Community Health Network Rehabilitation Hospital, LLC

Financial Statements
Years Ended December 31, 2014 and 2013

LATTIMORE BLACK MORGAN & CAIN, PC
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

Community Health Network Rehabilitation Hospital, LLC

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Independent Auditors' Report

To the Members of
Community Health Network Rehabilitation Hospital, LLC

We have audited the accompanying financial statements of Community Health Network Rehabilitation Hospital, LLC (the "Hospital"), which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of operations, members' capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting polices used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Network Rehabilitation Hospital, LLC as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Restatement of Previously Issued Financial Statements

As discussed in Note 2, the Hospital has restated its previously issued 2013 financial statements related to its accounting for the contribution of an intangible asset upon initial capitalization of the Hospital. Our opinion is not modified in regard to this matter.

Lattimore Black Morgan & Cain, P.C.

Brentwood, Tennessee
March 27, 2015

Community Health Network Rehabilitation Hospital, LLC

Balance Sheets

December 31,	2014	(Restated) 2013
Assets		
Current assets		
Cash and cash equivalents	$ 2,696,113	$ 2,475,315
Accounts receivable, less allowance for doubtful accounts of $407,281 and $74,361 as of December 31, 2014 and 2013, respectively	2,942,086	2,681,234
Cost report settlement receivable	316,664	-
Inventories	218,524	172,865
Prepaid expenses and other current assets	175,263	67,002
Total current assets	6,348,650	5,396,416
Property and equipment, net	1,720,063	2,068,972
Deposits	9,524	9,524
Intangible asset	8,500,000	8,500,000
Total assets	$ 16,578,237	$ 15,974,912
Liabilities and members' capital		
Current liabilities		
Accounts payable	$ 57,610	$ 37,521
Accounts payable, related parties	221,453	1,640,001
Current portion of long-term debt	52,371	47,407
Accrued expenses and other current liabilities	1,277,884	778,537
Total current liabilities	1,609,318	2,503,466
Long-term debt, excluding current portion	146,166	202,705
Deferred rent and other long-term liabilities	375,908	125,303
Total liabilities	2,131,392	2,831,474
Members' capital	14,446,845	13,143,438
Total liabilities and members' capital	$ 16,578,237	$ 15,974,912

See accompanying notes to financial statements.

Community Health Network Rehabilitation Hospital, LLC

Statements of Operations

Year Ended December 31,	2014	2013
Revenue		
Patient service revenue, net of contractual allowances	$ 21,463,077	$ 5,236,544
Less provision for doubtful accounts	(369,323)	(74,361)
Net patient service revenue	21,093,754	5,162,183
Other revenue	57,361	14,179
Total revenue	21,151,115	5,176,362
Operating expenses		
Salaries, wages and employee benefits	11,503,391	5,093,389
Outside services	708,238	379,285
Rent	1,870,654	989,760
Supplies and drugs	1,087,353	427,216
Other operating expenses	2,178,362	1,263,867
Depreciation and amortization	404,201	280,908
Interest, net	20,450	13,308
Total expenses	17,772,649	8,447,733
Net income (loss)	$ 3,378,466	$ (3,271,371)

See accompanying notes to financial statements.

Community Health Network Rehabilitation Hospital, LLC

Statements of Members' Capital

	CRH Of Indianapolis, LLC	Community Health Network, Inc.	Total
Balances at December 31, 2012	**$ 97,090**	**$ (128,448)**	**$ (31,358)**
Cash contributions	**7,946,167**	**-**	**7,946,167**
Contribution of assets (Note 2)	**-**	**8,500,000**	**8,500,000**
Net loss	**(1,602,972)**	**(1,668,399)**	**(3,271,371)**
Balances at December 31, 2013 (restated)	6,440,285	6,703,153	13,143,438
Cash distributions	**(1,016,779)**	**(1,058,280)**	**(2,075,059)**
Net income	**1,655,448**	**1,723,018**	**3,378,466**
Balances at December 31, 2014	$ 7,078,954	$ 7,367,891	$ 14,446,845

See accompanying notes to financial statements.

Community Health Network Rehabilitation Hospital, LLC

Statements of Cash Flows

Year ended December 31,	2014	(Restated) 2013
Cash flows from operating activities		
Net income (loss)	$ 3,378,466	$ (3,271,371)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	404,201	280,908
Provision for bad debts	369,323	74,361
Deferred rent and other long-term liabilities	250,605	125,303
Change in operating assets:		
Accounts receivable	(630,175)	(2,755,595)
Cost report settlement receivable	(316,664)	-
Inventories	(45,659)	(172,865)
Prepaid expenses and other assets	(108,261)	(66,922)
Deposits	-	(9,524)
Change in operating liabilities:		
Accounts payable	20,089	32,483
Accounts payable, related parties	(1,418,548)	1,410,420
Accrued expenses and other current liabilities	499,347	755,952
Net cash provided (used) by operating activities	2,402,724	(3,596,850)
Cash flows used in investment activities		
Purchases of property and equipment	(55,292)	(2,048,484)
Cash flows from financing activities		
Capital contributions	-	7,946,167
Capital distributions	(2,075,059)	-
Principal payments on long-term debt	(51,575)	(25,550)
Net cash provided (used) by financing activities	(2,126,634)	7,920,617
Net increase in cash and cash equivalents	220,798	2,275,283
Cash and cash equivalents at beginning of year	2,475,315	200,032
Cash and cash equivalents at end of year	$ 2,696,113	$ 2,475,315
Supplemental cash flow information:		
Cash paid for interest	$ 22,877	$ 15,449
Property and equipment acquired under capital lease obligation	-	275,662
Contribution of intangible asset	-	8,500,000

See accompanying notes to financial statements.

1. Ownership and nature of business

Community Health Network Rehabilitation Hospital, LLC (the "Hospital") is a 60-bed acute inpatient rehabilitation hospital located in Indianapolis, Indiana. The Hospital is owned by its two members, CRH of Indianapolis, LLC ("CRH of Indy") (49%) and Community Health Network, Inc. ("Community") (51%). The Hospital was formed on September 28, 2011 and started accepting patients on June 14, 2013.

The parent company of CRH of Indy was acquired by Kindred Healthcare, Inc. ("Kindred") effective January 1, 2015. The impact of the acquisition on the Hospital is still being assessed.

2. Restatement of previously issued financial statements

In connection with the acquisition described in Note 1, management reassessed the level of control maintained over the Hospital through the Hospital's operating and management agreements. As a result of this analysis, management determined that Centerre, and subsequently Kindred, maintains effective control of the Hospital, under generally accepted accounting principles. As such, the inpatient rehabilitation line of business contributed by Community in connection with the initial capitalization of the Hospital can be recorded as a separately identifiable intangible asset on the contribution date.

The value assigned to the line of business is estimated to have an indeterminate useful economic life and is evaluated for impairment annually. This contribution did not include any significant tangible assets or liabilities. This contribution was valued, by an independent agency, to be worth $8,500,000. The Hospital's 2013 balance sheet has been restated to reflect a $8,500,000 separately identifiable intangible asset, while members' equity has been restated to reflect Community's $8,500,000 non-cash contribution. The Hospital's 2013 statement of cash flows has also been restated to reflect the $8,500,000 non-cash contribution of the separately identifiable intangible asset. There was no impact on the Hospitals' 2013 statement of operations as a result of this restatement.

3. Summary of significant accounting policies

The significant accounting policies followed by the Hospital are described below and are in conformity with accounting principles generally accepted in the United States of America.

Fair value measurements - Fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, fair value accounting standards establish a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity including quoted market prices in active markets for identical assets (Level 1), or significant other observable inputs (Level 2) and the reporting entity's own assumptions about market participant assumptions (Level 3). The Hospital does not have any fair value measurements using significant unobservable inputs (Level 3) as of December 31, 2014 or 2013, except for the valuation of the separately identifiable intangible asset contributed by Community in conjunction with the capitalization of the Hospital (see Note 2).

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents - The Hospital considers all highly-liquid investments with a maturity upon acquisition of three months or less to be cash equivalents.

Allowance for doubtful accounts - Accounts receivable primarily consists of amounts due from third-party payors and patients. The Hospital's ability to collect outstanding receivables is critical to its results of operations and cash flows. To provide for accounts receivable that could become uncollectible in the future, the Hospital establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty of such allowances lies with uninsured patient receivables and deductibles, co-payments or other amounts due from individual patients.

The Hospital's policy to record an allowance for doubtful accounts is based upon a percentage of net receivables by age of balance after discharge date as follows:

Age (Days)	% Reserved
0-60	2%
61-120	3%
121-180	10%
181-240	25%
241-300	50%
301-360	75%
361+	100%

The Hospital has an established process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the analytical tools that the Hospital utilizes include, but are not limited to, historical cash collection experience, revenue trends by payor classification and revenue days in accounts receivable. Individual patient accounts receivable are written off after collection efforts have been followed in accordance with the Hospital's policies.

Cost report settlements - Revenue under third-party payor agreements is subject to audit and retroactive adjustment. Provisions for estimated third-party payor settlements are provided in the period the related services are rendered. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the year of settlement. Adjustments relating to tentative or final settlements to estimated reimbursement amounts pertaining to prior periods resulted in an increase of net patient revenue of $25,593 for the year ended December 31, 2014.

There were no adjustments relating to tentative or final settlements to estimated settlement amounts pertaining to prior periods during the year ended December 31, 2013.

Inventories - Inventories are stated at the lower of cost (first-in, first-out) or market and consist of purchased items. These inventory items are primarily operating supplies used in the direct or indirect treatment of patients.

Property and equipment - Property and equipment are recorded at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets which range from 3 to 15 years. Leasehold improvements are amortized over the shorter of the estimated useful economic life or the respective lease term.

Expenditures for repairs, maintenance and minor renewals are charged to income as incurred. Expenditures, including the cost of parts and internal labor, which improve an asset or extend its estimated useful life, are capitalized. When equipment is retired or otherwise disposed of, the related cost and accumulated depreciation or amortization are removed from the accounts and any gain or loss is included in operations.

The carrying value of property and equipment is assessed for recoverability by management based on analysis of future undiscounted cash flows expected to result from the use and expected disposition of the asset. An impairment loss is recognized in income if the carrying amount of the asset is not recoverable and exceeds its fair value. Management believes there has been no impairment at December 31, 2014 or 2013.

Intangible asset - Intangible assets with indefinite lives are not amortized but reviewed for impairment annually or more frequently if certain indicators arise. Management believes there has been no impairment at December 31, 2014 and 2013.

Deferred rent - The Hospital facility lease provides for escalating rent payments over the life of the lease. Generally accepted accounting standards require that rent expense be recognized on a straight-line basis over the life of the lease. This accounting results in a non-interest bearing liability that increases during the early portion of the lease term, as the cash paid is less than the expense recognized, and reverses by the end of the lease term.

Net patient service revenue - The Hospital recognizes revenues in the period in which services are performed. Accounts receivable primarily consist of amounts due from third-party payors and patients. Amounts the Hospital receives for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations, preferred provider organizations and other private insurers are generally less than the Hospital's established billing rates. Accordingly, the revenues and accounts receivable reported in the Hospital's financial statements are recorded at the net amount expected to be received.

The Hospital derives a significant portion of its revenues from Medicare, Medicaid and other payors that receive discounts from its established billing rates. The Hospital must estimate the total amount of these discounts to prepare its financial statements. The Medicare and Medicaid regulations and various managed care contracts under which these discounts must be calculated are complex and are subject to interpretation and adjustment. The Company estimates the allowance for contractual discounts on a patient-specific basis given its interpretation of the applicable regulations or contract terms. These interpretations sometimes result in payments that differ from the Hospital's estimates. Additionally, updated regulations and contract renegotiations occur frequently, necessitating regular review and assessment of the estimation process by management. Changes in estimates related to the allowance for contractual discounts affect revenues reported in the Hospital's statements of operations.

Self-pay revenues are derived primarily from patients who do not have any form of healthcare coverage. The revenues associated with self-pay patients are generally reported at the Hospital's gross charges. The Hospital evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid or other governmental assistance programs, as well as the Hospital's policy for charity/indigent care.

Charity care - The Hospital provides care without charge to certain patients that qualify under the charity care policy. For the years ended December 31, 2014 and 2013, the Hospital provided charity care services with direct and indirect costs amounting to $218,697 and $336,660, respectively. The Hospital does not report a charity care patient's charges in revenues or in the provision for doubtful accounts as it is the Hospital's policy not to pursue collection of amounts related to these patients.

Income taxes - The Hospital has been organized as a limited liability company and has elected to be treated as a partnership for federal income tax purposes. As a general rule, the Hospital is also treated as a partnership for state income tax purposes. As such, federal and state taxable income and losses pass through to the individual members for inclusion in their respective income tax returns.

Under generally accepted accounting principles, a tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Hospital has no material uncertain tax positions that qualify for either recognition or disclosure in the financial statements.

As of December 31, 2014 and 2013, the Hospital has accrued no interest and no penalties related to uncertain tax positions. It is the Hospital's policy to recognize interest and/or penalties related to income tax matters in income tax expense.

The Hospital files U.S. Federal and State of Indiana income tax returns. The Hospital is currently open to audit under the statute of limitations for the years ended December 31, 2011 through December 31, 2013.

Events occurring after the reporting date - The Hospital has evaluated events and transactions that occurred between December 31, 2014 and March 27, 2015, which is the date the financial statements were available to be issued, for possible recognition or disclosure in the financial statements. See Note 9 for disclosure of subsequent events occurring after December 31, 2014.

4. Credit risk and other concentrations

The Hospital maintains cash and cash equivalents on deposit at banks in excess of federally insured amounts. The Hospital has not experienced any losses in such accounts and management believes the Hospital is not exposed to any significant credit risk related to cash and cash equivalents.

During the years ended December 31, 2014 and 2013, approximately 67% and 59% of the Hospital's net revenues related to patients participating in the Medicare and Medicaid programs, respectively. Accounts receivable from Medicare and Medicaid accounted for approximately 69% and 54% of total accounts receivable as of December 31, 2014 and 2013, respectively. The Hospital's management recognizes that revenues and receivables from government agencies are significant to the Hospital's operations, but it does not believe that there is significant credit risk associated with these government agencies. During the years ended December 31, 2014 and 2013, approximately 17% and 23% of the Hospital's net revenues related to patients covered by Anthem/Blue Cross of Indiana, respectively. Accounts receivable from this payor accounted for approximately 13% and 16% of total accounts receivable as of December 31, 2014 and 2013, respectively. The Hospital's management does not believe that there are any other significant concentrations of revenues from any particular payor that would subject the Hospital to any significant credit risks in the collection of its accounts receivable.

5. Property and equipment

Property and equipment consists of the following at December 31, 2014 and 2013:

	2014	2013
Equipment	**$ 1,535,290**	**$ 1,503,020**
Data processing equipment	**350,164**	**331,286**
Furniture and fixtures	**299,439**	**295,295**
Leasehold Improvements	**217,168**	**217,168**
	2,402,061	**2,346,769**
Less accumulated depreciation and amortization	**(681,998)**	**(277,797)**
	$ 1,720,063	**$ 2,068,972**

6. Long-term debt

Long-term debt consists of the following at December 31, 2014 and 2013:

	2014	2013
Capital lease obligation with CareFusion with monthly payments of $5,857, which includes principal and interest based on a fixed rate of 10.0%, with final installment due on May 1, 2018.	**$ 198,537**	**$ 250,112**
Less current portion	**(52,371)**	**(47,407)**
Long term portion	**$ 146,166**	**$ 202,705**

Future maturities of long-term debt at December 31, 2014 are as follows:

Year Ending December 31,		
2015	$	**52,371**
2016		**57,855**
2017		**63,913**
2018		**24,398**
Total	**$**	**198,537**

7. Related party balances and transactions

The Hospital conducts transactions with both members.

Management of the hospital - The Hospital is party to a management agreement with CHC Management Services, LLC ("CHC Management"), which shares common ownership with CRH of Indy, under which CHC Management provides certain management services to the Hospital, including the following: long-range planning, management planning, quality assurance programs, materials management, staffing for key positions, budget control systems, financial reporting systems, business office support, accounts receivable management, and risk management programs. The Hospital has agreed to pay CHC Management a monthly management fee according to the terms of the management services agreement. Total fees and expenses incurred related to CHC Management during the years ended December 31, 2014 and 2013 were $822,172 and $371,900, respectively. The amounts payable to CHC Management for these services and other expenses paid on behalf of the Hospital were $238,179 and $985,054 as of December 31, 2014 and 2013, respectively.

Community - Community provides a number of services for the Hospital. This includes: laboratory, occupational health, radiology, medical credentialing, biomed and diagnostic services. Also, the Hospital leased eighteen employees from Community as of December 31, 2014 and 2013. The Hospital incurred $1,205,916 and $777,703 for these services for the years ended December 31, 2014 and 2013, respectively. The amounts receivable (payable) to Community for these services and other payments made on behalf of the Hospital were $16,726 and ($654,947) as of December 31, 2014 and 2013, respectively.

8. Commitments and contingencies

Legal - The Hospital is, from time to time, subject to various claims and legal actions arising in the normal course of business. In the opinion of management, any such claims and actions will be either adequately covered by insurance or will not have a material adverse effect on the Hospital's financial position, results of operations or liquidity.

Payors - Laws and regulations governing Medicare, Medicaid, and other payor health care programs are complex and subject to interpretation. The Hospital's management believes that the Hospital is in compliance with all applicable laws and regulations in all material respects. Compliance with such laws and regulations is subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare, Medicaid, and other payor health care programs.

The Centers for Medicare and Medicaid Services ("CMS") have implemented a Recovery Audit Contractors ("RAC") program. The purpose of the program is to reduce improper Medicare and Medicaid payments through the detection and recovery of overpayments. CMS has engaged subcontractors to perform these audits and they are being compensated on a contingency basis based on the amount of overpayments that are recovered. While management believes that all Medicare and Medicaid billings are proper and adequate support is maintained, certain aspects of Medicare and Medicaid billing, coding and support are subject to interpretation and may be viewed differently by the RAC auditors than by Hospital management. As of December 31, 2014, there have been no recoveries made under the RAC process. As the amount of recovery, if any, is unknown, management has not recorded any reserves related to potential RAC audits at this time.

Healthcare Reform - In March 2010, Congress adopted comprehensive health care insurance legislation, the Patient Care Protection and Affordable Care Act ("collectively, the "Health Care Reform Legislation"). The Health Care Reform Legislation, among other matters, is designed to expand access to health care coverage to substantially all citizens through a combination of public program expansion and private industry health insurance. Provisions of the Health Care Reform Legislation become effective at various dates over the next several years and a number of additional steps are required to implement these requirements. Due to the complexity of the Health Care Reform Legislation, reconciliation and implementation of the legislation continues to be under consideration by lawmakers, and it is not certain as to what changes may be made in the future regarding health care policies. The State of Indiana has adopted the Medicaid expansion provisions of the Health Care Reform Legislation. Management does not anticipate these changes to have a significant impact on the Hospital's operations. While the full impact of Health Care Reform Legislation is not yet fully known, changes to policies regarding reimbursement, universal health insurance and managed competition may materially impact the Hospital's operations.

Leases - The Hospital leases the building and grounds under a 15 year operating lease ending in June 2028. The Hospital has the option to purchase the building from the landlord at fair value at the end of the seventh year of the lease and at the end of the lease term. Rent expense for the building and grounds leases, on a straight line basis, for 2014 and 2013 was \$1,776,888 and \$958,662, respectively. The related deferred rent of \$375,908 and \$125,303 at December 31, 2014 and 2013, respectively, is included in long-term liabilities on the accompanying balance sheet.

The approximate future minimum lease payments under the Hospital's building and grounds operating leases are as follows:

Year Ending December 31,	
2015	1,562,000
2016	1,594,000
2017	1,626,000
2018	1,660,000
2019	1,694,000
Thereafter	15,988,000
Total	**$ 24,124,000**

9. Subsequent events In January and February 2015, the Board of Managers declared and paid cash distributions to the members totaling $814,069.