KINDRED HEALTHCARE, INC
Form DEF 14A
April 03, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a)

OF THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement
x Definitive Proxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to Rule 14a-12

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KINDRED HEALTHCARE, INC.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

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(1) Title of each class of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee was calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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¨ Fee paid previously with preliminary materials.

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

KINDRED HEALTHCARE, INC.

April 3, 2012

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of Kindred Healthcare, Inc. to be held at 10:00 a.m., local time, on Thursday, May 17, 2012, at the Warwick New York Hotel, 65 West 54th Street, New York, New York 10019.

Information concerning the business to be conducted at the meeting is included in the accompanying Notice of Annual Meeting of Shareholders and Proxy Statement. Please give all of the information contained in the proxy statement your careful attention.

In accordance with rules adopted by the Securities and Exchange Commission, we are providing access to our proxy materials over the Internet. Accordingly, we are mailing to our shareholders a Notice of Internet Availability of Proxy Materials, which contains instructions on how to access our proxy materials over the Internet and vote online. If you received a Notice of Internet Availability of Proxy Materials, you will not receive a printed copy of our proxy materials by mail unless you request one. If you wish to receive a printed copy of our proxy materials for the 2012 Annual Meeting, please follow the instructions for requesting those materials set forth in the Notice of Internet Availability of Proxy Materials.

YOUR VOTE IS VERY IMPORTANT. Whether or not you plan to attend the meeting, it is important that your shares be represented. Therefore, we urge you to vote by submitting your proxy over the Internet, by telephone or by mail. Please refer to the Notice of Internet Availability of Proxy Materials for more detailed voting instructions. If you attend the meeting, you will, of course, have the right to vote in person.

I look forward to greeting you personally, and on behalf of our Board of Directors and management, I would like to express our appreciation for your interest in Kindred.

Sincerely,

Paul J. Diaz

President and Chief Executive Officer

Kindred Healthcare, Inc.

680 South Fourth Street

Louisville, Kentucky 40202-2412

KINDRED HEALTHCARE, INC.

680 SOUTH FOURTH STREET

LOUISVILLE, KENTUCKY 40202-2412

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON MAY 17, 2012

To the Shareholders of Kindred Healthcare, Inc.:

The Annual Meeting of Shareholders of Kindred Healthcare, Inc. (Kindred) will be held at 10:00 a.m., local time, on Thursday, May 17, 2012, at the Warwick New York Hotel, 65 West 54th Street, New York, New York 10019 for the following purposes:

(1) to elect a board of 11 directors;

(2) to hold an advisory vote on Kindred s executive compensation program;

(3) to approve the Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors;

(4) to ratify the appointment of PricewaterhouseCoopers LLP as Kindred s independent registered public accounting firm for fiscal year 2012;

(5) to consider and act upon a shareholder proposal described in the accompanying proxy statement, if properly presented at the Annual Meeting; and

(6) to transact such other business as may properly come before the meeting.

Only shareholders of record at the close of business on March 23, 2012 will be entitled to notice of, and to vote at, the meeting and any adjournments or postponements thereof.

IT IS IMPORTANT THAT YOU VOTE YOUR SHARES. WHETHER YOU PLAN TO ATTEND THE MEETING OR NOT, PLEASE SUBMIT YOUR VOTING INSTRUCTIONS AS SOON AS POSSIBLE IN ORDER TO AVOID ADDITIONAL SOLICITING EXPENSES TO KINDRED. THE PROXY IS REVOCABLE AND WILL NOT AFFECT YOUR RIGHT TO VOTE IN PERSON IN THE EVENT YOU FIND IT CONVENIENT TO ATTEND THE MEETING.

April 3, 2012

Paul J. Diaz

President and Chief Executive Officer

PROXY STATEMENT

FOR ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD ON MAY 17, 2012

GENERAL INFORMATION

Overview

This proxy statement and the accompanying form of proxy are being provided to Kindred Healthcare, Inc. (Kindred or the Company) shareholders as part of a solicitation of proxies by the board of directors (the Board or Board of Directors) of Kindred for use at the Annual Meeting of shareholders (the Annual Meeting) and at any adjournments or postponements thereof. This proxy statement is dated April 3, 2012 and is first being furnished to shareholders on or about April 5, 2012. This proxy statement provides shareholders with information they need to know to be able to vote or instruct their vote to be cast at the Annual Meeting.

Date, Time and Place of the Annual Meeting

The Annual Meeting will be held at the Warwick New York Hotel, 65 West 54th Street, New York, New York 10019, on May 17, 2012, at 10:00 a.m., local time.

Purposes of the Annual Meeting

At the Annual Meeting, shareholders will be asked:

- to elect the director nominees named in this proxy statement;
- to hold an advisory vote on Kindred s executive compensation program;
- to approve the Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors;
- to ratify the appointment of PricewaterhouseCoopers LLP as Kindred s independent registered public accounting firm for fiscal year 2012;
- to consider and act upon a shareholder proposal described in this proxy statement, if properly presented at the Annual Meeting; and
- to transact such other business as may properly come before the meeting.

Record Date; Outstanding Shares; Shares Entitled to Vote

The record date for the Annual Meeting is March 23, 2012. This means that you must be a shareholder of record of common stock, $0.25 par value per share (Common Stock), of the Company at the close of business on March 23, 2012, in order to vote at the Annual Meeting. You are entitled to one vote for each share of Common Stock you own. At the close of business on March 23, 2012, there were 52,184,059 shares of Common Stock outstanding and entitled to vote, held by approximately 2,000 holders of record.

A complete list of shareholders entitled to vote at the Annual Meeting will be available for inspection at the Company s principal place of business during regular business hours for a period of no less than ten days before the Annual Meeting and at the Annual Meeting during the meeting.

Internet Availability of Proxy Materials

In accordance with rules adopted by the Securities and Exchange Commission (the SEC), the Company is providing access to its proxy materials over the Internet. Accordingly, on or about April 5, 2012, the Company is mailing to its record and beneficial shareholders a Notice of Internet Availability of Proxy Materials, which contains instructions on how to access the Company s proxy materials over the Internet and vote online. If you

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received a Notice of Internet Availability of Proxy Materials, you will not receive a printed copy of the Company s proxy materials by mail unless you request one. If you wish to receive a printed copy of the Company s proxy materials for the 2012 Annual Meeting, please follow the instructions for requesting those materials set forth in the Notice of Internet Availability of Proxy Materials.

Quorum and Vote Required

A quorum of shareholders is necessary to hold a valid Annual Meeting. The required quorum for the transaction of business at the Annual Meeting is a majority of the issued and outstanding shares of Common Stock entitled to vote on a matter at the Annual Meeting, whether in person or by proxy. Shares of Common Stock represented at the Annual Meeting but not voted, including abstentions and broker non-votes, will be counted for purposes of determining whether a quorum is present at the Annual Meeting.

Under rules of the New York Stock Exchange (NYSE), matters subject to shareholder vote are classified as routine or non-routine. In the case of non-routine matters, brokers may not vote shares held in street name for which they have not received instructions from the beneficial owner (which are referred to as broker non-votes), whereas they may vote those shares in their discretion in the case of any routine matter. The ratification of the appointment of the independent registered public accounting firm (proposal 4) is a routine matter. All other matters, including the election of directors, are non-routine matters, and therefore may not be voted absent specific instructions from the beneficial owner of such shares of Common Stock. Abstentions will be counted as shares present and entitled to vote on all routine and non-routine proposals.

The Company s bylaws provide for majority voting for directors in uncontested elections. This means that each director-nominee listed in this proxy statement will be elected if the votes cast for such nominee s election exceed the votes cast against such nominee s election (proposal 1). As set forth in the Company s Corporate Governance Guidelines, the Board of Directors expects a director to tender his or her resignation for consideration by the Board of Directors if he or she fails to receive the requisite number of votes for re-election.

The affirmative vote of a majority of the shares of Common Stock present in person or represented by proxy at the Annual Meeting and entitled to vote on the subject matter will be necessary to approve, on a non-binding, advisory basis, the Company s executive compensation program (proposal 2), to approve the Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors (proposal 3), to ratify the appointment of PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm for fiscal year 2012 (proposal 4), to approve the shareholder proposal described in this proxy statement, if properly presented at the Annual Meeting (proposal 5) and to approve any other matters that may properly come before the Annual Meeting for shareholder consideration.

Abstentions with respect to the election of directors will have no effect on the outcome of the vote. Abstentions with respect to each of the other proposals will have the same effect as an **AGAINST** vote.

Broker non-votes will not be counted for purposes of determining the number of votes present in person or represented by proxy at the Annual Meeting and entitled to vote with respect to any proposal that is a non-routine matter and therefore will have no effect on the outcome of the vote on that proposal. Proposals 1, 2, 3 and 5 are non-routine matters, but the ratification of the appointment of the independent registered public accounting firm is a routine matter.

Votes cast by proxy or in person at the Annual Meeting will be tabulated by the inspectors of election appointed for the Annual Meeting, who also will determine whether a quorum is present.

Voting of Proxies

Shares of Common Stock represented by duly executed and unrevoked proxies in the form of the accompanying proxy will be voted at the Annual Meeting in accordance with specifications made therein by the

shareholders, unless authority to do so is withheld. If no specification is made, shares represented by duly executed and unrevoked proxies in the form of the accompanying proxy will be voted **FOR** proposals 1, 2, 3 and 4 and **AGAINST** proposal 5. If your shares of Common Stock are held in street name by your bank, brokerage firm or other nominee, you should instruct your bank, brokerage firm or other nominee on how to vote your shares of Common Stock using the instructions provided by your bank, brokerage firm or other nominee.

How to Vote

Whether or not you plan to attend the Annual Meeting, the Company requests that you complete, sign, date and return the accompanying proxy card or use the telephone or Internet to grant your proxy and vote. Please refer to the Notice of Internet Availability of Proxy Materials or the accompanying proxy card for instructions on how to vote by mail, telephone or the Internet.

If you hold shares of the Company s Common Stock in a stock brokerage account or through a bank, brokerage firm or other nominee, or, in other words, in street name, please follow the voting instructions provided by that entity. If you receive more than one set of proxy materials or voting instructions, it means that you have multiple accounts at the transfer agent and/or with banks, brokerage firms or other nominees. Please follow the voting instructions provided for each set of proxy materials received to ensure that all of your shares are voted.

A number of banks and brokerage firms participate in a program that permits shareholders whose shares are held in street name to direct their vote by telephone or over the Internet. If your shares are held in an account at a bank or brokerage firm that participates in such a program, you may direct the vote of these shares by telephone or over the Internet by following the voting instructions enclosed with the proxy form from the bank or brokerage firm. Directing the voting of your shares will not affect your right to vote in person if you decide to attend the Annual Meeting; however, you must first obtain a signed and properly executed legal proxy from your bank, brokerage firm or other nominee to vote your shares held in street name at the Annual Meeting. Requesting a legal proxy prior to the deadline described above will automatically cancel any voting directions you have previously given by telephone or over the Internet with respect to your shares.

Revoking Your Proxy

If you are the owner of record of your shares of the Company s Common Stock, you can revoke your proxy at any time before its exercise at the Annual Meeting by:

- sending a written notice to the Company, at 680 South Fourth Street, Louisville, Kentucky 40202, Attention: Corporate Secretary, bearing a date later than the date of the proxy, that is received prior to the Annual Meeting and states that you revoke your proxy;
- submitting your proxy again by telephone or over the Internet, so long as you do so before the deadline of 11:59 p.m., Eastern Daylight Time, on May 16, 2012;
- signing another proxy card(s) bearing a later date and mailing it to the address set forth therein so that it is received prior to the Annual Meeting; or
- attending the Annual Meeting and voting in person, although attendance at the Annual Meeting will not, by itself, revoke a proxy.

If your shares of Common Stock are held in street name by your broker, you will need to follow the instructions you receive from your broker to revoke or change your proxy.

Other Voting Matters

Voting in Person

If you plan to attend the Annual Meeting and wish to vote in person, the Company will give you a ballot at the Annual Meeting. However, if your shares of Common Stock are held in street name, you must first obtain from your bank, brokerage firm or other nominee a legal proxy authorizing you to vote the shares in person, which you must bring with you to the Annual Meeting. If your shares of Common Stock are held in street name by your bank, brokerage firm or other nominee, and you plan to attend the Annual Meeting, you must present proof of your ownership of Common Stock such as a bank or brokerage account statement, to be admitted to the meeting.

Persons with Disabilities

The Company can provide reasonable assistance to help you to participate in the Annual Meeting if you inform the Company about your disability and how you plan to attend. Please write to the Company at 680 South Fourth Street, Louisville, Kentucky 40202-2412, Attention: Corporate Secretary, or call at (502) 596-7300.

Proxy Solicitations and Expenses

The cost of preparing, assembling, posting and mailing the Notice of Internet Availability of Proxy Materials (including the notice of Annual Meeting), proxy statement and proxies will be paid by the Company. In addition to the use of the mail, proxies may be solicited by directors, officers and other employees of the Company, without additional compensation, in person, by telephone or other electronic means. The Company has also engaged Georgeson Inc., a proxy solicitation firm, to assist in the solicitation of proxies for a fee estimated not to exceed $25,000, plus reimbursement of expenses. The Company and its proxy solicitors also will request that banks, brokerage houses and other custodians, nominees and fiduciaries send proxy materials to the beneficial owners of Common Stock and will, if requested, reimburse them for their reasonable out-of-pocket expenses in doing so.

Adjournment or Postponement of the Annual Meeting

Although it is not currently expected, the Annual Meeting may be adjourned or postponed, including for the purpose of soliciting additional proxies, if there are insufficient votes at the time of the Annual Meeting because a quorum is not present. Other than an announcement to be made at the Annual Meeting of the time, date and place of an adjourned or postponed meeting, an adjournment or postponement generally may be made without notice. Any adjournment or postponement of the Annual Meeting for the purpose of soliciting additional proxies will allow shareholders who have already sent in their proxies to revoke them at any time prior to their use at the Annual Meeting as adjourned or postponed.

Other Business

The Board of Directors is not aware of any other business to be acted upon at the Annual Meeting. If, however, other matters are properly brought before the Annual Meeting, your proxies will have discretion to vote or act on those matters according to their best judgment and they intend to vote the shares as the Board of Directors may recommend.

PROPOSAL 1. PROPOSAL TO ELECT DIRECTORS

The Board of Directors currently consists of 12 persons. The Board of Directors has nominated the 11 persons listed below to be elected as directors at the Annual Meeting. Ms. Ann C. Berzin, a current director, has notified the Company that she does not wish to stand for re-election to the Board of Directors at the Annual Meeting. Ms. Berzin s term as a member of the Board of Directors will expire upon the conclusion of the Annual Meeting. Consistent with the Company s bylaws, the Board of Directors has unanimously adopted a resolution

to reduce the size of the Board of Directors from 12 to 11 members, effective upon conclusion of the Annual Meeting. Each director elected at the Annual Meeting will serve, subject to the provisions of the Company s bylaws, until the next annual meeting of shareholders or until his or her successor is duly elected and qualified. The names and ages of the nominees proposed for election as directors, all of whom are presently directors of the Company, together with certain information concerning the nominees, are set forth below.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION AS DIRECTORS OF EACH OF THE NOMINEES LISTED BELOW.

Nominees For Director

EDWARD L. KUNTZ (66) has served as Chairman of the Board of Directors of the Company since May 2009. He served as the Executive Chairman of the Board of Directors of the Company from January 2004 to May 2009 and as the Company s Chairman of the Board and Chief Executive Officer from January 1999 to December 31, 2003. He served as President of the Company from November 1998 until January 2002. He also served as Chief Operating Officer and a director of the Company from November 1998 to January 1999. Mr. Kuntz is a director of Rotech Healthcare, Inc. (OTCBB: ROHI), one of the largest providers of home medical equipment and related products and services in the United States, where he chairs the executive compensation committee and serves as a member of the audit and nominating and corporate governance committees. Mr. Kuntz served as a director of PharMerica Corporation (NYSE: PMC), a leading institutional pharmacy services company serving healthcare facilities in the United States, from July 2007 to July 2008. Mr. Kuntz served as Chief Executive Officer of two publicly traded post-acute healthcare companies. His extensive experience with post-acute care, as well as his familiarity and length of service with the Company, position him well to serve as Chairman of the Board of Directors. (1)

JOEL ACKERMAN (46) has served as a director of the Company since December 2008. Mr. Ackerman has served as Chief Executive Officer and a director of Champions Oncology, Inc. (OTC: CSBR), a company engaged in the development of advanced technology solutions and services to personalize the development and use of oncology drugs, since October 2010. Previously, Mr. Ackerman was a Senior Portfolio Fellow with the Acumen Fund, a non-profit global venture fund that uses entrepreneurial approaches to solve the problems of poverty, from November 2009 to July 2010, and Managing Director and head of the Health Services Group at Warburg Pincus LLC (Warburg Pincus), a global private equity firm, from January 1998 to September 2008. Mr. Ackerman is a director of Coventry Health Care, Inc. (NYSE: CVH), a national managed healthcare company, where he chairs the nominating and corporate governance committee. In his role with Warburg Pincus, Mr. Ackerman gained extensive experience with strategic planning, mergers and acquisitions and capital markets in the healthcare services sector. While at Warburg Pincus, he served as an advisor to senior executives of more than 15 healthcare services companies and reviewed over 500 healthcare services opportunities. His experience at Warburg Pincus and his service on the boards of other healthcare related companies serve him well in advising the Company on strategic matters. (1)(2)(3)

JONATHAN D. BLUM (53) has served as a director of the Company since December 2008. Mr. Blum has served as the Senior Vice President and Chief Public Affairs Officer for Yum! Brands, Inc. (NYSE: YUM), the world s largest restaurant company in terms of system restaurants and ranked number 214 in the Fortune 500, since 1997. Mr. Blum has also served as Chief Global Nutrition Officer for Yum! Brands, Inc. since March 2012. Mr. Blum has extensive experience in government and public affairs, corporate brand development and management and corporate communications. As a result of his role at YUM! Brands, Mr. Blum provides valuable insights into public relations matters, corporate compliance and best management practices of multi-site operators with large employee-based operations. (3)(5)

THOMAS P. COOPER, M.D. (67) has served as a director of the Company since May 2003. Dr. Cooper is the founder and Vice Chairman of Vericare Management, Inc. (Vericare), a provider of mental health services to patients in long-term care facilities. Dr. Cooper has served as Vice Chairman of Vericare since January 2012 and as Chairman from 1991 to January 2012. Dr. Cooper is a director of Hanger Orthopedic Group, Inc.

(NYSE: HGR), a leading provider of orthotic and prosthetic patient care services, where he serves as the lead independent director and chairs the corporate governance and nominating committee, as well as a member of the executive compensation committee. Dr. Cooper is also a director of IPC The Hospitalist Company, Inc. (NASDAQ: IPCM), a leading provider of hospitalist services in the United States, where he chairs the quality committee and serves on the executive compensation committee. Dr. Cooper has substantial experience in healthcare from his roles as a practicing physician as well as an entrepreneur in several healthcare ventures. He held senior management positions in companies that provide mental health services, nurse triage services and physician services. Dr. Cooper brings a unique perspective on physician matters, quality of care issues and the business of healthcare. (1)(4)(5)

PAUL J. DIAZ (50) has served as a director of the Company since May 2002, as Chief Executive Officer of the Company since January 1, 2004 and as President of the Company since January 2002. He served as the Chief Operating Officer of the Company from January 2002 to December 31, 2003. Mr. Diaz is a director of Davita, Inc. (NYSE: DVA), a leading provider of kidney care in the United States, where he serves on the nominating and governance and public policy committees. Mr. Diaz served as a director of PharMerica Corporation (NYSE: PMC), a leading institutional pharmacy services company serving healthcare facilities in the United States, from July 2007 to July 2008. Mr. Diaz has served in various executive capacities with other long-term healthcare providers in operational, financial and legal positions. As the sole management representative on the Board, Mr. Diaz provides a unique perspective regarding the business and strategic direction of the Company and has experience in all aspects of the Company s businesses. (1)

CHRISTOPHER T. HJELM (50) has served as a director of the Company since June 1, 2011. He has served as the Senior Vice President and Chief Information Officer of The Kroger Co., which operates approximately 2,500 grocery retail stores in 31 states along with a number of convenience stores, jewelry stores and manufacturing plants, since August 2005. In addition to his role as Chief Information Officer, Mr. Hjelm is responsible for several business units, including convenience, jewelry and fuel. Mr. Hjelm served as a director of RehabCare Group, Inc. (formerly NYSE: RHB) (RehabCare) from July 2007 until June 2011. Mr. Hjelm has gained significant operational and information technology expertise during his tenure with The Kroger Co. that is beneficial to the Company. His service on the board of RehabCare allows him to provide valuable insights into operational and other integration-related matters. (2)(4)

ISAAC KAUFMAN (64) has served as a director of the Company since April 2001. Since September 1998, Mr. Kaufman has served as the Senior Vice President and Chief Financial Officer of Advanced Medical Management Inc., a manager of medical practices and an outpatient surgical center. Mr. Kaufman is a director of TransWorld Entertainment Corporation (NASDAQ: TWMC), a leading specialty retailer of entertainment software, including music, video and video games and related products, where he chairs the audit committee and serves on the compensation committee and the nominating and governance committee. Mr. Kaufman is also a director of Hanger Orthopedic Group, Inc. (NYSE: HGR), a leading provider of orthotic and prosthetic patient care services, where he chairs the audit committee and serves on the corporate governance and nominating committee. Mr. Kaufman has served in senior financial roles with healthcare companies and is a certified public accountant. In these roles, he has gained significant experience in financial and accounting matters, Sarbanes-Oxley compliance and corporate governance issues. He also has substantial experience with over 40 years of cumulative service on public company boards and currently chairs the two aforementioned audit committees. (2)(4)

FREDERICK J. KLEISNER (67) has served as a director of the Company since March 2009. Since October 2007, Mr. Kleisner has served as President and a director of Hard Rock Hotel Holdings, LLC, a destination casino and resort company. Mr. Kleisner served as President and Chief Executive Officer of Morgans Hotel Group Co. (NASDAQ: MHGC), a hospitality company that owns, operates, acquires, develops and redevelops boutique hotels in the United States and Europe, from September 2007 to March 2011 and as a director from February 2006 to March 2011. From January 2006 to September 2007, Mr. Kleisner served as the President, Chairman and Chief Executive Officer of Rex Advisors, LLC, a hotel advisory firm. From March 2000 to January 2006, Mr. Kleisner was the Chairman, President and Chief Executive Officer of Wyndham

International, Inc., a global hospitality company that operates and develops hotels and vacation ownership resorts. Since April 2008, Mr. Kleisner has served as a Director and Trustee of Innkeepers USA Trust (previously Other-OTC: INKPP), a real estate investment trust. Mr. Kleisner also serves as a director and member of the audit and compensation committees of Apollo Residential Mortgage, Inc. (NYSE: AMTG), a residential real estate finance company that is focused primarily on investing in, financing, and managing mortgage-backed securities, residential mortgage loans, and other residential mortgage assets in the United States. Mr. Kleisner has substantial management experience in operating multi-site locations in the hospitality industry. His prior tenure in a Chief Executive Officer position along with his experience at other hotel operators has provided him with strong operating, market repositioning and financial management experience. (4)(5)

EDDY J. ROGERS, JR. (71) has served as a director of the Company since August 2003. Mr. Rogers has been a partner with the law firm of Andrews Kurth LLP since October 2001. During his over 40 years of legal practice, Mr. Rogers has focused his practice on venture capital, mergers and acquisitions, executive compensation, restructurings and general corporate matters, and has represented several clients in the healthcare industry. In addition, Mr. Rogers has previously served on the board of directors of other healthcare companies. His substantial legal and business experience uniquely positions him to provide valuable insight on corporate governance, compliance, operations and corporate strategy, including acquisition and development activities. (2)(3)

JOHN H. SHORT, Ph.D. (67) has served as a director of the Company since June 1, 2011. Mr. Short has been Executive Chairman of the Board of Directors of Vericare since March 2012. He served as President and Chief Executive Officer of RehabCare (formerly NYSE: RHB) from May 2004 until June 1, 2011, and as a director from 1991 to June 1, 2011. Mr. Short serves as a principal of Short Consulting, LLC, a firm that provides business consulting services to a broad range of healthcare providers. His substantial experience as a former Chief Executive Officer and director of RehabCare uniquely positions him to advise the Company on strategic, operational and integration-related matters. (1)(5)

PHYLLIS R. YALE (54) has served as a director of the Company since January 1, 2010. Ms. Yale has been a senior advisor with Bain & Company Inc., a global management consulting firm, since July 2010. Ms. Yale was a partner with Bain & Company Inc. from 1987 to July 2010. Ms. Yale served as a director of NeighborCare, Inc. (formerly NASDAQ:NCRX), an institutional pharmacy provider to nursing centers between 2003 and 2005, and as a director of the now privately-held Pediatric Services of America, Inc., a comprehensive pediatric home healthcare services provider, from February 2006 to April 2007. In her role at Bain, Ms. Yale has obtained a deep knowledge base in several segments of the healthcare industry. Her experience includes advising healthcare clients on corporate strategies, marketing, cost and quality management as well as mergers and acquisitions. (1)(3)(5)

(1) Member of the Strategic Development Committee of which Mr. Diaz is Chair.
(2) Member of the Nominating and Governance Committee of which Ms. Berzin is Chair.
(3) Member of the Executive Compensation Committee of which Mr. Rogers is Chair.
(4) Member of the Audit Committee of which Mr. Kaufman is Chair.
(5) Member of the Quality and Compliance Committee of which Dr. Cooper is Chair.

The information contained in this proxy statement concerning the nominees is based upon statements made or confirmed to the Company by or on behalf of such nominees, except to the extent certain information appears in its records. Directors ages are given as of January 1, 2012.

SHARES OF COMMON STOCK OF THE COMPANY REPRESENTED BY PROXIES EXECUTED AND RETURNED PURSUANT TO THE INSTRUCTIONS SET FORTH IN THE NOTICE OF INTERNET AVAILABILITY OF PROXY MATERIALS WILL BE VOTED FOR THE ELECTION AS DIRECTORS OF ALL OF THE NOMINEES, UNLESS OTHERWISE SPECIFIED. The Board of Directors does not contemplate that any of the nominees will be unable to serve as a director. However, in the event that one or more nominees are unable or unwilling to accept or are unavailable to serve, the persons named in the proxies or their substitutes will have the authority, according to their judgment, to vote or refrain from voting for other individuals as directors.

CORPORATE GOVERNANCE AND BOARD MATTERS

Board Meetings and Committees

During 2011, the Board of Directors held seven meetings, including six regular meetings and one special meeting. During 2011, each director attended more than 75% of the total number of meetings held by the Board of Directors and each committee of which he or she was a member.

The Board of Directors has established an Audit Committee, a Quality and Compliance Committee, an Executive Compensation Committee, a Nominating and Governance Committee and a Strategic Development Committee. Each committee has a written charter, which is available on the Company s website at *www.kindredhealthcare.com*. The Company s Corporate Governance Guidelines also are available on its website. Information on the Company s website is not part of this proxy statement.

Audit Committee

The Audit Committee has five members consisting of Mr. Isaac Kaufman (Chair), Ms. Ann C. Berzin, Thomas P. Cooper, M.D., Mr. Christopher T. Hjelm and Mr. Frederick J. Kleisner. As previously noted, Ms. Berzin has notified the Company that she does not wish to stand for re-election to the Board of Directors, and her term as a member of the Board and the Audit Committee will expire upon the conclusion of the Annual Meeting. Each member of the Audit Committee is independent and financially literate as defined under the listing standards of the NYSE. The Board of Directors has determined that each member of the Audit Committee qualifies as an audit committee financial expert as defined in Item 407 of Regulation S-K promulgated under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the Exchange Act). The Audit Committee held six meetings during 2011. The Audit Committee assists the Board of Directors in monitoring: (1) the adequacy of the Company s system of internal controls, accounting policies, financial reporting practices, and the quality and integrity of the Company s financial reporting; (2) the independent registered public accounting firm s qualifications and independence; (3) the performance of the Company s internal audit function and independent registered public accounting firm; and (4) the Company s compliance with legal and regulatory requirements.

Quality and Compliance Committee

The Quality and Compliance Committee has five members consisting of Thomas P. Cooper, M.D. (Chair), Mr. Jonathan D. Blum, Mr. Frederick J. Kleisner, Mr. John H. Short and Ms. Phyllis R. Yale. All members of the Quality and Compliance Committee are independent as defined under the listing standards of the NYSE except for Mr. Short. The Quality and Compliance Committee held four meetings during 2011. The Quality and Compliance Committee assists the Board of Directors in overseeing, monitoring, and evaluating the Company s: (1) compliance with applicable healthcare laws, regulations, policies, professional standards and industry guidelines; (2) compliance with the Company s Code of Conduct; and (3) programs, policies, procedures and performance improvement practices that support and enhance the quality of care provided by the Company.

Executive Compensation Committee

The Executive Compensation Committee has four members consisting of Mr. Eddy J. Rogers, Jr. (Chair), Mr. Joel Ackerman, Mr. Jonathan D. Blum and Ms. Phyllis R. Yale. Each member of the Executive Compensation Committee is independent as defined under the listing standards of the NYSE, qualifies as an outside director within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), and qualifies as a non-employee director within the meaning of Rule 16b-3 under the Exchange Act. The Executive Compensation Committee held five meetings during 2011. The Executive Compensation Committee assists the Board of Directors in fulfilling its responsibility to the shareholders, potential shareholders and the investment community by ensuring that the Company s key executives, officers and Board members are compensated in accordance with the Company s overall compensation policies and executive compensation

program. The Executive Compensation Committee recommends and approves compensation policies, programs and pay levels that are necessary to support the Company s objectives and that are rational and reasonable to the value of the services rendered. The Executive Compensation Committee also reviews and discusses with management the Compensation Discussion and Analysis prepared for inclusion in this proxy statement and, based upon such review, determines whether to recommend to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement. Furthermore, the Executive Compensation Committee prepared the section entitled Compensation Committee Report on page 59 of this proxy statement.

The Executive Compensation Committee s processes and procedures for the consideration and determination of executive compensation, including the role of the Company s Chief Executive Officer in making recommendations to the Executive Compensation Committee and the role of compensation consultants in assisting the Executive Compensation Committee in its functions, are more fully described below in the section entitled Compensation Discussion and Analysis beginning on page 16 of this proxy statement.

Nominating and Governance Committee

The Nominating and Governance Committee has five members consisting of Ms. Ann C. Berzin (Chair), Mr. Joel Ackerman, Mr. Christopher T. Hjelm, Mr. Isaac Kaufman and Mr. Eddy J. Rogers, Jr. As previously noted, Ms. Berzin has notified the Company that she does not wish to stand for re-election to the Board of Directors, and her term as a member of the Board and the Nominating and Governance Committee will expire upon the conclusion of the Annual Meeting. Each member of the Nominating and Governance Committee is independent as defined under the listing standards of the NYSE. The Nominating and Governance Committee held four meetings during 2011. The Nominating and Governance Committee assists the Board of Directors by: (1) identifying individuals qualified to become members of the Board of Directors, approving the director nominees for the next annual meeting of shareholders and approving nominees to fill vacancies on the Board of Directors; (2) recommending to the Board of Directors nominees for director and chair(s) for each committee; (3) leading the Board of Directors in its annual review of the Board of Directors and senior management s performance; and (4) recommending to the Board of Directors the Corporate Governance Guidelines applicable to the Company. The Nominating and Governance Committee also recommends to the Board of Directors whether or not to accept the expected resignation of any director who fails to receive the required vote for re-election in any uncontested election as set forth in the Company s bylaws and Corporate Governance Guidelines, or whether other action should be taken.

Strategic Development Committee

The Strategic Development Committee has six members consisting of Mr. Paul J. Diaz (Chair), Mr. Joel Ackerman, Thomas P. Cooper, M.D., Mr. Edward L. Kuntz, Mr. John H. Short and Ms. Phyllis R. Yale. With the exception of Messrs. Diaz, Kuntz and Short, each member of the Strategic Development Committee is independent as defined under the listing standards of the NYSE. The Strategic Development Committee held one meeting during 2011. The Strategic Development Committee assists the Board of Directors and management in the development and evaluation of the Company s business and strategic initiatives.

Compensation Committee Interlocks and Insider Participation

None of the persons who served on the Executive Compensation Committee during the last completed fiscal year is, or has been, an employee or officer of the Company or had any relationship requiring disclosure under Item 404 of Regulation S-K. In addition, none of the Company s executive officers serves, or has served during the last completed fiscal year, as a member of the board of directors or compensation committee of any other entity that has or has had one or more of its executive officers serving as a member of the Board of Directors.

Director Independence

The Board of Directors has determined that the following nine directors are independent, as defined under the listing standards of the NYSE: Mr. Joel Ackerman, Ms. Ann C. Berzin, Mr. Jonathan D. Blum, Thomas P. Cooper, M.D., Mr. Christopher T. Hjelm, Mr. Isaac Kaufman, Mr. Frederick J. Kleisner, Mr. Eddy J. Rogers, Jr. and Ms. Phyllis R. Yale.

The independent directors have regularly scheduled meetings at which members of management are not present. The Company s lead independent director presides as chair of these meetings. Thomas P. Cooper, M.D. has served as the Company s lead independent director since May 2009.

The Board of Directors independence determination for each director was based upon a review in which each director s independence was evaluated on a case-by-case basis. In performing the independence evaluations, the Board of Directors considers any matters that could affect the ability of each outside director to exercise independent judgment in discharging his or her responsibilities as a director, including all transactions and relationships between each such director, the director s family members and organizations with which the director or the director s family members have an affiliation and the Company, its subsidiaries and its management. Any such matters are evaluated both from the standpoint of the director and from that of persons or organizations with which the director has an affiliation. In addition, the Board of Directors also considers any other transactions, relationships or arrangements that could affect director independence.

In 2011, the Board of Directors reviewed relationships between the Company and other entities for which a director of the Company also serves as a director. This review included analysis of ordinary course business transactions between the Company and: (1) Coventry Health Care, Inc. for which Mr. Ackerman serves as a non-employee director; (2) Champions Oncology, Inc. for which Mr. Ackerman serves as Chief Executive Officer and a director; (3) Ingersoll-Rand plc for which Ms. Berzin serves as a non-employee director; (4) Constellation Energy Group, Inc., an entity acquired by Exelon Corporation in March 2012 for which Ms. Berzin served as a non-employee director during 2011; (5) Hanger Orthopedic Group, Inc. for which Dr. Cooper and Mr. Kaufman serve as non-employee directors; (6) IPC The Hospitalist Company, Inc. for which Dr. Cooper serves as a non-employee director; and (7) Trident USA Health Service for which Dr. Cooper serves as a non-employee director.

In this review, the Board of Directors identified no transactions, relationships or arrangements in which a director of the Company had or will have a direct or indirect material interest or which otherwise adversely impacted the Board of Directors independence evaluation of the applicable outside directors.

Board Leadership Structure and Role in Risk Oversight

The Board of Directors has no policy with respect to the separation of the offices of Chairman of the Board of Directors and the Chief Executive Officer. The Board of Directors believes that this issue is part of the succession planning process and that it is in the best interests of the Company for the Board of Directors to make a determination when it elects a new Chief Executive Officer. Currently, the Board of Directors has elected to separate the roles of Chairman of the Board of Directors and Chief Executive Officer.

In addition, it is the policy of the Board of Directors that a lead independent director be chosen annually by the independent directors from among the independent directors. Dr. Cooper currently serves as the Company s lead independent director. The lead independent director: (1) presides at all meetings of the directors at which the Chairman of the Board of Directors is not present, including all meetings of the independent directors; (2) serves as a liaison between the Chairman of the Board of Directors and the independent directors; (3) has the authority to call meetings of the independent directors; and (4) is available for direct communication with the Company s shareholders.

The independent directors meet in executive session at least quarterly to consider such matters as they deem appropriate, including, but not limited to, a review of the performance of the Chief Executive Officer.

The Board of Directors annually reviews a company-wide enterprise risk assessment, as presented by the Company s senior strategy, risk management and internal audit executives. This presentation is intended to give the Board of Directors a current view of the Company s primary operational, compliance, financial and strategic risks, on both a company-wide as well as a division-specific basis. In addition to this annual enterprise risk assessment, an evaluation of principal areas of risk and corresponding mitigation strategies are examined in further detail during the year by: (1) the Board of Directors regarding key strategic risks; (2) the Audit Committee regarding key financial risks; (3) the Quality and Compliance Committee regarding key operational and quality risks; and (4) the Executive Compensation Committee regarding the relationship of the Company s executive compensation program and risk.

Policies Governing Director Nominations

It is the policy of the Nominating and Governance Committee to consider director candidates recommended by shareholders in accordance with the procedures set forth below and who appear to be qualified to serve on the Board of Directors. The Nominating and Governance Committee may choose not to consider an unsolicited recommendation if no vacancy exists on the Board of Directors. There have been no material changes to the procedures by which shareholders may recommend director candidates since the Company last disclosed such procedures.

To submit a recommendation of a director candidate to the Nominating and Governance Committee, a shareholder should submit the following information in writing, addressed to the Chair of the Nominating and Governance Committee, care of the Corporate Secretary, at the Company s principal office:

1. the name of the person recommended as a director candidate;

2. all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors pursuant to Regulation 14A under the Exchange Act;

3. the written consent of the person being recommended as a director candidate to being named in the proxy statement as a nominee and to serving as a director if elected;

4. as to the shareholder making the recommendation, the name and address, as they appear on the Company s records, of such shareholder; provided, however, that if the shareholder is not a registered holder of the Company s Common Stock, the shareholder should submit his or her name and address along with a current written statement from the record holder of the shares that reflects ownership of the Company s Common Stock, and the number and class of all shares of each class of stock of the Company owned of record or beneficially by such holder; and

5. a statement disclosing whether such shareholder is acting with or on behalf of any other person and, if applicable, the identity of such person.

In order for a director candidate to be considered for nomination at the Company s annual meeting of shareholders to be held in 2013, the recommendation must be received in accordance with the requirements for other shareholder proposals.

The Nominating and Governance Committee has generally identified director nominees based upon suggestions by outside directors, members of management and/or shareholders and outside search firms, and has interviewed and evaluated those persons on its own. On occasion, the Company engages outside search firms to identify and screen potential director candidates.

As set forth in its written charter, the Nominating and Governance Committee generally will seek directors who possess integrity, a high level of education and business experience, broad-based business acumen, an

understanding of the Company s business and the healthcare industry in general, strategic thinking and a willingness to share ideas, a network of contacts and diversity of experiences, expertise and backgrounds. Further, as set forth in the Company s Corporate Governance Guidelines, the Nominating and Governance Committee is responsible for annually reviewing with the Board of Directors the requisite skills and characteristics of new Board members, as well as the composition of the Board of Directors as a whole. This assessment includes a review of each director s independence, as well as consideration of diversity, age, skills, expertise and experience in the context of the needs of the Board of Directors. While the Corporate Governance Guidelines do not prescribe diversity standards, as a matter of practice, the Nominating and Governance Committee considers diversity in the context of the Board of Directors as a whole and takes into account the personal characteristics and experience of current and prospective directors to facilitate deliberations that reflect a broad range of perspectives. The Nominating and Governance Committee uses the above criteria to evaluate potential nominees, and does not evaluate proposed nominees differently depending upon who has made the proposal. The Nominating and Governance Committee reviews current directors who may be proposed for re-election considering the factors described above and their past contributions to the Board of Directors. In so doing, the Nominating and Governance Committee has determined that the directors proposed for election at the Annual Meeting have experience, skills and qualifications consistent with the principles set out in the charter of the Nominating and Governance Committee as described above under Nominees for Director.

Director Attendance at Annual Meetings of Shareholders

The Board of Directors does not require directors to attend the annual meeting of shareholders. Mr. Diaz attended the 2011 annual meeting of shareholders.

Code of Business Conduct and Ethics

The Company has adopted a Code of Conduct that serves as its code of ethics and applies to all of the Company s directors and employees, including the principal executive officer, principal financial officer, principal accounting officer, and certain other persons performing similar functions. The text of the Company s Code of Conduct is posted on the Company s website located at *www.kindredhealthcare.com* under the Investors section and is available in print to any requesting shareholder. Information contained on the Company s website is not part of this proxy statement. In addition, the Company intends to disclose on its website: (1) the nature of any amendment to a provision of the Code of Conduct that applies to the Company s principal executive officer, principal financial officer, principal accounting officer, or persons performing similar functions; and (2) the nature of any waiver, including an implied waiver, from provisions of the Code of Conduct that is granted to one of these specified individuals (which may only be made by the Board of Directors or a Board committee), the name of the person to whom the waiver was granted and the date of the waiver. Such disclosure will be made within four business days following the date of the applicable amendment or waiver.

The Code of Conduct generally prohibits the Company s directors, executive officers and employees from engaging in activities that conflict with the interests of the Company and the residents and patients served by the Company. Situations that may give rise to a potential conflict of interest under the Code of Conduct include: (1) having a material direct or indirect financial or business interest in any entity that does business with the Company; (2) having a direct or indirect financial or business interest in any transaction between the Company and a third party; and (3) serving as a director, officer, employee, consultant or agent of an organization that does business with the Company.

To facilitate compliance with these rules, the Code of Conduct requires that individuals report to their supervisors, or to the Board of Directors in the case of directors and executive officers, circumstances that may create or appear to create a conflict between the personal interests of the individual and the interests of the Company, regardless of the amount involved. In addition, each director and executive officer annually confirms to the Company certain information about potential related person transactions as part of the preparation of the Company s Annual Report on Form 10-K and its annual proxy statement. Director nominees and persons

promoted to executive officer positions also must confirm such information. In addition, management reviews its records and makes additional inquiries of management personnel and, as appropriate, third parties and other resources for purposes of identifying related person transactions, including related person transactions involving beneficial owners of more than 5% of the Company s voting securities.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company s directors and executive officers and persons who own more than 10% of the Common Stock of the Company to file initial stock ownership reports and reports of changes in ownership with the SEC. Based upon a review of these reports and on written representations from the Company s directors and executive officers that no other reports were required, the Company believes that the applicable Section 16(a) reporting requirements were complied with for all transactions that occurred in 2011, except as noted below.

On March 21, 2011, Richard A. Lechleiter, Executive Vice President and Chief Financial Officer, filed two Form 4/As to reflect the tendering of Common Stock in connection with his exercise of stock options, and to amend the amount of Common Stock beneficially owned by him after such tendering, updating his Form 4 filings from March 4, 2011 and March 10, 2011, respectively.

Related Person Transactions

In accordance with the charter for the Audit Committee of the Board of Directors, the Audit Committee evaluates each related person transaction involving a director or executive officer for the purpose of determining whether to recommend to the disinterested members of the Board that the transactions are fair, reasonable and within Company policy, and whether they should be ratified and approved by the Board. The Audit Committee considers each related person transaction in light of all relevant factors and the controls implemented to protect the interests of the Company and its shareholders.

Relevant factors include:

- the benefits of the transaction to the Company;
- the terms of the transaction and whether the terms have been negotiated at arm s-length and in the ordinary course of the Company s business;
- the direct or indirect nature of the related person s interest in the transaction;
- the amount involved and the expected term of the transaction; and
- other facts and circumstances that bear on the materiality of the related person transaction under applicable law and listing standards.

Approval by the Board of Directors of any related person transaction involving a director also must be made in accordance with applicable law and the Company s organizational documents as from time to time in effect. When a vote of the disinterested directors is required, such vote is called only following full disclosure to such directors of the facts and circumstances of the relevant related person transaction. Transactions that are not approved or ratified as required by the Code of Conduct are subject to termination by the Company, if so directed by an employee s supervisor, the Audit Committee or the Board of Directors, as applicable, taking into account such factors as such individual or body deems appropriate and relevant. Based upon its review, the Audit Committee did not identify any related person transactions under Item 404 of Regulation S-K for 2011 or that are currently proposed.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding beneficial ownership of the Common Stock as of March 1, 2012 by (1) each person who is a director or nominee for director, (2) each of the Company s named executive officers, (3) all of the persons who are directors and executive officers of the Company, as a group, and (4) each shareholder known by the Company to be the beneficial owner of more than 5% of its outstanding shares of Common Stock.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class (1)
Directors, Nominees and Named Executive Officers		
Edward L. Kuntz	342,659	*
Paul J. Diaz	1,044,641	2.0%
Joel Ackerman	23,796	*
Ann C. Berzin	41,216	*
Jonathan D. Blum	23,796	*
Thomas P. Cooper, M.D.	59,651	*
Christopher T. Hjelm	12,770	*
Isaac Kaufman	63,690	*
Frederick J. Kleisner	23,796	*
Eddy J. Rogers, Jr.	68,694	*
John H. Short, Ph.D.	79,288	*
Phyllis R. Yale	14,246	*
Richard A. Lechleiter	274,753	*
Benjamin A. Breier	163,219	*
Lane M. Bowen	161,580	*
Richard E. Chapman	122,463	*
All Directors and Executive Officers as a Group (22 persons)	2,940,599	5.5%
Other Security Holders with More than 5% Ownership		
T. Rowe Price Associates, Inc. (2)	4,949,283	9.5%
Wellington Management Company, LLP (3)	4,315,325	8.3%
BlackRock, Inc. (4)	3,976,101	7.6%
Dimensional Fund Advisors LP (5)	3,661,045	7.0%
Snow Capital Management, L.P. (6)	2,899,089	5.6%
The Vanguard Group, Inc. (7)	2,805,392	5.4%

* Denotes less than 1%.

(1) Includes shares subject to stock options which are exercisable within 60 days from March 1, 2012. The number of shares of Common Stock that may be acquired through exercise of stock options, which are exercisable as of, or within 60 days after, March 1, 2012, are as follows: Mr. Kuntz 204,332 shares; Mr. Diaz 614,023 shares; Mr. Ackerman 11,250 shares; Ms. Berzin 26,170 shares; Mr. Blum 11,250 shares; Dr. Cooper 47,105 shares; Mr. Kaufman 35,328 shares; Mr. Kleisner 11,250 shares; Mr. Rogers 53,648 shares; Mr. Lechleiter 164,244 shares; Mr. Breier 56,526 shares; Mr. Bowen 74,922 shares; and Mr. Chapman 60,115 shares. Unless otherwise noted, the Company believes that all persons named in the table have sole voting and investment power with respect to all shares of Common Stock beneficially owned by them. The total for Mr. Lechleiter includes his indirect beneficial ownership of 2,000 shares held by his wife as custodian for his children under the Uniform Transfer to Minors Act.

(2) Based upon a Schedule 13G jointly filed by T. Rowe Price Associates, Inc. (T. Rowe Price) and T. Rowe Price Mid-Cap Value Fund, Inc. (Mid-Cap Value Fund) with the SEC on February 8, 2012. According to the Schedule 13G, T. Rowe Price is an investment adviser and Mid-Cap Value Fund is an investment company for which T. Rowe Price serves as investment adviser. Their address is 100 E. Pratt Street,

Baltimore, Maryland 21202. T. Rowe Price has sole voting power over 684,338 shares of Common Stock and sole dispositive power over 4,949,283 shares of Common Stock. For purposes of the reporting requirements of the Exchange Act, T. Rowe Price is deemed to be a beneficial owner of Common Stock; however, T. Rowe Price expressly disclaims that it is, in fact, the beneficial owner of such shares of Common Stock. Mid-Cap Value Fund beneficially owns and maintains sole voting power over 4,237,000 shares of Common Stock.

(3) Based upon a Schedule 13G/A filed by Wellington Management Company, LLP (Wellington) with the SEC on February 14, 2012. According to the Schedule 13G/A, Wellington is an investment adviser with an address of 280 Congress Street, Boston, Massachusetts 02210. Wellington has shared voting power over 1,563,006 shares of Common Stock and shared dispositive power over 4,315,325 shares of Common Stock. For purposes of the reporting requirements of the Exchange Act, Wellington, in its capacity as an investment adviser, may be deemed to be a beneficial owner of such shares of Common Stock, which are held of record by the clients of Wellington.

(4) Based upon a Schedule 13G/A filed by BlackRock, Inc. (BlackRock) with the SEC on February 13, 2012. According to the Schedule 13G/A, BlackRock is a parent holding company for subsidiaries that hold Common Stock. The address of BlackRock is 40 East 52nd Street, New York, New York 10022. BlackRock has sole voting and dispositive power over 3,976,101 shares of Common Stock.

(5) Based upon a Schedule 13G/A filed by Dimensional Fund Advisors LP (Dimensional) with the SEC on February 14, 2012. According to the Schedule 13G/A, Dimensional, as an investment adviser, furnishes investment advice to four investment companies and serves as investment manager to certain other commingled group trusts and separate accounts (which are collectively referred to as the Funds). As further qualified below, Dimensional has sole voting power over 3,592,706 shares of Common Stock and sole dispositive power over 3,661,045 shares of Common Stock. According to the Schedule 13G/A, in its role as investment adviser, sub-adviser or manager, Dimensional and its subsidiaries may be deemed to be the beneficial owner of the shares of Common Stock owned by the Funds, but Dimensional and its subsidiaries disclaim beneficial ownership of such shares of Common Stock. The address of Dimensional is Palisades West, Building One, 6300 Bee Cave Road, Austin, Texas 78746.

(6) Based upon a Schedule 13G/A filed by Snow Capital Management, L.P. (Snow Capital) with the SEC on February 2, 2012. According to the Schedule 13G/A, Snow Capital is an investment adviser with an address of 2100 Georgetowne Drive, Suite 400, Sewickley, PA 15143. Snow Capital has sole voting power over 2,862,664 shares of Common Stock and sole dispositive power over 2,899,089 shares of Common Stock.

(7) Based upon a Schedule 13G filed by The Vanguard Group, Inc. (Vanguard) with the SEC on February 9, 2012. According to the Schedule 13G, Vanguard is an investment adviser with an address of 100 Vanguard Blvd., Malvern, Pennsylvania 19355. Vanguard has sole voting power over 80,181 shares of Common Stock, sole dispositive power over 2,725,211 shares of Common Stock, and shared dispositive power over 80,181 shares of Common Stock. Vanguard Fiduciary Trust Company (VFTC), a wholly-owned subsidiary of Vanguard, is the beneficial owner of 80,181 shares of Common Stock as a result of its serving as investment manager of collective trust accounts. VFTC directs the voting of these shares.

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

COMPENSATION DISCUSSION AND ANALYSIS

Executive Summary

The Company s executive compensation program is designed to (1) motivate and retain executive officers, (2) award the achievement of short-term and long-term performance goals, (3) establish a reasonable and appropriate relationship between executive pay and short-term and long-term performance and (4) align executive officers interests with those of the Company s stockholders. The primary elements of the Company s compensation program are base salary, annual cash incentive awards, long-term cash incentive awards, equity-based compensation and other perquisites and benefits. The Company believes that each element supports one or more of the objectives of the Company s executive compensation program and provides sufficient flexibility to its Executive Compensation Committee (the Committee) to structure future awards to address new issues and challenges facing the Company.

The Company s executive compensation program generally attempts to target total direct compensation for the named executive officers between the 50th and 75th percentiles of the Company s peers, depending upon the individual performance of the named executive officer, his level of responsibility, and the performance of the Company. While the Committee uses this range as a measure of competitiveness, it ultimately uses its discretion to provide appropriate compensation to attract and retain qualified and experienced healthcare executives and to respond to issues impacting the Company, the healthcare industry and the general economy.

The Committee structures the executive compensation program to address the stated objectives referenced above and remain responsive to the challenges arising from a changing healthcare landscape. At the 2011 annual meeting of shareholders, the non-binding advisory vote to approve the Company s compensation for its named executive officers received a greater than 82% favorable vote. Despite the high approval rating, the Committee continues to reevaluate the Company s executive compensation program to best achieve its stated objectives. The following highlights the key approaches used by the Committee during 2011 as it evaluated executive compensation.

Pay for Performance. The Committee continues to link total direct compensation for the named executive officers with various measures of performance contained in its cash incentive plans and performance-based equity awards. The Committee has established several financial goals that encourage the named executive officers to strive for appropriate financial results related to the Company s operating budget and key financial measures. The Committee also establishes objective quality goals under the Company s short-term incentive plan to maintain long-term focus on the quality and customer service objectives of the Company. The Committee believes that providing quality services is critical in achieving favorable short-term and long-term financial results.

During 2011, the Committee also completed its annual evaluation of the performance metrics used in the Company s short-term and long-term incentive plans, including any risks such performance metrics might create or encourage. The Committee concluded that while there are challenges with having a large number of performance metrics, the selected metrics create several advantages, including:

- ensuring through performance and financial hurdles that earnings will be sufficient to justify payouts;
- creating a balanced view of the Company s performance, focusing on both financial results and how those results are achieved;
- reducing the risk that results could be manipulated to achieve improper payouts; and
- accurately reflecting the complexity of the Company s operating model with support center payouts being directly linked to the results of the Company s operating divisions.

Significant Portion of Executive Officers Pay is at Risk. The Committee places a significant portion of total compensation of the named executive officers at risk by using performance measures in connection with the Company s short-term and long-term cash incentive plans, as well as performance-based equity awards. For 2011, the average at risk compensation for the named executive officers approximated 80% of their total cash and equity compensation. In February 2011, the Committee reaffirmed the financial performance hurdles for the Company s short-term incentive plan. The Committee provided that if the participants fail to satisfy 95% of the targeted corporate earnings before interest, income taxes, depreciation, amortization and rent (EBITDAR) goal or 92.5% of the targeted segment earnings before interest, income taxes, depreciation, amortization, rent and corporate overhead (EBITDARM) goal, or experience issues with poor survey and quality measures, or significant audit or compliance issues, then all or a portion of any short-term award could be forfeited, at the Committee s discretion, even if other component goals of the award had been achieved. The Committee believes that these financial hurdles are appropriate since a significant portion of the goals under the short-term incentive plan are based solely on quality and customer service measures.

Responsiveness to Regulatory Changes. The Committee adjusts executive compensation to address the realities of a difficult operating environment for post-acute healthcare companies. On July 29, 2011, the Centers for Medicare and Medicaid Services announced final rules which, among other things, significantly reduced Medicare payments to the Company s nursing centers and changed the reimbursement provisions related to the Company s rehabilitation business effective October 1, 2011. In August 2011, Congress passed the Budget Control Act of 2011 which the Company believes will result in an additional automatic 2% reduction on each claim submitted by the Company to Medicare beginning in February 2013. The Company believes that these Medicare reimbursement changes were the impetus to a material reduction in the market value of the Company s Common Stock in the latter part of 2011.

In response to these reductions in Medicare reimbursement, the Company has initiated several mitigation strategies. To that end, the Committee took several actions in February and March 2012 to reduce compensation as part of an overall mitigation strategy. These actions include:

- Reducing the 2012 short-term target bonus for the named executive officers by 20%;
- Reducing the base salaries for Mr. Diaz by 10% and for the other named executive officers by 5%;
- Reducing the number of participants in the Company s long-term incentive plan by approximately 45%; and
- Reducing the 2012 quarterly cash retainer paid to the members of the Board of Directors by 10%.

The Company, like many other post-acute healthcare providers, faces continuing challenges in 2012 and beyond in response to the recent and further impending Medicare reimbursement reductions, healthcare reform and reductions in Medicaid reimbursement. Nevertheless, the Committee believes the Company s executive compensation program provides sufficient flexibility to retain and motivate its named executive officers during a difficult operating environment and allows the Committee the ability to respond to the Company s economic challenges. Moreover, the Committee believes the current program is heavily weighted to achievement of performance measures and at risk pay. As such, the Committee does not believe it is necessary to substantially deviate from its current compensation practices at this time.

Responding to Best Pay Practices. The Committee has responded to best practices in executive compensation over the last few years including moving to performance-based equity awards, amending the Company s change in control severance agreements to eliminate a single trigger in favor of providing a double trigger and modifying the Company s stock ownership requirements in response to comments from stockholders. During 2011, the Committee also spent a considerable amount of time evaluating several structural changes to the Company s long-term incentive plan, primarily with the objective of promoting more emphasis on long-term performance. Given the high level of uncertainty in the federal and state reimbursement environment, the Committee elected not to make any structural changes in the long-term incentive plan during 2011. In 2012, the Committee intends to further evaluate ways to tie a greater percentage of named executive officer compensation to long-term performance.

Significant Compensation Results in 2011

In 2011, the Company completed the acquisition of RehabCare (the RehabCare Merger) and the related integration and realization of significant cost synergies. In February 2011, the Committee elected to provide increases in the base salaries to the named executive officers. The Committee viewed these increases as appropriate given that the base salaries were trending well below the 50th percentile of the Company s peer group and given the expanded size, scope and complexity of the Company s business following several acquisitions, including the RehabCare Merger. In the RehabCare Merger, the Company acquired 32 long-term acute care (LTAC) hospitals, five inpatient rehabilitation hospitals, approximately 1,200 rehabilitation therapy sites of service and 102 hospital-based inpatient rehabilitation units.

During 2011, the Company achieved several of its financial and quality goals provided under the short-term incentive plan, the long-term incentive plan and performance-based equity. The Company experienced strong operating performance in the first three quarters of 2011, but was adversely impacted in the fourth quarter of 2011 by the Medicare regulatory changes discussed above that significantly reduced Medicare revenues in its nursing center and rehabilitation businesses and increased rehabilitation therapy costs during the fourth quarter of 2011. These changes reduced the Company s year-end results and negatively impacted the performance of the named executive officers under the Company s short-term and long-term incentive plans.

The Executive Compensation Process

During 2011, the Committee was comprised of four independent directors. Each director who served on the Committee during 2011 is independent as defined under the NYSE listing standards and qualifies as an outside director within the meaning of Section 162(m) of the Code and as a non-employee director within the meaning of Rule 16b-3 under the Exchange Act. The Committee meets regularly to review and oversee the Company s executive compensation program. The Committee reviews all components of, and makes all decisions regarding, the compensation of the named executive officers.

During the period commencing in December of the prior fiscal year and ending in February of the upcoming fiscal year, the Committee reviews base salaries and incentive compensation targets for the upcoming fiscal year for the Company s key employees, including the named executive officers. During this time, the Committee also determines whether performance targets under each of the incentive plans were achieved for the prior fiscal year. The Committee also considers other executive compensation issues and discusses trends and current topics in executive compensation at various times throughout the year.

The 2011 base salaries for the named executive officers were established in February 2011. The 2011 performance goals under the Company s short-term and long-term cash incentive plans, as well as its performance-based restricted stock units, were also established in February 2011 after review of the Company s 2011 operating budget. As discussed below, the awards under these plans are formulaic, based upon the achievement of objective financial and quality goals established annually by the Committee. Nevertheless, the Committee retains the right to administer these plans in its discretion, including the ability to decrease incentive awards otherwise payable to a named executive officer for unforeseen events or circumstances, such as restatements of the Company s financial statements.

The Committee generally grants equity-based awards to the named executive officers to coincide with the Committee s evaluation of the annual performance of the Company and each named executive officer. Considering equity-based awards at or after the cash incentive plan awards have been determined allows the Committee to consider the value of the equity-based award in relation to the total direct compensation for each named executive officer, enabling the Committee to award total direct compensation that is competitive within the healthcare industry (and, in particular, the Company s peer group) and relative to the performance of the Company and the named executive officer. During 2011, the Committee elected to grant equity awards after the public announcement of the RehabCare Merger, which was favorably received in the marketplace. From time to time, the Committee may grant equity-based awards at other times, particularly in connection with promotions, exceptional performance or changes in a named executive officer s level of responsibility.

As Chief Executive Officer, Mr. Diaz participates frequently in the meetings of the Committee, and the Committee also regularly holds executive sessions not attended by any members of management or any non-independent directors. The Committee discusses Mr. Diaz s compensation with him and then makes decisions with respect to Mr. Diaz s compensation without him present. Mr. Diaz provides written evaluations related to the performance of the Company s other executive officers and discusses the roles and responsibilities of such executive officers with the Committee. Members of the Committee also frequently interact with the Company s executive officers and thereby gain an appreciation of the roles and levels of responsibility, as well as the performance of the executive officers. Mr. Diaz also makes recommendations for the Committee s consideration regarding executive compensation, including base salary, incentive targets, performance measures, equity compensation and any special awards for the Company s executive officers other than himself. The Committee is not obligated to accept Mr. Diaz s recommendations with respect to executive compensation. The other named executive officers do not make recommendations on incentive compensation or otherwise significantly participate in the Committee s compensation decision-making process.

As noted above, the Committee took several actions during its February and March meetings in 2012 to reduce the Company s compensation expense. The Committee also determined, as discussed below, which performance targets were achieved in 2011 by the named executive officers under the short-term incentive plan and the long-term incentive plan and the performance-based restricted stock units. In March 2012, the Committee established the 2012 goals under these cash incentive plans and for certain tranches of the outstanding performance-based restricted stock units. The Committee also considered and approved annual equity awards for the officers of the Company, including the named executive officers and the independent directors.

Use of Consultants

The Committee retains Frederic W. Cook & Co. (Cook), a national executive compensation consulting firm, to assist it in an independent review of the Company s executive compensation program, which generally includes base salaries, as well as short-term and long-term incentive compensation. Cook is engaged directly by the Committee as an independent advisor. Cook provides no other services to the Company and does not interact with the Company s senior management in performing its services for the Committee other than to request data.

In early 2011, the Committee engaged Cook to conduct an independent review of the Company s executive compensation program covering the following areas: (1) executive compensation benchmarks; (2) executive compensation program design and practices; (3) design recommendations for the Company s long-term cash incentive plan; and (4) non-employee directors compensation. The executive compensation benchmark review analyzed total direct compensation levels, which included 2010 base salaries and targeted short-term and long-term incentive opportunities for the Company s 11 most senior executive positions. The Committee used the report from Cook to validate the structural components of the Company s executive compensation program and to make recommendations for improving the compensation program.

During 2011, Mercer LLC (Mercer), a global human resources consulting firm, was engaged by management to assist management and the Committee in conducting a competitive market review of the Company s executive compensation program and to assist in the evaluation of other compensation issues. Mercer regularly seeks input from Mr. Diaz and the Chair of the Committee, to assist it in analyzing the effectiveness of the Company s executive compensation strategy. Mercer reviewed the Company s executive compensation strategy and provided compensation benchmarks to the Committee for each named executive officer, including comparisons of base salary, cash incentives, equity-based compensation and total direct compensation. Mercer also provided the Committee with other relevant market data and made recommendations on potential executive compensation alternatives. In addition, Mercer assisted the Committee in its review of the Company s long-term incentive plan and suggested potential structural changes to the plan that were further evaluated by the Committee. Mercer also was engaged by management to develop recommendations on potential equity award levels for the Chief Executive Officer and for the other participants in the Company s equity plan as well as to review outside director pay practices and develop recommendations for appropriate levels of outside director

pay. The Committee used this information, along with its views on the Company s performance, to size the equity pool for 2011. The aggregate fees incurred during 2011 by the Company for Mercer s services related to executive and outside director compensation were approximately $131,000.

The Company s management also engages Mercer to advise it on various other employee benefit and compensation matters impacting the Company and its employees such as strategic analysis and actuarial support related to the Company s benefit plans. During 2011, Mercer assisted in various employee and benefit matters in connection with the RehabCare Merger. Mercer also assisted the Company in the analysis and administration of benefit plans for the Company s employees and on other human resources issues. The Company paid Mercer approximately $1.9 million in 2011 for services unrelated to executive and outside director compensation. The Company did not seek the Committee s approval of the engagement of Mercer for these services.

Peer Group

Following consultation with Mercer and Cook, the Committee revised its peer group of companies during 2011 primarily in response to the increased size, scope and complexity of the Company following the RehabCare Merger. As part of this process, two companies used in the 2010 peer group were removed (RehabCare and Extendicare REIT) and four new companies were added (Qwest Diagnostics, Inc., OmniCare, Inc., Laboratory Corp. of America and Vanguard Health Systems). The Committee compared each component of compensation for the named executive officers with peer group data assembled by Mercer. The Company began using the following companies for compensation benchmarking purposes during 2011:

Brookdale Senior Living, Inc.	HealthSouth Corporation	DaVita, Inc.
Universal Health Services, Inc.	Lifepoint Hospitals, Inc.	OmniCare, Inc.
Community Health Systems, Inc.	Tenet Healthcare Corp.	Select Medical, Inc.
Health Management Associates, Inc.	Sun Healthcare Group, Inc.	Qwest Diagnostics, Inc.
Laboratory Corp. of America	Vanguard Health Systems	

The peer group is periodically reviewed and updated by the Committee based upon organic changes in the peer companies and upon recommendations from Cook and Mercer. The Committee believes that these peer companies compete for executives with similar talents and expertise to those of the named executive officers and also reflect the diversified nature of the Company s businesses and the healthcare industry. The Committee also considers, to a lesser extent, comparisons of compensation from companies outside the healthcare industry and published compensation surveys.

Components of Executive Compensation

The Company s executive compensation program generally uses the following components to structure the total direct compensation for the named executive officers:

- base salary;
- short-term cash incentives;
- long-term cash incentives;
- equity-based incentive compensation; and
- other perquisites and benefits.

The Company believes that the combination of these elements enables the Committee to award total direct compensation that is competitive within the healthcare industry and the Company s peer group and that promotes the goals of the executive compensation program. This

combination of elements also takes into consideration the Company s capital structure and relatively low number of outstanding shares compared to the Company s adjusted enterprise value and complexity of its operations.

The Committee generally structures base salaries at or below the 50th percentile of the Company s peer group because it believes that a greater portion of total direct compensation should be subject to the attainment of performance goals. Historically, the Company s annual short-term and long-term cash incentive plans have provided the named executive officers with the ability to achieve significant additional cash compensation, typically at or above the median level of the peer group for such awards, provided targeted levels of financial and quality performance are achieved or exceeded.

The named executive officers are generally awarded equity-based compensation below the median level of the peer group. The Committee considers the amount of total cash compensation earned by the named executive officers in determining the amount of equity-based compensation to award. While the Committee does not have a set allocation between cash and equity compensation, the Committee generally provides for a greater percentage of cash compensation than its peers since equity awards have a greater dilutive impact on stockholders given the Company s relatively low number of outstanding shares. Moreover, the Company s capital structure places practical limits on the amount of equity compensation that can be awarded to the named executive officers. The Committee uses a mixture of these components so that total direct compensation to the named executive officers (1) awards short-term and long-term performance, (2) is competitive within its peer group, and (3) is aligned with the interests of stockholders.

The following chart provides a brief summary of the Company s incentive compensation plans used during 2011.

Summary of Incentive Compensation Programs

		Performance Period	Vesting /Payout Timing	Performance Measures (2)	Target Incentive Opportunity (% of Salary) CEO	Other NEOs
Short-Term Incentive Plan (1)		1 year	Paid in full in the year following the respective performance period	Adjusted EBITDAR, Consolidated EBITDAR, Adjusted EBITDARM, Growth, Efficiency, Capital, Quality & Service, Employee Measures, Organizational Excellence	100%	75%
Long-Term Incentive Plan (1)		1 year	Pro rata payouts over 3 years after the respective performance period (4 years total)	Adjusted Earnings Before Interest and Income Taxes (EBIT), Adjusted Earnings per Share (EPS), Stock Price Appreciation, Strategic Plan	50%	45%
Equity Compensation	Performance- Based Restricted Stock Units (1)	Each tranche based on 1 year performance	3 year pro rata	Adjusted EBIT, Adjusted EPS	(3)	(3)
	Service-Based Restricted Stock	n/a	4 year pro rata	n/a	(3)	(3)

(1) No awards are paid unless certain minimum levels of performance are achieved.

(2) For information about the calculation of non-GAAP financial measures based on the Company s audited financial statements, see Short-Term Incentive Plan Table B and Long-Term Incentive Plan.

(3) Awards vary based on peer analysis, the Company s performance and the named executive officer s individual performance as discussed in more detail below.

The Committee does not have a pre-established policy for the allocation between fixed compensation, such as base salary, and variable or at risk compensation, such as short-term and long-term cash incentives and equity. However, the Committee generally places a significant portion of total direct compensation for the named executive officers at risk. The following chart reflects the mix of fixed and at risk compensation comprising the total direct compensation earned by the named executive officers for 2011.

Percent of Total Direct Compensation in 2011 (1)

	Fixed	At Risk			
	Base Salary	Short-term Incentive Plan	Long-term Incentive Plan	Equity Awards	Special Cash Bonus
Mr. Diaz	15.9%	17.6%	11.7%	54.8%	
Mr. Lechleiter	24.5%	20.3%	16.1%	39.1%	
Mr. Breier	19.9%	16.5%	13.2%	50.4%	
Mr. Bowen	24.6%	18.3%	16.2%	40.9%	
Mr. Chapman	23.5%	19.5%	15.5%	35.9%	5.6%

(1) This chart excludes all compensation earned by the respective named executive officer in 2011 for the amounts reported as Changes in Pension Value and Non-Qualified Deferred Compensation Earnings and All Other Compensation in the Summary Compensation Table beginning on page 41. For the equity awards, these amounts reflect a grant date fair value of $24.50 per share for each share of service-based restricted stock and each share of performance-based restricted stock unit granted in 2011 to the named executive officers. For purposes of this disclosure, the Company has assumed that the grant date fair value for each of the three tranches of performance-based restricted stock units granted to the named executive officers during 2011 could be valued at the closing price of the Company s Common Stock on the date of grant and that these performance-based restricted stock units are ultimately earned by the named executive officer.

At risk compensation under the Company s cash incentive plans incentivizes the named executive officers to reach or exceed the financial and quality goals established by the Committee. Moreover, at risk compensation under the Company s equity incentive plans incentivizes the named executive officers to meet critical financial and strategic targets as well as grow the value of the Company s Common Stock to enhance the benefit of their equity-based compensation. The Company s cash and equity incentive plans also promote the retention of the named executive officers and align the interests of the named executive officers with those of the Company s stockholders.

In establishing cash performance goals, the Committee considers the allocation of potential compensation among financial and quality goals. The Committee believes that continued emphasis on maintaining or improving the quality of the Company s services is a key driver in reaching desired financial results and reflects an appropriate risk allocation between financial and quality goals. With respect to the financial goals, the Committee aligns these goals with the Company s operating budgets that have been reviewed and approved by the Company s Board of Directors. As noted previously, the Committee believes that the performance measures it chose appropriately reward performance without encouraging unnecessary and excessive risk taking on the part of the Company s employees.

Mr. Diaz s compensation is higher than the compensation of the other named executive officers. The Committee believes that higher compensation for the Chief Executive Officer is consistent with the practices of other healthcare companies, including the Company s peer group. In addition, Mr. Diaz s compensation reflects the unique nature and scope of his leadership and strategic responsibilities, the level of accountability for the Company s overall performance and the competitive market for attracting and retaining a talented chief executive officer. The Committee annually compares the appropriateness of Mr. Diaz s compensation with other chief executive officers in its peer group.

Base Salary

Base salaries are provided to the named executive officers to compensate them for their services performed during the year. The base salary for each named executive officer is determined annually by the Committee following a review of each individual executive officer s performance, changes in executive officer responsibility, relevant comparisons to the peer group data, an assessment of overall Company performance, and

general market salary increases for all employees. As part of the process, Mr. Diaz provides the Committee with a written evaluation of each named executive officer. As noted above, the Committee generally attempts to structure base salaries at or below the 50th percentile of the Company s peer group. Salary adjustments also may be considered in connection with promotions or other changes in job responsibility. As part of its analysis, the Committee considered salary comparisons prepared by Mercer to determine if base salaries for the named executive officers are competitive with the base salaries of similarly situated executives in the peer group and the healthcare industry generally. The Committee also considers how changes in base salary may impact the total direct compensation for the named executive officers. Moreover, the Committee considers general economic conditions and challenges facing the Company s operations. In addition, the Chief Executive Officer makes recommendations on base salaries for the other named executive officers.

While certain aspects of performance of the named executive officers can be measured in financial and quality metrics, when considering annual base salary increases, the Committee also evaluates the named executive officers in other performance areas that are more subjective. These areas include the success of the named executive officer in developing and executing the Company s strategic objectives, capitalizing on growth opportunities, addressing significant challenges affecting the Company from a financial and quality perspective, developing key employees, succession planning and exercising leadership.

In February 2011, the Committee conducted its annual review of base salaries for the named executive officers. The Committee noted that the base salaries for the named executive officers had not increased in the last two years and that the salaries were trending well below the 50th percentile of the Company s peer group. The Committee also considered the enhanced responsibilities of the named executive officers due to the increased size, scope and complexity of the Company s operations resulting from the RehabCare Merger. As a result, the Committee approved increases in the base salaries to bring them to levels that approximate the 50th percentile of the peer group.

The change in base salaries for the named executive officers for 2011 were as follows:

	2010 Base Salary	2011 Base Salary
Mr. Diaz	$ 1,002,000	$ 1,025,000
Mr. Lechleiter	$ 435,000	$ 470,000
Mr. Breier	$ 550,000	$ 600,000
Mr. Bowen	$ 426,000	$ 443,000
Mr. Chapman	$ 402,000	$ 420,000

At its February 2012 meeting, the Committee elected to reduce the base salaries for Mr. Diaz by 10% and for the other named executive officers by 5% in response to recent reductions in Medicare reimbursement. The Committee noted that recent reductions in Medicare reimbursement have negatively impacted the Company s financial results and its operating budget for 2012. These changes were made to reduce compensation costs in response to these conditions. These changes also effectively limit potential awards under the short-term and long-term cash incentive plans, as these awards are based on percentages of each named executive officer s base salary. While the Committee noted that the new base salaries will be below the 50th percentile of the Company s peer group, the Committee still believes that total direct compensation is competitive.

Cash Incentives

Under the Company s executive compensation program, a significant portion of total cash compensation for the named executive officers is subject to the attainment of measurable financial and quality goals. This approach creates a direct incentive for the named executive officers to achieve pre-established financial and quality performance objectives and places a significant percentage of each named executive officer s total direct cash compensation at risk. The Company uses two cash incentive plans: an annual short-term incentive plan and a

long-term incentive plan. The Committee believes a strong emphasis on cash compensation is appropriate, given the Company s existing capital structure. The Company s cash incentive plans also provide sufficient flexibility to allow the Committee to establish non-routine goals that may be integral to the success of the Company over the short-term or long-term, as appropriate.

Short-term Incentive Plan

Under the short-term incentive plan, the Committee establishes annual financial and quality goals for the Company s named executive officers. These goals are based upon similar financial and quality measures but the actual goals vary depending upon the operational responsibilities of the named executive officer. As such, the goals are tailored for the corporate support center or operating division for which the named executive officer is primarily responsible. Messrs. Diaz, Lechleiter, Breier and Mr. Chapman are assigned to the corporate support center and, as such, the goals under the short-term incentive plan applicable to them were generally based upon Company-wide measures and aggregated financial and quality goals from each of the Company s operating divisions. Mr. Bowen leads the Company s nursing center division and his short-term incentive goals are based primarily on measures tailored to his operating division and its financial and quality objectives.

For 2011, the financial measures for the participating named executive officers were based upon:

- achieving targeted levels of EBITDAR;
- collecting accounts receivable;
- achieving patient admission, census and revenue goals;
- managing costs and improving operating efficiencies; and
- realization of operating synergies from the RehabCare Merger.

These goals are established based upon the historic operating results of the Company and its operating divisions and are the key drivers necessary for the Company to achieve its 2011 operating budget. The Company believes that several of these financial goals are measures generally used by investors to value the Company s Common Stock. In addition, the Committee believes that these financial goals reward management for addressing reimbursement reductions or challenges caused by healthcare reform. The Committee included synergy goals for 2011 because it believed that the synergies were critical to the success of the RehabCare Merger.

For 2011, the quality goals under the short-term incentive plan were based upon:

- operational and clinical measures of quality care;
- customer satisfaction measures obtained from customer satisfaction surveys; and
- achieving targeted employee retention rates.

These goals are established based upon the historic clinical results achieved by the operating divisions and new initiatives to improve the quality of care. The quality goals are objective measures and often include various sub-components. The goals are established with a view to be challenging but achievable with solid operational focus on the Company s businesses.

The Company believes that objective quality and customer service goals are critical to promoting a culture of quality throughout the Company which enhances the services offered by the Company. Moreover, the Company believes that there is a direct link between providing quality services and achieving favorable short-term and long-term financial results.

Annual cash bonuses under the short-term incentive plan are based upon a percentage of the participating named executive officer s base salary. No awards are earned under the short-term incentive plan until certain minimum levels of performance are achieved.

In 2011, the Committee established performance hurdles that would need to be achieved prior to awarding bonuses under the short-term incentive plan to ensure that there was sufficient financial performance to support the cash incentives. The goals for 2011 provided that if a participant fails to satisfy 95% of the targeted corporate EBITDAR goal or 92.5% of the targeted segment EBITDARM goal, or experienced issues with poor survey and quality measures, or significant audit or compliance issues, then all or a portion of any short-term award could be forfeited, in the Committee s discretion, even if other component goals of the award had been achieved. These additional performance hurdles ensure that financial performance will be sufficient to justify the bonus payouts.

The following chart reflects the potential award levels for the named executive officers as a percentage of their base salary for 2011:

Short-Term Incentive Plan Table A

	Percentage of Base Salary		
	Minimum	**Target**	**Maximum**
Mr. Diaz	40%	100%	135%
Mr. Lechleiter	30%	75%	101%
Mr. Breier	30%	75%	101%
Mr. Bowen	30%	75%	101%
Mr. Chapman	30%	75%	101%

The following chart sets forth the minimum, target and maximum goals for 2011 under the short-term incentive plan, as well as the actual levels achieved for 2011.

Short-Term Incentive Plan Table B

Support Center Goals applicable for Messrs. Diaz, Lechleiter, Breier and Chapman

	2011 Incentive Goals Minimum		2011 Incentive Goals Target		2011 Incentive Goals Maximum (1)				Award % of Base Salary	
	Goal	% of Bonus	Goal	% of Bonus	Goal	% of Bonus	Actual Performance Achieved	% of Target Bonus Achieved	Mr. Diaz	Other Named Executive Officers
Financial goals:										
Adjusted EBITDAR (2) (dollars in millions)	$ 611.1	6.00%	$ 643.3	15.00%	$ 675.5	27.50%	$ 644.3	15.00%	15.00%	11.25%
Consolidated EBITDAR (3) (dollars in millions)	$ 749.9	4.00%	$ 789.4	10.00%	$ 828.9	20.00%	$ 764.2	5.71%	5.71%	4.28%
Accounts receivable days outstanding	54.4	2.00%	51.7	5.00%	49.2	7.50%	53.3(4)	3.13%	3.13%	2.35%
RehabCare annualized synergies (dollars in millions)	$ 20.0	10.00%	$ 25.0	25.00%	$ 35.0	37.50%	$ 41.8	37.50%	37.50%	28.13%
Hospital admissions	46,682	0.44%	49,139	1.11%	51,596	1.67%	49,577	1.11%	1.11%	0.83%
Hospital average daily census	3,971	0.44%	4,180	1.11%	4,389	1.67%	3,955			
Hospital net revenue per patient day	$ 1,374	0.44%	$ 1,446	1.11%	$ 1,518	1.67%	$ 1,508	1.56%	1.56%	1.17%
Hospital operating cost per patient day	$ 1,276	0.67%	$ 1,212	1.67%	$ 1,154	2.51%	$ 1,245	1.07%	1.07%	0.80%
Hospital total labor cost per patient day	$ 604	0.67%	$ 574	1.67%	$ 547	2.51%	$ 588	1.07%	1.07%	0.80%
Hospital workers compensation cost as % of payroll	1.80%	0.34%	1.70%	0.84%	1.60%	1.26%	2.40%			
Nursing center average daily census	22,754	0.44%	23,952	1.11%	25,150	1.67%	23,242	0.71%	0.71%	0.53%
Nursing center net revenue per patient day	$ 253.63	0.44%	$ 266.98	1.11%	$ 280.00	1.67%	$ 263.60	0.84%	0.84%	0.63%
Nursing center Medicare/Managed care admissions	66,283	0.44%	69,772	1.11%	73,261	1.67%	66,366	0.45%	0.45%	0.34%
Nursing hours per patient day	3.34	0.53%	3.43	1.33%	3.52	2.00%	3.47	1.50%	1.50%	1.13%
Nursing center total operating expenses per patient day	$ 239	0.53%	$ 232	1.33%	$ 225	2.00%	$ 232	1.17%	1.17%	0.88%
Nursing center total ancillary expenses per patient day	$ 45.53	0.27%	$ 44.16	0.67%	$ 42.87	1.01%	$ 44.68	0.51%	0.51%	0.38%
Rehabilitation revenue per patient day hospitals	$ 60.51	0.33%	$ 59.07	0.83%	$ 58.35	1.25%	$ 58.81	0.94%	0.94%	0.71%
Rehabilitation total revenue (dollars in millions)	$ 551	1.00%	$ 580	2.50%	$ 609	3.75%	$ 612.9	3.75%	3.75%	2.81%
Rehabilitation skilled nursing productivity	76.4%	0.33%	78.0%	0.83%	79.6%	1.25%	81.8%	1.25%	1.25%	0.94%
Rehabilitation hospital productivity	78.4%	0.17%	80.0%	0.42%	81.6%	0.63%	84.8%	0.63%	0.63%	0.47%
Rehabilitation skilled nursing therapist care ratio	73.5%	0.67%	75.0%	1.67%	76.5%	2.51%	78.3%	2.50%	2.50%	1.88%
Rehabilitation hospital therapist care ratio	58.8%	0.17%	60.0%	0.42%	61.2%	0.63%	60.0%	0.42%	0.42%	0.32%

Short-Term Incentive Plan Table B (continued)

Support Center Goals applicable for Messrs. Diaz, Lechleiter, Breier and Chapman

	2011 Incentive Goals								Award % of Base Salary	
	Minimum		Target		Maximum (1)					
	Goal	% of Bonus	Goal	% of Bonus	Goal	% of Bonus	Actual Performance Achieved	% of Target Bonus Achieved	Mr. Diaz	Other Named Executive Officers
Quality goals:										
Hospital clinical quality index	3.38	0.67%	3.21	1.67%	3.12	2.51%	2.56	2.50%	2.50%	1.88%
Hospital customer service index	4.26	0.33%	4.48	0.83%	4.61	1.25%	4.52	0.92%	0.92%	0.69%
Clearing tags on first follow-up hospitals	85.5%	0.33%	90.0%	0.83%	92.7%	1.25%	99.7%	1.25%	1.25%	0.94%
Hospital ADR acceptance %	84.6%	0.34%	89.0%	0.84%	93.5%	1.26%	91.8%	1.09%	1.09%	0.82%
Nursing center survey results	1.11	0.67%	1.08	1.67%	1.05	2.51%	1.07	1.83%	1.83%	1.37%
Nursing center clearing tags on first follow-up	91.2%	0.33%	94.0%	0.83%	96.8%	1.25%	94.6%	0.92%	0.92%	0.69%
Nursing center customer satisfaction	73.7%	0.33%	76.0%	0.83%	78.3%	1.25%	76.3%	0.83%	0.83%	0.62%
Nursing center implementation of clinical assessments	85.5%	0.34%	90.0%	0.84%	92.7%	1.26%	99.1%	1.26%	1.26%	0.95%
Nursing center consistent staffing assignment	77.6%	0.34%	80.0%	0.84%	82.4%	1.26%	99.1%	1.26%	1.26%	0.95%
Rehabilitation customer satisfaction	3.76	0.44%	3.96	1.11%	4.00	1.67%	4.28	1.67%	1.67%	1.25%
Rehabilitation skilled nursing outcomes measurement	74.3%	0.44%	78.2%	1.11%	80.5%	1.67%	78.4%	1.11%	1.11%	0.83%
Rehabilitation hospital outcomes measurement	57.5%	0.44%	60.5%	1.11%	62.3%	1.67%	68.1%	1.67%	1.67%	1.25%
Rehabilitation handheld utilization	86.5%	0.68%	91.0%	1.65%	95.6%	2.36%	89.1%	1.07%	1.07%	0.80%
Consolidated aggregate employee turnover	31.6%	4.00%	30.0%	10.00%	29.1%	15.00%	29.6%	12.0%	12.0%	9.00%
Overall maximum limitation						-25.00%				
Total		40.00%		100.00%		135.00%		110.20%	110.20%	82.67%

Short-Term Incentive Plan Table B (continued)

Nursing Center Division Goals applicable for Mr. Bowen

	2011 Incentive Goals								
	Minimum		Target		Maximum (1)		Actual	% of Target	Award %
	Goal	% of Bonus	Goal	% of Bonus	Goal	% of Bonus	Performance Achieved	Bonus Achieved	of Base Salary
Financial goals:									
Adjusted EBITDARM (dollars in millions) (5)	$ 337.3	7.50%	$ 355.1	18.75%	$372.9	33.12%	$ 341.9	9.11%	6.83%
Consolidated EBITDAR (dollars in millions) (3)	$ 749.9	2.50%	$ 789.4	6.25%	$828.9	14.38%	$ 764.2	3.57%	2.68%
Accounts receivable days outstanding	46.1	2.00%	43.8	5.00%	41.7	7.50%	44.8(4)	3.60%	2.70%
Average daily census	22,754	1.33%	23,952	3.33%	25,150	5.00%	23,242	2.13%	1.60%
Net revenue per patient day	$ 253.63	1.33%	$ 266.98	3.33%	$280.00	5.00%	$ 263.60	2.53%	1.90%
Medicare/Managed care admissions	66,283	1.34%	69,772	3.34%	73,261	5.00%	66,366	1.34%	1.01%
Hours per patient day	3.34	1.60%	3.43	4.00%	3.52	6.00%	3.47	4.50%	3.38%
Total operating expenses per patient day	$ 239	1.60%	$ 232	4.00%	$225	6.00%	$ 232	3.52%	2.64%
Ancillary expenses per patient day	$ 45.53	0.80%	$ 44.16	2.00%	$42.87	3.00%	$ 44.68	1.52%	1.14%
RehabCare annualized synergies (dollars in millions)	$ 20.0	10.00%	$ 25.0	25.00%	$35.0	37.50%	$ 41.8	37.50%	28.13%
Quality goals:									
Survey results	1.11	2.00%	1.08	5.00%	1.05	7.50%	1.07	5.50%	4.13%
Clearing tags on first follow-up	91.2%	1.00%	94.0%	2.50%	96.8%	3.75%	94.6%	2.75%	2.06%
Customer satisfaction	73.7%	1.00%	76.0%	2.50%	78.3%	3.75%	76.3%	2.50%	1.88%
Implementation of clinical assessments	85.5%	1.00%	90.0%	2.50%	92.7%	3.75%	99.1%	3.75%	2.81%
Consistent staffing assignment	77.6%	1.00%	80.0%	2.50%	82.4%	3.75%	99.1%	3.75%	2.81%
Total employee turnover	40.9%	2.00%	39.7%	5.00%	38.5%	7.50%	39.2%	6.00%	4.50%
Employee retention	70.1%	2.00%	72.3%	5.00%	74.5%	7.50%	73.1%	5.50%	4.13%
Overall maximum limitation						-25.00%			
Total		40.00%		100.00%		135.00%		99.07%	74.33%

(1) Except as noted below, the maximum award level is capped in the aggregate at 125% of the target award for the named executive officers. If the named executive officer achieves or exceeds the maximum EBITDAR goal, the maximum award level is then capped in the aggregate at 135% of the target award.

(2) The Company s performance goals include the non-GAAP financial measure EBITDAR from both continuing and discontinued operations, as adjusted for certain items as described below (Adjusted EBITDAR). The Company uses the term operating income (loss) in the Company s Annual Report on Form 10-K filed with the SEC on February 29, 2012 (the 2011 Audited Financials) when referring to

EBITDAR. The Company believes that net income (loss) is the most comparable GAAP measure to Adjusted EBITDAR. Adjusted EBITDAR for the year ended December 31, 2011 is calculated by excluding from net income (loss) the impact of the following items related to both continuing and discontinued operations: loss on divestiture of operations, interest expense, investment income, income taxes, depreciation, amortization and rent. For purposes of the 2011 calculation of Adjusted EBITDAR, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities, and impairment charges are also excluded from the Company s 2011 targets and the Company s actual comparative results. See Notes 5 and 7 of the 2011 Audited Financials for additional information about the calculation of EBITDAR.

(3) The Company s performance goals include the non-GAAP financial measure EBITDAR from both continuing and discontinued operations, as adjusted for certain items as described below (Consolidated EBITDAR). The Company believes that net income (loss) is the most comparable GAAP measure to Consolidated EBITDAR. Consolidated EBITDAR for the year ended December 31, 2011 is calculated by excluding from net income (loss) the impact of the following items related to both continuing and discontinued operations: loss on divestiture of operations, interest expense, investment income, income taxes, depreciation, amortization and rent. For purposes of the 2011 calculation of Consolidated EBITDAR, the results of operations from acquisitions other than the RehabCare Merger, the costs and expenses of significant acquisition and development activities (including the RehabCare Merger), and impairment charges are also excluded from the Company s 2011 targets and the Company s actual comparative results. See Notes 5 and 7 of the 2011 Audited Financials for additional information about the calculation of EBITDAR.

(4) These goals are established by quarter and vary by quarter. The results shown reflect a compilation of the four quarterly targets and actual results for 2011.

(5) The Company s performance goals include the non-GAAP financial measure EBITDARM from both continuing and discontinued operations, as adjusted for certain items as described below (Adjusted EBITDARM). The Company uses the term operating income (loss) in the 2011 Audited Financials when referring to EBITDARM. The Company believes that net income (loss) is the most comparable GAAP measure to Adjusted EBITDARM. Net income (loss) is reported on a consolidated (rather than a segment) basis in the 2011 Audited Financials and is calculated by adding income (loss) from continuing operations and income (loss) from discontinued operations. The actual performance achieved towards each segment s 2011 EBITDARM goals can be calculated by adding segment EBITDARM from continuing operations to segment EBITDARM from discontinued operations. For purposes of the 2011 calculation of Adjusted EBITDARM, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities (including the RehabCare Merger), and impairment charges are excluded from the Company s 2011 targets and the Company s actual comparative results. A reconciliation of segment EBITDARM from continuing operations to income from continuing operations is presented in Note 7 of the 2011 Audited Financials. Segment EBITDARM from discontinued operations is set forth in Note 5 of the 2011 Audited Financials.

To calculate the final awards under the short-term incentive plan, the Committee multiplies the target bonus percentage for the named executive officer with the percentage of target achieved and the named executive officer s base salary. The calculations for 2011 were as follows:

Short-Term Incentive Plan 2011 Bonus Calculation

	Target Bonus % (Table A)	x	% of Target Bonus Achieved (Table B)	x	2011 Base Salary	=	2011 Actual Award
Mr. Diaz	100%		110.2%		$ 1,025,000		$ 1,129,553
Mr. Lechleiter	75%		110.2%		$ 470,000		$ 388,470
Mr. Breier	75%		110.2%		$ 600,000		$ 495,914
Mr. Bowen	75%		99.1%		$ 443,000		$ 329,274
Mr. Chapman	75%		110.2%		$ 420,000		$ 347,142

The Committee exercised no discretion in 2011 to adjust these awards. Notwithstanding the foregoing, the Committee retains the right to administer the short-term incentive plan in its discretion, including the ability to reduce awards otherwise payable to a named executive officer for unforeseen events or circumstances, such as restatements of the Company s financial statements.

As noted previously, the Committee has established performance goals for 2012 under the short-term incentive plan. These goals generally use similar metrics to the 2011 goals but reflect certain changes to focus the named executive officers and management on the operational and financial challenges the Company expects to face in 2012. In addition, the Committee reduced the short-term incentive target bonus opportunity for each named executive officer by 20% for 2012. The Committee reduced the target bonus opportunity to reduce compensation costs in response to significant reductions in Medicare reimbursement.

Long-term Incentive Plan

The Company s long-term incentive plan provides cash awards to the Company s key employees, including the named executive officers, upon the attainment of specified performance objectives. For 2011, the performance period under the long-term incentive plan covered one year. For each performance period, the Committee selects participants who are in a position to contribute materially to the success of the Company and establishes the performance goal or goals to be measured under the plan. For 2011, the performance goals for the named executive officers were based upon:

- achieving targeted levels of EBIT;
- achieving targeted levels of EPS;
- attaining targeted levels of stock price appreciation; and
- successfully implementing specified components of the Company s strategic plan.

These goals were the same for each participant in the long-term incentive plan, including each named executive officer, and reflected Company-wide measures. These goals are established with a view to be challenging but achievable with good operational focus on the Company s businesses.

Cash awards under the long-term incentive plan are payable in three equal annual installments on or about each of the first, second, and third anniversaries of the end of the relevant performance period, provided generally that the participant is employed by the Company at the time payments are due. This delayed payment feature serves as a significant retention vehicle for the Company. The awards earned in 2011 will be paid in three equal annual installments commencing on or about November 15, 2012.

Under the long-term incentive plan, participants are eligible to receive cash awards based upon a percentage of their base salary. These percentages vary depending upon the participant s position within the Company and the extent to which the performance goals established by the Committee are attained. The maximum awards available under the long-term incentive plan as a percentage of base salary are 100% for the Chief Executive Officer and 90% for the other named executive officers. No awards are earned under the long-term incentive plan until certain minimum levels of performance are achieved.

The following chart reflects the potential award levels for the named executive officers as a percentage of base salary for 2011:

	Long-Term Incentive Plan % of Base Salary		
	Minimum	**Target**	**Maximum**
Mr. Diaz	10%	50%	100%
Mr. Lechleiter	9%	45%	90%
Mr. Breier	9%	45%	90%
Mr. Bowen	9%	45%	90%
Mr. Chapman	9%	45%	90%

The following chart depicts the minimum, target and maximum goals under the long-term incentive plan for 2011, as well as the actual levels achieved for 2011 for Mr. Diaz and the other participating named executive officers.

Long-Term Incentive Plan

	2011 Incentive Goals							
	Minimum		**Target**		**Maximum**			
	Goal	**Award % of Salary**	**Goal**	**Award % of Salary**	**Goal**	**Award % of Salary (1)**	**Actual Achieved**	**Award as a % of Base Salary**
Mr. Diaz:								
Adjusted EBIT (dollars in millions) (2)	$ 114.4	4.0%	$ 133.7	20.0%	$ 153.0	54.0%	$ 141.3	26.8%
Adjusted EPS (3)	$ 1.45	3.5%	$ 1.75	17.5%	$ 2.04	47.2%	$ 2.02	41.3%
Stock price appreciation	$ 19.29	1.5%	$ 20.21	7.5%	$ 22.04	20.3%	$ 11.77	
Strategic plan (4)	Level I	1.0%	Level II	5.0%	Level III	13.5%	Level II	5.0%
Total								73.1%
Other named executive officers:								
Adjusted EBIT (dollars in millions) (2)	$ 114.4	3.6%	$ 133.7	18.0%	$ 153.0	48.6%	$ 141.3	24.1%
Adjusted EPS (3)	$ 1.45	3.1%	$ 1.75	15.7%	$ 2.04	42.5%	$ 2.02	37.2%
Stock price appreciation	$ 19.29	1.4%	$ 20.21	6.8%	$ 22.04	18.2%	$ 11.77	
Strategic plan (4)	Level I	0.9%	Level II	4.5%	Level III	12.2%	Level II	4.5%
Total								65.8%

(1) The maximum award level is capped in the aggregate at 100% of base salary for Mr. Diaz and 90% of base salary for the other participating named executive officers.

(2) The Company s performance goals include the non-GAAP financial measure EBIT from both continuing and discontinued operations, as adjusted for certain items as described below (Adjusted EBIT). The Company believes that net income (loss) is the most comparable GAAP measure to Adjusted EBIT.

Adjusted EBIT for the year ended December 31, 2011 is calculated by excluding from net income (loss) the impact of the following items related to both continuing and discontinued operations: loss on divestiture of operations, interest expense, investment income and income taxes. For purposes of the 2011 calculation of Adjusted EBIT, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities, and impairment charges are excluded from the Company s 2011 targets and the Company s actual comparative results. See Notes 5 and 7 of the 2011 Audited Financials for additional information about the calculation of EBIT.

(3) The Company s performance goals include the non-GAAP financial measure EPS from both continuing and discontinued operations, as adjusted for certain items as described below (Adjusted EPS). The Company believes that diluted net income (loss) per share is the most comparable GAAP measure to Adjusted EPS. For purposes of the 2011 calculation of Adjusted EPS, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities and impairment charges (each net of applicable income tax provision (benefit)) and the shares of Common Stock issued in connection with the RehabCare Merger are excluded from the Company s 2011 targets and the Company s actual comparative results.

(4) The strategic planning goals are approved by the Committee and are based upon the achievement of specified levels of the Company s strategic plan. The minimum target is achieved by satisfying Level I objectives, the target goal is achieved by satisfying Level I and Level II objectives and the maximum goal is achieved by satisfying Level I, Level II and Level III objectives.

The Committee exercised no discretion in 2011 to adjust these awards. Notwithstanding the foregoing, the Committee retains the right to administer the long-term incentive plan in its discretion, including the ability to reduce awards otherwise payable to a named executive officer for unforeseen events or circumstances, such as restatements of the Company s financial statements.

As noted previously, the Committee has established performance goals for 2012 under the long-term incentive plan. These goals use similar metrics to the 2011 goals but reflect certain changes to focus the named executive officers and management on the operational and financial challenges the Company expects to face in 2012 and beyond. In addition, the Committee has elected to reduce the number of participants in the plan by approximately 45% for 2012, to reduce compensation costs in response to significant reductions in Medicare reimbursement.

Special Cash Bonus

The Committee awarded Mr. Chapman a special cash bonus of $100,000 in recognition of his exceptional performance in 2011. The Committee noted that Mr. Chapman successfully led integration activities associated with information technology, human resources and benefit program conversions for the RehabCare Merger and other significant acquisitions during 2011.

Equity-Based Compensation

The Company uses equity-based compensation as a key component of its overall executive compensation strategy. Such awards provide a direct and long-term link between the results achieved for the Company s stockholders and the total direct compensation provided to the named executive officers. Equity-based compensation is designed to retain the named executive officers through time-based vesting conditions, improve financial results by subjecting a portion of the equity compensation to the achievement of certain financial goals, and to motivate the named executive officer to enhance the value of the Company s Common Stock by aligning the financial interests of the named executive officers with those of the Company s stockholders.

Historically, the Committee has awarded a mixture of equity awards between stock options, service-based restricted stock and performance-based restricted stock units to achieve the Company s compensation strategies

in relation to the total cost to the Company. Many companies in the Company s peer group also allocate equity awards between various forms of equity. The Committee believes that such equity awards provide an effective incentive for management to create stockholder value over several years since the full benefit of this element of compensation is primarily realized as a result of appreciation in the price of the Company s Common Stock. When evaluating equity-based compensation, the Committee also considers the limitations imposed by the Company s capital structure, the accounting costs associated with the form of equity award and the perceived benefits by management of the awards.

In 2011, the Committee granted performance-based restricted stock units and service-based restricted stock to its named executive officers. The performance-based restricted stock units further enhance the Company s pay for performance strategies by linking the vesting of the performance-based restricted stock units to the Company s financial performance during the applicable performance period. Performance-based restricted stock units are not issued, nor do they entitle the potential recipient to vote or receive distributions, until the relevant performance goals are achieved. The Committee believes that service-based restricted stock promotes retention of the named executive officers and builds their ownership stake in the Company.

While the Committee does not have a formal policy with respect to the timing of grants of equity-based awards in connection with the release of material non-public information, the Committee generally considers issues raised by the timing of grants when making such awards. The exercise price of stock options is equal to the closing price of the Company s Common Stock on the NYSE on the date of grant. The Committee has not granted options with an exercise price that is less than the closing price of the Company s Common Stock on the NYSE on the grant date and it has not granted stock options that are priced on a date other than the grant date.

The amount of equity awarded to the named executive officers is based upon a number of factors. First, the Committee considers an overall assessment of the Company s performance and the equity granting practices of other companies in the healthcare industry and its peer group. In addition, the Committee considers information prepared by Mercer with respect to the form of the equity awards and the relative costs. Based upon this assessment, the Committee then establishes an aggregate pool of potential equity awards for all participants in the equity-based incentive plan, including the named executive officers.

Once the aggregate pool of potential equity awards is established, the Committee considers benchmarks by position from the peer group in evaluating potential awards to the named executive officers. The Chief Executive Officer also provides an assessment to the Committee of the level of performance for the other named executive officers. The Committee then considers the performance of the named executive officer and his actual and potential contribution to the Company s growth and long-term performance in determining individual awards. The assessment of actual and potential contribution is based upon the Committee s subjective evaluation of each named executive officer in light of various operational and strategic challenges and opportunities facing the named executive officer during the relevant year. The Committee also considers how the potential equity award impacts a named executive officer s total direct compensation. Based upon these assessments, the Committee ranks each named executive officer on a grade level ranging from A through D. These award levels are converted to a multiple of base salary, generally within the relevant benchmark, and awards are made from the Company s aggregate pool of available equity awards established by the Committee.

In February 2011, after evaluating the performance of the Company for 2010, the Committee established an aggregate pool of approximately 502,000 shares for potential equity awards to all employee participants. The Committee determined that the aggregate pool was appropriate given the Company s overall performance along with the successful acquisition activities occurring in late 2010 and early 2011, the cost of the awards, and the dilutive effect of the awards on stockholders equity given the Company s relatively low number of outstanding shares.

In February 2011, the Committee granted annual equity awards to the named executive officers from the aggregate pool as follows:

	2011 Equity Grant	
	Performance-based Restricted Stock Units	**Service-based Restricted Stock**
Mr. Diaz	72,000	72,000
Mr. Lechleiter	15,284	15,284
Mr. Breier	30,850	30,850
Mr. Bowen	14,978	14,978
Mr. Chapman	13,057	13,057

An award of performance-based restricted stock units is divided into three equal annual tranches relating to three consecutive annual performance periods. At the beginning of the relevant performance period, the Committee establishes the performance goals for the applicable tranches. If the performance goals are not satisfied in a given year, then the unearned performance-based restricted stock units in such year s tranche will be forfeited by the named executive officer. The service-based restricted stock vests in equal annual installments over four years.

As noted above, the individual awards also are based upon the Committee s subjective evaluation of the named executive officer s performance. The Committee determined that Mr. Diaz and Mr. Chapman had performed at the B+ level and Messrs. Lechleiter, Breier and Bowen had performed at the A level for 2010.

In making these grants, the Committee considered the performance of Mr. Diaz in successfully growing the Company s three operating businesses despite significant changes in healthcare policy and reform. Mr. Diaz also led the Company s strategic acquisition activities in the Company s key cluster markets. The Committee noted that the Company had recently acquired five LTAC hospitals in southern California, three nursing and rehabilitation centers in the Dallas/Fort Worth market, a combined nursing and rehabilitation center and assisted living facility in Cleveland, Ohio and a home health operation in central Ohio, each of which should provide additional earnings growth going forward. The Committee also took note of Mr. Diaz s efforts related to the RehabCare Merger and his active promotion of the Company s ongoing efforts to improve clinical quality and customer service.

With respect to Mr. Lechleiter, the Committee recognized his excellent performance in managing the Company s cash flows and capital expenditures. Mr. Lechleiter also contributed to the Company s efforts in managing costs and obtaining operating efficiencies and played a key role in obtaining financing for the RehabCare Merger.

The awards for Mr. Breier reflect his efforts to continue the Company s strategic operational and growth plan centered on improving quality, taking care of the Company s people, pursuing operational efficiencies, maximizing operating cash flows and continued execution of the Company s cluster market strategy.

In evaluating Mr. Bowen s performance, the Committee noted that the nursing center division had made significant operational changes to adapt to a new patient classification system and patient assessment system. These operational changes allowed the division to position itself to provide higher levels of care to medically complex patients who require more nursing, rehabilitation therapy and other ancillary services. Additionally, the division also made significant improvements in employee turnover, quality and customer service.

With respect to Mr. Chapman, the Committee noted his efforts in leading several integration activities associated with the recent acquisitions from a human resources, employee benefits and information technology standpoint.

During 2011, three tranches of performance-based restricted stock units were eligible for vesting. Each of the tranches was subject to the same performance goals. The following chart depicts the minimum, target and maximum goals established for the 2011 performance period for these tranches of performance-based restricted stock units.

	Minimum		Target		Maximum			
	Goal	**% of Award**	**Goal**	**% of Award**	**Goal**	**% of Award (1)**	**Actual Performance Achieved**	**% of Award Achieved (1)**
Adjusted EBIT (dollars in millions) (2)	$ 114.4	10.0%	$ 133.7	50.0%	$ 153.0	67.5%	$ 141.3	67.5%
Adjusted EPS (3)	$ 1.45	10.0%	$ 1.75	50.0%	$ 2.04	67.5%	$ 2.02	67.5%
Less maximum limit								35.0%
Total								100.0%

(1) The maximum award level is capped in the aggregate at 100% of the potential award.

(2) The Company s performance goals include the non-GAAP financial measure Adjusted EBIT. The Company believes that net income (loss) is the most comparable GAAP measure to Adjusted EBIT. Adjusted EBIT for the year ended December 31, 2011 is calculated by excluding from net income (loss) the impact of the following items related to both continuing and discontinued operations: loss on divestiture of operations, interest expense, investment income and income taxes. For purposes of the 2011 calculation of Adjusted EBIT, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities, and impairment charges are excluded from the Company s 2011 targets and the Company s actual comparative results. See Notes 5 and 7 of the 2011 Audited Financials for additional information about the calculation of EBIT.

(3) The Company s performance goals include the non-GAAP financial measure Adjusted EPS. The Company believes that diluted net income (loss) per share is the most comparable GAAP measure to Adjusted EPS. For purposes of the 2011 calculation of Adjusted EPS, the results of operations from acquisitions (including the RehabCare Merger), the costs and expenses of significant acquisition and development activities and impairment charges (each net of applicable income tax provision (benefit)) and the shares of Common Stock issued in connection with the RehabCare Merger are excluded from the Company s 2011 targets and the Company s actual comparative results.

Performance-Based Restricted Stock Units Earned in 2011

The following chart reflects the actual performance-based restricted stock units earned for achieving the 2011 goals:

	Mr. Diaz	**Mr. Lechleiter**	**Mr. Breier**	**Mr. Bowen**	**Mr. Chapman**
Shares eligible from 2009 grant	9,752	4,620	4,384	2,417	1,417
Shares eligible from 2010 grant	33,334	7,274	8,031	8,554	5,386
Shares eligible from 2011 grant	24,000	5,094	10,283	4,992	4,352
Total eligible shares	67,086	16,988	22,698	15,963	11,155
% of goals achieved	100%	100%	100%	100%	100%
Shares actually earned	67,086	16,988	22,698	15,963	11,155

The Committee has established performance goals for the 2012 performance period for certain tranches of the outstanding performance-based restricted stock units. These 2012 goals use similar metrics to the 2011 goals but reflect revised targets for 2012.

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Stock Ownership Guidelines

In 2010, the Company revised its stock ownership guidelines for its executive officers, including the named executive officers. In response to comments raised by stockholders, the Committee reviewed all facets of the guidelines. The Committee considered the stock ownership requirements of peer companies as well as the Company s historic equity grants and its expected ability to grant equity in the future. The Committee believes that the revised guidelines will ensure that the named executive officers hold a sufficient amount of the Company s Common Stock to further strengthen the long-term link between the results achieved for the Company s stockholders and the compensation provided to the named executive officers.

The stock ownership guidelines for the named executive officers are determined as a multiple of the named executive officer s base salary as follows:

	Multiple of Base Salary
Mr. Diaz	3.0x
Mr. Lechleiter	2.0x
Mr. Breier	2.0x
Mr. Bowen	1.5x
Mr. Chapman	1.5x

The minimum number of shares to be held by the named executive officers will be calculated on each August 3 based upon the average of the high and low price of the Company s Common Stock on the NYSE on that date.

If the applicable guideline is not achieved, the named executive officer is required to retain an amount equal to 50% of net shares received under any equity awards. If the applicable guideline is not achieved by August 3, 2015, the named executive officer is required to retain 100% of net shares received under any subsequent equity awards. The Company s Board of Directors may, at its discretion, waive the stock ownership guidelines if compliance would create a substantial hardship or prevent a named executive officer from complying with a court order.

In determining whether a named executive officer satisfies the required ownership level, the calculation will include stock held directly by the named executive officer or owned either jointly with, or separately by, his immediate family members residing in the same household, shares held in trust for the benefit of the named executive officer or his immediate family members and service-based restricted stock. Stock ownership does not include unexercised stock options, stock appreciation rights, or the non-vested portion of any performance-based restricted stock units.

Regardless of whether the applicable minimum ownership requirement has been met, each director and executive officer shall be prohibited from selling, assigning or otherwise transferring all net shares received upon the exercise of any stock option or vesting of a restricted stock award for a one year period beginning on the date the underlying stock option is exercised or the restricted stock award is vested.

Stock Trading Restrictions

The Company maintains a securities trading policy which applies to its employees including the named executive officers. As part of the securities trading policy, the Company s employees are prohibited from (1) short selling Common Stock, (2) purchasing Common Stock on margin, and (3) entering into hedging transactions involving Common Stock. Named executive officers who violate such prohibitions are subject to disciplinary proceedings including dismissal.

Section 401(k) Plan and Other Perquisites and Benefits

The Company maintains a Section 401(k) plan (the 401(k) Plan) that is a tax-qualified defined contribution retirement savings plan under which all eligible employees, including the named executive officers, are eligible to contribute the lesser of (1) 30% of their pay or (2) the limit prescribed by the Internal Revenue Service (IRS), on a pretax basis. In 2011, the Committee elected to provide a profit-sharing match based on achievement of targeted EBITDAR goals. For 2011, the Committee awarded all employees participating in the 401(k) Plan an aggregate of $1.8 million in profit sharing contributions. The Company no longer matches employee contributions. All employee contributions to the 401(k) Plan are fully vested upon contribution and the Company s profit sharing contribution vests in equal installments over four years or in full immediately once the employee has four years of service. Contributions to the 401(k) Plan by the named executive officers are limited by IRS rules.

In addition, the named executive officers may participate in the Company s Deferred Compensation Plan (the DCP), which is available to certain employees who are deemed highly compensated under the applicable IRS regulations. A participant in the DCP may elect to defer up to 25% of such participant s base salary and up to 100% of such participant s award under the short-term incentive plan into the DCP during each plan year. The DCP provides for the Company to contribute to such participant s account balance an amount equal to (1) the 401(k) Plan contribution that would be calculated using the contribution formula in effect for such plan year, less (2) the amount such participant would receive during the plan year as a contribution under the 401(k) Plan if such participant had contributed the maximum amount of elective deferral contribution permissible under the administrative provisions of the 401(k) Plan for persons of such participant s status. For 2011, the Committee elected to continue to suspend the Company s contribution. The DCP is discussed in further detail under the heading Non-Qualified Deferred Compensation Table Fiscal Year 2011 beginning on page 49.

The Company and the Committee believe that, in order to attract and retain qualified executives and other key employees, the provision of certain perquisites and other personal benefits to such executives and other key employees is reasonable and consistent with the Company s overall executive compensation program. Such benefits provided to the named executive officers include the payment of life insurance premiums, limited personal use of the Company s aircraft and the ability to receive a discounted cash payment in lieu of accumulated paid time off benefits.

Employment and Other Agreements

For several years, the Company has maintained employment agreements with its executive officers, including the named executive officers. The Committee believes that these arrangements are typical in healthcare companies and ease the consequences of an unexpected termination of employment. The Committee also believes that severance terms and benefits under these agreements are generally competitive within the healthcare industry and are important factors in attracting and retaining executive talent. These agreements do not provide for any form of tax gross ups. These agreements also support the retention of key employees during periods of uncertainty.

Mr. Diaz

Effective January 1, 2004, the Company entered into an employment agreement with Mr. Diaz in connection with his promotion to Chief Executive Officer that was revised in December 2008 to ensure documentary compliance with Section 409A of the Code and related regulations (Section 409A). The agreement has a three-year term, which is extended automatically each day by one day unless the Company notifies Mr. Diaz of its intent not to extend the term. Upon such notification, the employment agreement will terminate in three years. Mr. Diaz s employment agreement provides for a base salary and the ability to participate in the Company s short-term and long-term incentive plans, the Company s equity-based plans and other employee benefit plans. Mr. Diaz may receive increases in his base salary as approved by the Committee.

Mr. Diaz s employment agreement also provides for severance payments if his employment is terminated under certain circumstances. The amount and circumstances giving rise to these severance payments are discussed in further detail under the heading Potential Payments upon Termination or Change in Control beginning on page 50.

Mr. Breier

Mr. Breier was promoted to Chief Operating Officer effective on August 31, 2010. Mr. Breier previously served as the Company s executive vice president and president, hospital division. In connection with his promotion, the Company entered into a new employment agreement (the COO Agreement) with Mr. Breier. The COO Agreement has a one-year term which is extended automatically each day by one day unless the Company notifies Mr. Breier of its intent not to extend the term. Upon such notification, the COO Agreement will terminate in one year. The COO Agreement provides that Mr. Breier is entitled to an annual base salary and participation in the Company s short-term incentive plan with a full-year target bonus of 75% of base salary, the Company s long-term incentive plan with a full-year target bonus of 45% of base salary, the Company s equity-based plans and other employee benefit plans. Mr. Breier may receive increases in his base salary as approved by the Committee.

The COO Agreement also provides for severance payments if his employment is terminated under certain circumstances. The amount and circumstances giving rise to these severance payments are discussed in further detail under the heading Potential Payments upon Termination or Change in Control beginning on page 50.

Mr. Lechleiter, Mr. Bowen and Mr. Chapman

The Company also has employment agreements with Messrs. Lechleiter, Bowen and Chapman. The agreements for Mr. Lechleiter, Mr. Bowen and Mr. Chapman were revised in December 2008 to ensure documentary compliance with Section 409A. The agreements for Mr. Lechleiter, Mr. Bowen and Mr. Chapman contain substantially similar terms. These agreements have a one-year term, which is extended automatically each day by one day unless the Company notifies the named executive officer of its intent not to extend the term. Upon such notification, the employment agreement will terminate in one year.

The employment agreements provide a base salary and the ability of these named executive officers to participate in the Company s short-term and long-term cash incentive plans, the Company s equity-based plans and other employee benefit plans. The named executive officer may receive increases in his base salary as approved by the Committee.

The employment agreements also provide for severance payments if the named executive officer s employment is terminated under certain circumstances. The amount and circumstances giving rise to these severance payments are discussed in further detail under the heading Potential Payments upon Termination or Change in Control beginning on page 50.

Change in Control Severance Agreements

For several years, the Company has had change in control severance agreements with its executive officers, including each of the named executive officers. The agreements for the named executive officers generally contain substantially similar terms. These agreements provide for the payment of severance benefits under certain circumstances. The amount and circumstances giving rise to these severance benefits are discussed in further detail under the heading Potential Payments upon Termination or Change in Control beginning on page 50. None of these agreements provide for any form of tax gross up. The Committee has provided change in control severance agreements to its named executive officers because it believes that these arrangements are typical in healthcare companies and to avoid the distraction and loss of key management personnel that may occur in connection with a rumored or actual change in control. The Committee believes that such agreements protect the Company and its stockholders by maintaining employee focus and alignment with stockholders during rumored or actual change in control activities and support the retention of key employees during periods of uncertainty.

Executive Compensation Tax Deductibility

Section 162(m) of the Code generally provides that the compensation paid by publicly held corporations to the chief executive officer and any employee whose compensation is required to be reported to stockholders by reason of such employee being among the three other most highly paid executive officers of the Company (other than the chief financial officer) in the year for which a deduction is claimed by the Company (including its subsidiaries) in excess of $1 million per executive will be deductible by the Company only if paid pursuant to qualifying performance-based compensation plans approved by stockholders of the Company. Compensation as defined by the Code includes, among other things, base salary, incentive compensation and gains on stock options and restricted stock. Although the Company attempts to structure incentive compensation to be deductible for federal income tax purposes, the Company s primary policy is to maximize the effectiveness of the Company s executive compensation program. In that regard, the Committee intends to remain flexible to take actions that are deemed to be in the best interests of the Company and its stockholders. Such actions may not always qualify for tax deductibility under the Code.

Beginning on January 1, 2006, the Company began accounting for equity-based incentive compensation in accordance with the requirements of the authoritative guidance for stock-based compensation, now known as Financial Accounting Standards Board Accounting Standards Codification Topic 718 Stock Compensation (FASB ASC Topic 718).

Proposed Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors

On March 27, 2012, the Company s Board of Directors approved, subject to stockholder approval, a new Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors that will provide for the issuance of up to 200,000 shares of Common Stock. The Committee anticipates that the additional number of shares being requested will be sufficient for competitive and effective equity awards to the Company s non-employee directors for two to three years. For more information, see Proposal 3 Proposal to Approve the Kindred Healthcare, Inc. 2012 Equity Plan for Non-Employee Directors beginning on page 64.

Evaluation of Compensation Policies and Practices as They Relate to Risk Management

The Committee believes that the performance measures it has selected appropriately reward performance without encouraging unnecessary and excessive risk taking on the part of the Company s employees. The allocation of potential awards among various financial and quality goals encourages the Company s employees to balance short-term objectives with long-term operational and clinical performance and financial stability. Moreover, the selected performance measures are aligned with the Company s key success factors and operational objectives. In addition, the goals are tied to facility, district, regional, divisional and enterprise performance with no single goal comprising a material portion of the overall award. The Committee believes that the incentive plans and goals are administered consistently throughout the Company s operating divisions. The Company also has in place various compensating controls such as internal audit functions, a compliance hotline and quality controls to further support the Committee s conclusions on the risk assessment.

SUMMARY COMPENSATION TABLE

The following table sets forth certain information regarding compensation for fiscal years 2011, 2010 and 2009 for the Company s named executive officers.

Name and Principal Position	Year	Salary	Bonus	Stock Awards (1)	Option Awards (2)	Non-Equity Incentive Plan Compensation (3)	Change in Pension Value and Non-Qualified Deferred Compensation Earnings (4)	All Other Compensation (5)	Total
Paul J. Diaz	2011	$ 1,024,130		$ 3,407,607(6)		$ 1,878,830	$ 3,992	$ 111,561	$ 6,426,120
President and Chief	2010	$ 1,002,290	$ 150,000(7)	$ 2,724,211		$ 1,617,195	$ 2,675	$ 90,414	$ 5,586,785
Executive Officer	2009	$ 1,040,839	$ 300,000(8)	$ 706,636	$ 422,721	$ 2,161,940	$ 5,475	$ 107,893	$ 4,745,504
Richard A. Lechleiter	2011	$ 468,661		$ 790,664(6)		$ 697,695	$ 938	$ 64,347	$ 2,022,305
Executive Vice President and	2010	$ 434,741		$ 632,709		$ 569,359	$ 695	$ 36,304	$ 1,673,808
Chief Financial Officer	2009	$ 451,462		$ 298,925	$ 128,028	$ 693,064	$ 1,739	$ 38,655	$ 1,611,873
Benjamin A. Breier	2011	$ 598,094		$ 1,311,926(6)		$ 890,665		$ 161,478	$ 2,962,163
Chief Operating Officer	2010	$ 449,046		$ 1,093,832		$ 635,339		$ 152,739	$ 2,330,956
	2009	$ 415,390	$ 250,000(8)	$ 312,235	$ 117,798	$ 576,008		$ 63,962	$ 1,735,393
Lane M. Bowen	2011	$ 442,366		$ 758,055(6)		$ 620,736	$ 4,074	$ 30,241	$ 1,855,472
Executive Vice President and	2010	$ 426,026		$ 789,487		$ 603,955	$ 2,507	$ 36,262	$ 1,858,237
President, Nursing Center Division	2009	$ 442,411		$ 177,690	$ 112,525	$ 676,614	$ 4,867	$ 58,986	$ 1,473,093
Richard E. Chapman	2011	$ 419,335	$ 100,000(9)	$ 593,195(6)		$ 623,469	$ 4,494	$ 3,688	$ 1,744,181
Executive Vice President and	2010	$ 402,355		$ 437,103		$ 526,944	$ 2,793	$ 9,399	$ 1,378,594
Chief Administrative and Information Officer	2009	$ 417,830		$ 104,401	$ 80,375	$ 641,435	$ 5,482	$ 7,516	$ 1,257,039

(1) Amounts in this column represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718. The aggregate grant date fair value for awards of service-based restricted stock is calculated using the closing price of the Company s Common Stock on the date of grant, without regard to when and how the service-based restricted stock vests. With respect to performance-based restricted stock units, because each award consists of three tranches and performance goals are established annually at the beginning of each tranche s respective single-year performance period, aggregate grant date fair value is calculated for purposes of FASB ASC Topic 718 using the closing price of the Company s Common Stock on the date of grant for the first tranche of an award and using the closing price of the Company s Common Stock on the date performance goals are established for each remaining tranche. During 2011, performance goals were established for the third tranche of the 2009 award, the second tranche of the 2010 award and the first tranche of the 2011 award. Accordingly, the amount in this column for fiscal 2011 represents the aggregate grant date fair value of the first tranche of the 2011 award, the second tranche of the 2010 award, and the third tranche of the 2009 award. The aggregate grant date fair value for the third tranche of the 2010 award and the second and third tranches of the 2011 award will be calculable and reported in subsequent years, using the closing price of Common Stock on the date performance goals are established for each tranche. The assumptions used in calculating aggregate grant date fair value with respect to fiscal year 2011 are discussed in Note 14 of the Company s audited financial statements for the year ended December 31, 2011 included in the Company s Annual Report on Form 10-K filed with the SEC on February 29, 2012.

(2) There were no awards of options to any of the named executive officers during 2011 or 2010. Amounts for 2009 represent the aggregate grant date fair value computed in accordance with FASB ASC Topic 718. The assumptions used in calculating these amounts with respect to fiscal year 2009 are discussed in Note 14 of the Company s audited financial statements for the year ended December 31, 2009 included in the Company s Annual Report on Form 10-K filed with the SEC on February 26, 2010.

(3) These amounts represent amounts earned under the Company s short-term incentive plan and the long-term incentive plan. The named executive officers earned the following amounts under the Company s short-term incentive plan during 2011, 2010 and 2009:

Year	Mr. Diaz	Mr. Lechleiter	Mr. Breier	Mr. Bowen	Mr. Chapman
2011	$ 1,129,553	$ 388,470	$ 495,914	$ 329,274	$ 347,142
2010	$ 952,176	$ 309,753	$ 306,898	$ 349,554	$ 286,678
2009	$ 1,159,650	$ 301,797	$ 216,003	$ 293,191	$ 279,315

The named executive officers earned the following amounts under the Company s long-term incentive plan during 2011, 2010 and 2009:

Year	Mr. Diaz	Mr. Lechleiter	Mr. Breier	Mr. Bowen	Mr. Chapman
2011	$ 749,277	$ 309,225	$ 394,751	$ 291,462	$ 276,327
2010	$ 665,019	$ 259,606	$ 328,441	$ 254,401	$ 240,266
2009	$ 1,002,290	$ 391,267	$ 360,005	$ 383,423	$ 362,120

Amounts earned under the long-term incentive plan are payable in three equal installments on or about each of the first, second and third anniversaries of the end of the relevant performance period, provided generally that the participant is employed by the Company at the time payments are due.

(4) These amounts represent the above-market interest earned in the DCP during the respective year. For 2011, above-market interest equals the amount of interest in excess of 120% of the federal long-term rate as of October 1 of the prior year. The federal long-term rate as of October 1, 2010, 2009, and 2008 was 3.32%, 4.10% and 4.32%, respectively.

(5) The amounts in this column include the Company s contributions for the respective periods for the benefit of the named executive officers to the Company s 401(k) Plan, the taxable value of life insurance premiums paid by the Company, certain transportation-related benefits (which we refer to as TRB), and discounted cash payments in lieu of accumulated paid time off benefits (which we refer to as PTO). These amounts for 2011 were as follows:

	401(k)	Life	TRB (a)	PTO	Total
Mr. Diaz	$ 750	$ 2,622	$ 93,405	$ 14,784	$ 111,561
Mr. Lechleiter	750	1,162	42,097	20,338	64,347
Mr. Breier	750	661	134,105	25,962	161,478
Mr. Bowen	750	3,120	1,292	25,079	30,241
Mr. Chapman	750	2,938			3,688

(a) For purposes of determining the value of the TRB, the Company bases the calculation on the aggregate incremental cost to the Company for the use of the Company s aircraft or chartered aircraft by each named executive officer and such named executive officer s requested occupants. The aggregate incremental cost for the Company s aircraft is based upon a cost-per-flight-hour charge developed from the annual direct costs to operate the Company s aircraft. The incremental cost for any chartered aircraft is the actual cost of the chartered aircraft paid by the Company.

(6) The amounts in this column include the aggregate grant date fair value for awards of service-based restricted stock and performance-based restricted stock units, computed in accordance with FASB ASC Topic 718. As previously discussed, the Company granted awards of performance-based restricted stock units in 2011, 2010 and 2009. Each award consists of three tranches, the first of which will vest based upon performance during the year of grant, the second of which will vest based upon performance during the year immediately following the year of grant and the third of which will vest based upon performance during the second year immediately following the year of grant. Performance criteria for the relevant tranches are not established until the year of performance with respect to which such tranche may vest. The grant date fair value for

future tranches of the 2010 and 2011 awards cannot be determined for purposes of FASB ASC Topic 718 until the date the performance goals of each remaining tranche are established. As a result, the amounts in this column for 2011 include the grant date fair values, calculated pursuant to FASB ASC Topic 718, of (i) the first tranche of performance-based restricted stock units granted during 2011, (ii) the second tranche of performance-based restricted stock units granted during 2010, and (iii) the third tranche of performance-based restricted stock units granted during 2009, as follows:

Year/Tranche	Mr. Diaz	Mr. Lechleiter	Mr. Breier	Mr. Bowen	Mr. Chapman
2011 Tranche 1	$ 588,000	$ 124,803	$ 251,934	$ 122,304	$ 106,624
2010 Tranche 2	$ 816,683	$ 178,213	$ 196,759	$ 209,573	$ 131,957
2009 Tranche 3	$ 238,924	$ 113,190	$ 107,408	$ 59,217	$ 34,717

The grant date fair value for all performance-based restricted stock units granted to the named executive officers during 2011, assuming for purposes of this disclosure that each of the three tranches could be valued under FASB ASC Topic 718 at the closing price of the Company s Common Stock on the date of grant ($24.50), is as follows:

Year	Mr. Diaz	Mr. Lechleiter	Mr. Breier	Mr. Bowen	Mr. Chapman
2011	$ 1,764,000	$ 374,458	$ 755,825	$ 366,961	$ 319,897

As previously discussed, the grant date fair value for tranches 2 and 3 of the 2011 performance-based restricted stock units cannot be calculated until the performance goals for each respective period have been established.

(7) This amount represents a cash bonus awarded to Mr. Diaz for exceptional performance during 2010.

(8) These amounts represent cash bonuses awarded to Messrs. Diaz and Breier for exceptional performance during 2009.

(9) This amount represents a cash bonus awarded to Mr. Chapman for exceptional performance during 2011.

Grants of Plan-Based Awards Table Fiscal Year 2011

The following table sets forth information regarding grants of awards under incentive compensation programs to the Company s named executive officers during fiscal year 2011.

Name	Grant Date	Estimated Possible/Future Payouts Under Non-Equity Incentive Plan Awards Minimum	Target	Maximum	Estimated Future Payouts under Equity Incentive Plan Awards (#)(1)(2)	All Other Stock Awards: Number of Shares of Stock or Units (#)(1)(3)	All Other Option Awards: Number of Shares of Securities Underlying Options (#)(1)(4)	Exercise or Base Price of Option Awards ($)	Grant Date Fair Value of Stock Awards ($) (5)
Paul J. Diaz									
Short-term incentive plan (6)	N/A	$ 410,001	$ 1,025,003	$ 1,383,754					
Long-term incentive plan (7)	N/A	$ 102,500	$ 512,502	$ 1,025,003					
	2/16/11				72,000				$ 588,000(8)
	2/16/11					72,000			$ 1,764,000
Richard A. Lechleiter									
Short-term incentive plan (6)	N/A	$ 141,005	$ 352,514	$ 475,893					
Long-term incentive plan (7)	N/A	$ 42,302	$ 211,508	$ 423,016					
	2/16/11				15,284				$ 124,803(8)
	2/16/11					15,284			$ 374,458
Benjamin A. Breier									
Short-term incentive plan (6)	N/A	$ 180,005	$ 450,013	$ 607,517					
Long-term incentive plan (7)	N/A	$ 54,002	$ 270,008	$ 540,015					
	2/16/11				30,850				$ 251,934(8)
	2/16/11					30,850			$ 755,825
Lane M. Bowen									
Short-term incentive plan (6)	N/A	$ 132,906	$ 332,264	$ 448,557					
Long-term incentive plan (7)	N/A	$ 39,872	$ 199,359	$ 398,717					
	2/16/11				14,978				$ 122,304(8)
	2/16/11					14,978			$ 366,961
Richard E. Chapman									
Short-term incentive plan (6)	N/A	$ 126,004	$ 315,011	$ 425,264					
Long-term incentive plan (7)	N/A	$ 37,801	$ 189,006	$ 378,013					
	2/16/11				13,057				$ 106,624(8)
	2/16/11					13,057			$ 319,897

(1) These amounts reflect awards under the Kindred Healthcare, Inc. 2001 Stock Incentive Plan, Amended and Restated (which we refer to as the 2001 Stock Incentive Plan).

(2) These amounts reflect all performance-based restricted stock units granted during 2011 to the named executive officers, regardless of when, or if, such performance-based restricted stock units vest. These performance-based restricted stock unit grants are divided into three equal tranches corresponding to annual performance periods for 2011, 2012 and 2013. The Committee establishes performance goals annually for the current year s tranche. If the performance goals are not satisfied in a given performance period, then some or all of the performance-based restricted stock units in the relevant performance period will be forfeited by the named executive officer. See the Equity-Based Compensation portion of the Compensation Discussion and Analysis section beginning on page 16 for a description of the minimum, target and maximum goals established for the 2011 performance period for the performance-based restricted stock units granted in 2011. With respect to the first and second tranches of the performance-based restricted stock units granted during 2011, performance above a minimum threshold in respect of one of either of the two relevant goals would result in an award percentage of 10% of such tranche. Further, because a 100% cap has been established as the maximum award level with respect to the first and second tranches of performance-based restricted stock units granted during 2011, the target award payout for the first and second tranches equals the maximum possible payout. In February 2012, based upon the Company s performance with respect to the 2011 performance period, each named executive officer earned the following number of shares from the first tranche of the 2011 award: Mr. Diaz 24,000 shares; Mr. Lechleiter 5,094 shares; Mr. Breier 10,283 shares; Mr. Bowen 4,992 shares; and Mr. Chapman 4,352 shares. Threshold, target and maximum performance criteria have not yet been established for the third tranche of the 2011 performance-based restricted stock units.

(3) The shares of service-based restricted stock granted in 2011 vest in four equal annual installments, beginning on the first anniversary of the date of grant. These share awards entitle each named executive officer to receive dividends if and when declared by the Board of Directors. The Company has not paid, and does not anticipate that it will pay in the foreseeable future, any cash dividends.

(4) No stock options were granted during 2011.