

KINDRED HEALTHCARE, INC  
Form 10-Q  
August 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

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

Commission file number: 001-14057

KINDRED HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	61-1323993
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)
680 South Fourth Street Louisville, KY	40202-2412

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(Address of principal executive offices) (Zip Code)

(502) 596-7300

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Exchange Act). Yes ☐ No ☒

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

Class of Common Stock	Outstanding at July 31, 2014
Common stock, \$0.25 par value	64,632,257 shares

KINDRED HEALTHCARE, INC.

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## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Revenues	\$1,275,964	\$1,191,030	\$2,562,706	\$2,450,464
Salaries, wages and benefits	770,321	715,619	1,544,133	1,497,484
Supplies	80,794	80,603	162,782	164,749
Rent	80,209	77,324	161,257	153,843
Other operating expenses	261,418	227,981	511,022	458,656
Other income	(154 )	(26 )	(388 )	(1,035 )
Impairment charges	—	438	—	625
Depreciation and amortization	39,442	38,554	78,779	80,152
Interest expense	80,530	29,074	106,329	57,233
Investment income	(2,449 )	(1,474 )	(2,632 )	(1,559 )
	1,310,111	1,168,093	2,561,282	2,410,148
Income (loss) from continuing operations before income taxes	(34,147 )	22,937	1,424	40,316
Provision (benefit) for income taxes	(13,082 )	9,208	503	15,713
Income (loss) from continuing operations	(21,065 )	13,729	921	24,603
Discontinued operations, net of income taxes:				
Loss from operations	(8,153 )	(1,050 )	(14,654 )	(6,426 )
Loss on divestiture of operations	(2,018 )	(10,852 )	(5,024 )	(12,877 )
Loss from discontinued operations	(10,171 )	(11,902 )	(19,678 )	(19,303 )
Net income (loss)	(31,236 )	1,827	(18,757 )	5,300
(Earnings) loss attributable to noncontrolling interests:				
Continuing operations	(4,828 )	(116 )	(9,357 )	(583 )
Discontinued operations	253	34	323	85
	(4,575 )	(82 )	(9,034 )	(498 )
Income (loss) attributable to Kindred	\$(35,811 )	\$1,745	\$(27,791 )	\$4,802
Amounts attributable to Kindred stockholders:				
Income (loss) from continuing operations	\$(25,893 )	\$13,613	\$(8,436 )	\$24,020
Loss from discontinued operations	(9,918 )	(11,868 )	(19,355 )	(19,218 )
Net income (loss)	\$(35,811 )	\$1,745	\$(27,791 )	\$4,802
Earnings (loss) per common share:				
Basic:				
Income (loss) from continuing operations	\$(0.48 )	\$0.25	\$(0.16 )	\$0.45
Discontinued operations:				
Loss from operations	(0.15 )	(0.02 )	(0.27 )	(0.12 )
Loss on divestiture of operations	(0.04 )	(0.20 )	(0.09 )	(0.24 )
Loss from discontinued operations	(0.19 )	(0.22 )	(0.36 )	(0.36 )
Net income (loss)	\$(0.67 )	\$0.03	\$(0.52 )	\$0.09
Diluted:				

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Income (loss) from continuing operations	\$ (0.48 )	\$ 0.25	\$ (0.16 )	\$ 0.45
Discontinued operations:				
Loss from operations	(0.15 )	(0.02 )	(0.27 )	(0.12 )
Loss on divestiture of operations	(0.04 )	(0.20 )	(0.09 )	(0.24 )
Loss from discontinued operations	(0.19 )	(0.22 )	(0.36 )	(0.36 )
Net income (loss)	\$ (0.67 )	\$ 0.03	\$ (0.52 )	\$ 0.09
Shares used in computing earnings (loss) per common share:				
Basic	53,714	52,265	53,180	52,164
Diluted	53,714	52,284	53,180	52,184
Cash dividends declared and paid per common share	\$0.12	\$—	\$ 0.24	\$—

See accompanying notes.

## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income (loss)	\$ (31,236)	\$ 1,827	\$ (18,757)	\$ 5,300
Other comprehensive income (loss):				
Available-for-sale securities (Note 9):				
Change in unrealized investment gains	347	15	484	1,628
Reclassification of gains realized in net income (loss)	(2,095 )	(1,228 )	(2,103 )	(1,109 )
Net change	(1,748 )	(1,213 )	(1,619 )	519
Interest rate swaps (Note 1):				
Change in unrealized gains (losses)	(1,966 )	472	(3,046 )	1,316
Reclassification of ineffectiveness realized in net income (loss)	52	(276 )	84	(276 )
Reclassification of (gains) losses realized in net income (loss), net of payments	802	3	797	(2 )
Net change	(1,112 )	199	(2,165 )	1,038
Income tax expense (benefit) related to items of other comprehensive income (loss)	1,358	239	1,737	(698 )
Other comprehensive income (loss)	(1,502 )	(775 )	(2,047 )	859
Comprehensive income (loss)	(32,738)	1,052	(20,804)	6,159
Earnings attributable to noncontrolling interests	(4,575 )	(82 )	(9,034 )	(498 )
Comprehensive income (loss) attributable to Kindred	\$ (37,313)	\$ 970	\$ (29,838)	\$ 5,661

See accompanying notes.

## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

	June 30, 2014	December 31, 2013
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$45,416	\$ 35,972
Cash – restricted	3,490	3,713
Insurance subsidiary investments	93,527	96,295
Accounts receivable less allowance for loss of \$50,827 – June 30, 2014 and \$41,025 – December 31, 2013	1,006,963	916,529
Inventories	25,660	25,780
Deferred tax assets	39,658	37,920
Income taxes	50,812	36,846
Other	38,651	43,673
	1,304,177	1,196,728
Property and equipment	1,942,214	1,906,366
Accumulated depreciation	(1,024,411)	(979,791 )
	917,803	926,575
Goodwill	994,854	992,102
Intangible assets less accumulated amortization of \$62,578 – June 30, 2014 and \$52,211 – December 31, 2013	411,260	423,303
Assets held for sale	8,435	20,978
Insurance subsidiary investments	160,565	149,094
Deferred tax assets	–	17,043
Other	235,716	220,046
Total assets	\$ 4,032,810	\$ 3,945,869
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 162,040	\$ 181,772
Salaries, wages and other compensation	346,318	361,192
Due to third party payors	18,413	33,747
Professional liability risks	69,657	60,993
Other accrued liabilities	135,420	146,495
Long-term debt due within one year	10,233	8,222
	742,081	792,421
Long-term debt	1,530,340	1,579,391
Professional liability risks	243,536	246,230
Deferred tax liabilities	5,286	–
Deferred credits and other liabilities	215,855	206,611
Commitments and contingencies (Note 11)		
<b>Equity:</b>		
<b>Stockholders' equity:</b>		



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Common stock, \$0.25 par value; authorized 175,000 shares; issued 63,784 shares – June 30, 2014 and 54,165 shares – December 31, 2013	15,946	13,541
Capital in excess of par value	1,346,561	1,146,193
Accumulated other comprehensive loss	(2,299 )	(252 )
Accumulated deficit	(107,327 )	(76,825 )
	1,252,881	1,082,657
Noncontrolling interests	42,831	38,559
Total equity	1,295,712	1,121,216
Total liabilities and equity	\$ 4,032,810	\$ 3,945,869

See accompanying notes.

## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
<b>Cash flows from operating activities:</b>				
Net income (loss)	\$ (31,236 )	\$ 1,827	\$ (18,757 )	\$ 5,300
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:				
Depreciation and amortization	40,922	46,960	82,226	99,914
Amortization of stock-based compensation costs	6,378	3,840	8,963	6,088
Amortization of deferred financing costs	16,832	4,407	19,229	7,020
Payment of capitalized lender fees related to debt issuance	(19,125 )	(1,600 )	(19,125 )	(1,600 )
Provision for doubtful accounts	12,133	10,071	20,893	21,337
Deferred income taxes	17,528	(24,977 )	21,503	(25,321 )
Impairment charges	220	646	664	1,082
Loss on divestiture of discontinued operations	2,018	10,852	5,024	12,877
Other	70	(1,284 )	2,114	(864 )
<b>Change in operating assets and liabilities:</b>				
Accounts receivable	(41,066 )	48,294	(112,895 )	(19,117 )
Inventories and other assets	(3,769 )	4,747	(9,987 )	(3,400 )
Accounts payable	(5,425 )	(3,288 )	(18,877 )	(19,078 )
Income taxes	(40,476 )	10,025	(11,063 )	22,700
Due to third party payors	(12,354 )	(8,187 )	(14,367 )	(9,215 )
Other accrued liabilities	7,387	(48,699 )	(21,262 )	(19,256 )
<b>Net cash provided by (used in) operating activities</b>	<b>(49,963 )</b>	<b>53,634</b>	<b>(65,717 )</b>	<b>78,467</b>
<b>Cash flows from investing activities:</b>				
Routine capital expenditures	(24,485 )	(17,430 )	(46,162 )	(39,800 )
Development capital expenditures	(372 )	(5,086 )	(1,123 )	(7,474 )
Acquisitions, net of cash acquired	(1,383 )	(26,933 )	(24,098 )	(26,933 )
Sale of assets	8,927	7,243	13,961	12,303
Purchase of insurance subsidiary investments	(13,179 )	(11,759 )	(23,293 )	(22,595 )
Sale of insurance subsidiary investments	17,758	15,526	26,520	25,528
<b>Net change in insurance subsidiary cash and cash equivalents</b>	<b>(4,957 )</b>	<b>(9,782 )</b>	<b>(11,556 )</b>	<b>(42,878 )</b>
<b>Change in other investments</b>	<b>70</b>	<b>39</b>	<b>710</b>	<b>358</b>
<b>Other</b>	<b>17</b>	<b>(77 )</b>	<b>(534 )</b>	<b>(221 )</b>
<b>Net cash used in investing activities</b>	<b>(17,604 )</b>	<b>(48,259 )</b>	<b>(65,575 )</b>	<b>(101,712)</b>
<b>Cash flows from financing activities:</b>				
Proceeds from borrowings under revolving credit	648,315	377,900	1,157,015	861,400
Repayment of borrowings under revolving credit	(943,715)	(385,200)	(1,369,515)	(844,400)
Proceeds from issuance of senior unsecured notes	500,000	—	500,000	—
Proceeds from issuance of term loan, net of discount	997,500	—	997,500	—

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Repayment of senior unsecured notes	(550,000)	–	(550,000 )	–
Repayment of term loan	(781,594)	(1,969 )	(783,563 )	(3,969 )
Repayment of other long-term debt	(67 )	(91 )	(157 )	(757 )
Payment of deferred financing costs	(2,378 )	(455 )	(2,648 )	(657 )
Equity offering, net of offering costs	203,977	–	203,977	–
Issuance of common stock in connection with employee benefit plans	883	203	4,687	207
Dividends paid	(6,572 )	–	(13,086 )	–
Distributions to noncontrolling interests	(2,662 )	(1,019 )	(5,595 )	(1,510 )
Other	248	19	2,121	351
Net cash provided by (used in) financing activities	63,935	(10,612 )	140,736	10,665
Change in cash and cash equivalents	(3,632 )	(5,237 )	9,444	(12,580 )
Cash and cash equivalents at beginning of period	49,048	42,664	35,972	50,007
Cash and cash equivalents at end of period	\$ 45,416	\$37,427	\$ 45,416	\$37,427
Supplemental information:				
Interest payments	\$ 68,065	\$42,753	\$ 79,666	\$55,845
Income tax payments (refunds)	4,329	23,461	(21,565 )	13,830
See accompanying notes.				

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION

Business

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates transitional care (“TC”) hospitals, inpatient rehabilitation hospitals (“IRFs”), nursing centers, assisted living facilities, a contract rehabilitation services business and a home health and hospice business across the United States (collectively, the “Company” or “Kindred”). At June 30, 2014, the Company’s hospital division operated 97 TC hospitals (certified as long-term acute care (“LTAC”) hospitals under the Medicare program) and five IRFs in 22 states. The Company’s nursing center division operated 98 nursing centers and six assisted living facilities in 21 states. The Company’s rehabilitation division provided rehabilitation services primarily in hospitals and long-term care settings. The Company’s care management division (formerly known as the Company’s home health and hospice division) primarily provided home health, hospice and private duty services from 153 locations in 13 states.

The Company has completed several transactions related to the divestiture or planned divestiture of unprofitable hospitals and nursing centers to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses or impairments associated with these transactions have been classified as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all periods presented. Assets held for sale at June 30, 2014 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying unaudited condensed consolidated balance sheet. See Note 2 for a summary of discontinued operations.

Recently issued accounting requirements

In June 2014, the Financial Accounting Standards Board (the “FASB”) issued authoritative guidance which changes the requirements for accounting for share-based payments when the terms of an award provide that a performance target could be achieved after the requisite service period. This guidance is effective for annual and interim periods beginning on or after December 15, 2015. The adoption of this standard is not expected to have a material impact on the Company’s business, financial position, net income or liquidity.

In May 2014, the FASB issued authoritative guidance which changes the requirements for recognizing revenue when entities enter into contracts with customers. Under the new provisions, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. This guidance is effective for annual and interim periods beginning on or after December 15, 2016 and early adoption is not permitted. The Company is still assessing this guidance.

In April 2014, the FASB issued authoritative guidance which changes the requirements for reporting discontinued operations. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity’s

operations and financial results when any of the following occurs: (1) the component or group of components meets the criteria to be classified as held for sale, (2) the component or group of components is disposed of by sale, or (3) the component or group of components is disposed of other than by sale (for example, abandonment). The entity shall present separately, for each comparative period, the assets and liabilities of the discontinued operation in the statement of financial position. In addition to the required disclosures for discontinued operations, entities also will be required to provide disclosures about a disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation in the financial statements. The guidance also states an entity shall expand disclosures about significant continuing involvement with a discontinued operation, until the results of operations of the discontinued operation are no longer presented in the statement of operations. The guidance is applicable prospectively for all disposals that occur within annual periods beginning on or after December 15, 2014 and early adoption is permitted. The adoption of the guidance is not expected to have a material impact on the Company's business, financial position, net income or liquidity but may have a material impact on the Company's income from continuing operations if planned or completed disposals of components of the Company's business do not qualify for discontinued operations under the new guidance.

## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 1 – BASIS OF PRESENTATION (Continued)

## Equity

The following table sets forth the changes in equity attributable to noncontrolling interests and equity attributable to Kindred stockholders for the six months ended June 30, 2014 and 2013 (in thousands):

	Amounts attributable to		Total
	Kindred stockholders	Noncontrolling interests	equity
For the six months ended June 30, 2014:			
Balance at December 31, 2013	\$ 1,082,657	\$ 38,559	\$ 1,121,216
Comprehensive income (loss):			
Net income (loss)	(27,791 )	9,034	(18,757 )
Other comprehensive loss	(2,047 )	–	(2,047 )
	(29,838 )	9,034	(20,804 )
Issuance of common stock in connection with employee benefit plans	4,687	–	4,687
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(5,790 )	–	(5,790 )
Income tax benefit in connection with the issuance of common stock under employee benefit plans	1,311	–	1,311
Stock-based compensation amortization	8,963	–	8,963
Equity offering, net of offering costs	203,977	–	203,977
Dividends paid	(13,086 )	–	(13,086 )
Contribution made by noncontrolling interests	–	833	833
Distributions to noncontrolling interests	–	(5,595 )	(5,595 )
Balance at June 30, 2014	\$ 1,252,881	\$ 42,831	\$ 1,295,712
For the six months ended June 30, 2013:			
Balance at December 31, 2012	\$ 1,256,159	\$ 36,685	\$ 1,292,844
Comprehensive income:			
Net income	4,802	498	5,300
Other comprehensive income	859	–	859
	5,661	498	6,159
Issuance of common stock in connection with employee benefit plans	207	–	207
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(2,964 )	–	