Facility. Effective as of the Carthage Closing Date, if at all, the following shall apply:

(a) Lessor hereby leases to Lessee and Lessee hereby hires from Lessor, the Leased Property of the Carthage Facility upon all of the terms, covenants and conditions set forth in or incorporated into this Amendment.

(b) All references herein and in the Lease or this Amendment to (i) a "Facility" or "Facilities" shall mean each Facility (as defined in the Lease, as hereby amended) together with the Carthage Facility and (ii) the "Leased Property" shall include the Land, Leased Improvements, Related Rights and Fixtures of the Carthage Facility. In addition, the Leased Property of the Carthage Facility shall include the machinery, equipment, furniture and other personal property described on Exhibit F attached hereto, together with all replacements,

modifications, alterations and substitutes therefor (whether or not constituting an upgrade) (collectively, "Lessor's Personal Property").

(c) Lessee shall hold and occupy the Leased Property of the Carthage Facility upon all of the terms and provisions of the Lease, as hereby amended, applicable to the Leased Property of the other Facilities, except that:

(i) The "Commencement Date" of the Lease with respect to the Carthage Facility shall be the Carthage Closing Date;

(ii) Lessee shall pay Rent with respect to the Carthage Facility in accordance with Section 2(d) below;

(iii) The "Primary Intended Use" of the Carthage Facility shall be a long-term skilled nursing care facility having the number of licensed and operating beds set forth on Exhibit C attached hereto and incorporated herein by this reference with respect to the Carthage Facility and such other uses necessary of incidental to such use;

(iv) Each "Lease Year" with respect to the Carthage Facility shall be each period of twelve (12) full calendar months from and after the Carthage Closing Date, unless the Carthage Closing Date is a day other than August 1, 2004, in which case the first Lease Year for the Carthage Facility shall be the period commencing on the Carthage Closing Date and ending on July 31, 2004, and each subsequent Lease Year for the Carthage Facility shall be each period of twelve (12) full calendar months after the last day of the prior Lease Year for such Facility; provided, however, that the last Lease Year for the Carthage Facility during the Term may be a period of less than twelve (12) full calendar, months and shall end on the last day of the Term for such Facility;

(v) The Term of the Lease with respect to the Carthage Facility shall commence on the Carthage Closing Date, as determined pursuant to Recital F and as set forth in Section 2(c)(i) above, and shall be coterminous with the Term for the balance of the Group 1 Facilities; and

(vi) The Carthage Facility shall be added to and become part of the Group 1 Facilities.

(d) Rent payable with respect to the Carthage Facility shall be as follows:

(i) Subject to upward adjustments as provided in clause (ii) below, for the period from the Carthage Closing Date through the expiration of the first Lease Year for the Carthage Facility, the initial monthly "Allocated Minimum Rent" for the Carthage Facility shall be equal to Sixty-Four Thousand Five Hundred Eighty Three and 33/100 Dollars ($64,583.33). The first monthly payment of Allocated Minimum Rent for the Carthage Facility shall be payable on the Carthage Closing Date (prorated as to any partial calendar month at the beginning of the Term for such Facility).

(ii) Commencing upon the expiration of the first (1st) Lease Year of the Fixed Term of the Carthage Facility, and upon the expiration of each Lease Year of the Carthage Facility thereafter during the Term (including the Extended Term, if any) of the Carthage Facility, the then current monthly Allocated Minimum Rent for the Carthage Facility for such Lease Year shall be increased in accordance with Section 3.1(c) of the Original Lease.

(iii) In addition to Allocated Minimum Rent, Lessee shall pay and discharge all other Additional Charges and other Rent payable with respect to the Carthage Facility, as and when payable under the Lease, as hereby amended.

3. Notices to Lessor. All notices to Lessor under the Lease, as hereby amended, shall be sent in the manner provided in the Lease to the following address:

If to Lessor:	Health Care Property Investors, Inc. 3760 Kilroy Airport Way, Suite 300 Long Beach, California 90806	
	Attn:	Legal Department
	Fax:	(562) 733-5200
with a copy to:	Latham & Watkins LLP 650 Town Center Drive, Suite 2000 Costa Mesa, California 92626	
	Attn:	David C. Meckler, Esq.
	Fax:	(714) 755-8290

4. Exhibits and Schedules. Effective as of each Sale Property Closing Date, if any, Exhibit A-16 (with respect to the Kansas City, Missouri Facility), Exhibit A-19 (with respect to the West Roxbury, Massachusetts Facility) and Exhibit A-21 (with respect to the Oshkosh, Wisconsin Facility), as applicable, and any reference to the applicable Sale Property in the Exhibits to the Lease shall be deleted in its entirety. Effective as of the Carthage Closing Date, if at all, Exhibit A-23 attached hereto shall be added to the Lease as Exhibit A-23, Exhibit F attached hereto shall be added to the Lease as Exhibit F, and each of Exhibit B and Exhibit C attached to the Original Lease, as previously amended and replaced by Exhibit B and Exhibit C to the Second Amendment, shall be deleted in its entirety and replaced with Exhibit B and Exhibit C attached hereto, respectively; provided, however, that if the Carthage Closing Date occurs prior to the Sale Property Closing Date of any Sale Property, then such Exhibit B and Exhibit C may at any time thereafter be updated by Lessor to include any Sale Property for which the Sale Property Closing Date fails to occur.

5. Defined Terms. All terms used in this Amendment with initial capital letters and not defined herein shall have the meanings given to such terms in the Lease.

6. Lease in Effect. Lessor and Lessee acknowledge and agree that the Lease, as hereby amended, remains in full force and effect in accordance with its terms.

7. Counterparts. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute a single instrument. Delivery of an executed counterpart of a signature page to this Amendment

via telephone facsimile transmission shall be as effective as delivery of a manually executed counterpart of this Amendment.

[Signature Page Follows]

IN WITNESS WHEREOF, Lessor and Lessee have executed this Amendment as of the Effective Date.

"LESSOR"

HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation

By: /s/ Paul Gallagher
Paul Gallagher
Executive Vice President

"HCP"

HEALTH CARE PROPERTY PARTNERS, a California general partnership

By: HEALTH CARE PROPERTY INVESTORS, INC., a Maryland corporation, its Managing General Partner

By: /s/ Paul Gallagher
Paul Gallagher
Executive Vice President

"HCPP"

"LESSEE"

KINDRED NURSING CENTERS EAST, L.L.C., a Delaware limited liability company

By: /s/ Greg C. Miller
Greg C. Miller
Its: Vice President Corporate Development & Financial Planning

By: /s/ Paul Eiseman
Its: VP Development

KINDRED NURSING CENTERS WEST, L.L.C., a Delaware limited liability company

By: /s/ Greg C. Miller
Greg C. Miller
Its: Vice President Corporate Development & Financial Planning

By: /s/ Paul Eiseman
Its: VP Development

KINDRED NURSING CENTERS LIMITED PARTNERSHIP, a Delaware limited partnership

By: Kindred Healthcare Operating, Inc., its general partner

By: /s/ Greg C. Miller
Greg C. Miller
Its: Vice President Corporate Development & Financial Planning

By: /s/ Paul Eiseman
Its: VP Development

CONSENT AND REAFFIRMATION OF GUARANTORS

The undersigned Guarantors hereby consent to the foregoing Third Amendment to Master Lease and reaffirm to Lessor that their obligations under the Guaranty remain in full force and effect with respect to the Lease, as amended hereby.

KINDRED HEALTHCARE, INC., a Delaware corporation

By:	/s/ Greg C. Miller
	Greg C. Miller
Its:	Vice President Corporate Development & Financial Planning
By:	/s/ Paul Eiseman
Its:	VP Development

KINDRED HEALTHCARE OPERATING, INC., a Delaware corporation

By:	/s/ Greg C. Miller
	Greg C. Miller
Its:	Vice President Corporate Development & Financial Planning
By:	/s/ Paul Eiseman
Its:	VP Development

EXHIBIT A-23

Legal Description of the Land of the Carthage, Tennessee Facility
(Facility No. 0274)

LEGAL DESCRIPTION

The land referred to herein is described as follows:

TRACT 1:

LAND in the Town of Carthage, First (1st) Civil District of Smith County, Tennessee, being more particularly described according to a survey made by HLS, Inc., Consulting Engineers, dated April 1983, of record in Plat Book 3, page 24, Register's Office for Smith County, Tennessee, as follows:

BEGINNING at an iron pin located in the fence on the west side of the subject property, said iron pin being at the southwest corner of the subject property, and being further identified as being North 8 degrees 36 minutes East 433.20 feet from the Fisher Heirs southwest corner; running thence North 8 degrees 36 minutes East 228.24 feet with the fence to an iron pin; thence North 23 degrees 52 minutes East 375.0 feet to an iron pin located at the northwest corner of the subject property; thence South 81 degrees 26 minutes East 316.0 feet to an iron pin located at the northeast corner of the subject property; thence South 8 degrees 36 minutes West 589.9 feet to an iron pin located at the southeast corner of the subject property; thence North 81 degrees 26 minutes West 414.84 feet to the point of beginning, containing 5.21 acres, more or less.

TRACT 2:

LAND in the Town of Carthage, First (1st) Civil District of Smith County, Tennessee, and being more particularly described according to a survey made by Petty & Petty, Surveyors, dated September 15, 1983, which is a re-survey of Part of Lot No. 1 and of Lot No. 2, as shown on plan of record in Warranty Deed Book 59, page 320, Register's Office for Smith County, Tennessee, said survey by Petty & Petty, Surveyors, being of record in Plat Book 3, page 22, said Register's Office, as follows:

Said Lot begins at an iron pipe located on the easterly right of way of Hospital Drive, the common northwest corner of the subject property and southwest corner of the Dr., Robert J. Wright property; running thence South 82 degrees 10 minutes 00 seconds East 186.00 feet with the Wright south line to an iron pipe by a cedar tree; thence South 23 degrees 52 minutes 00 seconds West 177.00 feet to an iron pipe; thence North 80 degrees 02 minutes 07 seconds West 143.20 feet to an iron pipe located on the easterly right of way of Hospital Drive; thence North 9 degrees 55 minutes 00 seconds East 164.89 feet with the easterly right of way of Hospital Drive to the point of beginning, containing 27.628 square feet, more or less.

TOGETHER WITH THE FOLLOWING EASEMENTS:

Being two certain tracts or parcels of land located and situated in the Town of Carthage, First (1st) Civil District of Smith County, Tennessee, and being more particularly described according to a survey made by Petty & Petty, Surveyors, dated July 18, 1983, of record in Plat Book 3, page 24, Register's Office for Smith County, Tennessee.

[Carthage, TN]

EASEMENT TRACT 1:

BEGINNING at a point, same being located on the south line of the subject property at the common northwest corner of the Dr. R.J. Wright property and the northeast corner of Hospital Drive; running thence North 64 degrees 45 minutes East 220.00 feet to an iron pipe; thence North 23 degrees 52 minutes East 50.00 feet to an iron pipe set at the end of a curb; thence North 68 degrees 30 minutes West 42.00 feet to a point; thence South 52 degrees 00 minutes West 58.30 feet to a point; thence South 63 degrees 45 minutes West 148.00 feet with a concrete curb to a point at the end of the curb; thence South 55 degrees 00 minutes West 77.92 feet to a point on the South line of subject property and the north extremity of Hospital Drive; thence South 80 degrees 02 minutes East 60.00 feet along the North extremity of Hospital Drive to the point of Beginning.

EASEMENT TRACT 2:

BEGINNING at an iron pipe at the end of a curb on the East side of a present paved road leading to the Smith County Memorial Hospital; running thence South 68 degrees 30 minutes East 89.00 feet to an iron pipe located on the West line of the Smith County Health Care Center, Inc., property, same being its Northwest corner; thence South 23 degrees 52 minutes West 50.00 feet with the Smith County Health Care Center, Inc., West line to an iron pipe; thence North 68 degrees 30 minutes West 89.00 feet to an iron pipe; thence North 23 degrees 52 minutes East 50.00 feet to the point of beginning, containing 0.102 acre, more or less.

And being part of the easement granted to Smith County Health Care Center, Inc., by grant of easement from Hospital Corporation of Smith and Overton County, in Warranty Deed Book 102, pages 409-412, said Register's Office; and being part of the easement granted to Smith County Health Care Center, Inc., a Tennessee Corporation, by grant of easement from Hospital Development Properties, Inc., a Delaware Corporation, of record in Deed Book 119, pages 725-728, Register's Office for Smith County, Tennessee.

Being the same property conveyed to Kindred Nursing Centers Limited Partnership by Special Warranty Deed from The Health and Educational Facilities Board of Smith County, Tennessee, of record in Book 66, page 57, in the Register's Office for Smith County, Tennessee.

[Carthage, TN]

EXHIBIT B

List of Facilities, Facility Groups and Annual and Monthly Allocated Minimum Rent for the Facilities

(August 1, 2003 – July 31, 2004)

[Effective as of Carthage Closing Date and after Sale Property Closings]

Kindred Facility #	City. St. Location	Group	Annual Allocated Minimum Rent	Monthly Allocated Minimum Rent
0171	Bolivar TN	1	$ 748,470	$ 62,372.49
0174	Camden TN	1	$ 562,083	$ 46,840.27
0175	Jefferson City TN	1	$ 1,054,416	$ 37,868.04
0177	Loudon TN	1	$ 944,025	$ 78,668.74
0178	Memphis TN	1	$ 1,527,793	$ 127,316.09
0179	Huntingdon TN	1	$ 647,690	$ 53,974.13
0183	Ripley TN	1	$ 690,510	$ 57,542.52
0184	Blountville TN	1	$ 708,138	$ 59,011.52
0187	Maryville TN	1	$ 1,142,308	$ 95,192.35
0189	Maryville TN	1	$ 456,023	$ 38,001.94
0274	Carthage TN	1	$ 775,000	$ 64,583.33
	Group 2			
0237	Newark OH		$ 1,446,162	$ 120,513.48
0287	Vincennes IN	2	$ 1,140,058	$ 95,004.85
0271	Mayfield KY	2	$ 606,304	$ 50,525.30
0295	Whitehouse OH	2	$ 466,139	$ 38,844.89
0870	Marion OH	2	$ 528,461	$ 44,038.38
	Group 3			
0849	Denver CO	3	$ 1,098,601	$ 91,550.12
0531	Fairhaven MA	3	$ 391,765	$ 32,647.12
0205	Livermore CA	3	$ 359,118	$ 29,926.53
0541	Westborough MA	3	$ 579,875	$ 48,322.92
			$ 15,872,939	$ 1,322,745.01

EXHIBIT C

Number of Licensed and Operating Beds for Each Facility

[Effective as of Carthage Closing Date and after Sale Property Closings]

Kindred Facility #	City. State Location	# of Available Beds	# of Licensed Beds
0171	Bolivar TN	134	134
0174	Camden TN	150	150
0175	Jefferson City TN	170	170
0177	Loudon TN	182	182
0178	Memphis TN	233	233
0179	Huntingdon TN	150	150
0183	RipleyTN	144	144
0184	Blountville TN	170	170
0187	Maryville TN	187	187
0189	Maryville TN	75	75
0274	Carthage TN	128	128
	Group 2		
0237	Newark OH	300	300
0287	Vincennes IN	205	216
0271	Mayfield KY	100	100
0295	Whitehouse OH	88	94
0870	Marion OH	110	110
	Group 3		
0849	Denver CO	172	180
0531	Fairhaven MA	106	107
0205	Livermore CA	80	83
0541	Westborough MA	122	123

EXHIBIT F

Itemization of Lessor's Personal Property

Asset	SNo.	Cap. date	Asset description
403845	0	10/03/2001	DISPOSAL GARBAGE
411947	0	02/04/2002	WASHER EXTRACTOR 100LBHARDMOUNT
421187	0	04/03/2002	WHEELCHAIR TRACER IV W/ASTICULATING LEG
451749	0	11/30/2002	Equipment – Appraised Value at Purchase
456804	0	12/23/2002	COPIER DIGITAL AFICIO 1035, ARDF,FINISHER
465457	0	02/18/2003	ICE MACHINE WATER COOLED 320LB/24HR
465252	0	04/11/2003	BED ULTRACARE 80" W/STAFF CTL ASTRAIL
469252	1	04/11/2003	MATTRESS GEO-MATTRESS PLUS W/WINGS 80"
469253	0	04/11/2003	BED ULTRACARE 80" W/STAFF CTL ASTRAIL
469253	1	04/11/2003	MATTRESS GEO-MATTRESS PLUS W/WINGS 80"
469254	0	04/11/2003	BED ULTRACARE 80" W/STAFF CTL ASTRAIL
469254	1	04/11/2003	MATTRESS GEO-MATTRESS PLUS W/WINGS 80"
469255	0	04/11/2003	BED ULTRACARE 80" W/STAFF CTL ASTHDL
469255	1	04/11/2003	MATTRESS GEO-MATTRESS PLUS W/WINGS 80"
469258	0	04/11/2003	BED ULTRACARE 80" W/STAFF CTL ASTHDL
469259	1	04/11/2003	MATTRESS GEO-MATTRESS PLUS W/WINGS 80"
469253	2	04/11/2003	FREIGHT
470001	0	03/21/2003	STRAP STANDING DEVICE OVATION
500104	0	08/13/2003	REFRIGERATOR W/FULL DOORS TWOSECTIONS
500812	0	07/31/2003	LIFT STAND UP W/LOW BASE W/2BATTERIES
504199	0	09/20/2003	ULTRASOUND & STIMULATOR INTELECTCOMBO
521661	0	01/09/2004	EXERCISE APPARATUS
531640	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531641	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531642	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531643	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531644	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531645	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531646	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531647	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531648	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531649	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531650	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531651	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531652	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531653	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531654	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531655	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531656	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531657	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531658	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531659	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531660	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531661	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531662	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531663	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531664	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531665	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531666	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531667	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531668	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531669	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531670	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531671	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531672	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531673	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531674	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531675	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531676	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531677	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531678	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531679	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531680	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531681	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531682	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531683	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531684	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531685	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL

531686	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531687	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531688	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531689	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531690	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531691	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531692	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531693	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531694	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531695	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531696	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531697	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531698	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531699	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531700	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531701	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531702	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL
531703	0	02/06/2004	BED	ULTRACARE	80"	W/STAFF	CTL	AST	RAIL

Asset	SNo.	Cap. date	Asset description
531704	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531705	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531706	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531707	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531708	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531709	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531710	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531711	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531712	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531713	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531714	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531715	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531716	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531717	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531718	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531719	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531720	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531721	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531722	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531723	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531724	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531725	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531726	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531727	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531728	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531729	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531730	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531731	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531732	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531733	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531734	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531735	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531736	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531737	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531738	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531739	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531740	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531741	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531742	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531743	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531744	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531745	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531746	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531747	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531748	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531749	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531750	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
531751	0	02/06/2004	BED ULTRACARE 80" W/STAFF CTL AST RAIL
537507	0	03/11/2004	CONVECTION OVER SNG DECK 150826
552306	0	04/30/2004	CABINET STORAGE 45-GAL FORFLAMMABLES
Asset determination 00018090 MAJOR MOVABLE			
414020	0	01/01/2002	I 215002 - CPU SLIMLINE P3/866MHZ 15GB128MB
414021	0	01/01/2002	I 215002 - CPU SLIMLINE P3/866MHZ 15GB128MB
414022	0	01/01/2002	I 215002 - CPU SLIMLINE P3/866MHZ 15GB128MB
414023	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414024	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414025	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414026	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414027	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414028	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414029	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414030	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414031	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414032	0	01/01/2002	I 215002 - CPU SLIMLINE P1.0/20GB/128MB
414033	0	01/01/2002	I 215002 - CISCO ROUTER
414034	0	01/01/2002	I 215002 - COMPAQ SERVER ML370
414035	0	01/01/2002	I 215002 - LASERJET PRINTER
414036	0	01/01/2002	I 215002 - SPRINT 2 SWITCHES

414037	0	01/01/2002	I 215002 - SPRINT 2 SWITCHES
414038	0	01/01/2002	I 215002 - TIMECLOCK ECOT N/BARCODE
414039	0	01/01/2002	I 215002 - GE CAPITAL CABLING
432513	0	06/19/2002	PCR: COMPAQ DESKTOP
434789	0	06/26/2002	PCR: COMPAQ DESKTOP [Not Readable]
469932	0	03/20/2003	PCR: DESKTOP ACCESSORIES
473654	0	04/08/2003	NETGAIN: CABLING FOR DSSI PROJECT
499918	0	07/01/2003	I228207 - DSSI COMPAQ EVO D510
503985	0	08/01/2003	I228207 - DSSI LEXMARK X5226 PRINTER

FIRST AMENDMENT TO MASTER LEASE AGREEMENT

THIS FIRST AMENDMENT TO MASTER LEASE AGREEMENT ("Amendment") is dated as of June 20, 2007 ("Amendment Effective Date") between **HCRI MASSACHUSETTS PROPERTIES TRUST II,** a Massachusetts business trust organized under the laws of the Commonwealth of Massachusetts ("Landlord"), having its principal office located at One SeaGate, Suite 1500, P. O. Box 1475, Toledo, Ohio 43603-1475, and **KINDRED NURSING CENTERS EAST, L.L.C.**, a Delaware limited liability company organized under the laws of the State of Delaware ("Tenant"), having its chief executive office located at 680 South Fourth Avenue, Louisville, Kentucky 40202.

RECITALS

A. Landlord has leased to Tenant property located in Massachusetts (collectively called "Property") pursuant to a Master Lease Agreement dated as of February 28, 2006, as amended from time to time ("Lease").

B. As of the Amendment Effective Date of this Amendment, and pursuant to the exercise of Tenant's Option to Purchase, HCN-MA II has conveyed the Dedham MOB (as defined in the Lease) located in Dedham Massachusetts.

C. Landlord and Tenant desire to amend the Lease to remove the Dedham MOB from the Lease.

NOW, THEREFORE, in consideration of the foregoing recitals and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows.

1. Definitions. Any capitalized terms not defined in this Amendment shall have the meaning set forth in the Lease.

2. Amended Definitions. The definitions of "Investment Amount", "Option Amount", and "Rent Schedule" in §1.4 of the Lease are hereby amended to read in their entireties as follows (added language in italics):

> "Investment Amount means $122,000,000.00 as of the Effective Date *less the sum of (i) the MOB Base Price plus (ii) one-third of the property appreciation (as defined in Section 13.8).*
>
> "Option Amount" means the Investment Amount (as of the Effective Date), plus a cumulative annual increase by 2% on each anniversary of the Commencement Date *less the sum of [i] the MOB Base Price plus (ii) one-third of the property appreciation (as defined in Section 13.8).*

"Rent Schedule" means the schedule issued by Landlord to Tenant showing the Base Rent to be paid by Tenant pursuant to the terms of this Lease, as such schedule is amended from time to time by Landlord. The initial Rent Schedule is attached to this Lease as Schedule 1 or will be attached following Closing if the Rent Schedule cannot be determined until the day of Closing. *The Rent Schedule to be in effect upon the Amendment Effective Date of the First Amendment to Master Lease Agreement is attached as Schedule 1-A.*

3. Amendment Rent Schedule. The Lease is hereby amended to add a new Schedule 1-A in the form of Schedule 1-A attached hereto and made a part hereof.

4. Legal Description. Exhibit A-5 of the Lease is hereby amended to read in its entirety as set forth on Exhibit A-5 attached hereto and made a part hereof.

5. Permitted Exceptions. Exhibit B-5 of the Lease is hereby amended to read in its entirety as set forth on Exhibit B-5 attached hereto and made a part hereof.

6. Facility Information. Exhibit C of the Lease is hereby amended to read in its entirety as set forth on Exhibit C attached hereto and made a part hereof.

7. Assigned Leases and Tenancies. Exhibit G of the Lease is hereby amended to read in its entirety as set forth on Exhibit G attached hereto and made a part-hereof.

8. Affirmation. Except as specifically modified by this Amendment, the terms and provisions of the Lease are hereby affirmed and shall remain in full force and effect.

9. Binding Effect. This Amendment will be binding upon and inure to the benefit of the successors and permitted assigns of Landlord and Tenant.

10. Further Modification. The Lease may be further modified only by writing signed by Landlord and Tenant.

11. Counterparts. This Amendment may be executed in multiple counterparts, each of which shall be deemed an original hereof, but all of which will constitute one and the same document.

12. Consent of Guarantor. This Amendment shall have no force or effect unless and until each Guarantor has executed the Consent of Guarantor set forth below.

[THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, Landlord and Tenant have executed this Amendment as of the date first set forth above.

Signed and acknowledged in the presence of:

HCRI MASSACHUSETTS PROPERTIES TRUST II

Signature /s/ Rita J. Rogge
Print Name Rita J. Rogge

By: HCRI Massachusetts Properties, Inc., as Trustee, and not individually, and subject to the provisions of the Declaration of Trust of HCRI Massachusetts Properties Trust II filed with the Secretary of the Commonwealth of Massachusetts and the City Clerk of Boston

Signature /s/ Donna J. Lunsford
Print Name Donna J. Lunsford

By: /s/ Erin C. Ibele
Erin C. Ibele
Senior Vice President –
Administration and Corporate Secretary

By: /s/ Michael A. Crabtree
Michael A. Crabtree
Vice President and Treasurer

KINDRED NURSING CENTERS EAST, L.L.C.

Signature /s/ RICHARD MYERS
Print Name RICHARD MYERS

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

Signature /s/ MARILYN A. WEAVER
Print Name MARILYN A. WEAVER

STATE OF OHIO)
) SS:
COUNTY OF LUCAS)

The foregoing instrument was acknowledged before me this 15 day of June, 2007 by Erin C. Ibele, the Senior Vice President-Administration and Corporate Secretary of HCRI Massachusetts Properties, Inc., a Delaware corporation, as Trustee, on behalf of and as the free act and deed of HCRI Massachusetts Properties Trust II, a Massachusetts business trust.

/s/ Rita J. Rogge

Notary Public

My Commission Expires: ______________

[SEAL]

[SEAL]

COMMONWEALTH KENTUCKY

Jefferson, ss.

On this 18th day of June, 2007, before me, the undersigned notary public, personally appeared Gregory C. Miller, the Sr. V.P. Corp. Dev. & Fin. Planning of KINDRED NURSING CENTERS EAST, L.L.C. and proved to me through satisfactory evidence of identification, which was a Kentucky Driver's License, to be the person whose name is signed on this document, and acknowledged to me that he signed it voluntarily in his capacity as Sr. V.P. Corp. Dev. & Fin. Pl. for its stated purpose, as his free act and deed and the free act and deed of KINDRED NURSING CENTERS EAST, L.L.C.

/s/ Patricia A. Burkhead

Notary Public

My commission expires:

Patricia A. Burkhead
Notary Public, State at Large, KY
My commission expires Oct. 29 2007

THIS INSTRUMENT PREPARED BY:
Cynthia L. Rerucha, Esq.
Shumaker, Loop & Kendrick, LLP
1000 Jackson Street
Toledo, Ohio 43624

CONSENT OF GUARANTOR

In connection with the Unconditional and Continuing Lease Guaranty ("Guaranty") made by the undersigned Guarantors in favor of Landlord dated as of February 28, 2006, the undersigned Guarantors hereby [i] consent to the foregoing First Amendment to Master Lease Agreement ("Amendment"), [ii] affirm the Guaranty which shall remain in full force and effect and secure the Guaranteed Obligations, as defined in the Guaranty, and [iii] waive any suretyship defenses arising in connection with the Amendment All capitalized terms not defined herein shall have the meaning set forth in the foregoing Amendment.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

HARBORLIGHTS NURSING, L.L.C.

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

HIGHLANDER NURSING, L.L.C.

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

BRAINTREE NURSING, L.L.C.

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

MASSACHUSETTS ASSISTED LIVING, L.L.C.

By: /s/ Gregory C. Miller
Gregory C. Miller
Its: Senior Vice President
Corporate Development and Financial Planning

LAUREL LAKE HEALTH AND REHABILITATION, L.L.C.

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

HIGHGATE NURSING, L.L.C.

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

AVERY MANOR NURSING, L.L.C.

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

COUNTRY ESTATES NURSING, L.L.C

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

TOWER HILL NURSING, L.L.C.

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

FORESTVIEW NURSING, L.L.C.

By: /s/ Gregory C. Miller

Gregory C. Miller

Its: Senior Vice President

Corporate Development and Financial Planning

KINDRED HEALTHCARE OPERATING. INC. - MASTER LEASE
HEALTH CARE REIT, INC.

EFFECTIVE DATE	03/01/06	
INITIAL TERM COMMENCEMENT DATE	03/01/06	**Final**
INITIAL TERM	15 Yrs	
INITIAL TERM EXPIRATION DATE	02/28/21	
INITIAL INVESTMENT AMOUNT	122 000,000	
REVISED LEASE AMOUNT - 06/20/2007	118.926,986	
RATE OF RETURN	N/A	
(365/360 BASIS)	N/A	
INITIAL RATE OF RETURN	8.75%	
INCREASER	**As defined within the Master Lease Agreement**	

	DATES				*BEGINNING*		*ADJUSTED*		
			REVENUE		*RENT RATE*	*PERCENTAGE*	*RENT RATE*	*MONTHLY*	
			CONDITION MET	*INCREASER*	*OF RETURN*	*RATE*	*OF RETURN*	*RENT*	*ANNUAL*
LEASE YEAR	*FROM*	*TO*	*(YES/NO)*	*(BP)*	*(ROUNDED)*	*SHORTFALL*	*(ROUNDED)*	*AMOUNT*	*RENT AMOUNT*
1	03/01/06	02/28/07	YES	N/A	8.75%	N/A	N/A	889,583.33	10,674,999.96
2	03/01/07	05/31/07	TBD	2.5%	8.97%	N/A	N/A	911,822.91	2,735,468.73
2A	06/01/07	06/19/07	N/A	N/A	8.97%	N/A	N/A	577,568.33	
2B	06/20/07	06/30/07	N/A	N/A	8.97%	N/A	N/A	325,959.05	903,527.38
2C	07/01/07	02/28/08	N/A	N/A	8.97%	N/A	N/A	888,979.22	7,111,833.76
3	03/01/08	02/28/09	TBD	TBD	8.97%	TBD	TBD	888,979 22	10,667,750.64
4	03/01/09	02/28/10	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
5	03/01/10	02/28/11	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
6	03/01/11	02/29/12	TBD	TBD	8.97%	TSD	TBD	888,979.22	10,667,750.64
7	03/01/12	02/28/13	TBD	TBD	8.97%	TBD	TBD	888,979 22	10,667,750.64
8	03/01/13	02/28/14	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
9	03/01/14	02/28/15	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
10	03/01/15	02/29/16	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
11	03/01/16	02/28/17	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
12	03/01/17	02/28/18	TBD	TBD	8.87%	TBD	TBD	888,979.22	10,667,750.64
13	03/01/18	02/28/19	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
14	03/01/19	02/29/20	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64
15	03/01/20	02/28/21	TBD	TBD	8.97%	TBD	TBD	888,979.22	10,667,750.64

12/12/2007

EXHIBIT A-5: LEGAL DESCRIPTION

Facility Name: Highgate Manor Center for Health and Rehabilitation

The land together with the improvements now or hereafter located thereon, situated in Dedham, Norfolk County, Commonwealth of Massachusetts, known as 10 Carematrix Drive, being depicted as Lot 9 on a plan entitled, "Subdivision of Lot 5 as shown on Land Court Plan 25941B in Dedham, Massachusetts Prepare for Dedham Endicott LLC, Prepared by Vanasse Hangen Brustlin, Inc., Scale: 1 inch = 80 Feet, Dated July 6, 2005, Revised: August 5, 2005," filed with the Land Registration Office on May 30, 2007 and filed as Land Court Plan No. 25941C.

EXHIBIT B-5: PERMITTED EXCEPTIONS

Facility Name: Highgate Manor Center for Health and Rehabilitation

1. The lien of real estate taxes and other governmental charges not yet due and payable and the lien of municipal betterments assessed after the Effective Date of this Lease (including the tax payments required by the agreement among the Town of Dedham, Massachusetts, HCRI Massachusetts Properties Trust II and WEJJ-MED Realty LLC dated May 1, 2002).
2. The rights of tenants and parties in possession pursuant to the Assigned Leases and Tenancies.
3. Title to and rights of the public and others entitled thereto in and to those portions of the insured premises lying within the bounds of adjacent streets, roads, and ways.
4. All matters as shown on the survey entitled "ALTA/ACSM Land Title Survey Special K Highgate Manor Center for Health & Rehab. 10 Care Matrix Dr. (One Allied Drive) Dedham, MA County of Berkshire" drawn by American National llc, dated July 26, 2005, Reference No. 20050110-006 (the "Survey") including: a. Utility Pole and overhead utility lines encroach onto premises by 65.26'; b. Sewer line encroaches onto adjacent property by 14.52' c. Storm sewer line encroaches onto adjacent property by 45.87'.
5. Easement to New England Telephone and Telegraph Company and Boston Edison Company dated March 12, 1996 and filed as Document No. 745303.
6. Rights of way and agreements as set forth in a deed from Joseph Schwartz to United States Rubber Company, dated December 30, 1955, recorded in Book 3438, Page 444, and in a deed from Joseph Schwartz to Allied Container Corporation, dated December 30, 1955, recorded in Book 3438, Page 446, as shown on the Survey, as affected by an agreement set forth in an instrument by and among Joseph Schwartz, Allied Container Corporation, and United States Rubber Company, dated December 21, 1956, filed as Document No. 189581.
7. Taking by the Town of Dedham for the layout of Allied Drive, by Instrument dated April 10, 1958, filed as Document No. 198103.
8. 10' wide drainage easement across a portion of Lot 6 (Allied Drive Extension), recorded in Book 293, Page 127. NOTE: This easement affects only a portion of Lot 6 of Land Court Plan 25941.
9. Right of Way granted to the Massachusetts Bay Transportation Authority as recited in Taking dated June 16, 1993 and filed as Document No. 659951.

10. Access Rights over Allied Drive and utility easements over Lot 5, as set forth in the taking by Massachusetts Bay Transportation Authority dated March 29, 1995 and filed as Document No. 712036.

11. Order of Department of Natural Resources dated November 14, 1974, filed as Document No. 346776.

12. Order of Conditions, DEP File No. 141-72, filed as Document No. 558736, as affected by Certificate of Compliance by the Dedham Conservation Commission Filed as Document No. 581494.

13. Amended Order of Conditions by the Town of Dedham Conservation Commission filed as Document No. 741912, as affected by a Partial Certificate of Compliance filed as Document No. 921377.

14. Second Amended Order of Conditions from the Town of Dedham Conservation Commission, DEP File No. 141-175, filed as Document No. 792555, as affected by a Partial Certificate of Compliance filed as Document No. 921377.

15. Order of Conditions, DEP File No. 141-101, filed as Document No. 599671, as affected by an Amended Order of Conditions filed as Document No. 741912, as affected by a Partial Certificate of Compliance recorded as Document No. 921377 and as further affected by a Second Amended Order of Conditions recorded as Document No. 792555.

16. Decision by the Town of Dedham Zoning Board of Appeals filed as Document No. 1048362.

17. Declaration of Easements by HCRI Massachusetts Properties Trust II.

EXHIBIT C: FACILITY INFORMATION

Facility Name ***Affiliate Subtenant***	**Street Address County**	**Facility Type (per license) Beds/Units**
Harborlights Rehabilitation and Nursing Center ("South Boston Facility") *Harborlights Nursing, L.L.C.*	804 East 7th Street South Boston, MA 02127 Suffolk County	Convalescent or Nursing Home 89 licensed beds 89 operating beds 46 units
Highlander Rehabilitation and Nursing Center ("Fall River Facility") Highlander Nursing, L.L.C.	1748 Highland Avenue Fall River, MA 02720 Bristol County	Convalescent or Nursing Home 176 licensed beds 176 operating beds 88 units
Braintree Manor Rehabilitation and Nursing Center ("Braintree Facility") *Braintree Nursing, L.L.C.*	1102 Washington Street Braintree, MA 02184 Norfolk County	Convalescent or Nursing Home 177 licensed beds 164 operating beds 74 units
Laurel Lake Center for Health and Rehabilitation and The Village at Laurel Lake ("Laurel Lake Facility") *Laurel Lake Health and Rehabilitation, L.L.C. (SNF)* *Massachusetts Assisted Living, L.L.C.(ALF)*	600-620 Laurel Street Lee, MA 01238 Berkshire County	Nursing Home 88 licensed beds 88 operating beds 48 units Assisted Living Facility 66 beds 53 licensed units 53 operating units
Highgate Manor Center for Health and Rehabilitation ("Dedham Facility") *Highgate Nursing, L.L.C.*	10 CareMatrix Drive Dedham, MA 02026 Norfolk County	Nursing Home 142 licensed beds 142 operating beds 79 units

Facility Name ***Affiliate Subtenant***	**Street Address County**	**Facility Type (per license) Beds/Units**
Avery Manor, Avery Crossing, and Avery Medical Office Building ("Needham Facility") *Avery Manor Nursing, L.L.C. (SNF)* *Massachusetts Assisted Living, L.L.C. (ALF)*	100-110 West Street Needham, MA 02494 Norfolk County	Nursing Home 142 licensed beds 142 operating beds 76 units Assisted Living Facility 60 operating beds 60 licensed units 60 operating units
Country Estates of Agawam ("Agawam Facility") *Country Estates Nursing, L.L.C.*	1200 Suffield Street Agawam, MA 01001 Hampden County	Nursing Home 176 licensed beds 176 operating beds 100 units
Tower Hill Center for Health and Rehabilitation ("Canton Facility") *Tower Hill Nursing, L.L.C.*	One Meadowbrook Way Canton, MA 02021 Norfolk County	Nursing Home 164 licensed beds 164 operating beds 90 units
Forestview Nursing Home of Wareham ("Wareham Facility") *Forestview Nursing, L.L.C.*	50 Indian Neck Road Wareham, MA 02571 Plymouth County	Nursing Home 175 licensed beds 175 operating beds 91 units

EXHBIT G: ASSIGNED LEASES AND TENANCIES

AVERY MEDICAL OFFICE BUILDING LEASES

Name of Tenant/Subtenant	Lease Date	S.F	Premises
Deaconess Glover Hospital	Tenant-At-Will	3,520	98 West Street Needham, MA

FIRST AMENDMENT TO MASTER LEASE AGREEMENT

THIS FIRST AMENDMENT TO MASTER LEASE AGREEMENT ("Amendment") is dated as of July 25, 2007 ("Amendment Effective Date") among **HCRI MASSACHUSETTS PROPERTIES TRUST**, a Massachusetts business trust organized under the laws of the Commonwealth of Massachusetts ("HCN-MA" and a "Landlord"), having its principal office located at One SeaGate, Suite 1500, P. O. Box 1475, Toledo, Ohio 43603-1475, **HCRI MASSACHUSETTS PROPERTIES TRUST II**, a Massachusetts business trust organized under the laws of the Commonwealth of Massachusetts ("HCN-MA II" and a "Landlord"), having its principal office located at One SeaGate, Suite 1500, P. O. Box 1475, Toledo, Ohio 43603-1475, and **KINDRED HOSPITALS EAST, L.L.C**, a Delaware limited liability company organized under the laws of the State of Delaware ("Tenant"), having its chief executive office located at 680 South Fourth Avenue, Louisville, Kentucky 40202.

RECITALS

A. Landlord has leased to Tenant property located in Massachusetts (collectively called "Property") pursuant to a Master Lease Agreement dated as of February 28, 2006, as amended from time to time ("Lease").

B. As of the Amendment Effective Date of this Amendment, HCN-MA II is acquiring an unimproved parcel of property located in Leicester, Massachusetts ("Leicester Unimproved Property").

C. Landlord desires to lease the Leicester Unimproved Property to Tenant and Tenant desires to lease the Leicester Unimproved Property from Landlord upon the terms set forth in the Lease.

D. Landlord and Tenant desire to amend the Lease to include the Leicester Unimproved Property and to modify certain terms and conditions.

NOW, THEREFORE, in consideration of the foregoing recitals and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows.

1. Definitions. Any capitalized terms not defined in this Amendment shall have the meaning set forth in the Lease.

2. Amended Definitions. The definitions of "Closing Certificate", "Commitment", "Option Amount", and "Rent Schedule" in §1.4 of the Lease are hereby amended to read in their entireties as follows (added language in italics):

> "Closing Certificate" means the Closing Certificate of even date from Tenant and Affiliate Subtenant in favor of Landlord *and any Closing Certificate executed in connection with an amendment of this Lease.*

"Commitment" means the Amended and Restated Term Sheet for the Lease dated February 21, 2006, as amended *and the Project Approval Letter dated November 16, 2006.*

"Option Amount" means the Investment Amount.

"Rent Schedule" means the schedule issued by Landlord to Tenant showing the Base Rent to be paid by Tenant pursuant to the terms of this Lease, as such schedule is amended from time to time by Landlord. The initial Rent Schedule is attached to this Lease as Schedule 1 or will be attached following Closing if the Rent Schedule cannot be determined until the day of Closing. *The Rent Schedule to be in effect upon the Amendment Effective Date of the First Amendment to Master Lease Agreement is attached as Schedule 1-A.*

3. Base Rent. Section 2.1 of the Lease is hereby amended to read in its entirety as follows (added language in italics):

2.1 Base Rent. Tenant shall pay Landlord base rent ("Base Rent") in advance in consecutive monthly installments payable on the first day of each month during the Term commencing on the Commencement Date. If the Effective Date is not the first day of a month, Tenant shall pay Landlord Base Rent on the Effective Date for the partial month, i.e., for the period commencing on the Effective Date and ending on the day before the Commencement Date. The Base Rent payable for the first Lease Year is as shown on the Rent Schedule, subject to adjustment pursuant to §2.2.2 if applicable. For the second and each subsequent Lease Year of the Initial Term, the Base Rent shall be paid in accordance with the most recent revised Rent Schedule provided by Landlord pursuant to §2.2, as applicable. The Base Rent for each Renewal Term will be determined in accordance with §12.2. *Notwithstanding the foregoing, the Base Rent may also be adjusted if Landlord makes a payment to acquire additional Leased Property. In such cases, Landlord shall issue, and Tenant shall pay Base Rent according to, a revised Rent Schedule. The increase in Base Rent shall be based on the applicable rate of return to Landlord as set forth in the Commitment and shall be effective as of the date that Landlord makes the payment to acquire the additional Leased Property.*

4. Early Option to Purchase. Section 13.7 of the Lease is hereby amended to read in its entirety as follows (added language in italics):

13.7 Early Option to Purchase. Notwithstanding any provision to the contrary contained in this Article 13, Tenant may exercise the Option to Purchase all of the Leased Property by giving notice of such exercise within 24 months after the Effective Date ("Early Option Period") subject to the same terms and conditions of this Article 13 except for §13.3 and except that [i] the required Purchase Notice may be given at any time during the Early Option Period; [ii] the Option Price for the Leased Property shall be *$72,225,000.00;* [iii] the purchase of the Leased Property shall close no later than 90 days after Landlord's receipt of the Purchase Notice; and [iv] no Event of Default shall have occurred and be continuing. The Option to Purchase pursuant to this §13.7 shall be referred to as the "Early Option".

5. Parking Lot Improvements. Article 15 of the Lease is hereby amended to add a new Section 15.12 as follows:

15.12 Parking Lot Improvements. Tenant shall improve the Land as a parking lot to provide additional parking for Kindred Hospital Parkview Central Mass. The parking lot shall be constructed according to plans and specifications approved by Landlord (such approval not to be unreasonably withheld), prior to commencement of construction and in accordance with all applicable legal requirements, including but not limited to requirements of the Massachusetts Wetlands Protection Act. Tenant shall use diligent, commercially reasonable efforts to complete construction of the parking lot on or before December 31, 2007.

6. Amendment Rent Schedule. The Lease is hereby amended to add a new Schedule 1-A in the form of Schedule 1-A attached hereto and made a part hereof.

7. Legal Description. Exhibit A-4 of the Lease is hereby amended to read in its entirety as set forth on Exhibit A-4 attached hereto and made a part hereof.

8. Permitted Exceptions. Exhibit B-4 of the Lease is hereby amended to read in its entirety as set forth on Exhibit B-4 attached hereto and made a part hereof.

9. Affirmation. Except as specifically modified by this Amendment, the terms and provisions of the Lease are hereby affirmed and shall remain in full force and effect.

10. Binding Effect. This Amendment will be binding upon and inure to the benefit of the successors and permitted assigns of Landlord and Tenant.

11. Further Modification. The Lease may be further modified only by writing signed by Landlord and Tenant.

12. Counterparts. This Amendment may be executed in multiple counterparts, each of which shall be deemed an original hereof, but all of which will constitute one and the same document.

13. Consent of Guarantor. This Amendment shall have no force or effect unless and until each Guarantor has executed the Consent of Guarantor set forth below.

[THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, Landlord and Tenant have executed this Amendment as of the date first set forth above.

Signed and acknowledged in the presence of:

HCRI MASSACHUSETTS PROPERTIES TRUST

Signature /s/ Rita J. Rogge
Print Name Rita J. Rogge

By: HCRI Massachusetts Properties, Inc., as Trustee, and not individually, and subject to the provisions of the Declaration of Trust of HCRI Massachusetts Properties Trust filed with the Secretary of the Commonwealth of Massachusetts and the City Clerk of Boston

Signature /s/ Donna J. Lunsford
Print Name Donna J. Lunsford

By: /s/ Erin C. Ibele
Erin C. Ibele
Senior Vice President – Administration and Corporate Secretary

By: /s/ Michael A. Crabtree
Michael A. Crabtree
Vice President and Treasurer

HCRI MASSACHUSETTS PROPERTIES TRUST II

Signature /s/ Rita J. Rogge
Print Name Rita J. Rogge
Signature /s/ Donna J. Lunsford
Print Name Donna J. Lunsford

By: HCRI Massachusetts Properties, Inc., as Trustee, and not individually, and subject to the provisions of the Declaration of Trust of HCRI Massachusetts Properties Trust II filed with the Secretary of the Commonwealth of Massachusetts and the City Clerk of Boston

By: /s/ Erin C. Ibele
Erin C. Ibele
Senior Vice President – Administration and Corporate Secretary

By: /s/ Michael A. Crabtree
Michael A. Crabtree
Vice President and Treasurer

KINDRED HOSPITALS EAST, L.L.C.

Signature	/s/ RICHARD MYERS	By: /s/ Douglas L. Curnutte
Print Name	RICHARD MYERS	Douglas L. Curnutte Vice President of Facilities and Real Estate Development
Signature	/s/ Lisa Adams	
Print Name	Lisa Adams	

STATE OF OHIO)
) SS:
COUNTY OF LUCAS)

The foregoing instrument was acknowledged before me this 8 day of August, 2007 by Erin C. Ibele, the Senior Vice President-Administration and Corporate Secretary, and Michael A. Crabtree, the Vice President and Treasurer of HCRI Massachusetts Properties, Inc., a Delaware corporation, as Trustee, on behalf of and as the free act and deed of HCRI Massachusetts Properties Trust, a Massachusetts business trust.

/s/ Rita J. Rogge
Notary Public

My Commission Expires: ____________________

[SEAL]

STATE OF OHIO)
) SS:
COUNTY OF LUCAS)

The foregoing instrument was acknowledged before me this 8 day of August, 2007 by Erin C. Ibele, the Senior Vice President-Administration and Corporate Secretary, and Michael A. Crabtree, the Vice President and Treasurer of HCRI Massachusetts Properties, Inc., a Delaware corporation, as Trustee, on behalf of and as the free act and deed of HCRI Massachusetts Properties Trust II, a Massachusetts business trust.

/s/ Rita J. Rogge
Notary Public

My Commission Expires: ____________________

[SEAL]

COMMONWEALTH OF MASSACHUSETTS

State of Kentucky
Jefferson County

On this 25th day of July, 2007, before me, the undersigned notary public, personally appeared Douglas L. Curnutte, the Vice President of Facilities and Real Estate Development of KINDRED HOSPITALS EAST, L.L.C. and proved to me through satisfactory evidence of identification, which was a Kentucky Driver's License, to be the person whose name is signed on this document, and acknowledged to me that he signed it voluntarily in his capacity as Vice President of Facilities and Real Estate Development, for its stated purpose, as his free act and deed and the free act and deed of KINDRED HOSPITALS EAST, L.L.C.

/s/ Patricia A. Burkhead

Notary Public
My commission expires:

Patricia A. Burkhead
Notary Public, State at Large, KY
My commission expires Oct. 29, 2007

THIS INSTRUMENT PREPARED BY:
Cynthia L. Rerucha, Esq.
Shumaker, Loop & Kendrick, LLP
1000 Jackson Street
Toledo, Ohio 43624

CONSENT OF GUARANTOR

In connection with the Unconditional and Continuing Lease Guaranty ("Guaranty") made by the undersigned Guarantors in favor of Landlord dated as of February 28, 2006, the undersigned Guarantors hereby [i] consent to the foregoing First Amendment to Master Lease Agreement ("Amendment"), [ii] affirm the Guaranty which shall remain in full force and effect and secure the Guaranteed Obligations, as defined in the Guaranty, and [iii] waive any suretyship defenses arising in connection with the Amendment. All capitalized terms not defined herein shall have the meaning set forth in the foregoing Amendment.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

GODDARD NURSING, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

SPRINGFIELD PARK VIEW HOSPITAL, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

MEADOWS NURSING, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

KINDRED BRAINTREE HOSPITAL, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

SCHEDULE 1-A: FIRST AMENDMENT RENT SCHEDULE

KINDRED HEALTHCARE OPERATING, INC. - MASTER LEASE
HEALTH CARE REIT, INC.

EFFECTIVE DATE	03/01/06	
INITIAL TERM COMMENCEMENT DATE	03/01/06	FINAL
INITIAL TERM	15 Yrs	
INITIAL TERM EXPIRATION DATE	02/28/21	
INITIAL INVESTMENT AMOUNT	72,450,000	
AMENDED INVESTMENT AMOUNT EFFECTIVE 7/25/07	72,575,000	
RATE OF RETURN	N/A	
(365/360 BASIS)	N/A	
INITIAL RATE OF RETURN	8.75%	
INCREASER	As defined within the Master Lease Agreement	

	DATES				*BEGINNING*		*ADJUSTED*		
			REVENUE		*RENT RATE*	*PERCENTAGE*	*RENT RATE*	*MONTHLY*	
			CONDITION MET	*INCREASER*	*OF RETURN*	*RATE*	*OF RETURN*	*RENT*	*ANNUAL*
LEASE YEAR	*FROM*	*TO*	*(YES/NO)*	*(BP)*	*(ROUNDED)*	*SHORTFALL*	*(ROUNDED)*	*AMOUNT*	*RENT AMOUNT*
1	03/01/06	02/28/07	YES	N/A	8.75%	N/A	N/A	528,281.25	6,339,375.00
2	03/01/07	06/30/07	TBD	2.5%	8.97%	N/A	N/A	541,488.28	2,165,953.12
2A	07/01/07	07/24/07	N/A	N/A	8.97%	N/A	N/A	419,216.73	419,216.73
2B	07/25/07	07/31/07	N/A	N/A	8.97%	N/A	N/A	122,499.58	122,499.58
2C	08/01/07	02/29/08	TBD	N/A	8.97%	N/A	N/A	542,498.13	3,797,486.91
3	03/01/08	02/28/09	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
4	03/01/09	02/28/10	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
5	03/01/10	02/28/11	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
6	03/01/11	02/29/12	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
7	03/01/12	02/28/13	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
8	03/01/13	02/28/14	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
9	03/01/14	02/28/15	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
10	03/01/15	02/29/16	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
11	03/01/16	02/28/17	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
12	03/01/17	02/28/18	TSD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
13	03/01/18	02/28/19	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
14	03/01/19	02/29/20	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56
15	03/01/20	02/28/21	TBD	TBD	8.97%	TBD	TBD	542,498.13	6,509,977.56

12/12/2007

EXHIBIT A-4: LEGAL DESCRIPTION

Facility Name: The Meadows Rehabilitation and Nursing Center and
Kindred Hospital Park View - Central Mass.

Parcel 1:

Real property in the County of Worcester, Commonwealth of Massachusetts, described as follows:

A certain piece of land in Leicester, Worcester County, Massachusetts on the northeasterly side of Huntoon Memorial Highway, also known as State Road 56, depicted as Lot 5-A on a plan entitled, "Plan of Land Prepared for David A. Cooper, et al" dated September 16, 1993 and prepared by Charles L. Rowley & Associates and recorded with the Worcester County Registry of Deeds in Plan Book 676, Plan No. 81. Said Lot No. 5-A on said Plan is bounded and described as follows:

Beginning at a point on the northeasterly sideline of Huntoon Memorial Highway (Route 56) at the most southwesterly corner of the lot to be described:

Thence N31°04'36" W along the northeasterly sideline of Huntoon Memorial Highway a distance of 37.12 feet to a point opposite an iron pipe and continuing in said sideline a distance of 213.40 feet to an iron rod at land of Edwin Buczak;

Thence N 78°42'27" E, along land of Buczak and along a stonewall a distance of 184.66 feet to a corner of stonewalls;

Thence N 08°21'20" W along land of said Buczak and along a stonewall a distance of 209.13 feet to a point at other land of David A. Cooper, et al;

Thence in line of land of said Cooper, N 80°02'46" E, a distance of 356.18 feet to a point at a corner of stonewalls;

Thence in line of land of Stephen P. Magnuson and Mary A. Magnuson and in line of land of I. Virginia Magnuson, S 07°25'20" E along a stone wall, a distance of 364.55 feet to a point;

Thence in line of land of I. Virginia Magnuson, S 14°3'28" E, along a stonewall a distance of 48.12 feet to a point opposite an iron pipe and continuing in the same course along said stonewall, a distance of 35.00 feet to a point;

Thence in line of remaining land of David A. Cooper, et al, S 80°02'46" W, a distance of 446.87 feet to the POINT OF BEGINNING.

Parcel 2:

A certain parcel of land being subdivided from a larger parcel presently owned by David, James, Marjorie and Richard Cooper, located to the east of Huntoon Highway, Mass Highway Route 56, in the Town of Leicester, in Worcester County, Massachusetts more particularly bounded and described as follows:

BEGINNING at an iron pipe located at the southerly corner of the lot herein described, proceed North 04° 41' 33" West along land owned, by Edwin Buczak, seven and ninety hundredths feet (7.90') to a point on a stone wall;

THENCE proceed North 09° 33' 01" West along land owned by Edwin Buczak and land owned by Stephen & Carol Asquith, one hundred thirteen and seventeen hundredths feet (113.17') to a point on the same stone wall;

THENCE proceed North 10° 07' 25" West along land owned by Stephen & Carol Asquith, one hundred sixteen and thirty one hundredths feet (116.31') to a point on the same stone wall;

THENCE 30° 34' 15" East along Lot 2 now or formerly owned by Cooper, forty nine and thirty seven hundredths feet (49.37') to a point;

THENCE proceed North 80° 15' 45" East along Lot 2 now or formerly owned by Cooper, one hundred sixty seven and seventy hundredths feet (167.70') to a point;

THENCE proceed South 09° 44' 15" East along remainder of land owned by Cooper, two hundred fifty four and twenty seven hundredths feet (254.27') to a point;

THENCE proceed North 80° 03' 09" East along remainder of land owned by Cooper, one hundred fifty six and eighteen hundredths feet (156.18') to a point;

THENCE proceed South 09° 56' 51" East along remainder of land owned by Cooper, twenty and zero hundredths feet (20.00') to a point;

THENCE proceed South 80° 03' 09" West by land owned by HCRI Massachusetts Properties Trust II, three hundred fifty six and eighteen hundredths feet (356.18') to the point of beginning at the land of Edwin Buczak.

Said parcel containing 57,238 square feet and is shown as Lot #3 on a "Plan of Land" in Leicester, Massachusetts, owned by David, James, Marjorie and Richard Cooper, prepared by Land Planning, Inc., and dated June 29, 2006, and recorded in Plan Book 847, Plan 58.

EXHIBIT B: PENDING LITIGATION

None.

EXHIBIT B-4: PERMITTED EXCEPTIONS

Facility Name: The Meadows Rehabilitation and Nursing Center and
Kindred Hospital Park View – Central Mass.

1. The lien of real estate taxes and other governmental charges not yet due and payable and the lien of municipal betterments assessed after the Amendment Effective Date of the Amendment to Master Lease Agreement.

2. Title to and rights of the public and others entitled thereto in and to those portions of the . insured premises lying within the bounds of adjacent streets, roads, and ways.

3. The following matters as shown on the survey entitled "ALTA/ACSM Land Title Survey Special K The Meadows of Leicester 111 Huntoon Memorial Hwy (Route 56) Rochdale, MA County of Worcester" drawn by American National llc, dated July 25, 2005, Reference No. 20050110-010 (the "Survey"): a. Small portion of Unit Sign encroaches onto public road right-of-way by 1.20'; b. Building encroaches onto building setback line by 1.60'.

4. Easement to Massachusetts Electric Company, dated July 22, 1994, recorded with said Deeds, Book 16510, Page 55.

5. Order of Conditions issued by the Town of Leicester, recorded in Book 15527, Page 186.

6. The following matters as shown on the survey entitled "ALTA/ACSM Land Title Survey drawn by Land Planning, Inc., dated September 15, 2006, Job No. G 6615 (the "Survey"): a. Gravel parking encroachment onto the property next northerly and easterly to the extent shown on said survey.

7. First Amendment of Memorandum of Lease between Landlord and Tenant.

EXHIBIT 10.62

SECOND AMENDMENT TO MASTER LEASE AGREEMENT

THIS SECOND AMENDMENT TO MASTER LEASE AGREEMENT ("Amendment") is dated as of December 5, 2007 ("Amendment Effective Date") among **HCRI MASSACHUSETTS PROPERTIES TRUST,** a Massachusetts business trust organized under the laws of the Commonwealth of Massachusetts ("HCN-MA" and a "Landlord"), having its principal office located at One SeaGate, Suite 1500, P. 0. Box 1475, Toledo, Ohio 43603-1475, **HCRI MASSACHUSETTS PROPERTIES TRUST II,** a Massachusetts business trust organized under the laws of the Commonwealth of Massachusetts ("HCN-MA II" and a "Landlord"), having its principal office located at One SeaGate, Suite 1500, P, O. Box 1475, Toledo, Ohio 43603-1475, and **KINDRED HOSPITALS EAST, L.L.C.,** a Delaware limited liability company organized under the laws of the State of Delaware ("Tenant"), having its chief executive office located at 680 South Fourth Avenue, Louisville, Kentucky 40202.

RECITALS

A. Landlord has leased to Tenant property located in Massachusetts (collectively called "Property") pursuant to a Master Lease Agreement dated as of February 28, 2006, as amended from time to time ("Lease").

B. Under the Lease, Tenant has an option to purchase the Property prior to the end of the Lease Term. Tenant has requested that Landlord extend the time during which this option can be exercised by three months. Landlord has agreed to this request subject to the terms and conditions of this Amendment.

C. Landlord and Tenant desire to amend the Lease to modify the terms and conditions of the early option.

NOW, THEREFORE, in consideration of the foregoing recitals and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows.

1. Definitions. Any capitalized terms not defined in this Amendment shall have the meaning set forth in the Lease.

2. Early Option to Purchase. Section 13.7 of the Lease is hereby amended to read in its entirety as follows (added language in italics):

13.7 Early Option to Purchase. Notwithstanding any provision to the contrary contained in this Article 13, Tenant may exercise the Option to Purchase all of the Leased Property by giving notice of such exercise within *27* months after the Effective Date ("Early Option Period") subject to the same terms and conditions of this Article 13 except for §13.3 and except that [i] the required Purchase Notice may be given at any time during the Early Option Period; [ii] the Option Price for the Leased Property shall

be $72,225,000.00; [iii] the purchase of the Leased Property shall close no later than 90 days after Landlord's receipt of the Purchase Notice; and [iv] no Event of Default shall have occurred and be continuing. The Option to Purchase pursuant to this §13.7 shall be referred to as the "Early Option".

3. Affirmation. Except as specifically modified by this Amendment, the terms and provisions of the Lease are hereby affirmed and shall remain in full force and effect.

4. Binding Effect. This Amendment will be binding upon and inure to the benefit of the successors and permitted assigns of Landlord and Tenant.

5. Further Modification. The Lease may be further modified only by writing signed by Landlord and Tenant.

6. Counterparts. This Amendment may be executed in multiple counterparts, each of which shall be deemed an original hereof, but all of which will constitute one and the same document.

7. Consent of Guarantor. This Amendment shall have no force or effect unless and until each Guarantor has executed the Consent of Guarantor set forth below.

[THE REMAINDER OF THIS PAGE IS INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, Landlord and Tenant have executed this Amendment as of the date first set forth above.

Signed and acknowledged in the presence of:

HCRI MASSACHUSETTS PROPERTIES TRUST

Signature	/s/ Rita J. Rogge	By:	HCRI Massachusetts Properties, Inc., as Trustee, and not individually, and subject to the provisions of the Declaration of Trust of HCRI Massachusetts Properties Trust filed with the Secretary of the Commonwealth of Massachusetts and the City Clerk of Boston
Print Name	Rita J. Rogge		
Signature	/s/ Donna J. Lunsford		
Print Name	Donna J. Lunsford		

By: /s/ Erin C. Ibele
Erin C. Ibele
Senior Vice President – Administration and Corporate Secretary

By: /s/ Michael A. Crabtree
Michael A. Crabtree
Vice President and Treasurer

HCRI MASSACHUSETTS PROPERTIES TRUST II

Signature	/s/ Rita J. Rogge		
Print Name	Rita J. Rogge		
Signature	/s/ Donna J. Lunsford	By:	HCRI Massachusetts Properties, Inc., as Trustee, and not individually, and subject to the provisions of the Declaration of Trust of HCRI Massachusetts Properties Trust II filed with the Secretary of the Commonwealth of Massachusetts and the City Clerk of Boston
Print Name	Donna J. Lunsford		

By: /s/ Erin C. Ibele
Erin C. Ibele
Senior Vice President – Administration and Corporate Secretary

By: /s/ Michael A. Crabtree
Michael A. Crabtree
Vice President and Treasurer

KINDRED HOSPITALS EAST, L.L.C.

Signature	/s/ RICHARD MYERS	By:	/s/ Douglas L. Curnutte
Print Name	RICHARD MYERS		Douglas L. Curnutte Vice President of Facilities and Real Estate Development
Signature	/s/ Lisa Adams		
Print Name	Lisa Adams		

STATE OF OHIO)
) SS:
COUNTY OF LUCAS)

The foregoing instrument was acknowledged before me this 7 day of December, 2007 by Erin C. Ibele, the Senior Vice President-Administration and Corporate Secretary, and Michael A. Crabtree, the Vice President and Treasurer of HCRI Massachusetts Properties, Inc., a Delaware corporation, as Trustee, on behalf of and as the free act and deed of HCRI Massachusetts Properties Trust a Massachusetts business trust.

/s/ Rita J. Rogge
Notary Public

My Commission Expires: ______________ [SEAL]

STATE OF OHIO)
) SS:
COUNTY OF LUCAS)

The foregoing instrument was acknowledged before me this 7 day of December, 2007 by Erin C. Ibele, the Senior Vice President-Administration and Corporate Secretary, and Michael A. Crabtree, the Vice President and Treasurer of HCRI Massachusetts Properties, Inc., a Delaware corporation, as Trustee, on behalf of and as the free act and deed of HCRI Massachusetts Properties Trust II, a Massachusetts business trust.

/s/ Rita J. Rogge
Notary Public

My Commission Expires: ______________ [SEAL]

COMMONWEALTH OF KENTUCKY

Jefferson Co.

On this 5th day of December, 2007, before me, the undersigned notary public, personally appeared Douglas L. Curnutte, the Vice President of Facilities and Real Estate Development of KINDRED HOSPITALS EAST, L.L.C. and proved to me through satisfactory evidence of identification, which was a Kentucky Driver's License, to be the person whose name is signed on this document, and acknowledged to me that he signed it voluntarily in his capacity as Vice President of Facilities and Real Estate Development, for its stated purpose, as his free act and deed and the free act and deed of KINDRED HOSPITALS EAST, L.L.C.

/s/ Jenny McGarry

Notary Public
My commission expires: 2/16/2008

THIS INSTRUMENT PREPARED BY:
Cynthia L. Rerucha, Esq.
Shumaker, Loop & Kendrick, LLP
1000 Jackson Street
Toledo, Ohio 43624

CONSENT OF GUARANTOR

In connection with the Unconditional and Continuing Lease Guaranty ("Guaranty") made by the undersigned Guarantors in favor of Landlord dated as of February 28, 2006, the undersigned Guarantors hereby [i] consent to the foregoing Second Amendment to Master Lease Agreement ("Amendment"), [ii] affirm the Guaranty which shall remain in full force and effect and secure the Guaranteed Obligations, as defined in the Guaranty, and [iii] waive any suretyship defenses arising in connection with the Amendment. All capitalized terms not defined herein shall have the meaning set forth in the foregoing Amendment.

KINDRED HEALTHCARE OPERATING, INC.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

GODDARD NURSING, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

SPRINGFIELD PARK VIEW HOSPITAL, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

MEADOWS NURSING, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte
Vice President of Facilities and Real Estate Development

KINDRED BRAINTREE HOSPITAL, L.L.C.

By: /s/ Douglas L. Curnutte

Douglas L. Curnutte

Vice President of Facilities and Real Estate Development

EXHIBIT 10.67

NON-QUALIFIED STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this ____ day of ______, 20__ between Kindred Healthcare, Inc. (the "Company") and __________ (the "Participant").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan") to promote the interests of the Company and its Affiliates and stockholders by providing the Company's key employees, who are largely responsible for the management, growth and protection of the business of the Company, incentives and rewards to encourage them to continue in the employ of the Company.

WHEREAS, the Plan provides for the grant to Participants in the Plan of non-qualified stock options to purchase shares of Common Stock of the Company.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant a non-qualified stock option (the "Option") with respect to __________ (______) shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is ______, 20__.

3. Incorporation of Plan. All terms, conditions and restrictions of the Plan are incorporated herein and made part hereof as if stated herein. If there is any conflict between the terms and conditions of the Plan and this Agreement, the terms and conditions of this Agreement, as interpreted by the Committee, shall govern. All capitalized terms used and not defined herein shall have the meanings given to such terms in the Plan.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $______.

5. Vesting Date. The Option shall become exercisable as follows:

(i) ______ of the Options shall vest on ______.

(ii) An additional ______ Options shall vest on ______.

(iii) An additional ______ Options shall vest on ______.

(iv) An additional ______ Options shall vest on ______.

Notwithstanding the foregoing, in the event of a Change in Control or the death or Disability of the Participant while employed with the Company, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, with respect to the Option or any portion thereof which has not become exercisable, the Option shall expire on the date the Participant's Employment is terminated for any reason, and with respect to any Option or any portion thereof which has become exercisable, the Option shall expire on the earlier of (i) the commencement of business on the date the Participant's Employment is terminated for Cause; (ii) ninety (90) days after the date the Participant's Employment is terminated for any reason other than for Cause or on account of death, Disability or Retirement; (iii) two years after the date of Participant's Retirement, (iv) two years after the date the Participant's Employment is terminated by reason of death or Disability; or (v) the tenth anniversary of the Grant Date.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the exercise price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the exercise price as of the Exercise Date.

8. Adjustment Upon Changes in Common Stock.

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Options outstanding on the date on which such change occurs and in the exercise price of any such Options.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Option outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the Participant an amount in cash for each share subject to the Option, the excess of (A) the value of the property (including cash) received by the holder of a share of Common Stock as a result of such event over (B) the exercise price of such Option; or

(ii) provide for the exchange of each Option outstanding immediately prior to such event (whether or not then vested or exercisable) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to such Option would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, and/or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Option.

9. Construction of Agreement. Any provision of this Agreement (or portion thereof) which is deemed invalid, illegal or unenforceable in any jurisdiction shall, as to that jurisdiction and subject to this section, be ineffective to the extent of such invalidity, illegality or unenforceability, without affecting in any way the remaining provisions thereof in such jurisdiction or rendering that or any other provisions of this Agreement invalid, illegal, or unenforceable in any other jurisdiction. No waiver of any provision or violation of this Agreement by the Company shall be implied by the Company's forbearance or failure to take action.

10. Delays or Omissions. No delay or omission to exercise any right, power or remedy accruing to any party hereto upon any breach or default of any party under this Agreement, shall impair any such right, power or remedy of such party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of or in any similar breach or default thereafter occurring nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party of any breach or default under this Agreement, or any waiver on the part of any party or any provisions or conditions of this Agreement, shall be in writing and shall be effective only to the extent specifically set forth in such writing.

11. Limitation on Transfer. During the lifetime of the Participant, the Option shall be exercisable only by the Participant. The Option shall not be assignable or transferable other than by will or by the laws of descent and distribution and in accordance with the Plan.

12. Integration. This Agreement, and the other documents referred to herein or delivered pursuant hereto which form a part hereof contain the entire understanding of the parties with respect to its subject matter. There are no restrictions, agreements, promises, representations, warranties, covenants or undertakings with respect to the subject matter hereof other than those expressly set forth herein and in the Plan. This Agreement, including without limitation the Plan, supersedes all prior agreements and understandings between the parties with respect to its subject matter.

13. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

14. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to the provisions governing conflict of laws.

15. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan. The Participant hereby acknowledges that all decisions, determinations and interpretations of the Committee in respect of the Plan, this Agreement and the Option shall be final and conclusive.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on his own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan as of the day and year first written above.

KINDRED HEALTHCARE, INC.

By:	Richard A. Lechleiter
Title:	Executive Vice President and Chief Financial Officer

Name of Individual

EXHIBIT 10.68

INCENTIVE STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this ____ day of ______, 20__ between Kindred Healthcare, Inc. (the "Company") and __________ (the "Participant").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan") to promote the interests of the Company and its Affiliates and stockholders by providing the Company's key employees, who are largely responsible for the management, growth and protection of the business of the Company, incentives and rewards to encourage them to continue in the employ of the Company.

WHEREAS, the Plan provides for the grant to Participants in the Plan of incentive stock options to purchase shares of Common Stock of the Company.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant an incentive stock option (the "Option") with respect to __________ (______) shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is ______, 20__.

3. Incorporation of Plan. All terms, conditions and restrictions of the Plan are incorporated herein and made part hereof as if stated herein. If there is any conflict between the terms and conditions of the Plan and this Agreement, the terms and conditions of this Agreement, as interpreted by the Committee, shall govern. All capitalized terms used and not defined herein shall have the meanings given to such terms in the Plan.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $______.

5. Vesting Date. The Options shall become exercisable as follows:

(i) ______ of the Options shall vest on ______.

(ii) An additional ______ Options shall vest on ______.

(iii) An additional ______ Options shall vest on ______.

(iv) An additional ______ Options shall vest on ______.

Notwithstanding the foregoing, in the event of a Change in Control or the death or Disability of the Participant while employed with the Company, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, with respect to the Option or any portion thereof which has not become exercisable, the Option shall expire on the date the Participant's Employment is terminated for any reason, and with respect to any Option or any portion thereof which has become exercisable, the Option shall expire on the earlier of (i) the commencement of business on the date the Participant's Employment is terminated for Cause; (ii) ninety (90) days after the date the Participant's Employment is terminated for any reason other than for Cause or on account of death or Disability; (iii) one year after the date the Participant's Employment is terminated by reason of death or Disability; or (iv) the tenth anniversary of the Grant Date.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the exercise price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the exercise price as of the Exercise Date.

8. Adjustment Upon Changes in Common Stock.

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Options outstanding on the date on which such change occurs and in the exercise price of any such Options.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Option outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the Participant an amount in cash for each share subject to the Option, the excess

of (A) the value of the property (including cash) received by the holder of a share of Common Stock as a result of such event over (B) the exercise price of such Option; or

(ii) provide for the exchange of each Option outstanding immediately prior to such event (whether or not then vested or exercisable) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to such Option would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, and/or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Option.

9. Construction of Agreement. Any provision of this Agreement (or portion thereof) which is deemed invalid, illegal or unenforceable in any jurisdiction shall, as to that jurisdiction and subject to this section, be ineffective to the extent of such invalidity, illegality or unenforceability, without affecting in any way the remaining provisions thereof in such jurisdiction or rendering that or any other provisions of this Agreement invalid, illegal, or unenforceable in any other jurisdiction. No waiver of any provision or violation of this Agreement by the Company shall be implied by the Company's forbearance or failure to take action.

10. Delays or Omissions. No delay or omission to exercise any right, power or remedy accruing to any party hereto upon any breach or default of any party under this Agreement, shall impair any such right, power or remedy of such party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of or in any similar breach or default thereafter occurring nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party of any breach or default under this Agreement, or any waiver on the part of any party or any provisions or conditions of this Agreement, shall be in writing and shall be effective only to the extent specifically set forth in such writing.

11. Limitation on Transfer. During the lifetime of the Participant, the Option shall be exercisable only by the Participant. The Option shall not be assignable or transferable other than by will or by the laws of descent and distribution and in accordance with the Plan.

12. Integration. This Agreement, and the other documents referred to herein or delivered pursuant hereto which form a part hereof contain the entire understanding of the parties with respect to its subject matter. There are no restrictions, agreements, promises, representations, warranties, covenants or undertakings with respect to the subject matter hereof other than those expressly set forth herein and in the Plan. This Agreement, including without limitation the Plan, supersedes all prior agreements and understandings between the parties with respect to its subject matter.

13. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

14. Governing Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware without regard to the provisions governing conflict of laws.

15. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan. The Participant hereby acknowledges that all decisions, determinations and interpretations of the Committee in respect of the Plan, this Agreement and the Option shall be final and conclusive.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on Participant's own behalf, thereby representing that Participant has carefully read and understands this Agreement and the Plan as of the day and year first written above.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and Chief Financial Officer

Name of Individual

EXHIBIT 10.69

RESTRICTED SHARE AWARD AGREEMENT

THIS AGREEMENT, made as of this ____ day of ____, 2007 between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and _________ (the "Participant").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to participants in the Plan of restricted shares of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock").

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Restricted Stock. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant __________ (______) shares of Common Stock (the "Shares," and this grant shall be referred to herein as the "Award"). The Shares shall vest only in accordance with the provisions of this Agreement and of the Plan. The certificates representing the Shares, together with stock powers duly authorized in blank by the Participant, shall be deposited with the Company to be held by it until the Shares vest in accordance with Section 3 hereof or are forfeited in accordance with Section 4. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Non-Transferability. Prior to the vesting of the Shares as described in Section 3 hereof, neither the Shares nor the rights represented thereby shall be assignable, transferable, pledged or otherwise encumbered under any circumstances. In addition, the Shares and the rights represented thereby shall not be assignable or transferable for 90 days after the date of this Agreement. Such 90 day transfer restriction shall not subject the Shares to a substantial risk of forfeiture. Any purported or attempted transfer of such Shares or such rights in contravention of this Section 2 shall be null and void and shall result in the immediate forfeiture of the Shares.

3. Vesting of Shares.

(a) Except as provided in Section 3(b) and Section 4, the Shares subject to this Award shall vest and become fully transferable without restriction according to the following schedule:

(i) ______ of the Shares subject to this Award shall vest ____, 2008.

(ii) An additional ______ of the Shares subject to this Award shall vest on ____, 2009.

(iii) An additional ______ of the Shares subject to this Award shall vest on ____, 2010.

(iv) An additional ______ of the Shares subject to this Award will vest on ____, 2011.

(b) Notwithstanding the foregoing, in the event of (1) a Change in Control or (2) the death or Disability of the Participant, the Shares shall automatically vest, all restrictions on the Shares shall lapse and the Company shall deliver to Participant a certificate representing the Shares; provided, however, in no event may the vesting of any Shares held by an Participant subject to Section 16(b) of the Exchange Act be accelerated until such time as the vesting would not violate Section 16(b).

4. Forfeiture of Shares. If the employment of the Participant with the Company shall terminate for any reason other than death or Disability, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be forfeited and reconveyed to the Company by Participant without additional consideration and Participant shall have no further rights with respect thereto.

5. Modification and Waiver. Except as provided in this Agreement and in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Participant and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

6. Rights as Stockholder. Participant shall be considered a stockholder of the Company with respect to all such Shares that have not been forfeited and shall have all rights appurtenant thereto, including the right to vote or consent to all matters that may be presented to the stockholders and to receive all dividends and other distributions paid on such Shares. If any dividends or distributions are paid in Common Stock, such Common Stock shall be subject to the same restrictions as the Shares with respect to which it was paid.

7. Adjustment Upon Changes in Common Stock

(a) In the event of any change in the capitalization of the Company or other corporate change or transaction involving the Company or its securities, the Committee shall make equitable adjustments in the number and class of shares subject to the Award outstanding on the date on which such change occurs.

(b) In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall either:

(i) cancel each Share outstanding immediately prior to such event (whether or not then vested), and, in full consideration of such cancellation, pay to the Participant an equitable amount in cash for each Share equal to the value of the property (including cash) received by the holder of a share of Common Stock; or

(ii) provide for the exchange of each Share outstanding immediately prior to such event (whether or not then vested) for an option, a stock appreciation right or a share of restricted stock with respect to, as appropriate, some or all of the property which a holder of the number of shares of Common Stock subject to the Award would have received in such transaction and, incident thereto, make an equitable adjustment in the exercise price of the option or stock appreciation right, or the number of shares or amount of property subject to the option, stock appreciation right or share of restricted stock, or, if appropriate, provide for a cash payment to the Participant in partial consideration for the exchange of the Shares.

8. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

9. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

10. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern except as specifically provided in Section 2 and Section 7 hereof.

11. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Shares and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Shares and such matters.

12. No Contract of Employment. This Agreement shall not confer upon the Participant any right with respect to the continuation of such Participant's employment by the Company or prohibit the Company at any time from terminating such employment or increasing or decreasing the base salary or other compensation for such Participant.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on the Participant's own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and Chief Financial Officer

EXHIBIT 10.70

STOCK BONUS AWARD AGREEMENT

THIS AGREEMENT is made as of this ____ day of ______, 20__ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and __________ (the "Participant").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to participants in the Plan of stock bonuses of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock").

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Stock Bonus. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant __________ (______) shares of Common Stock (the "Shares," and this grant shall be referred to herein as the "Award"). All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Vesting of Shares. The Shares subject to this Award shall vest and become fully transferable without restriction as of the date hereof and the Company shall promptly deliver to Participant a certificate representing the Shares, subject to any reduction in the number of Shares to satisfy any withholding taxes.

3. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Participant and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

4. Rights as Stockholder. Participant shall be considered a stockholder of the Company with respect to all the Shares and shall have all rights appurtenant thereto, including

the right to vote or consent to all matters that may be presented to the stockholders and to receive all dividends and other distributions paid on such Shares.

5. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

6. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

7. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

8. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Shares and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Shares and such matters.

9. No Contract of Employment. This Agreement shall not confer upon the Participant any right with respect to the continuation of such Participant's employment by the Company or prohibit the Company at any time from terminating such employment or increasing or decreasing the base salary or other compensation for such Participant.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on the Participant's own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and
Chief Financial Officer

EXHIBIT 10.71

PERFORMANCE UNIT AWARD AGREEMENT

THIS AGREEMENT, made as of this ____ day of _____, 20___ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and ______________ (the "Participant").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to participants in the Plan of the right to receive shares of common stock of Kindred Healthcare, Inc., par value $.25 per share (the "Common Stock"), upon the achievement of specified performance goals.

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Performance Units. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Participant ____________ Performance Units. The Performance Units shall vest only in accordance with the provisions of this Agreement and of the Plan. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Performance Goals/Performance Period.

(a) The Committee shall establish the Performance Goals applicable to a particular Performance Period within ninety (90) days of the commencement of such Performance Period in accordance with the terms and conditions of Section 9(b) of the Plan. As soon as reasonably practicable following the establishment of such Performance Goals, the Committee shall communicate the Performance Goals to the Participant.

(b) The Performance Periods applicable to the Performance Units during which the Performance Goals shall be measured shall be as follows:

(i) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__;

(ii) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__; and

(iii) With respect to one-third (1/3) of the Performance Units, the Performance Period shall be calendar year 20__.

(c) As soon as practicable after the end of the applicable Performance Period, the Committee shall determine and certify the extent to which the Performance Goals for such Performance Period were achieved, if at all. If the Performance Goals are achieved in full, and the Participant remains employed with the Company as of the last day of the applicable Performance Period, the Company shall pay to the Participant an amount equal to the number of Units earned with respect to such Performance Period, such payment to be made as soon as reasonably practicable following the Committee's certification pursuant to Section 2(c) of this Agreement, but in no event later than the date that is two and one-half (2 1/2) months following the end of the applicable Performance Period. The Committee may determine, in its sole and absolute discretion, at the time of payment hereunder whether such payment shall be made (a) in cash (equal to the Fair Market Value of a Share multiplied by the number of Performance Units), (b) in Shares or (c) in a combination of cash and Shares.

3. Non-Transferability. No Performance Unit shall be assignable or transferable otherwise than by will or the laws of descent and distribution. Any purported or attempted transfer of a Performance Unit in contravention of this Section 3 shall be null and void and shall result in the immediate forfeiture of the Performance Unit.

4. Consequences Upon Change in Control. Upon a Change in Control, to the extent not already vested and paid, the Performance Units shall become fully vested and immediately payable as if the Performance Goals were fully achieved, without any proration, in which case payment shall be in cash equal to the product of the number of Performance Units and the greater of (i) the Fair Market Value of a Share on the date of such Change in Control and (ii) the highest price per Share paid in connection with such Change in Control. Any payment pursuant to this Section 4 shall be made no later than the date that is two and one-half (2 1/2) months following the end of the year in which such Change in Control occurs.

5. Effect of Termination of Employment.

(a) If the employment of Participant shall terminate with the Company prior to the expiration of the applicable Performance Period for any reason other than for death or Disability, the Performance Units shall immediately terminate and be of no further force or effect.

(b) In the event that the employment of Participant with the Company shall terminate on account of the Disability or death of Participant prior to the expiration of the Period, all Performance Units shall be paid to Participant or Participant's estate, as the case may be, as if all applicable Performance Goals had been fully achieved; provided that such payment shall be prorated to reflect the portion of the Performance Period during which Participant was employed; provided further that such payment shall be made as soon as reasonably practicable following the date of such termination of employment but in no event later than the date that is two and one-half (2 1/2) months following the end of the year in which such termination occurs.

6. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither

this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Participant and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

7. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

8. Participant Acknowledgment. The Participant hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Performance Units and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Performance Units and such matters.

11. No Contract of Employment. This Agreement shall not confer upon the Participant any right with respect to the continuation of such Participant's employment by the Company or prohibit the Company at any time from terminating such employment or increasing or decreasing the base salary or other compensation for such Participant.

12. Code Section 409A. Each Performance Unit is intended not to be subject to Section 409A of the Code by reason of being a short-term deferral and shall be interpreted accordingly. In the event any of the payments provided to a Participant pursuant to this Agreement would result in a violation of Section 409A of the Code (including any regulations promulgated thereunder), the Company will use its reasonable best efforts to amend this Agreement in the least restrictive manner necessary in order, where applicable (i) to ensure that such compensation is not considered "nonqualified deferred compensation" for purposes of Section 409A of the Code, or (ii) to comply with the provisions of Section 409A, in each case, where possible, without any diminution in the value of the compensation to be paid or provided to the Participant pursuant to this Agreement; provided, that nothing in this Agreement shall require the Company to provide any gross-up or other tax reimbursement to a Participant in connection with any violation of Section 409A or otherwise.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Participant has hereunto signed this Agreement on the Participant's own behalf, thereby representing that the Participant has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By:	Richard A. Lechleiter
Title:	Executive Vice President and Chief Financial Officer

EXHIBIT 10.73

NON-QUALIFIED
STOCK OPTION GRANT AGREEMENT

THIS AGREEMENT, made as of this __ day of ______, ____ between Kindred Healthcare, Inc. (the "Company") and __________ (the "Non-Employee Director").

WHEREAS, the Company has adopted and maintains the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the grant to Non-Employee Directors of non-qualified stock options to purchase shares of common stock of the Company, par value $.25 per share (the "Common Stock").

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Options. Pursuant to, and subject to, the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Non-Employee Director a non-qualified stock option (the "Option") with respect to ______ shares of Common Stock of the Company.

2. Grant Date. The Grant Date of the Option hereby granted is __________, ____.

3. Non-Transferability. Prior to the vesting of the Option as described in Section 5 hereof, the Option and the rights represented thereby shall be non-transferable and will not be subject in any manner to sale, transfer, alienation, pledge, encumbrance or charge; provided, however, that (i) the Committee may, in its sole discretion, permit the transfer of the Option to a family trust for estate planning purposes and (ii) in the event the Non-Employee Director was nominated to or chosen to serve on the Board pursuant to an arrangement between the Company and another Person, such Non-Employee Director may, upon notice in writing to the Board, direct the initial issuance of the Option to such other Person or transfer such Option to such other Person. Any purported or attempted transfer of such Option or such rights in contravention of this Section 3 shall be null and void and shall result in the immediate forfeiture of the Option.

4. Exercise Price. The exercise price of each share underlying the Option hereby granted is $______.

5. Vesting Date. The Option shall become exercisable as follows: Approximately one-fourth of the Option shall become exercisable on each of the first, second, third and fourth anniversaries of the Grant Date; provided that, the number of shares to become exercisable on any Vesting Date shall be rounded up to the nearest

share, but in no event shall more than the total number of shares underlying the Option become exercisable in the aggregate. Notwithstanding the foregoing, in the event of a Change in Control, the Option shall immediately become fully exercisable.

6. Expiration Date. Subject to the provisions of the Plan and the terms of this Agreement, with respect to the Option or any portion thereof which has not become exercisable, the Option shall expire on the date the Non-Employee Director ceases to be a director of the Company, and with respect to any Option or any portion thereof which has become exercisable, the Option shall expire on the earlier of (i) the date of removal if the Non-Employee Director is removed for Cause; (ii) three months after the date the Non-Employee Director ceases to be a director of the Company for any reason other than for death, Disability or removal for Cause; (iii) in the event of the Non-Employee Director's death or Disability while a director of the Company, or in the case of the Non-Employee Director's death within three months after the Non-Employee Director ceases to be a director (other than by reason of removal for Cause), 12 months after the date of the Non-Employee Director's death or Disability, or (iv) the tenth anniversary of the Grant Date.

7. Exercise Procedure. Vested portions of the Option may be exercised, in whole or in part, by delivery to the Company's principal office of a written notice of exercise, to the attention of the Corporate Secretary, no less than three (3) business days in advance of the effective date of the proposed exercise (the "Exercise Date"), setting forth the number of shares of Common Stock with respect to which the Option is to be exercised, the Grant Date of the Option and the Exercise Date and accompanied by full payment of the Option Exercise Price and all applicable withholding taxes. Applicable withholding taxes shall be calculated based on the excess of the Fair Market Value of the shares of Common Stock over the Option Exercise Price as of the Exercise Date.

8. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Non-Employee Director and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. If any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same instrument.

11. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

12. Non-Employee Director Acknowledgment. The Non-Employee Director hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

13. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Option and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Option and such matters.

14. No Right to Re-Election. This Agreement shall not confer upon the Non-Employee Director any right to continue as a director of the Company, to be renominated by the Board or re-elected by the shareholders of the Company.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Non-Employee Director has hereunto signed this Agreement on the Non-Employee Director's own behalf, thereby representing that the Non-Employee Director has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and Chief Financial Officer

EXHIBIT 10.74

RESTRICTED SHARE AWARD AGREEMENT

THIS AGREEMENT, made as of this __ day of ______ ____ between Kindred Healthcare, Inc., a Delaware corporation and its successors (the "Company"), and __________ (the "Non-Employee Director").

WHEREAS, the Company adopted and maintains the Kindred Healthcare, Inc. 2001 Equity Plan for Non-Employee Directors, Amended and Restated (the "Plan");

WHEREAS, the Plan provides for the award to Non-Employee Directors of restricted shares of common stock of Kindred Healthcare, Inc., par value $. 25 per share (the "Common Stock").

NOW THEREFORE, in consideration of the premises and the mutual covenants hereinafter set forth, the parties hereto hereby agree as follows:

1. Grant of Restricted Stock. Pursuant and subject to the terms and conditions set forth herein and in the Plan, the Company hereby grants to the Non-Employee Director __________ (______) shares of Common Stock (the "Shares," and this grant shall be referred to herein as the "Award"). The Shares shall vest only in accordance with the provisions of this Agreement and of the Plan. The certificates representing the Shares, together with stock powers duly authorized in blank by the Non-Employee Director, shall be deposited with the Company to be held by it until the Shares vest in accordance with Section 3 hereof or are forfeited in accordance with Section 4. All capitalized terms used herein and not defined herein shall have the meanings assigned to them in the Plan.

2. Non-Transferability. Prior to the vesting of the Shares as described in Section 3 hereof, the Shares and the rights represented thereby shall be non-transferable and will not be subject in any manner to sale, transfer, alienation, pledge, encumbrance or charge; provided, however, that (i) the Committee may, in its sole discretion, permit the transfer of the Shares to a family trust for estate planning purposes and (ii) in the event the Non-Employee Director was nominated to or chosen to serve on the Board pursuant to an arrangement between the Company and another Person, such Non-Employee Director may, upon notice in writing to the Board, direct the initial issuance of the Shares to such other Person or transfer such Shares to such other Person. Any purported or attempted transfer of such Shares or such rights in contravention of this Section 2 shall be null and void and shall result in the immediate forfeiture of the Shares.

3. Vesting of Shares.

(a) Except as provided in Section 3(b) and Section 4, the Shares subject to this Award shall vest and become fully transferable without restriction according to the following schedule:

(i) ______ of the Shares subject to this Award shall vest ______ __, ____.

(ii) An additional ______ of the Shares subject to this Award shall vest on ______ __, ____.

(iii) An additional ______ of the Shares subject to this Award shall vest on ______ __, ____.

(iv) An additional ______ of the Shares subject to this Award shall vest on ______ __, ____.

(b) Notwithstanding the foregoing or anything in the Plan to the contrary, in the event of (1) a Change in Control, or (2) the Disability or death of the Non-Employee Director while serving as a director of the Company, the Shares shall automatically immediately vest, all restrictions on the Shares shall lapse and the Company shall deliver to Non-Employee Director a certificate representing the Shares; provided, however, in no event may the vesting of any Shares held by an Non-Employee Director be accelerated until such time as the vesting would not violate Section 16(b).

4. Forfeiture of Shares. Notwithstanding anything in the Plan to the contrary, if the Non-Employee Director ceases to be a director of the Company for any reason other than death or Disability, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be immediately cancelled and forfeited without additional consideration and Non-Employee Director shall have no further rights with respect thereto. Notwithstanding anything in the Plan to the contrary, if the Non-Employee Director ceases to be a director of the Company because of removal for Cause or Retirement, all of the Shares which have not vested in accordance with Section 3 of this Agreement shall be cancelled and forfeited on the date of removal or Retirement without additional consideration and Non-Employee Director shall have no further rights with respect thereto.

5. Modification and Waiver. Except as provided in the Plan with respect to determinations of the Committee and subject to the Company's right to amend the Plan, neither this Agreement nor any provision hereof can be changed, modified, amended, discharged, terminated or waived orally or by any course of dealing or purported course of dealing, but only by an agreement in writing signed by the Non-Employee Director and the Company. No such agreement shall extend to or affect any provision of this Agreement not expressly changed, modified, amended, discharged, terminated or waived or impair any right consequent on such a provision. The waiver of or failure to enforce any breach of this Agreement shall not be deemed to be a waiver or acquiescence in any other breach thereof.

6. Rights as Stockholder. Non-Employee Director shall be considered a stockholder of the Company with respect to all such Shares that have not been forfeited and shall have all rights appurtenant thereto, including the right to vote or consent to all matters that may be presented to the stockholders and to receive all dividends and other distributions paid on such

Shares. If any dividends or distributions are paid in Common Stock, such Common Stock shall be subject to the same restrictions as the Shares with respect to which it was paid.

7. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware.

8. Non-Employee Director Acknowledgment. The Non-Employee Director hereby acknowledges receipt of a copy of the Plan and a Plan prospectus.

9. Incorporation of Plan. All terms and provisions of the Plan are incorporated herein and made part hereof as if stated herein. Except as provided in Section 3 and Section 4 of this Agreement, if any provision hereof and of the Plan shall be in conflict, the terms of the Plan shall govern.

10. Entire Agreement. This Agreement and the Plan represent the final, complete and total agreement of the parties hereto respecting the Shares and the matters discussed herein and this Agreement supersedes any and all previous agreements and understandings, whether written, oral or otherwise, relating to the Shares and such matters.

11. No Right to Re-Election. This Agreement shall not confer upon the Non-Employee Director any right to continue as a director of the Company, to be renominated by the Board or re-elected by the shareholders of the Company.

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its duly authorized officer and said Non-Employee Director has hereunto signed this Agreement on the Non-Employee Director's own behalf, thereby representing that the Non-Employee Director has carefully read and understands this Agreement and the Plan, as of the day and year first above written.

KINDRED HEALTHCARE, INC.

By: Richard A. Lechleiter
Title: Executive Vice President and Chief Financial Officer

EXHIBIT 21

REGISTRANT'S SUBSIDIARIES

DECEMBER 31, 2007

Corporations and Limited Liability Companies

Cornerstone Insurance Company, a Cayman Islands corporation

Homestead Health and Rehabilitation Center, L.L.C., a Delaware limited liability company

Kindred Healthcare Operating, Inc., a Delaware corporation

- Kindred Acute Pulmonary East, Inc., a Delaware corporation
- Kindred Development 27, L.L.C., a Delaware limited liability company
- Kindred Development 29, L.L.C., a Delaware limited liability company
- Kindred Hospitals East, L.L.C., a Delaware limited liability company
  - Goddard Nursing, L.L.C., a Delaware limited liability company
  - Kindred Braintree Hospital, L.L.C., a Delaware limited liability company
  - Kindred Hospital Palm Beach, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Pittsburgh-North Shore, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Springfield, L.L.C., a Delaware limited liability company
  - Kindred Hospital-Toledo, L.L.C., a Delaware limited liability company
  - Kindred Development 15, L.L.C., a Delaware limited liability company
  - Kindred Development 17, L.L.C., a Delaware limited liability company
  - Springfield Park View Hospital, L.L.C., a Delaware limited liability company
- Kindred Hospitals West, L.L.C., a Delaware limited liability company
- Kindred Nursing Centers East, L.L.C., a Delaware limited liability company
  - Avery Manor Nursing, L.L.C., a Delaware limited liability company
  - Braintree Nursing, L.L.C., a Delaware limited liability company
  - Country Estates Nursing, L.L.C., a Delaware limited liability company
  - Forestview Nursing, L.L.C., a Delaware limited liability company
  - Greens Nursing and Assisted Living, L.L.C., a Delaware limited liability company
  - Harborlights Nursing, L.L.C., a Delaware limited liability company

Highgate Nursing, L.L.C., a Delaware limited liability company

Highlander Nursing, L.L.C., a Delaware limited liability company

Kindred Development Holdings 3, L.L.C., a Delaware limited liability company

Kindred Development Holdings 5, L.L.C., a Delaware limited liability company

Kindred Development 7, L.L.C., a Delaware limited liability company

Kindred Development 8, L.L.C., a Delaware limited liability company

Kindred Development 9, L.L.C., a Delaware limited liability company

Kindred Development 10, L.L.C., a Delaware limited liability company

Kindred Development 11, L.L.C., a Delaware limited liability company

Kindred Development 12, L.L.C., a Delaware limited liability company

Kindred Development 13, L.L.C., a Delaware limited liability company

Laurel Lake Health and Rehabilitation, L.L.C., a Delaware limited liability company

Massachusetts Assisted Living, L.L.C., a Delaware limited liability company

Meadows Nursing, L.L.C., a Delaware limited liability company

Tower Hill Nursing, L.L.C., a Delaware limited liability company

Kindred Nursing Centers West, L.L.C., a Delaware limited liability company

Kindred Development 4, L.L.C., a Delaware limited liability company

Maine Assisted Living, L.L.C., a Delaware limited liability company

California Nursing Centers, L.L.C., a Delaware limited liability company

Bayberry Care Center, L.L.C., a Delaware limited liability company

Care Center of Rossmoor, L.L.C., a Delaware limited liability company

Greenbrae Care Center, L.L.C., a Delaware limited liability company

Medical Hill Rehab Center, L.L.C., a Delaware limited liability company

Pacific Coast Care Center, L.L.C., a Delaware limited liability company

Siena Care Center, L.L.C., a Delaware limited liability company

Ygnacio Valley Care Center, L.L.C., a Delaware limited liability company

Kindred Nursing Centers South, L.L.C., a Delaware limited liability company

Kindred Nursing Centers North, L.L.C., a Delaware limited liability company

Kindred Nevada, L.L.C., a Delaware limited liability company

Kindred Holdings, L.L.C., a Delaware limited liability company

Kindred Support Services, L.L.C., a Delaware limited liability company

Kindred Systems, Inc., a Delaware corporation

Kindred Healthcare Services, Inc., a Delaware corporation

    Kindred Hospice, Inc., a Kentucky corporation

Kindred Home Care Services, Inc., a Delaware corporation

Ledgewood Health Care Corporation, a Massachusetts corporation (1)

Kindred Rehab Services, Inc., a Delaware corporation

    Rehab Staffing, L.L.C., a Delaware limited liability company

    People*first* Virginia, L.L.C., a Delaware limited liability company

    Kindred Hospice Services, L.L.C., a Delaware limited liability company

        Peoplefirst HomeCare & Hospice of Colorado, L.L.C., a Delaware limited liability company

        Peoplefirst HomeCare & Hospice of Indiana, L.L.C., a Delaware limited liability company

    PF Development 4, L.L.C., a Delaware limited liability company

    PF Development 5, L.L.C., a Delaware limited liability company

KND Development 50, L.L.C., a Delaware limited liability company

KND Development 51, L.L.C., a Delaware limited liability company

KND Development 52, L.L.C., a Delaware limited liability company

KND Development 53, L.L.C., a Delaware limited liability company

KND Development 54, L.L.C., a Delaware limited liability company

KND Development 55, L.L.C., a Delaware limited liability company

KND Development 56, L.L.C., a Delaware limited liability company

KND Development 57, L.L.C., a Delaware limited liability company

KND Development 58, L.L.C., a Delaware limited liability company

KND Development 59, L.L.C., a Delaware limited liability company

KND Real Estate Holdings, L.L.C., a Delaware limited liability company

KND Real Estate 1, L.L.C., a Delaware limited liability company

KND Real Estate 2, L.L.C., a Delaware limited liability company

KND Real Estate 3, L.L.C., a Delaware limited liability company

KND Real Estate 4, L.L.C., a Delaware limited liability company

KND Real Estate 5, L.L.C., a Delaware limited liability company

KND Real Estate 6, L.L.C., a Delaware limited liability company

KND Real Estate 7, L.L.C., a Delaware limited liability company

KND Real Estate 8, L.L.C., a Delaware limited liability company

KND Real Estate 9, L.L.C., a Delaware limited liability company

KND Real Estate 10, L.L.C., a Delaware limited liability company

KND Real Estate 11, L.L.C., a Delaware limited liability company

KND Real Estate 12, L.L.C., a Delaware limited liability company

KND Real Estate 13, L.L.C., a Delaware limited liability company

KND Real Estate 14, L.L.C., a Delaware limited liability company

KND Real Estate 15, L.L.C., a Delaware limited liability company

KND Real Estate 16, L.L.C., a Delaware limited liability company

KND Real Estate 17, L.L.C., a Delaware limited liability company

KND Real Estate 18, L.L.C., a Delaware limited liability company

KND Real Estate 19, L.L.C., a Delaware limited liability company

KND Real Estate 20, L.L.C., a Delaware limited liability company

Helian Health Group, Inc., a Delaware corporation

Helian ASC of Northridge, Inc., a California corporation

MedEquities, Inc., a California corporation

Lafayette Health Care Center, Inc., a Georgia corporation

PersonaCare of Connecticut, Inc., a Connecticut corporation

Courtland Gardens Health Center, Inc., a Connecticut corporation

Homestead Health Center, Inc., a Connecticut corporation

PersonaCare of Georgia, Inc., a Delaware corporation

PersonaCare of Huntsville, Inc., a Delaware corporation

PersonaCare of Ohio, Inc., a Delaware corporation

PersonaCare of Pompano East, Inc., a Delaware corporation

PersonaCare of Reading, Inc., a Delaware corporation

PersonaCare of Shreveport, Inc., a Delaware corporation

PersonaCare of Warner Robbins, Inc., a Delaware corporation

PersonaCare of Wisconsin, Inc., a Delaware corporation

Tucker Nursing Center, Inc., a Georgia corporation

Specialty Healthcare Services, Inc., a Delaware corporation

Southern California Specialty Care, Inc., a California corporation

Specialty Hospital of Cleveland, Inc., an Ohio corporation

Specialty Hospital of Philadelphia, Inc., a Pennsylvania corporation

Specialty Hospital of South Carolina, Inc., a South Carolina corporation

Caribbean Behavioral Health Systems, Inc., a Nevada corporation

JB Thomas Hospital, Inc., a Massachusetts corporation

THC—Chicago, Inc., an Illinois corporation

THC—North Shore, Inc., an Illinois corporation

THC—Houston, Inc., a Texas corporation

THC—Orange County, Inc., a California corporation

THC—Seattle, Inc., a Washington corporation

Transitional Hospitals Corporation of Indiana, Inc., an Indiana corporation

Transitional Hospitals Corporation of Louisiana, Inc., a Louisiana corporation

Transitional Hospitals Corporation of New Mexico, Inc., a New Mexico corporation

Transitional Hospitals Corporation of Nevada, Inc., a Nevada corporation

Transitional Hospitals Corporation of Tampa, Inc., a Florida corporation

Transitional Hospitals Corporation of Texas, Inc., a Texas corporation

Transitional Hospitals Corporation of Wisconsin, Inc., a Wisconsin corporation

Transitional Hospitals Corporation of Michigan, Inc., a Michigan corporation

Partnerships

Kindred Hospitals Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Limited Partnership, a Delaware limited partnership

Kindred Nursing Centers Central Limited Partnership, a Delaware limited partnership

Kindred Home Care and Hospice Indiana Partnership, an Indiana general partnership

ProData Systems, Inc., an Alabama corporation

Foothill Nursing Company Partnership, a California general partnership

Fox Hill Village Partnership, a Massachusetts general partnership (1)

Starr Farm Partnership, a Vermont general partnership (1)

Hillhaven-MSC Partnership, a California general partnership

Northridge Surgery Center, Ltd., a California limited partnership (2)

Northridge Surgery Center Development Ltd., a California limited partnership (3)

(1) Only fifty percent (50%) is owned by one of the Registrant's subsidiaries

(2) Only forty-eight percent (48%) is owned by one or more of the Registrant's subsidiaries

(3) Only forty-three percent (43%) is owned by one of the Registrant's subsidiaries

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-59598, 333-62022, 333-88086 and 333-116755) and the Registration Statement on Form S-3 (No. 333-69646) of Kindred Healthcare, Inc. of our report dated February 28, 2008 relating to the consolidated financial statements, financial statement schedules and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
Louisville, Kentucky
February 28, 2008

EXHIBIT 31

Certification Required By Rules 13a-14(a) and 15d-14(a)
under the Securities Exchange Act of 1934

I, Paul J. Diaz, certify that:

1. I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2008

/s/ Paul J. Diaz
Paul J. Diaz
President and Chief Executive Officer

Certification Required By Rules 13a-14(a) and 15d-14(a)
under the Securities Exchange Act of 1934

I, Richard A. Lechleiter, certify that:

1. I have reviewed this annual report on Form 10-K of Kindred Healthcare, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 28, 2008

/s/ Richard A. Lechleiter
Richard A. Lechleiter
Executive Vice President and Chief Financial Officer