



RECOVERY ISN'T JUST A GOAL – IT'S OUR MISSION.

KINDRED HEALTHCARE 2009 **Annual Report**

Kindred
Healthcare  One of the
MOST ADMIRABLE

Healthcare Companies in the World, *Fortune Magazine*
2009 and 2010

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share amounts)

Operating results:	Year ended December 31,	
	2009	2008
Revenues	\$4,270,007	\$4,093,864
Net income:		
Income from continuing operations	\$62,612	\$60,460
Discontinued operations, net of income taxes:		
Income (loss) from operations	931	(3,399)
Loss on divestiture of operations	(23,432)	(20,776)
Net income	\$40,111	\$36,285
Diluted earnings per common share:		
Income from continuing operations	\$1.60	\$1.54
Discontinued operations:		
Income (loss) from operations	0.02	(0.09)
Loss on divestiture of operations	(0.60)	(0.53)
Net income	\$1.02	\$0.92
Diluted shares (000)	38,502	38,397
Cash flows from operations	\$233,720	\$172,285
Financial position:	Dec. 31, 2009	Dec. 31, 2008
Cash and cash equivalents	\$16,303	\$140,795
Working capital	241,032	403,917
Total assets	2,022,224	2,181,761
Long-term debt	147,647	349,433
Stockholders' equity	966,594	914,975

ABOUT KINDRED HEALTHCARE

Kindred Healthcare, Inc., a top-200 private employer in the United States, is a provider of diversified post-acute healthcare services based in Louisville, Kentucky with annual revenues of over \$4 billion and approximately 54,100 employees in 41 states. At December 31, 2009, Kindred through its subsidiaries provided healthcare services in 621 locations, including 83 long-term acute care hospitals, 222 skilled nursing centers and a contract rehabilitation

services business, *Peoplefirst* Rehabilitation, which served 316 non-affiliated facilities. Ranked first in *Fortune* magazine's 2009 Most Admired Companies "Health Care: Medical Facilities" category, Kindred's mission is to promote healing, provide hope, preserve dignity and produce value for each patient, resident, family member, customer, employee and shareholder we serve. For more information, please visit our website, www.kindredhealthcare.com.

DEDICATED TO HOPE, HEALING AND RECOVERY



Dear Shareholders,

Fiscal 2009 was a year of solid operational and financial performance at Kindred Healthcare, despite a difficult economic, regulatory and reimbursement environment. Our strong financial results were driven by continued improvement in our people, quality and customer services goals and reinforced our Management Philosophy: **If we take care of our people, and focus on quality and customer service, our business results will follow.** The financial highlights of the year included:

- Revenue gains in each of our three operating divisions: Hospitals – 5%, Nursing and Rehabilitation Centers – 3% and Peoplefirst 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 services 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, as our accounts receivable days outstanding declined 2% from 2008;
- Routine capital expenditures declined 11% to \$98 million in 2009, while development capital expenditures grew 24% to \$48 million (noteworthy, all routine and development capital expenditures in both 2009 and 2008 were financed through internal sources); and
- Our revolving credit borrowings, net of excess cash, declined nearly \$80 million, while the remaining unused capacity of our revolving credit facility totaled \$353 million at the end of the year, providing significant financial flexibility to pursue future growth opportunities.

Our hospital division exceeded its employee turnover and quality goals helping to drive solid admissions growth in 2009, with particularly strong growth in commercial and managed care admissions, as we continued to educate referral sources on the value of our hospital services from both a clinical and financial perspective. In addition, we continued to expand our service lines to further 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 with 409 licensed beds and have since announced 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, hospital operating income grew by 5% to \$364 million in 2009, primarily as a result of growth in managed care admissions and operational improvements in certain newer facilities.

Kindred Healthcare's mission is to promote healing, provide hope, preserve dignity and produce value for each patient, resident, family member, customer, employee and shareholder we serve.

Our nursing and rehabilitation centers also made significant improvements in employee turnover, quality and customer service in 2009, as we worked to bring a higher level of operational consistency and stability to this business. But despite strong admissions growth, our 2009 financial results reflected a more difficult government reimbursement environment with respect to both the Medicare and Medicaid programs. As a result, our nursing center division operating income declined 5% to \$305 million in 2009. Nevertheless, we continue to enhance our asset base through the development of our Transitional Care Centers and Units in selected markets and continue to invest in the physical plant improvements, clinical programs and professional staff necessary to appropriately care for and attract higher acuity patients who require extensive nursing and rehabilitation services.

Peoplefirst Rehabilitation reported an outstanding year in 2009, with improvements in most of the operational and financial measures we use to manage our contract rehabilitation business. Improvement in our employee and customer satisfaction scores resulted in strong growth in average revenues per site of service, improved therapist productivity, and resulted in 33% growth in Peoplefirst operating income to \$51 million in 2009. Growth in Peoplefirst operating income contributed significantly to the Company's consolidated net income growth we reported for the year.

As noted, 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 of our ongoing efforts to improve clinical outcomes, quality and customer service in each business and 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 and focus a great deal of attention on our nursing center standard survey and clinical indicator results (as measured against our peers) to identify ways to improve our clinical operations and enhance our services.

We also continued to pursue our organic development and external growth strategies in our key markets in 2009 and have announced the development of 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 our routine capital expenditures to approximate \$115 million to \$120 million and development capital expenditures to approximate \$70 million to \$80 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 supporting our colleagues and our efforts to effectively use and preserve our capital resources have positioned us as a leading provider of post-acute services, recognized by *Fortune* magazine as one of the most admired health care companies in the world.

With the passage of healthcare reform, we see opportunities to grow in a changing post-acute landscape. And to create more value for our patients, residents and shareholders we can build upon our foundation of operational success, mature and scalable systems, and a proven ability to adapt to change. More specifically, our long-term growth prospects are supported by strong demographic trends and significant increases in the incidence of chronic diseases, as payors, policy makers and consumers search for lower cost settings and clinical differentiation. Advances in medical technology, clinical practices and new integrated delivery models will accelerate under healthcare reform, and Kindred will work hard to be part of a healthcare delivery system that delivers better quality, improves care coordination and lowers costs, while increasing value for its shareholders.

Finally, on behalf of our 54,100 dedicated employees and our Board of Directors, we thank you for your continued support.

Sincerely,



Paul J. Diaz
President and Chief Executive Officer

Executive Officers

Paul J. Diaz
President and Chief Executive Officer

Frank J. Battafarano
Chief Operating Officer

Richard A. Lechleiter
Executive Vice President and Chief Financial Officer

Lane M. Bowen
Executive Vice President and President,
Health Services Division

Benjamin A. Breier
Executive Vice President and President, Hospital Division

Richard E. Chapman
Executive Vice President and Chief Administrative and
Information Officer

Christopher M. Bird
President, Peoplefirst Rehabilitation Division

William M. Altman
Senior Vice President, Strategy and Public Policy

Joseph L. Landenwich
Senior Vice President of Corporate Legal Affairs and
Corporate Secretary

Gregory C. Miller
Senior Vice President, Corporate Development and
Financial Planning

M. Suzanne Riedman
Senior Vice President and General Counsel

Directors

Edward L. Kuntz
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Joel Ackerman
Former Managing Director
Warburg Pincus LLC

Ann C. Berzin
Former Chairman and Chief Executive Officer
Financial Guaranty Insurance Company

Jonathan D. Blum
Senior Vice President - Public Affairs
Yum! Brands, Inc.

Thomas P. Cooper, M.D.
Founder and Chairman
Vericare Management, Inc.

Paul J. Diaz
President and Chief Executive Officer

Isaac Kaufman
Senior Vice President and Chief Financial Officer
Advanced Medical Management, Inc.

Frederick J. Kleisner
Chief Executive Officer
Morgans Hotel Group Co.

Eddy J. Rogers, Jr.
Partner
Andrews Kurth LLP

Phyllis R. Yale
Partner
Bain & Company, Inc.

Corporate Information

Annual Meeting

The annual meeting of shareholders will be held at the Company's corporate headquarters, 680 South Fourth Street, Louisville, Kentucky, on May 18, 2010. Formal notice of the meeting, together with instructions on how to access the Company's proxy statement and form of proxy, is sent to each holder of common stock.

Additional Information

The Company's reports filed with the Securities and Exchange Commission may be obtained without charge upon written request to the Corporate Secretary at the Company's corporate address or electronically through our website. Please visit our website, www.kindredhealthcare.com, for additional information about the Company, including governance-related documents.

Stock Listing

Kindred Healthcare, Inc. common stock is listed on the New York Stock Exchange under the ticker symbol KND.

Transfer Agent and Registrar

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Dedicated to Hope, Healing and Recovery