KINDRED HEALTHCARE INC
Form 10-Q/A
August 29, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q/A

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from   to   .

Commission file number: 001-14057

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

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

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

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [X] No [_]

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

Class of Common Stock	Outstanding at July 31, 2001
Common stock, $0.25 par value	15,600,000 shares

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

	Reorganized Company	Predecessor Company		
	Three months ended June 30, 2001	Three months ended June 30, 2000	Three months ended March 31, 2001	Six months ended June 30, 2000
		(Restated--see Note 2)		(Restated)
Revenues....................	$770,764	$713,424	$752,409	$1,428,880

Salaries, wages and benefits	432,182	392,383	427,649	797,696
Supplies	96,043	94,619	94,319	188,017
Rent	64,580	76,788	76,995	153,008
Other operating expenses	127,655	122,770	126,701	245,359
Depreciation and amortization	15,886	18,168	18,645	36,070
Interest expense	8,463	14,663	14,000	30,902
Investment income	(3,438)	(1,012)	(1,919)	(2,218)
	741,371	718,379	756,390	1,448,834
Income (loss) before reorganization items and income taxes	29,393	(4,955)	(3,981)	(19,954)
Reorganization items	-	2,530	(53,666)	5,595
Income (loss) before income taxes	29,393	(7,485)	49,685	(25,549)
Provision for income taxes	12,904	500	500	1,000
Income (loss) from operations before extraordinary items	16,489	(7,985)	49,185	(26,549)
Extraordinary gain on extinguishment of debt	1,396	-	422,791	-
Net income (loss)	17,885	(7,985)	471,976	(26,549)
Preferred stock dividend requirements	-	(262)	(261)	(523)
Income (loss) available to common stockholders	$ 17,885	$ (8,247)	$471,715	$ (27,072)
Earnings (loss) per common share:				
Basic:				
Income (loss) from operations before extraordinary items	$ 1.09	$ (0.12)	$ 0.69	$ (0.39)
Extraordinary gain on extinguishment of debt	0.09	-	6.02	-
Net income (loss)	$ 1.18	$ (0.12)	$ 6.71	$ (0.39)
Diluted:				
Income (loss) from operations before extraordinary items	$ 1.00	$ (0.12)	$ 0.69	$ (0.39)
Extraordinary gain on extinguishment of debt	0.08	-	5.90	-
Net income (loss)	$ 1.08	$ (0.12)	$ 6.59	$ (0.39)
Shares used in computing earnings (loss) per common share:				
Basic	15,090	70,147	70,261	70,194
Diluted	16,533	70,147	71,656	70,194

See accompanying notes.

KINDRED HEALTHCARE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except per share amounts)

	Reorganized Company	Predecessor Company
	June 30, 2001	December 31, 2000
		(Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 102,823	$ 184,642
Cash-restricted (see Note 12)	55,442	10,674
Insurance subsidiary investments	98,810	62,453
Accounts receivable less allowance for loss	414,942	322,483
Inventories	29,685	29,707
Other	60,607	85,893
	762,309	695,852
Property and equipment	456,126	693,586
Accumulated depreciation	(13,596)	(300,881)
	442,530	392,705
Reorganized value in excess of amounts allocable to identifiable assets	155,984	-
Goodwill	-	159,277
Other	73,951	86,580
	$1,434,774	$1,334,414
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 90,896	$ 115,468
Salaries, wages and other compensation	192,026	184,860
Due to third-party payors	39,969	44,561
Other accrued liabilities	170,779	81,452
Income taxes	30,796	2,350
Long-term debt due within one year	498	-
	524,964	428,691
Long-term debt	302,038	-
Professional liability risks	113,829	101,209
Deferred credits and other liabilities	31,407	14,132
Liabilities subject to compromise	-	1,260,373
Series A preferred stock (subject to compromise at December 31, 2000)	-	1,743

Contingencies		
Stockholders' equity (deficit):		
Reorganized Company common stock, $0.25 par value; authorized 39,000 shares; issued 15,600 shares -- June 30	3,900	-
Predecessor Company common stock, $0.25 par value; authorized 180,000 shares; issued 70,261 shares -- December 31	-	17,565
Capital in excess of par value	460,473	667,168
Deferred compensation	(19,722)	-
Retained earnings (accumulated deficit)	17,885	(1,156,467)
	462,536	(471,734)
	$1,434,774	$1,334,414

See accompanying notes.

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

	Reorganized Company	Predecessor Company		
	Three months ended June 30, 2001	Three months ended June 30, 2000	Three months ended March 31, 2001	Six mon ended June 3 2000
		(Restated)		(Restat
Cash flows from operating activities:				
Net income (loss)	$ 17,885	$ (7,985)	$ 471,976	$(26,5
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	15,886	18,168	18,645	36,0
Provision for doubtful accounts	8,740	8,567	6,305	17,3
Extraordinary gain on extinguishment of debt	(2,271)	-	(422,791)	
Unusual transactions	-	(4,535)	-	(4,5
Reorganization items	-	2,530	(53,666)	5,5
Other	271	7,267	1,357	10,8
Changes in operating assets and liabilities:				
Accounts receivable	(19,698)	11,667	(14,668)	9,8
Inventories and other assets	10,954	2,235	12,476	(4
Accounts payable	(3,034)	6,874	(10,845)	6,4
Income taxes	13,079	788	108	1,5
Due to third-party				

payors	(13,886)	(23,186)	2,051	(10,5
Other accrued liabilities	37,061	42,357	28,628	64,1
Net cash provided by operating activities before reorganization items	64,987	64,747	39,576	109,7
Payment of reorganization items	(24,723)	(1,371)	(3,745)	(3,7
Net cash provided by operating activities	40,264	63,376	35,831	106,0
Cash flows from investing activities:				
Purchase of property and equipment	(25,639)	(14,073)	(22,038)	(22,3
Sale of investment in Behavioral Healthcare Corporation	40,000	-	-	
Sale of other assets	5,162	10,715	-	13,0
Surety bond deposits	(300)	(200)	-	(4,1
Net change in investments	(45,985)	(7,915)	(28,178)	(30,4
Other	165	285	224	1,9
Net cash used in investing activities	26,597)	(11,188)	(49,992)	(41,8
Cash flows from financing activities:				
Repayment of long-term debt	(59,386)	(4,350)	(4,355)	(10,0
Payment of debtor-in possession deferred financing costs	-	-	(100)	(6
Other	(6,612)	(6,598)	(5,971)	(18,6
Net cash used in financing activities	(65,998)	(10,948)	(10,426)	(29,3
Change in cash and cash equivalents	(52,331)	41,240	(24,587)	34,7
Cash and cash equivalents at beginning of period	155,154	141,906	184,642	148,3
Cash and cash equivalents at end of period	$102,823	$183,146	$ 160,055	$183,1
Supplemental information:				
Interest payments	$ 950	$ 2,720	$ 2,606	$ 6,1
Income tax payments (refunds)	749	(229)	392	(5

See accompanying notes.

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

NOTE 1 -- BASIS OF PRESENTATION

Business

Kindred Healthcare, Inc. ("Kindred" or the "Company") (formerly Vencor, Inc.) provides long-term healthcare services primarily through the operation of nursing centers and hospitals. At June 30, 2001, the Company's health services division operated 315 nursing centers in 32 states and a rehabilitation therapy business. The Company's hospital division operated 56 hospitals in 23 states and an institutional pharmacy business.

Reorganization

On April 20, 2001 (the "Effective Date"), the Company and its subsidiaries emerged from proceedings under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") pursuant to the terms of its Amended Plan (as defined). On March 1, 2001, the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") approved the Company's fourth amended plan of reorganization filed with the Bankruptcy Court on December 14, 2000, as modified at the confirmation hearing (the "Amended Plan"). In connection with its emergence, the Company also changed its name to Kindred Healthcare, Inc.

Since filing for protection under the Bankruptcy Code on September 13, 1999, the Company had operated its businesses as a debtor-in-possession subject to the jurisdiction of the Bankruptcy Court. Accordingly, the unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7") and generally accepted accounting principles applicable to a going concern, which assume that assets will be realized and liabilities will be discharged in the normal course of business.

In connection with its emergence from bankruptcy, the Company reflected the terms of the Amended Plan in its consolidated financial statements by adopting the fresh-start accounting provisions of SOP 90-7. Under fresh-start accounting, a new reporting entity is deemed to be created and the recorded amounts of assets and liabilities are adjusted to reflect their estimated fair values. For accounting purposes, the fresh-start adjustments have been recorded in the unaudited condensed consolidated financial statements as of April 1, 2001. Since fresh-start accounting materially changed the amounts previously recorded in the Company's consolidated financial statements, a black line separates the post-emergence financial data from the pre-emergence data to signify the difference in the basis of preparation of the financial statements for each respective entity.

As used in this Form 10-Q/A, the term "Predecessor Company" refers to the Company and its operations for periods prior to April 1, 2001, while the term "Reorganized Company" is used to describe the Company and its operations for periods thereafter.

Comparability of Financial Information

The adoption of fresh-start accounting as of April 1, 2001 materially changed the amounts previously recorded in the consolidated financial statements of the Predecessor Company. With respect to reported operating results, management believes that business segment operating income of the Predecessor Company is generally comparable to that of the Reorganized Company. However, capital costs (rent, interest, depreciation and amortization) of the Predecessor Company that were based on pre-petition contractual agreements and historical costs are not comparable to those of the Reorganized Company. In addition, the reported financial position and cash flows of the Predecessor Company for periods prior to April 1, 2001 generally are not comparable to

those of the Reorganized Company.

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

NOTE 1 -- BASIS OF PRESENTATION (Continued)

Comparability of Financial Information (Continued)

In connection with the implementation of fresh-start accounting, the Company recorded an extraordinary gain of $422.8 million from the restructuring of its debt in accordance with the provisions of the Amended Plan. Other significant adjustments also were recorded to reflect the provisions of the Amended Plan and the fair values of the assets and liabilities of the Reorganized Company as of April 1, 2001. For accounting purposes, these transactions have been reflected in the operating results of the Predecessor Company for the three months ended March 31, 2001.

Spin-off

On May 1, 1998, Ventas, Inc. ("Ventas") completed the spin-off of its healthcare operations to its stockholders through the distribution of the Predecessor Company's equity securities (the "Spin-off"). Ventas retained ownership of substantially all of its real property and leases such real property to the Company. In anticipation of the Spin-off, the Company was incorporated on March 27, 1998 as a Delaware corporation. For accounting purposes, the consolidated historical financial statements of Ventas became the Company's historical financial statements following the Spin-off.

New Accounting Pronouncements

On January 1, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." The adoption of this pronouncement did not have a material impact on the Company's financial position or results of operations.

In June 2001, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 141 ("SFAS 141"), "Business Combinations," which provides that all business combinations should be accounted for using the purchase method of accounting and establishes criteria for the initial recognition and measurement of goodwill and other intangible assets recorded in connection with a business combination. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001 and to all business combinations accounted for by the purchase method that are completed after June 30, 2001.

In addition, the FASB issued in June 2001 SFAS No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which establishes the accounting for goodwill and other intangible assets following their recognition. SFAS 142 applies to all goodwill and other intangible assets whether acquired singly, as part of a group, or in a business combination. SFAS 142 also applies to excess reorganization value recognized in accordance with SOP 90-7. The new pronouncement provides that goodwill should not be amortized but should be tested for impairment annually using a fair-value based approach. In addition, SFAS 142 provides that intangible assets other than goodwill should be amortized over their useful lives and reviewed for impairment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS 142 will become effective for the

Company beginning on January 1, 2002. Upon adoption, the Company will be required to perform a transitional impairment test for the excess reorganization value recorded as of January 1, 2002. Any impairment loss recorded as a result of the transitional impairment test will be treated as a change in accounting principle. Management expects that the annual impact of eliminating the amortization of excess reorganization value beginning on January 1, 2002 will approximate $8 million. See Note 4.

Other Information

The accompanying unaudited condensed consolidated financial statements do not include all of the disclosures normally required by generally accepted accounting principles or those normally required in annual

NOTE 1 -- BASIS OF PRESENTATION (Continued)

Other Information (Continued)

reports on Form 10-K. The Reorganized Company has adopted the accounting policies of the Predecessor Company as described in the audited consolidated financial statements of the Predecessor Company for the year ended December 31, 2000 filed with the Securities and Exchange Commission (the "Commission") on Form 10-K/A.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the Company's customary accounting practices and the provisions of SOP 90-7. Management believes that the financial information included herein reflects all adjustments necessary for a fair presentation of interim results and, except for the items described in Note 4, all such adjustments are of a normal and recurring nature. Certain prior period amounts have been reclassified to conform with the current presentation.

On April 20, 2001, the Company announced that PricewaterhouseCoopers LLP ("PwC") had advised the Company that certain non-audit services provided to the Company during PwC's engagement as the Company's independent accountants by a subsidiary of PwC in connection with the Company's efforts to sell an equity investment raised an issue as to PwC's independence. PwC disclosed the situation to the Commission, which is currently investigating the issue. PwC has further advised the Company that, notwithstanding the provision of such non-audit services, PwC was and continues to be independent accountants with respect to the Company, and it is the present intention of PwC to sign audit opinions and consents to incorporation as necessary in connection with documents filed by the Company with the Commission and other third parties. The Company cannot predict at this time how this issue will be resolved or what impact, if any, such resolution will have on the Company's past or future filings with the Commission and other third parties.

NOTE 2 -- RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS

On August 14, 2001, the Company announced that it will restate certain of its previously issued consolidated financial statements. The Company recently determined that an oversight related to the allowance for professional liability risks had occurred in its consolidated financial statements beginning in 1998. The oversight resulted in the understatement of the provision for professional liability claims in 1998, 1999 and 2000 because the Company did

not record a reserve for claims incurred but not reported at the respective balance sheet dates.

The cumulative understatement of professional liability claims reserves approximated $5 million at December 31, 1998, $28 million at December 31, 1999 and $39 million at December 31, 2000. The previously reported cash flows of the Company will not be affected by the restatement. The restatement of prior year results had no effect on the Company's reported operating results for the first or second quarters of 2001.

The unaudited condensed consolidated financial statements included herein amend those previously included in the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2001. Consolidated financial statement information and related disclosures included in these amended unaudited condensed consolidated financial statements reflect, where appropriate, changes resulting from the restatement.

NOTE 2 -- RESTATEMENT OF PREVIOUSLY ISSUED FINANCIAL STATEMENTS (Continued)

The effect of the restatement on the Company's previously issued unaudited condensed consolidated financial statements follows (in thousands, except per share amounts):

	June 30, 2000			
	Three months ended		Six months ended	
	As previously reported	As restated	As previously reported	As restated
Loss from operations..................	$(5,192)	$(7,985)	$(20,963)	$(26,549)
Net loss..............................	(5,192)	(7,985)	(20,963)	(26,549)
Loss per common share:				
Basic:				
Loss from operations................	$ (0.08)	$ (0.12)	$ (0.31)	$ (0.39)
Net loss............................	(0.08)	(0.12)	(0.31)	(0.39)
Diluted:				
Loss from operations................	$ (0.08)	$ (0.12)	$ (0.31)	$ (0.39)
Net loss............................	(0.08)	(0.12)	(0.31)	(0.39)

	December 31, 2000	
	As previously reported	As restated
Professional liability		

risks..................	$ 62,327	$ 101,209
Total liabilities.......	1,765,523	1,804,405
Accumulated deficit.....	(1,117,585)	(1,156,467)
Stockholders' deficit...	(432,852)	(471,734)

NOTE 3 -- REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

On April 20, 2001, the Company and its subsidiaries emerged from proceedings under Chapter 11 of the Bankruptcy Code pursuant to the terms of the Amended Plan. The Company and substantially all of its subsidiaries filed voluntary petitions with the Bankruptcy Court for protection under Chapter 11 of the Bankruptcy Code on September 13, 1999.

The Chapter 11 cases were consolidated for purposes of joint administration under Case Nos. 99-3199 (MFW) through 99-3327 (MFW) (collectively, the "Chapter 11 Cases"). Following emergence, the Company is continuing to resolve proofs of claims filed in the Chapter 11 Cases. On the Effective Date, the automatic stay imposed by the Bankruptcy Code was terminated.

Amended Plan of Reorganization

The Amended Plan represents a consensual arrangement among Ventas, the Company's former senior bank lenders (the "Senior Lenders"), holders of the Company's $300 million 9 7/8% Guaranteed Senior Subordinated Notes due 2005 (the "1998 Notes"), the United States Department of Justice (the "DOJ"), acting on behalf of the Department of Health and Human Services' Office of the Inspector General (the "OIG"), and the Centers for Medicare and Medicaid Services (formerly the Health Care Financing Administration) ("CMS") (collectively, the "Government") and the advisors to the official committee of unsecured creditors.

The following is a summary of certain material provisions of the Amended Plan. The summary does not purport to be complete and is qualified in its entirety by reference to all of the provisions of the Amended Plan, as filed with the Commission.

NOTE 3 -- REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE (Continued)

Amended Plan of Reorganization (Continued)

The Amended Plan provided for, among other things, the following distributions:

Senior Lender Claims--On the Effective Date, the Senior Lenders received the Senior Secured Notes aggregating $300 million, bearing interest at the rate of LIBOR (as defined in the agreement) plus 4 1/2%, with a maturity of seven years. The interest on the Senior Secured Notes will begin to accrue approximately two quarters following the Effective Date and, in lieu of interest payments, the Company will pay a $25.9 million obligation under the Government Settlement (as defined) within the first two full fiscal quarters following the Effective Date as described below. In addition, holders of the Senior Lender claims received an aggregate distribution of 9,826,092 shares of the new common stock of Kindred (the "Common Stock") on the Effective Date.

Subordinated Noteholder Claims--The holders of the 1998 Notes and the remaining $2.4 million of the Company's 8 5/8% Senior Subordinated Notes due 2007 (collectively, the "Subordinated Noteholder Claims") received, in the aggregate, 3,675,408 shares of the Common Stock on the Effective Date. In addition, the holders of the Subordinated Noteholder Claims received warrants issued by the Company for the purchase of an aggregate of 7,000,000 shares of Common Stock, with a five-year term, comprised of warrants to purchase 2,000,000 shares at a price per share of $30.00 and warrants to purchase 5,000,000 shares at a price per share of $33.33 (collectively, the "Warrants").

Ventas Claim--Ventas received the following treatment under the Amended Plan:

On the Effective Date, the four master leases and a single facility lease with Ventas were assumed and simultaneously amended and restated as the Amended Leases. The principal economic terms of the Amended Leases are as follows:

(1) A decrease of $52 million in the aggregate minimum rent from the annual rent as of May 1, 1999 to a new initial aggregate minimum rent of $174.6 million (subject to the escalation described below).

(2) Annual aggregate minimum rent payable in cash will escalate at an annual rate of 3.5% over the prior period annual aggregate minimum rent for the period from May 1, 2001 through April 30, 2004. Thereafter, annual aggregate minimum rent payable in cash will escalate at an annual rate of 2.0%, plus an additional annual accrued escalator amount of 1.5% of the prior period annual aggregate minimum rent which will accrete from year to year (with an interest accrual at LIBOR plus 4 1/2%). All accrued rent will be payable upon the repayment or refinancing of the Senior Secured Notes, after which the annual aggregate minimum rent payable in cash will escalate at an annual rate of 3.5% and there will be no further accrual feature. The annual escalator in each period is contingent upon the attainment of certain financial targets as described in the Amended Leases.

(3) A one-time option, that can be exercised by Ventas 5 1/4 years after the Effective Date, to reset the annual aggregate minimum rent under one or more of the Amended Leases to the then current fair market rental in exchange for a payment of $5 million (or a pro rata portion thereof if fewer than all of the Amended Leases are reset) to the Company.

(4) Under the Amended Leases, the "Event of Default" provisions also were substantially modified and provide Ventas with more flexibility in exercising remedies for events of default.

In addition to the Amended Leases, Ventas received a distribution of 1,498,500 shares of the Common Stock on the Effective Date.

NOTE 3 -- REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE (Continued)

Amended Plan of Reorganization (Continued)

Ventas and the Company also entered into a tax escrow agreement as of the Effective Date that provides for the escrow of approximately $30 million of

federal, state and local refunds until the expiration of the applicable statutes of limitation for the auditing of the refund applications (the "Tax Escrow Agreement"). The escrowed funds will be available for the payment of certain tax deficiencies during the escrow period except that all interest paid by the government in connection with any refund or earned on the escrowed funds will be distributed equally to the parties. At the end of the escrow period, the Company and Ventas will each be entitled to 50% of any proceeds remaining in the escrow account.

All agreements and indemnification obligations between the Company and Ventas, except those modified by the Amended Plan, were assumed by the Company as of the Effective Date.

United States Claims--The claims of the Government (other than claims of the Internal Revenue Service and criminal claims, if any) were settled through a government settlement with the Company and Ventas which was effectuated through the Amended Plan (the "Government Settlement").

Under the Government Settlement, the Company will pay the Government a total of $25.9 million as follows:

(1) $10 million was paid on the Effective Date, and

(2) an aggregate of $15.9 million will be paid during the first two full fiscal quarters following the Effective Date, plus accrued interest at the rate of 6% per annum beginning as of the Effective Date.

Under the Government Settlement, Ventas will pay the Government a total of $103.6 million as follows:

(1) $34 million was paid on the Effective Date, and

(2) the remainder will be paid over five years, bearing interest at the rate of 6% per annum beginning as of the Effective Date.

In addition, the Company agreed to repay the remaining balance of the obligations owed to CMS (approximately $59 million as of the Effective Date) pursuant to the terms previously agreed to by the Company (the "CMS Agreement").

As previously announced, the Company entered into a Corporate Integrity Agreement with the OIG as part of the overall Government Settlement. The Corporate Integrity Agreement became effective on the Effective Date. The Government Settlement also provides for the dismissal of certain pending claims and lawsuits filed against the Company. See Note 11.

General Unsecured Creditors Claims--The general unsecured creditors of the Company will be paid the full amount of their allowed claims existing as of the date of the Company's filing for protection under the Bankruptcy Code. These amounts generally will be paid in equal quarterly installments over three years beginning on September 30, 2001. The Company will pay interest on these claims at the rate of 6% per annum from the Effective Date, subject to certain exceptions. A convenience class of unsecured creditors, consisting of creditors holding allowed claims in an amount less than or equal to $3,000, were paid in full within 30 days of the Effective Date.

Preferred Stockholder and Common Stockholder Claims--The holders of preferred stock and common stock of the Company prior to the Effective Date did not receive any distributions under the Amended Plan. The former preferred stock and common stock were canceled on the Effective Date.

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

NOTE 3 -- REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE (Continued)

Amended Plan of Reorganization (Continued)

Other Significant Provisions--As of the Effective Date, the board of directors of the Company consisted of seven members: Edward L. Kuntz, Chairman of the Board of Directors, Jeff Altman of Franklin Mutual Advisors, L.L.C., James Bolin of Appaloosa Management, L.P., Garry N. Garrison, Isaac Kaufman of Advanced Medical Management, Inc., John H. Klein of SBTS and David Tepper of Appaloosa Management, L.P.

A restricted share plan was approved under the Amended Plan that provided for the issuance of 600,000 shares of Common Stock to certain key employees of the Company. The restricted shares are non-transferable and subject to forfeiture until they have vested generally over a four-year period. In addition, a new stock option plan was approved under the Amended Plan for the issuance of stock options for up to 600,000 shares of Common Stock to certain key employees of the Company. The Amended Plan also approved the Vencor, Inc. 2000 Long-Term Incentive Plan that provides cash bonus awards to certain key employees on the attainment by the Company of specified performance goals, and also provided for the continuation of the Company's management retention plan and the payment of certain performance bonuses on the Effective Date.

Matters Related to Emergence

On the Effective Date, the Company entered into the Credit Facility, a five-year $120 million senior revolving credit facility (including a $40 million letter of credit subfacility) with a lending group led by Morgan Guaranty Trust Company of New York. The Credit Facility constitutes a working capital facility for general corporate purposes including payments related to the Company's obligations under the Amended Plan. Direct borrowings under the Credit Facility will bear interest, at the option of the Company, at (a) prime (or, if higher, the federal funds rate plus 1/2%) plus 3% or (b) LIBOR (as defined in the agreement) plus 4%. The Credit Facility is collateralized by substantially all of the assets of the Company and its subsidiaries, including certain owned real property.

On the Effective Date, the Company filed a registration statement on Form 8-A (the "Form 8-A") with the Commission to register its Common Stock and Warrants under Section 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act").

NOTE 4 -- FRESH-START ACCOUNTING

As previously discussed, the Company adopted the provisions of fresh-start accounting as of April 1, 2001. In adopting fresh-start accounting, the Company engaged an independent financial advisor to assist in the determination of the reorganization value or fair value of the entity. The independent financial advisor determined an estimated reorganization value of $762 million before considering any long-term debt or other obligations assumed in connection with the Amended Plan. This estimate was based upon the Company's cash flows, selected comparable market multiples of publicly traded companies, operating lease obligations and other applicable ratios and valuation techniques. The estimated total equity value of the Reorganized Company aggregating $435 million was determined after taking into account the values of the obligations

assumed in connection with the Amended Plan.

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

NOTE 4 -- FRESH-START ACCOUNTING (Continued)

A reconciliation of fresh-start accounting recorded as of April 1, 2001 follows (in thousands):

	Predecessor Company	Fresh-start			Reorga Comp
	March 31, 2001	Debt Restructuring	Adjustments	Reclassifications	April 1
ASSETS	(Restated)				
Current assets:					
Cash and cash equivalents...........	$ 160,055	$ -	$ (4,901)(i)	$ -	$ 155
Cash-restricted........	11,008	(2,763)(a)	6,000 (i)	-	14
Insurance subsidiary investments...........	90,617	-	-	-	90
Accounts receivable less allowance for loss..................	330,846	73,138 (b)	-	-	403
Inventories...........	29,132	-	-	-	29
Other.................	74,732	1,360 (a)	-	-	76
	696,390	71,735	1,099	-	769
Property and equipment..	708,232	-	(268,528)(j)	-	439
Accumulated depreciation...........	(316,862)	-	316,862 (j)	-	
	391,370	-	48,334	-	439
Reorganized value in excess of amounts allocable to identifiable assets.................	-	-	157,958 (k)	-	157
Goodwill................	156,765	-	(156,765)(l)	-	
Investment in affiliates.............	7,824	-	40,282 (m)	-	48
Other...................	77,673	(7,668)(a) 2,795 (c)	(1,823)(i) (52)(j)	-	70
	$ 1,330,022	$ 66,862	$ 89,033	$ -	$1,485
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)					
Current liabilities:					
Accounts payable.......	$ 90,279	$ (2,264)(b)	$ (4,030)(i)	$ 1,602 (r)	$ 85
Salaries, wages and other compensation....	178,319	-	(93)(i)	1,404 (r)	195

			7,700 (n) 8,511 (o)		
Due to third-party payors................	47,773	(4,569)(b)	-	10,651 (r)	53
Other accrued liabilities...........	91,132	2,795 (c) 25,900 (d)	25,337 (o)	43,865 (r)	189
Income taxes...........	2,850	-	-	14,867 (r)	17
Long-term debt due within one year.......	-	-	-	18,316 (r)	18
	410,353	21,862	37,425	90,705	560
Long-term debt..........	-	300,000 (e)	-	43,606 (r)	343
Professional liability risks..................	106,505	-	-	-	106
Deferred credits and other liabilities......	14,128	-	(1,777)(p)	28,071 (r)	40
Liabilities subject to compromise............	1,278,223	2,580 (a) (113,576)(b) (902,755)(f) (94,285)(g) (3,051)(h)	(2,028)(i) (2,726)(p)	(162,382)(r)	
Series A preferred stock (subject to compromise at March 31, 2001).....	1,743	(1,743)(h)	-	-	
Stockholders' equity (deficit):					
Reorganized Company common stock, par value.................	-	3,750 (h)	-	-	3
Predecessor Company common stock, par value.................	17,565	-	(17,565)(q)	-	
Capital in excess of par value............	667,187	431,289 (h)	17,565 (q)	(684,752)(s)	431
Retained earnings (accumulated deficit).............	(1,165,682)	(11,651)(a) 193,547 (b) (25,900)(d) (300,000)(e) 902,755 (f) 94,285 (g) (430,245)(h)	5,427 (i) 48,282 (j) 157,958 (k) (156,765)(l) 40,282 (m) (7,700)(n) (33,848)(o) 4,503 (p)	684,752 (s)	
	(480,930)	857,830	58,139	-	435
	$ 1,330,022	$ 66,862	$ 89,033	$ -	$1,485

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

NOTE 4 -- FRESH-START ACCOUNTING (Continued)

(a) To record the effect of the Tax Escrow Agreement.

(b) To record the discharge of pre-petition accounts receivable, allowances for loss and liabilities related to the Medicare program in connection with the Government Settlement.

(c) To record deferred financing costs incurred in connection with the Credit Facility and the Senior Secured Notes.

(d) To record the Government Settlement obligation.

(e) To record the issuance of the Senior Secured Notes.

(f) To record the discharge of indebtedness in accordance with the Amended Plan (in thousands):

Senior Lender Claims	$510,908
Subordinated Noteholder Claims	302,391
Accrued interest	99,185
Unamortized deferred financing costs	(9,729)
	$902,755

(g) To write off accrued Ventas rent discharged in accordance with the Amended Plan.

(h) To record the issuance of the Common Stock and Warrants of the Reorganized Company and eliminate the preferred stock (and related loans) and accrued dividends of the Predecessor Company in accordance with the Amended Plan.

(i) To record miscellaneous provisions of the Amended Plan.

(j) To adjust the property and equipment to fair value and to write off previously recorded accumulated depreciation.

(k) To record the reorganized value of the Company in excess of amounts allocable to identifiable assets. These costs will be amortized using the straight-line method over 20 years.

(l) To write off historical goodwill of the Predecessor Company.

(m) To adjust investment in affiliates to fair value.

(n) To record the value of the vested portion of restricted stock in accordance with the Amended Plan.

(o) To record reorganization costs consisting primarily of professional fees and management compensation to be paid in accordance with the Amended Plan.

(p) To adjust allowances for loss related to property disposals and non-income tax deficiencies.

(q) To eliminate the common stock of the Predecessor Company.

(r) To reclassify the pre-petition priority, secured and unsecured claims that were assumed by the Company in accordance with the Amended Plan.

(s) To eliminate the historical accumulated deficit and adjust stockholders' equity to reflect the fair value of the Company's total equity.

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

NOTE 5 -- PRO FORMA INFORMATION

The unaudited condensed pro forma effect of the Amended Plan assuming that the Effective Date occurred on January 1, 2000 follows (in thousands, except per share amounts):

	Six months ended June 30,	
	2001	2000
		(Restated)
Revenues	$1,523,173	$1,428,880
Income from operations before extraordinary items	26,782	10,053
Net income	28,178	10,053
Basic:		
Income from operations before extraordinary items	$ 1.76	$ 0.66
Net income	1.85	0.66
Diluted:		
Income from operations before extraordinary items	$ 1.62	$ 0.61
Net income	1.70	0.61

The pro forma results exclude reorganization items recorded prior to April 1, 2001. The pro forma results are not necessarily indicative of the financial results that might have resulted had the effective date of the Amended Plan actually occurred on January 1, 2000.

NOTE 6 -- REVENUES

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

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

Reorganized Company
Three months ended

	June 30, 2001
Medicare	$298,671
Medicaid	263,796
Private and other	223,593
	786,060
Elimination	(15,296)
	$770,764

NOTE 7 -- EARNINGS PER SHARE

Earnings per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings per common share for the Reorganized Company includes the dilutive effect of the Warrants issued in connection with the Amended Plan and stock options and non-vested restricted stock issued under various incentive plans. For the three months ended March 31, 2001, the diluted calculation of earnings per common share for the Predecessor Company includes the dilutive effect of its former convertible preferred stock.

NOTE 7 -- EARNINGS PER SHARE (Continued)

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

	Reorganized Company	Predecessor Company		
	Three months ended June 30, 2001	Three months ended June 30, 2000	Three months ended March 31, 2001	Six months ended June 30, 2000
		(Restated)		(Restated)
Earnings (loss):				
Income (loss) from operations before extraordinary items	$16,489	$(7,985)	$ 49,185	$(26,549)
Extraordinary gain on extinguishment of debt	1,396	-	422,791	-
Net income (loss)	17,885	(7,985)	471,976	(26,549)
Preferred stock dividend requirements	-	(262)	(261)	(523)
Income (loss) available to common				

stockholders--basic computation..	17,885	(8,247)	471,715	(27,072)
Elimination of preferred stock dividend requirements upon assumed conversion of preferred stock...........................	-	-	261	-
Net income (loss)--diluted computation.....................	$17,885	$(8,247)	$471,976	$(27,072)
Shares used in the computation:				
Weighted average shares outstanding--basic computation...	15,090	70,147	70,261	70,194
Dilutive effect of the Warrants, employee stock options and non-vested restricted stock..........	1,443	-	-	-
Assumed conversion of preferred stock...........................	-	-	1,395	-
Adjusted weighted average shares outstanding--diluted computation.....................	16,533	70,147	71,656	70,194
Earnings (loss) per common share:				
Basic:				
Income (loss) from operations before extraordinary items.......	$ 1.09	$ (0.12)	$ 0.69	$ (0.39)
Extraordinary gain on extinguishment of debt...........	0.09	-	6.02	-
Net income (loss)................	$ 1.18	$ (0.12)	$ 6.71	$ (0.39)
Diluted:				
Income (loss) from operations before extraordinary items.......	$ 1.00	$ (0.12)	$ 0.69	$ (0.39)
Extraordinary gain on extinguishment of debt...........	0.08	-	5.90	-
Net income (loss)................	$ 1.08	$ (0.12)	$ 6.59	$ (0.39)

NOTE 8 -- BUSINESS SEGMENT DATA

The Company operates two business segments: the health services division and the hospital division. The health services division operates nursing centers and a rehabilitation therapy business. The hospital division operates hospitals and an institutional pharmacy business. The Company defines operating income as earnings before interest, income taxes, depreciation, amortization and rent. Operating income reported for each of the Company's business segments excludes allocations of corporate overhead.

The carrying values of the Company's assets at June 30, 2001 and the capital costs (rent, interest, depreciation and amortization) included in the unaudited condensed consolidated statement of operations for the three months ended June 30, 2001 reflect the provisions of the Amended Plan and the impact of fresh-start accounting. These costs for periods prior to the Company's emergence from bankruptcy generally were recorded based on contractual agreements or historical costs and did not reflect the provisions of the Amended Plan. In addition, during the pendency of the Chapter 11 Cases, no interest costs were recorded related to the 1998 Notes. Accordingly, assets by business segment at June 30, 2001 and capital costs of the Reorganized Company for the three months ended June 30, 2001 are not comparable to those of the Predecessor Company.

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

NOTE 8 -- BUSINESS SEGMENT DATA (Continued)

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

	Reorganized Company	Predecessor Company		
	Three months ended June 30, 2001	Three months ended June 30, 2000 (Restated)	Three months ended March 31, 2001	Six months ended June 30, 2000 (Restated)
Revenues:				
Health services division:				
Nursing centers..................	$444,137	$413,159	$429,523	$ 825,862
Rehabilitation services..........	9,244	33,173	10,695	67,550
Other ancillary services.........	-	(2)	-	(7)
Elimination......................	-	(18,509)	-	(36,600)
	453,381	427,821	440,218	856,805
Hospital division:				
Hospitals........................	276,112	250,027	271,984	503,618
Pharmacy.........................	56,567	49,949	54,880	97,417
	332,679	299,976	326,864	601,035
	786,060	727,797	767,082	1,457,840
Elimination of pharmacy charges to Company nursing centers..........	(15,296)	(14,373)	(14,673)	(28,960)
	$770,764	$713,424	$752,409	$1,428,880
Income (loss) from operations before extraordinary items:				
Operating income (loss):				
Health services division:				
Nursing centers.................	$ 78,735	$ 75,348	$ 70,543	$ 144,060
Rehabilitation services.........	1,809	(1,059)	690	(573)
Other ancillary services........	103	242	250	372
	80,647	74,531	71,483	143,859
Hospital division:				
Hospitals.......................	55,685	51,547	54,778	106,945
Pharmacy........................	6,036	789	6,176	(411)
	61,721	52,336	60,954	106,534
Corporate overhead..............	(27,484)	(27,750)	(28,697)	(57,120)

Unusual transactions............	-	4,535	-	4,535
Reorganization items............	-	(2,530)	53,666	(5,595)
Operating income................	114,884	101,122	157,406	192,213
Rent............................	(64,580)	(76,788)	(76,995)	(153,008)
Depreciation and amortization.....	(15,886)	(18,168)	(18,645)	(36,070)
Interest, net....................	(5,025)	(13,651)	(12,081)	(28,684)
Income (loss) before income taxes...........................	29,393	(7,485)	49,685	(25,549)
Provision for income taxes........	12,904	500	500	1,000
	$ 16,489	$ (7,985)	$ 49,185	$ (26,549)
Rent:				
Health services division:				
Nursing centers.................	$ 40,190	$ 43,888	$ 44,253	$ 87,477
Rehabilitation services.........	27	130	39	199
Other ancillary services........	3	17	-	37
	40,220	44,035	44,292	87,713
Hospital division:				
Hospitals.......................	22,917	31,199	30,839	61,894
Pharmacy........................	968	853	941	1,753
	23,885	32,052	31,780	63,647
Corporate.......................	475	701	923	1,648
	$ 64,580	$ 76,788	$ 76,995	$ 153,008

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

NOTE 8 -- BUSINESS SEGMENT DATA (Continued)

	Reorganized Company	Predecessor Company		
	Three months ended June 30, 2001	Three months ended June 30, 2000	Three months ended March 31, 2001	Six months ended June 30, 2000
Depreciation and amortization:				
Health services division:				
Nursing centers..................	$ 5,055	$ 6,720	$ 7,219	$13,390
Rehabilitation services..........	11	1	-	4
Other ancillary services.........	-	263	129	548
	5,066	6,984	7,348	13,942
Hospital division:				

Hospitals	5,690	5,271	5,457	10,578
Pharmacy	447	491	627	1,017
	6,137	5,762	6,084	11,595
Corporate	4,683	5,422	5,213	10,533
	$ 15,886	$ 18,168	$18,645	$36,070
Capital expenditures:				
Health services division	$ 4,529	$ 3,794	$ 7,962	$ 6,702
Hospital division	8,644	2,944	8,901	6,480
Corporate:				
Information systems	3,135	6,767	3,496	8,113
Other	9,331	568	1,679	1,028
	$ 25,639	$ 14,073	$22,038	$22,323

	Reorganized Company	Predecessor Company
	June 30, 2001	December 31, 2000
Assets:		
Health services division	$ 395,934	$ 494,636
Hospital division	460,426	354,302
Corporate	578,414	485,476
	$1,434,774	$1,334,414

NOTE 9 -- INCOME TAXES

The provision for income taxes is based upon management's estimate of taxable income or loss for the respective periods and includes the effect of certain non-taxable and non-deductible items, such as reorganization intangible amortization, and the increase or decrease in the deferred tax valuation allowance.

The Company has reduced its net deferred tax assets by a valuation allowance to the extent management does not believe it is "more likely than not" that the asset ultimately will be realizable. If all or a portion of the pre-reorganization deferred tax asset is realized in the future, or considered to "more likely than not" be realizable by management, the reorganization intangible recorded in connection with fresh-start accounting will be reduced accordingly. If the reorganization intangible is eliminated in full, other intangibles will then be reduced, with any excess treated as an increase to capital in excess of par value.

The provision for income taxes for the three months ended June 30, 2000 and March 31, 2001 and the six months ended June 30, 2000 included charges of $2.5 million, $685,000 and $8.4 million, respectively, related to the deferred tax valuation allowance. No changes in the valuation allowance were recorded in the second quarter of 2001. As a result of fresh-start accounting, the deferred tax valuation allowance included in the Company's unaudited condensed consolidated balance sheet aggregated $284 million at June 30, 2001.

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

NOTE 9 -- INCOME TAXES (Continued)

In connection with the reorganization, the Company realized a gain from the extinguishment of certain indebtedness. This gain will not be taxable since the gain resulted from the reorganization under the Bankruptcy Code. However, the Company will be required, as of the beginning of its 2002 taxable year, to reduce certain tax attributes relating to the Company including (a) net operating loss carryforwards ("NOLs"), (b) certain tax credits and (c) tax bases in assets in an amount equal to such gain on extinguishment. The reorganization of the Company on the Effective Date constituted an ownership change under Section 382 of the Internal Revenue Code and the use of any of the Company's NOLs and tax credits generated prior to the ownership change, that are not reduced pursuant to the provisions discussed above, will be subject to an overall annual limitation of approximately $22 million.

The Company had NOLs of approximately $164 million (after the reductions in the attributes discussed above) and $215 million as of June 30, 2001 and December 31, 2000, respectively. These carryforwards expire in various amounts through 2021.

NOTE 10 -- EARLY EXTINGUISHMENT OF DEBT

In connection with the restructuring of its debt in accordance with the provisions of the Amended Plan, the Company realized an extraordinary gain of $422.8 million. For accounting purposes, this gain has been reflected in the operating results of the Predecessor Company for the three months ended March 31, 2001.

A summary of the extraordinary gain follows (in thousands):

Liabilities restructured:	
Debt obligations:	
Senior Lender Claims	$ 510,908
Subordinated Noteholder Claims	302,391
Accrued interest	99,185
Unamortized deferred financing costs	(9,729)
	902,755
Amounts related to prior year Medicare cost reports	193,547
Accrued Ventas rent	94,285
Other	(6,857)
	1,183,730
Consideration exchanged:	
Senior Secured Notes	300,000
Common Stock	368,339
Warrants	66,700
Government Settlement obligation	25,900
	760,939
	$ 422,791

On May 30, 2001, the Company prepaid the outstanding balance in full satisfaction of its obligations under the CMS Agreement, resulting in an extraordinary gain of $1.4 million. The transaction was financed through the use of existing cash.

NOTE 11 -- LITIGATION

Summary descriptions of various significant legal and regulatory activities follow.

On September 13, 1999, the Company and substantially all of its subsidiaries filed voluntary petitions for protection under Chapter 11 of the Bankruptcy Code. The Chapter 11 Cases have been styled In re: Vencor, Inc., et al., Debtors and Debtors in Possession, Case Nos. 99-3199 (MFW) through 99-3327 (MFW), Chapter 11, Jointly Administered. On March 1, 2001, the Bankruptcy Court approved the Company's fourth amended plan of reorganization filed with the Bankruptcy Court on December 14, 2000, as modified at the confirmation hearing. The order confirming the Amended Plan was signed on March 16, 2001 and entered on the docket of the Bankruptcy Court on March 19, 2001. The effective date of the Amended Plan was April 20, 2001. See Note 3.

On March 18, 1999, the Company served Ventas with a demand for mediation pursuant to the Agreement and Plan of Reorganization governing the Spin-off (the "Spin-off Agreement"). The Company was seeking a reduction in rent and other concessions under its master lease agreements with Ventas. On March 31, 1999, the Company and Ventas entered into a standstill agreement which provided that both companies would postpone through April 12, 1999 any claims either may have against the other. On April 12, 1999, the Company and Ventas entered into a second standstill which provided that neither party would pursue any claims against the other or any other third party related to the Spin-off as long as the Company complied with certain rent payment terms. The second standstill was scheduled to terminate on May 5, 1999. Pursuant to a tolling agreement, the Company and Ventas also agreed that any statutes of limitations or other time-related constraints in a bankruptcy or other proceeding that might be asserted by one party against the other would be extended and tolled from April 12, 1999 until May 5, 1999 or until the termination of the second standstill. As a result of the Company's failure to pay rent, Ventas served the Company with notices of nonpayment under the master lease agreements. Subsequently, the Company and Ventas entered into further amendments to the second standstill and the tolling agreement to extend the time during which no remedies may be pursued by either party and to extend the date by which the Company may cure its failure to pay rent.

In connection with the Chapter 11 Cases, the Company and Ventas entered into the stipulation that provided for the payment by the Company of a reduced aggregate monthly rent of approximately $15.1 million (the "Stipulation"). The Stipulation was approved by the Bankruptcy Court. The Stipulation tolled any statutes of limitations or other time constraints in a bankruptcy proceeding for claims that might be asserted by the Company against Ventas. The Stipulation automatically renewed for one-month periods unless either party provided a 14-day notice of termination. The Stipulation also provided that the Company would continue to fulfill its indemnification obligations arising from the Spin-off. The Stipulation was terminated on the Effective Date.

As a result of the consummation of the Amended Plan, the Company believes that all known material disputes between the Company and Ventas have been resolved. The Amended Plan also provided for comprehensive mutual releases between the Company and Ventas, other than for obligations that the Company is assuming under the Amended Plan.

The Company's subsidiary, formerly named TheraTx, Incorporated, is a plaintiff in a declaratory judgment action entitled TheraTx, Incorporated v. James W. Duncan, Jr., et al., No. 1:95-CV-3193, filed in the United States District Court for the Northern District of Georgia and currently pending in the United States Court of Appeals for the Eleventh Circuit, No. 99-11451-FF. The defendants asserted counterclaims against TheraTx, Incorporated ("TheraTx") under breach of contract, securities fraud, negligent misrepresentation and other

NOTE 11 -- LITIGATION (Continued)

fraud theories for allegedly not performing as promised under a merger agreement related to TheraTx's purchase of a company called PersonaCare, Inc. and for allegedly failing to inform the defendants/counterclaimants prior to the merger that TheraTx's possible acquisition of Southern Management Services, Inc. might cause the suspension of TheraTx's shelf registration under relevant rules of the Commission. The court granted summary judgment for the defendants/counterclaimants and ruled that TheraTx breached the shelf registration provision in the merger agreement, but dismissed the defendants' remaining counterclaims. Additionally, the court ruled after trial that defendants/counterclaimants were entitled to damages and prejudgment interest in the amount of approximately $1.3 million and attorneys' fees and other litigation expenses of approximately $700,000. The Company and the defendants/counterclaimants both appealed the court's rulings. The United States Court of Appeals for the Eleventh Circuit affirmed the trial court's rulings in TheraTx's favor, with the exception of the damages award, and certified the question of the proper calculation of damages under Delaware law to the Delaware Supreme Court. The Delaware Supreme Court issued an opinion on June 1, 2001, which sets forth a rule for determining such damages but did not calculate any actual damages. On June 25, 2001, the Eleventh Circuit remanded the action to the trial court to render a decision consistent with the Delaware Supreme Court's ruling. The Company is defending the action vigorously.

The Company is pursuing various claims against private insurance companies who issued Medicare supplement insurance policies to individuals who became patients of the Company's hospitals. After the patients' Medicare benefits are exhausted, the insurance companies become liable to pay the insureds' bills pursuant to the terms of these policies. The Company has filed numerous collection actions against various of these insurers to collect the difference between what Medicare would have paid and the hospitals' usual and customary charges. These disputes arise from differences in interpretation of the policy provisions and federal and state laws governing such policies. Various courts have issued various rulings on the different issues, some of which have been adverse to the Company and most of which have been appealed. The Company intends to continue to pursue these claims vigorously. If the Company does not prevail on these issues, future results of operations and liquidity could be materially adversely affected.

A class action lawsuit entitled A. Carl Helwig v. Vencor, Inc., et al., was filed on December 24, 1997 in the United States District Court for the Western District of Kentucky (Civil Action No. 3-97CV-8354). The class action claims were brought by an alleged stockholder of the Company's predecessor against the Company and Ventas and certain current and former executive officers and directors of the Company and Ventas. The complaint alleges that the Company, Ventas and certain current and former executive officers of the Company and Ventas during a specified time frame violated Sections 10(b) and 20(a) of the Exchange Act, by, among other things, issuing to the investing public a series of false and misleading statements concerning Ventas' then current operations and the inherent value of its common stock. The complaint further alleges that as a result of these purported false and misleading statements concerning Ventas' revenues and successful acquisitions, the price of the common stock was artificially inflated. In particular, the complaint alleges that the defendants issued false and misleading financial statements during the first, second and third calendar quarters of 1997 which misrepresented and understated the impact that changes in Medicare reimbursement policies would have on Ventas' core services and profitability. The complaint further alleges that the defendants issued a series of materially false statements concerning the purportedly successful integration of Ventas' acquisitions and prospective earnings per share for 1997 and 1998 which the defendants knew lacked any reasonable basis and were not being achieved. The suit seeks damages in an amount to be proven at trial, pre-judgment and post-judgment interest, reasonable attorneys' fees, expert witness fees and other costs, and any extraordinary equitable and/or injunctive relief permitted by law or equity to assure that the plaintiff has an effective remedy.

NOTE 11 -- LITIGATION (Continued)

In December 1998, the defendants filed a motion to dismiss the case. The court converted the defendants' motion to dismiss into a motion for summary judgment and granted summary judgment as to all defendants. The plaintiff appealed the ruling to the United States Court of Appeals for the Sixth Circuit. On April 24, 2000, the Sixth Circuit affirmed the district court's dismissal of the action on the grounds that the plaintiff failed to state a claim upon which relief could be granted. On July 14, 2000, the Sixth Circuit granted the plaintiff's petition for a rehearing en banc. On May 31, 2001, the Sixth Circuit issued its en banc decision reversing the trial court's dismissal of the complaint. The Company is defending this action vigorously.

A shareholder derivative suit entitled Thomas G. White on behalf of Vencor, Inc. and Ventas, Inc. v. W. Bruce Lunsford, et al., Case No. 98CI03669, was filed in June 1998 in the Jefferson County, Kentucky, Circuit Court. The suit was brought on behalf of the Company and Ventas against certain current and former executive officers and directors of the Company and Ventas. The complaint alleges that the defendants damaged the Company and Ventas by engaging in violations of the securities laws, engaging in insider trading, fraud and securities fraud and damaging the reputation of the Company and Ventas. The plaintiff asserts that such actions were taken deliberately, in bad faith and constitute breaches of the defendants' duties of loyalty and due care. The complaint is based on substantially similar assertions to those made in the class action lawsuit entitled A. Carl Helwig v. Vencor, Inc., et al., discussed above. The suit seeks unspecified damages, interest, punitive damages, reasonable attorneys' fees, expert witness fees and other costs, and any extraordinary equitable and/or injunctive relief permitted by law or equity

to assure that the Company and Ventas have an effective remedy. The Company believes that the allegations in the complaint are without merit and intends to defend this action vigorously.

A class action lawsuit entitled Jules Brody v. Transitional Hospitals Corporation, et al., Case No. CV-S-97-00747-PMP, was filed on June 19, 1997 in the United States District Court for the District of Nevada on behalf of a class consisting of all persons who sold shares of Transitional Hospitals Corporation ("Transitional") common stock during the period from February 26, 1997 through May 4, 1997, inclusive. The complaint alleges that Transitional purchased shares of its common stock from members of the investing public after it had received a written offer to acquire all of the Transitional common stock and without making the required disclosure that such an offer had been made. The complaint further alleges that defendants disclosed that there were "expressions of interest" in acquiring Transitional when, in fact, at that time, the negotiations had reached an advanced stage with actual firm offers at substantial premiums to the trading price of Transitional's stock having been made which were actively being considered by Transitional's Board of Directors. The complaint asserts claims pursuant to Sections 10(b), 14(e) and 20(a) of the Exchange Act, and common law principles of negligent misrepresentation and names as defendants Transitional as well as certain former senior executives and directors of Transitional. The plaintiff seeks class certification, unspecified damages, attorneys' fees and costs. In June 1998, the court granted the Company's motion to dismiss with leave to amend the Section 10(b) claim and the state law claims for misrepresentation. The court denied the Company's motion to dismiss the Section 14(e) and Section 20(a) claims, after which the Company filed a motion for reconsideration. On March 23, 1999, the court granted the Company's motion to dismiss all remaining claims and the case was dismissed. The plaintiff has appealed this ruling to the United States Court of Appeals for the Ninth Circuit. The Company is defending this action vigorously.

The Company was informed by the DOJ that the Company and Ventas were the subjects of investigations into various Medicare reimbursement issues, including hospital cost reporting issues, billing practices for ancillary services and various quality of care issues in the hospitals and nursing centers formerly operated by Ventas and currently operated by the Company. These investigations included some matters for which the

NOTE 11 -- LITIGATION (Continued)

Company indemnified Ventas in the Spin-off. In cases where neither the Company nor any of its subsidiaries are defendants but Ventas is the defendant, the Company agreed to defend and indemnify Ventas for such claims as part of the Spin-off. The Company cooperated fully in the investigations. All of these investigations have been resolved by the Government Settlement contained in the Amended Plan.

The DOJ previously informed the Company that it had intervened in several pending qui tam actions asserted against the Company and/or Ventas in connection with these investigations. In addition, the DOJ filed proofs of claims with respect to certain alleged claims in the Chapter 11 Cases. The Company, Ventas and the DOJ entered into the Government Settlement, which resolved all of the DOJ investigations including the pending qui tam actions, as part of the Amended Plan. The Government Settlement provides that within 30 days after the Effective Date, the Government will move to dismiss with

prejudice to the United States and the relators (except for certain claims which will be dismissed without prejudice to the United States in certain of the cases) the pending qui tam actions as against any or all of the Company and its subsidiaries, Ventas and any current or former officers, directors and employees of either entity. There can be no assurance that each court before which a qui tam action is pending will dismiss the case on the DOJ's motion. For a summary of the terms of the Government Settlement contained in the Amended Plan, see Note 3.

The following is a summary of the qui tam actions pending or previously pending against the Company and/or Ventas in which the DOJ intervened. Certain of the actions described below name other defendants in addition to the Company and Ventas.

(a) The Company, Ventas and the Company's subsidiary, American X-Rays, Inc. ("AXR"), are defendants in a civil qui tam action styled United States ex rel. Doe v. American X-Rays Inc., et al., No. LR-C-95-332, pending in the United States District Court for the Eastern District of Arkansas and served on AXR on July 7, 1997. The DOJ intervened in the suit which was brought under the Federal Civil False Claims Act and added the Company and Ventas as defendants. The Company acquired an interest in AXR when The Hillhaven Corporation ("Hillhaven") was merged into the Company in September 1995 and purchased the remaining interest in AXR in February 1996. AXR provided portable X-ray services to nursing centers (including some of those operated by Ventas or the Company) and other healthcare providers. The civil suit alleges that AXR submitted false claims to the Medicare and Medicaid programs. The suit seeks damages in an amount of not less than $1,000,000, treble damages and civil penalties. The Company has defended this action vigorously. The court dismissed the action based upon the pending settlement between the DOJ, the Company and Ventas. In a related criminal investigation, the United States Attorney's Office for the Eastern District of Arkansas ("USAO") indicted four former employees of AXR; those individuals were convicted of various fraud related counts in January 1999. AXR had been informed previously that it was not a target of the criminal investigation, and AXR was not indicted. However, the Company received several grand jury subpoenas for documents and witnesses which it moved to quash. The USAO has withdrawn the subpoenas which rendered the motion moot. The complaint against the Company, Ventas and AXR has been dismissed with prejudice as to the relators and the United States in accordance with the Government Settlement contained in the Amended Plan.

(b) The Company's subsidiary, Medisave Pharmacies, Inc. ("Medisave"), Ventas and Hillhaven (former parent company to Medisave), are the defendants in a civil qui tam action styled United States ex rel. Danley v. Medisave Pharmacies, Inc., et al., No. CV-N-96-00170-HDM, filed in the United States District Court for the District of Nevada on March 15, 1996. The plaintiff alleges that Medisave, an institutional pharmacy provider, formerly owned by Ventas and owned by the Company since the Spin-off: (a) charged the Medicare program for unit dose drugs when bulk drugs were administered and charged

NOTE 11 -- LITIGATION (Continued)

skilled nursing facilities more for the same drugs for Medicare patients than for non-Medicare patients; (b) improperly claimed special dispensing

fees that it was not entitled to under Medicaid; and (c) recouped unused drugs from skilled nursing facilities and returned these drugs to its stock without crediting Medicare or Medicaid, all in violation of the Federal Civil False Claims Act. The complaint also alleges that Medisave had a policy of offering kickbacks, such as free equipment, to skilled nursing centers to secure and maintain their business. The complaint seeks treble damages, other unspecified damages, civil penalties, attorneys' fees and other costs. The Company disputes the allegations in the complaint. The complaint has been dismissed in accordance with the Government Settlement contained in the Amended Plan.

(c) Ventas and the Company's subsidiary, Kindred Rehab Services, Inc. (formerly Vencare, Inc.) ("Vencare"), among others, are defendants in the action styled United States ex rel. Roberts v. Vencor, Inc., et al., No. 3:97CV-349-J, filed in the United States District Court for the Western District of Kansas on June 25, 1996 and consolidated with the action styled United States of America ex rel. Meharg, et al. v. Vencor, Inc., et al., No. 3:98SC-737-H, filed in the United States District Court for the Middle District of Florida on June 4, 1998. The complaint alleges that the defendants knowingly submitted and conspired to submit false claims and statements to the Medicare program in connection with their purported provision of respiratory therapy services to skilled nursing center residents. The defendants allegedly billed Medicare for respiratory therapy services and supplies when those services were not medically necessary, billed for services not provided, exaggerated the time required to provide services or exaggerated the productivity of their therapists. It is further alleged that the defendants presented false claims and statements to the Medicare program in violation of the Federal Civil False Claims Act, by, among other things, allegedly causing skilled nursing centers with which they had respiratory therapy contracts, to present false claims to Medicare for respiratory therapy services and supplies. The complaint seeks treble damages, other unspecified damages, civil penalties, attorneys' fees and other costs. The Company disputes the allegations in the complaints. The two complaints have been dismissed in accordance with the Government Settlement contained in the Amended Plan.

(d) In United States ex rel. Kneepkens v. Gambro Healthcare, Inc., et al., No. 97-10400-GAO, filed in the United States District Court for the District of Massachusetts on October 15, 1998, the Company's subsidiary, Transitional, and two unrelated entities, Gambro Healthcare, Inc. and Dialysis Holdings, Inc., are defendants in this suit alleging that they violated the Federal Civil False Claims Act and the Medicare and Medicaid antikickback, antifraud and abuse regulations and committed common law fraud, unjust enrichment and payment by mistake of fact. Specifically, the complaint alleges that a predecessor to Transitional formed a joint venture with Damon Clinical Laboratories to create and operate a clinical testing laboratory in Georgia that was then used to provide lab testing for dialysis patients, and that the joint venture billed at below cost in return for referral of substantially all non-routine testing in violation of Medicare and Medicaid antikickback and antifraud regulations. It is further alleged that a predecessor to Transitional and Damon Clinical Laboratories used multiple panel testing of end stage renal disease rather than single panel testing that allegedly resulted in the generation of additional revenues from Medicare and that the entities allegedly added non-routine tests to tests otherwise ordered by physicians that were not requested or medically necessary but resulted in additional revenue from Medicare in violation of the antikickback and antifraud regulations. Transitional has moved to dismiss the case. Transitional disputes the allegations in the complaint. The claims against Transitional have been dismissed with prejudice in accordance with the Government Settlement contained in the Amended Plan.

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

NOTE 11 -- LITIGATION (Continued)

(e) The Company and/or Ventas are defendants in the action styled United States ex rel. Huff and Dolan v. Vencor, Inc., et al., No. 97-4358 AHM (Mcx), filed in the United States District Court for the Central District of California on June 13, 1997. The plaintiff alleges that the defendant violated the Federal Civil False Claims Act by submitting false claims to the Medicare, Medicaid and CHAMPUS programs by allegedly: (a) falsifying patient bills and submitting the bills to the Medicare, Medicaid and CHAMPUS programs, (b) submitting bills for intensive and critical care not actually administered to patients, (c) falsifying patient charts in relation to the billing, (d) charging for physical therapy services allegedly not provided and pharmacy services allegedly provided by non-pharmacists, and (e) billing for sales calls made by nurses to prospective patients. The complaint seeks treble damages, other unspecified damages, civil penalties, attorneys' fees and other costs. Defendants dispute the allegations in the complaint. The complaint has been dismissed in accordance with the Government Settlement contained in the Amended Plan.

(f) Ventas is the defendant in the action styled United States ex rel. Brzycki v. Vencor, Inc., Civ. No. 97-451-JD, filed in the United States District Court for the District of New Hampshire on September 8, 1997. Ventas is alleged to have knowingly violated the Federal Civil False Claims Act by submitting and conspiring to submit false claims to the Medicare program. The complaint alleges that Ventas: (a) fabricated diagnosis codes by ordering medically unnecessary services, such as respiratory therapy; (b) changed referring physicians' diagnoses in order to qualify for Medicare reimbursement; and (c) billed Medicare for oxygen use by patients regardless of whether the oxygen was actually administered to particular patients. The complaint further alleges that Ventas paid illegal kickbacks to referring healthcare professionals in the form of medical consulting service agreements as an alleged inducement to refer patients, in violation of the Federal Civil False Claims Act, the antikickback and antifraud regulations and the Stark provisions. It is additionally alleged that Ventas consistently submitted Medicare claims for clinical services that were not performed or were performed at lower actual costs. The complaint seeks unspecified damages, civil penalties, attorneys' fees and costs. Ventas disputes the allegations in the complaint. The complaint has been dismissed in accordance with the Government Settlement contained in the Amended Plan.

(g) United States ex rel. Lanford and Cavanaugh v. Vencor, Inc., et al., Civ. No. 97-CV-2845, was filed against Ventas in the United States District Court for the Middle District of Florida, on November 24, 1997. The United States intervened in this civil qui tam lawsuit on May 17, 1999. On July 23, 1999, the United States filed its amended complaint in the lawsuit and added the Company as a defendant. The lawsuit alleges that the Company and Ventas knowingly submitted false claims and false statements to the Medicare and Medicaid programs including, but not limited to, claims for reimbursement of costs for certain ancillary services performed in defendants' nursing centers and for third-party nursing center operators that the United States alleges are not properly reimbursable costs through the hospitals' cost reports. The lawsuit involves the Company's hospitals which were owned by Ventas prior to the Spin-off. The complaint does not specify the amount of damages sought. The Company and Ventas dispute the

allegations in the amended complaint. The complaint has been dismissed with prejudice in accordance with the Government Settlement contained in the Amended Plan.

(h) In United States ex rel. Harris and Young v. Vencor, Inc., et al., filed in the United States District Court for the Eastern District of Missouri on May 25, 1999, the defendants include the Company, Vencare, and Ventas. The defendants allegedly submitted and conspired to submit false claims for payment to the Medicare and CHAMPUS programs, in violation of the Federal Civil False Claims Act. According to the complaint, the Company, through its subsidiary, Vencare, allegedly (a) over billed for respiratory therapy

NOTE 11 -- LITIGATION (Continued)

services, (b) rendered medically unnecessary treatment, and (c) falsified supply, clinical and equipment records. The defendants also allegedly encouraged or instructed therapists to falsify clinical records and over prescribe therapy services. The complaint seeks treble damages, other unspecified damages, civil penalties, attorneys' fees and other costs. The Company disputes the allegations in the complaint. The plaintiffs have filed an amended complaint with the court which removes all defendants associated with the Company or Ventas.

(i) In United States ex rel. George Mitchell, et al. v. Vencor, Inc., et al., filed in the United States District Court for the Southern District of Ohio on August 13, 1999, the defendants, consisting of the Company and its two subsidiaries, Vencare and Kindred Hospice, Inc. (formerly Vencor Hospice, Inc.), are alleged to have violated the Federal Civil False Claims Act by obtaining improper reimbursement from Medicare concerning the treatment of hospice patients. Defendants are alleged to have obtained inflated Medicare reimbursement for admitting, treating and/or failing to discharge in a timely manner hospice patients who were not "hospice appropriate." The complaint further alleges that the defendants obtained inflated reimbursement for providing medications for these hospice patients. The complaint alleges damages in excess of $1,000,000. The Company disputes the allegations in the complaint. The complaint has been dismissed in accordance with the Government Settlement contained in the Amended Plan.

(j) In Gary Graham, on Behalf of the United States of America v. Vencor Operating, Inc. et. al., filed in the United States District Court for the Southern District of Florida on or about June 8, 1999, the defendants, including the Company, its subsidiary, Kindred Healthcare Operating, Inc. (formerly Vencor Operating, Inc.), Ventas, Hillhaven and Medisave, are alleged to have presented or caused to be presented false or fraudulent claims for payment to the Medicare program in violation of, among other things, the Federal Civil False Claims Act. The complaint alleges that Medisave, a subsidiary of the Company which was transferred from Ventas to the Company in the Spin-off, systematically up-charged for drugs and supplies dispensed to Medicare patients. The complaint seeks unspecified damages, civil penalties, interest, attorneys' fees and other costs. The Company disputes the allegations in the complaint. The plaintiffs have filed an amended complaint with the court which removes all defendants associated with the Company or Ventas.

(k) In United States, et al., ex rel. Phillips-Minks, et al. v. Transitional Corp., et al., filed in the United States District Court for Southern District of California on July 23, 1998, the defendants, including Transitional and Ventas, are alleged to have submitted and conspired to submit false claims and statements to Medicare, Medicaid, and other federal and state funded programs during a period commencing in 1993. The conduct complained of allegedly violates the Federal Civil False Claims Act, the California False Claims Act, the Florida False Claims Act, the Tennessee Health Care False Claims Act, and the Illinois Whistleblower Reward and Protection Act. The defendants allegedly submitted improper and erroneous claims to Medicare, Medicaid and other programs, for improper or unnecessary services and services not performed, inadequate collections efforts associated with billing and collecting bad debts, inflated and nonexistent laboratory charges, false and inadequate documentation of claims, splitting charges, shifting revenues and expenses, transferring patients to hospitals that are reimbursed by Medicare at a higher level, failing to return duplicate reimbursement payments, and improperly allocating hospital insurance expenses. In addition, the complaint alleges that the defendants were inconsistent in their reporting of cost report data, paid kickbacks to increase patient referrals to hospitals, and incorrectly reported employee compensation resulting in inflated employee 401(k) contributions. The complaint seeks unspecified damages. The Company disputes the allegations in the complaint and intends to defend this action vigorously. On July 27, 2001, the court ordered that the DOJ be allowed to intervene in the action to effectuate the Government Settlement contained in the Amended Plan.

NOTE 11 -- LITIGATION (Continued)

In connection with the Spin-off, liabilities arising from various legal proceedings and other actions were assumed by the Company and the Company agreed to indemnify Ventas against any losses, including any costs or expenses, it may incur arising out of or in connection with such legal proceedings and other actions. The indemnification provided by the Company also covers losses, including costs and expenses, which may arise from any future claims asserted against Ventas based on the former healthcare operations of Ventas. In connection with its indemnification obligation, the Company has assumed the defense of various legal proceedings and other actions. Under the Amended Plan, the Company agreed to continue to fulfill its indemnification obligations arising from the Spin-off.

The Company is a party to certain legal actions and regulatory investigations arising in the normal course of its business. The Company is unable to predict the ultimate outcome of pending litigation and regulatory investigations. In addition, there can be no assurance that the DOJ, CMS or other regulatory agencies will not initiate additional investigations related to the Company's businesses in the future, nor can there be any assurance that the resolution of any litigation or investigations, either individually or in the aggregate, would not have a material adverse effect on the Company's results of operations, liquidity or financial position. In addition, the above litigation and investigations (as well as future litigation and investigations) are expected to consume the time and attention of the Company's management and may have a disruptive effect upon the Company's operations.

NOTE 12 -- SALE OF INVESTMENT

On May 2, 2001, the Company sold its investment in Behavioral Healthcare Corporation ("BHC") for $40 million. No gain or loss was recorded in connection with this transaction because the Company reflected the fair value of the investment on April 1, 2001 in connection with fresh-start accounting. Under the terms of the Credit Facility and Senior Secured Notes, proceeds from the sale of BHC will be available to fund future capital expenditures for a period of approximately one year from the sale. Any proceeds not expended during that period would be used to permanently reduce the commitments under the Credit Facility to $75 million and repay any outstanding loans in excess of such commitment. Any remaining proceeds would be used to repay loans under the Senior Secured Notes. For accounting purposes, the Company has classified these funds as "cash-restricted" in the unaudited condensed consolidated balance sheet at June 30, 2001.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement

Certain statements made in this Form 10-Q/A, including, but not limited to, statements containing the words such as "anticipate," "believe," "plan," "estimate," "expect," "intend," "may" and other similar expressions are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are inherently uncertain, and stockholders must recognize that actual results may differ materially from the Company's expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based on management's current expectations and include known and unknown risks, uncertainties and other factors, many of which the Company is unable to predict or control, that may cause the Company's actual results or performance to differ materially from any future results or performance expressed or implied by such forward-looking statements. Factors that may affect the plans or results of the Company include, without limitation, the ability of the Company to operate pursuant to the terms of its debt obligations and the Amended Leases; the Company's ability to meet its rental and debt services obligations; adverse developments with respect to the Company's liquidity or results of operations; the ability of the Company to attract and retain key executives and other healthcare personnel; the effects of healthcare reform and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry; changes in Medicare and Medicaid reimbursement rates; national and regional economic conditions, including their effect on the availability and cost of labor, materials and other services; the Company's ability to control costs, including labor costs, in response to the prospective payment system; implementation of the Corporate Integrity Agreement and other regulatory actions; the ability of the Company to comply with the terms of its Corporate Integrity Agreement; the effect of a restatement of the Company's consolidated financial statements previously filed with the Commission; and the increase in the costs of defending and insuring against alleged patient care liability claims. Many of these factors are beyond the control of the Company and its management. The Company cautions investors that any forward-looking statements made by the Company are not guarantees of future performance. The Company disclaims any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward-looking statements to reflect future events or developments.

General

The business segment data in Note 8 of the Notes to Condensed Consolidated Financial Statements should be read in conjunction with the following discussion and analysis.

The Company provides long-term healthcare services primarily through the operation of nursing centers and hospitals. At June 30, 2001, the Company's health services division operated 315 nursing centers (40,607 licensed beds) in 32 states and a rehabilitation therapy business. The Company's hospital division operated 56 hospitals (4,867 licensed beds) in 23 states and an institutional pharmacy business.

On April 20, 2001, the Company and its subsidiaries emerged from the proceedings under Chapter 11 of the Bankruptcy Code pursuant to the terms of the Amended Plan.

Since filing for protection under the Bankruptcy Code on September 13, 1999, the Company had operated its businesses as a debtor-in-possession subject to the jurisdiction of the Bankruptcy Court. Accordingly, the unaudited condensed consolidated financial statements of the Company have been prepared in accordance with SOP 90-7 and generally accepted accounting principles applicable to a going concern, which assume that assets will be realized and liabilities will be discharged in the normal course of business.

In connection with its emergence from bankruptcy, the Company reflected the terms of the Amended Plan in its consolidated financial statements by adopting the fresh-start accounting provisions of SOP 90-7. Under fresh-start accounting, a new reporting entity is deemed to be created and the recorded amounts of assets and

General (Continued)

liabilities are adjusted to reflect their estimated fair values. For accounting purposes, the fresh-start adjustments have been recorded in the unaudited condensed consolidated financial statements as of April 1, 2001. Since fresh-start accounting materially changed the amounts previously recorded in the Company's consolidated financial statements, a black line separates the post-emergence financial data from the pre-emergence data to signify the difference in the basis of preparation of the financial statements for each respective entity. See Note 4 of the Notes to Condensed Consolidated Financial Statements.

Comparability of Financial Information

The adoption of fresh-start accounting as of April 1, 2001 materially changed the amounts previously recorded in the consolidated financial statements of the Predecessor Company. With respect to reported operating results, management believes that business segment operating income of the Predecessor Company is generally comparable to that of the Reorganized Company. However, capital costs (rent, interest, depreciation and amortization) of the Predecessor Company that were based on pre-petition contractual agreements and historical costs are not comparable to those of the Reorganized Company. In addition, the reported financial position and cash flows of the Predecessor Company for periods prior to April 1, 2001 generally are not comparable to those of the Reorganized Company.

In connection with the implementation of fresh-start accounting, the Company

recorded an extraordinary gain of $422.8 million from the restructuring of its debt in accordance with the provisions of the Amended Plan. Other significant adjustments also were recorded to reflect the provisions of the Amended Plan and the fair values of the assets and liabilities of the Reorganized Company as of April 1, 2001. For accounting purposes, these transactions have been reflected in the operating results of the Predecessor Company for the three months ended March 31, 2001.

Regulatory Changes

The Balanced Budget Act of 1997 (the "Budget Act") contained extensive changes to the Medicare and Medicaid programs intended to reduce the projected amount of increase in payments under those programs over a five year perioions (#) (1)

Exercise or Base Price of Options Awards ($/Sh) (2)

Grant Date Fair Value of Stock and Option Awards ($) (3)
Jong S. Whang
11/19/2014

11/19/2014

$64,000

$320,000

$480,000

—

50,000

$9.98

$304,495
Fokko Pentinga
11/19/2014

11/19/2014

$61,050

$305,250

$457,875

—

50,000

$9.98

$304,495
Bradley C. Anderson
11/19/2014

11/19/2014

$32,065

$160,325

$240,488

—

35,000

$9.98

$213,147

(1) The stock and option awards listed above vest in four (4) installments in equal amounts on each of the first four anniversaries of the date of grant.

(2) The exercise price is equal to the closing price of the Company's Common Stock on the previous trading day before the grant.

(3) See Stock-Based Compensation under Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended September 30, 2015 filed with the SEC November 19, 2015 for the assumptions used to value equity based compensation.

(4) Estimated amounts are based on the annual base salaries of $400,000, $407,000 and $291,500 for Messieurs Whang, Pentinga and Anderson, respectively.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information regarding grants of plan-based option awards held by our named executive officers as of September 30, 2015:

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

Name	Option Awards Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable		Options Exercise Price ($)	Option Expiration Date	Stock Awards Number of Shares or Units of Stock that have Not Vested (#)		Market Value of Shares or Units of Stock that have Not Vested ($)
Jong S. Whang	16,250	—		$6.90	12/8/2016			
	10,000	—		$6.15	11/20/2019			
	10,000	—		$10.64	8/6/2020			
	36,667	—		$7.98	12/15/2021			
	—	12,500	(1)	$2.95	12/11/2022			
	12,500	37,500	(2)	$7.01	12/12/2023			
	—	50,000	(3)	$9.98	11/19/2024			
						4,583	(4)	$19,707
Fokko Pentinga	18,750	—		$3.80	12/9/2018			
	10,000	—		$6.15	11/20/2019			
	6,667	—		$10.64	8/6/2020			
	85,000	—		$7.98	12/15/2021			
	—	12,500	(1)	$2.95	12/11/2022			
	12,500	37,500	(2)	$7.01	12/12/2023			
	—	50,000	(3)	$9.98	11/19/2024			
						3,750	(4)	$16,125
Bradley C. Anderson	7,500	—		$6.15	11/20/2019			
	5,000	—		$10.64	8/6/2020			
	16,667	—		$7.98	12/15/2021			
	—	10,000	(1)	$2.95	12/11/2022			
	8,852	26,554	(2)	$7.01	12/12/2023			
	—	35,000	(3)	$9.98	11/19/2024			
						2,083	(4)	$8,957

(1) Unvested option awards will vest in equal installments on the first through fourth anniversaries of the December 11, 2012 grant date.

(2) Unvested option awards will vest in equal installments on the first through fourth anniversaries of the December 12, 2013 grant date.

(3) Unvested option awards will vest in equal installments on the first through fourth anniversaries of the November 19, 2015 grant date.

(4) The remaining unvested restricted stock awards for Messrs. Whang, Pentinga and Anderson vested in December 2015.

Option Exercises and Stock Vested

The following table shows all stock options exercised and the value realized upon exercise, and all stock awards vested and the value realized upon vesting, by the named executive officers during fiscal 2015, which ended on September 30, 2015.

OPTION EXERCISES AND STOCK VESTED FOR FISCAL 2015

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)(1)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)(2)
Jong S. Whang	30,000	183,388	7,916	63,398
Fokko Pentinga	16,250	148,850	6,666	57,839
Bradley C. Anderson	20,002	102,050	3,541	30,523

(1) The value realized equals the difference between the option exercise price and the fair market value of Amtech common stock on the date of exercise, multiplied by the number of shares for which the option was exercised.

(2) The value realized equals the fair market value of Amtech common stock on the vesting date, multiplied by the number of shares that vested.

Pension Benefits

As previously discussed, Mr. Pentinga, our President and Chief Executive Officer, is a participant in Pensioenfonds Metaal en Techniek, a multi-employer pension plan that covers our employees in the Netherlands. As of September 30, 2015, Mr. Pentinga had 21 years of credited service and the present value of accumulated benefit thereunder was $748,000. No payments were made thereunder in fiscal 2015. None of our other named executive officers receive pension benefits.

Nonqualified Deferred Compensation

None of our named executive officers receive nonqualified deferred compensation benefits.

EMPLOYMENT AND CHANGE IN CONTROL ARRANGEMENTS

Employment Agreement with Executive Chairman

On February 9, 2012, we entered into a Second Amended and Restated Employment Agreement with Jong S. Whang, our executive chairman, as amended on July 1, 2012, June 8, 2013, April 9, 2015 and November 19, 2015. Below is a summary of the terms and conditions of Mr. Whang's employment agreement.

Term

Mr. Whang's employment agreement provides for an employment period commencing on the date of the employment agreement and continuing for an initial term of six years. Thereafter, the employment period will continue for successive one-year terms unless either we or Mr. Whang provides written notice of termination of the employment period at least 120 days prior to the end of any given term. If Mr. Whang remains in the full-time employ of our company beyond the employment period without any written agreement, his employment agreement will be deemed to continue on a month to month basis and either party will have the right to terminate the employment agreement at the end of any ensuing calendar month with written notice of at least 30 days.

Base Salary

Pursuant to his current employment agreement, Mr. Whang receives a base salary of $200,000 per annum, which base salary shall be reviewed on an annual basis by our Compensation and Stock Option Committee. Effective July 1, 2012, Mr. Whang had voluntarily reduced his annual salary from $400,000 to $320,000. Effective July 1, 2013, Mr. Whang voluntarily further reduced his annual base salary to $224,000. Effective December 1, 2014, upon approval of the Compensation and Stock Option Committee on November 18, 2014, Mr. Whang's base salary was restored to $400,000 per annum. Effective January 1, 2016, Mr. Whang voluntarily reduced his annual salary to $200,000. The reduction in base salary may be restored at any time in Mr. Whang's sole discretion with advance written notice to the Compensation and Stock Option Committee.

Incentive Compensation

Mr. Whang is also entitled to an annual cash bonus for each fiscal year that will be determined in accordance with an annual bonus plan adopted by our Compensation and Stock Option Committee. The annual bonus plan may not be any less favorable to Mr. Whang than the bonus plan for fiscal 2010 that was adopted by our Compensation and Stock Option Committee on December 21, 2009. The terms of Mr. Whang's 2015 bonus plan are described above in more detail in the section "Annual Cash Compensation" under the caption "Cash Bonuses".

Stock Options

Pursuant to Mr. Whang's employment agreement, any currently outstanding options held by Mr. Whang will remain in full force and effect in accordance with our stock option plans and applicable stock option agreements. Mr. Whang will also be issued an annual grant of stock options by our Compensation and Stock Option Committee within 90 days after the end of each fiscal year during his employment period. All of the options granted to Mr. Whang will be incentive stock options within the meaning of the Internal Revenue Code of 1986, or if they do not qualify as incentive stock options, they will be non-qualified stock options. The amount and terms of the grants will be determined by our Compensation and Stock Option Committee.

Benefits

Mr. Whang will be entitled to receive from our Company such employee benefits as are provided to other executive officers of the Company, including family medical, dental, vision, disability and life insurance, and participation in pension and retirement plans, incentive compensation plans, stock option plans, Company-sponsored welfare benefit plans for disability and life insurance and other benefit plans. We will provide Mr. Whang with an annual automobile allowance of not less than $14,000 (annual allowance is currently $18,000), a life insurance policy in the face amount of $500,000 and such other benefits as we may deem appropriate from time to time. Effective July 1, 2013, Mr. Whang voluntarily suspended, for an indefinite period of time, his annual auto allowance, which was fully restored by the Compensation and Stock Option Committee on November 18, 2014.

Termination

Mr. Whang's employment is "at will" and either we or Mr. Whang can terminate his employment agreement at any time, with or without "cause" or "good reason" (as those terms are defined in Mr. Whang's employment agreement), upon 30 days written

notice. Mr. Whang’s employment agreement can also be terminated by us due to the disability of Mr. Whang after at least 30 days’ written notice by us of our intention to terminate his employment.

Severance

If we terminate the employment of Mr. Whang against his will and without cause (including by giving notice of termination of his employment agreement as described above), or if Mr. Whang terminates his employment for good reason, Mr. Whang is entitled to receive salary, incentive compensation and vacation accrued through the date of termination, plus (i) an amount equal to Mr. Whang’s base salary in effect on the date of termination for the remainder of the initial three-year term or two years, whichever is greater. (which, would be up to $1,200,000 if terminated during the first year of the term, or $800,000 if terminated after the first year of the term); (ii) an amount equal to the maximum amount of incentive compensation he could earn for the fiscal year in which the termination occurs; and (iii) full vesting of all outstanding stock options and restricted stock held by Mr. Whang. The value of Mr. Whang’s unvested stock options and unvested restricted stock at September 30, 2015 was approximately $37,000. If Mr. Whang voluntarily terminates his employment other than for good reason, if we terminate Mr. Whang’s employment for cause, or if Mr. Whang’s employment is terminated due to his death or disability, Mr. Whang will be entitled to receive salary and accrued vacation through the date of termination only. However, in the event Mr. Whang’s employment is terminated due to his death or disability, he will also be entitled to receive (i) a pro-rata portion of the amount of incentive compensation he would earn for the fiscal year in which the termination occurs if the results of operations of Amtech for such fiscal year were annualized, and (ii) full vesting of all outstanding stock options and restricted stock held by him.

On November 17, 2015, the Board of Directors, following the recommendation of the Company's Compensation and Options Committee of the Board of Directors, agreed to amend the change in control provisions of Mr. Whang's employment agreement to establish the base salary, for purposes of calculating the applicable termination payment, at $400,000.

Post-Employment Consulting

Mr. Whang’s employment agreement provides that upon termination of Mr. Whang against his will and without cause (including by giving notice of termination of his employment agreement as described above), or by Mr. Whang for good reason, for a period of two (2) years following the date of such termination, (i) Mr. Whang will make himself available for an average of 20 hours per week in order to consult with the Company in such manner and on such matters as the Company shall reasonably request, (ii) Mr. Whang will make himself available to serve on the Board of Directors of the Company, and (iii) in consideration for Mr. Whang’s agreement to perform such services, the Company will (A) pay Mr. Whang an annual amount equal to 40% of his base salary in effect on the date he was terminated and (B) include Mr. Whang in the Company’s family medical, dental and vision insurance plans, or, if Mr. Whang’s inclusion in such plans is not permitted, provide substantially the same benefits to the Mr. Whang at the Company’s expense.

Noncompetition

Mr. Whang agreed that during the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries. He also agreed that for a period of two years after the end of the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries and he would not own, directly or indirectly, more than a 5% interest in entities which compete with us or our subsidiaries.

Change in Control

In the event that Mr. Whang’s employment with us is terminated either (i) by us for any reason other than for cause during a “pending change in control” (as that term is defined in Mr. Whang’s employment agreement) of our Company or within one year following the occurrence of a “change in control” (as that term is defined in Mr. Whang’s employment agreement), or (ii) by Mr. Whang for good reason within one year following the occurrence of a change in control of our Company, then Mr. Whang will be entitled to receive within 30 days of the date of termination of his employment (provided, however, if such 30 day period begins in one calendar year and ends in another calendar year, Mr. Whang will not have the right to designate the calendar year of payment), in lieu of the severance payment otherwise payable, (i) an amount equal to three years of his base salary in effect on the date of termination of his employment, (ii) the

maximum amount of the incentive compensation which he could earn for the fiscal year in which the termination occurs, and (iii) full vesting of all outstanding stock options and restricted stock he holds.

Employment Agreement with Chief Executive Officer

On June 29, 2012, we entered into an Employment Agreement with Fokko Pentinga, our chief executive officer, as amended on July 1, 2012, on June 29, 2013, and on April 9, 2015. Below is a summary of the terms and conditions of Mr. Pentinga's employment agreement.

Term

Mr. Pentinga's employment agreement provides for an employment period commencing on the date of the employment agreement and continuing for an indefinite period as required by Dutch statutory employment law.

Base Salary

Pursuant to his Employment Agreement, Mr. Pentinga receives a base salary of $407,000 per annum (€343,055, the euro equivalent based on a six month average exchange rate fixed one day before the effective date of the latest amendment to the Employment Agreement), which base salary shall be reviewed on an annual basis by our Compensation and Stock Option Committee and can be increased, but not decreased below $370,000, at the discretion of our Compensation and Stock Option Committee. Effective July 1, 2012, Mr. Pentinga voluntarily reduced his annual base salary to $314,500. Effective July 1, 2013, Mr. Pentinga voluntarily further reduced his annual base salary to $251,600 (€193,330). His salary is paid partially in euros and partially in U.S. dollars depending on where he performs his work. Effective December 1, 2014, upon approval of the Compensation and Stock Option Committee on November 18, 2014, Mr. Pentinga’s base salary was restored to $370,000 per annum (which salary will be paid in euros based upon the exchange rate in effect as of December 15, 2011). Effective April 9, 2015, upon approval of the Compensation and Stock Option Committee on April 9, 2015, Mr. Pentinga's annual base salary was increased to $407,000.

Incentive Compensation

Mr. Pentinga is also entitled to an annual cash bonus for each fiscal year that will be determined in accordance with an annual bonus plan adopted by our Compensation and Stock Option Committee. The annual bonus plan may not be any less favorable to Mr. Pentinga than the bonus plan for fiscal 2012 that was adopted by our Compensation and Stock Option Committee on December 15, 2011. The terms of Mr. Pentinga's 2014 bonus plan are described above in more detail in the section “Annual Cash Compensation,” under the caption “Cash Bonuses.”

Stock Options

Pursuant to Mr. Pentinga's employment agreement, any currently outstanding options held by Mr. Pentinga will remain in full force and effect in accordance with our stock option plans and applicable stock option agreements. Mr. Pentinga will also be issued an annual grant of stock options by our Compensation and Stock Option Committee within 90 days after the end of each fiscal year during his employment period. All of the options granted to Mr. Pentinga will be non-qualified stock options within the meaning of the Internal Revenue Code of 1986.

Benefits

Mr. Pentinga will be entitled to receive from our Company such employee benefits as are provided to other management level employees in his country of domicile (i.e. the Netherlands), including disability and life insurance, and participation in pension and retirement plans, incentive compensation plans, stock option plans, disability and life insurance and other benefit plans. We will provide Mr. Pentinga with a leased automobile at a cost of not more than €29,500 and such other benefits as we may deem appropriate from time to time.

Termination

Either we or Mr. Pentinga can terminate his employment agreement with prior written notice of termination given in accordance with Dutch statutory employment law, including observance of the Dutch statutory notice period, or by mutual agreement, or by the Company at any time for cause, as defined in the agreement. Mr. Pentinga's employment agreement can also be terminated by us due to the disability of Mr. Pentinga after meeting the requirements of Dutch statutory employment law.

Severance

If we terminate the employment of Mr. Pentinga against his will and without cause (including by giving notice of termination of his employment agreement as described above), or if Mr. Pentinga terminates his employment for good reason, Mr. Pentinga is entitled to receive salary, incentive compensation and vacation accrued through the date of termination, plus (i) an amount equal to Mr. Pentinga's base salary in effect on the date of termination for two years, which, amounts to $814,000 (€686,110); (ii) an amount equal to the maximum amount of incentive compensation he could earn for the fiscal year in which the termination occurs; and (iii) full vesting of all outstanding stock options and restricted stock held by Mr. Pentinga. The value of Mr. Pentinga's unvested stock options and unvested restricted stock at September 30, 2015 was approximately $33,000.

If Mr. Pentinga voluntarily terminates his employment other than for good reason, if we terminate Mr. Pentinga's employment for cause, or if Mr. Pentinga's employment is terminated due to his death or disability, Mr. Pentinga will be entitled to receive salary and accrued vacation through the date of termination. In addition, if we terminate Mr. Pentinga's employment due to disability as a result of his becoming incapacitated as defined in the Dutch Civil Code, Mr. Pentinga will be entitled to 70% of the maximum daily social wage for a maximum of 52 weeks, which would total approximately $58,200. However, in the event Mr. Pentinga's employment is terminated due to his death or disability, he will also be entitled to receive (i) a pro-rata portion of the amount of incentive compensation he would earn for the fiscal year in which the termination occurs if the results of operations of Amtech for such fiscal year were annualized, and (ii) full vesting of all outstanding stock options and restricted stock held by him.

Noncompetition

Mr. Pentinga agreed that during the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries. He also agreed that for a period of two years after the end of the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries and he would not own, directly or indirectly, more than a 5% interest in entities which compete with us or our subsidiaries.

Change in Control

In the event that Mr. Pentinga's employment with us is terminated either (i) by us for any reason other than for cause during a “pending change in control” (as that term is defined in Mr. Pentinga's employment agreement) of our Company or within one year following the occurrence of a “change in control” (as that term is defined in Mr. Pentinga's employment agreement), or (ii) by Mr. Pentinga for good reason within one year following the occurrence of a change in control of our Company, then Mr. Pentinga will be entitled to receive within 30 days of the date of termination of his employment (provided, however, if such 30 day period begins in one calendar year and ends in another calendar year, Mr. Pentinga will not have the right to designate the calendar year of payment), in lieu of the severance payment otherwise payable, (i) an amount equal to two years of his base salary in effect on the date of termination of his employment, (ii) the maximum amount of the incentive compensation which he could earn for the fiscal year in which the termination occurs, and (iii) full vesting of all outstanding stock options and restricted stock he holds.

Employment Agreement with Chief Financial Officer

On April 9, 2015, we entered into an Employment Agreement with Bradley C. Anderson, our chief financial officer. Below is a summary of the terms and conditions of Mr. Anderson's employment agreement.

Term

Mr. Anderson’s employment agreement provides for an employment period commencing on the date of the employment agreement and continuing for an initial term of three years. Thereafter, the employment period will continue for successive one-year terms unless either we or Mr. Anderson provides written notice of termination of the employment period at least 120 days prior to the end of any given term. If Mr. Anderson remains in the full-time employ of our company beyond the employment period without any written agreement, his employment agreement will be deemed to continue on a month to month basis and either party will have the right to terminate the employment agreement at the end of any ensuing calendar month with written notice of at least 30 days.

Base Salary

Pursuant to his Employment Agreement, Mr. Anderson receives a base salary of $291,500 per annum which base salary shall be reviewed on an annual basis by our Compensation and Stock Option Committee and can be increased, but not decreased at the discretion of our Compensation and Stock Option Committee.

Incentive Compensation

Mr. Anderson is also entitled to an annual cash bonus for each fiscal year that will be determined in accordance with an annual bonus plan adopted by our Compensation and Stock Option Committee. The annual bonus plan may not be any less favorable to Mr. Anderson than the bonus plan for fiscal 2010 that was adopted by our Compensation and Stock Option Committee on December 21, 2009. The terms of Mr. Anderson's 2015 bonus plan are described above in more detail in the section “Annual Cash Compensation,” under the caption “Cash Bonuses.”

Stock Options

Pursuant to Mr. Anderson's employment agreement, any currently outstanding options held by Mr. Anderson will remain in full force and effect in accordance with our stock option plans and applicable stock option agreements. Mr. Anderson will also be issued an annual grant of stock options by our Compensation and Stock Option Committee within 90 days after the end of each fiscal year during his employment period. All of the options granted to Mr. Anderson will be incentive stock options within the meaning of the Internal Revenue Code of 1986, or if they do not qualify as incentive stock options, they will be non-qualified stock options. The amount and terms of the grants will be determined by our Compensation and Stock Option Committee.

Benefits

Mr. Anderson will be entitled to receive from our Company such employee benefits as are provided to other executive officers of the Company, including family medical, dental, vision, disability and life insurance, and participation in pension and retirement plans, incentive compensation plans, stock option plans, Company-sponsored welfare benefit plans for disability and life insurance and other benefit plans. We will provide Mr. Anderson with an annual automobile allowance of not less than $10,000 (annual allowance is currently $10,000) and such other benefits as we may deem appropriate from time to time. Effective July 1, 2013, Mr. Anderson voluntarily suspended, for an indefinite period of time, his annual auto allowance, which was fully restored by the Compensation and Stock Option Committee on November 18, 2014.

Termination

Mr. Anderson’s employment is “at will” and either we or Mr. Anderson can terminate his employment agreement at any time, with or without “cause” or “good reason” (as those terms are defined in Mr. Anderson’s employment agreement), upon 30 days written notice. Mr. Anderson’s employment agreement can also be terminated by us due to the disability of Mr. Anderson after at least 30 days’ written notice by us of our intention to terminate his employment.

Severance

If we terminate the employment of Mr. Anderson against his will and without cause (including by giving notice of termination of his employment agreement as described above), or if Mr. Anderson terminates his employment for good reason, Mr. Anderson is entitled to receive salary, incentive compensation and vacation accrued through the date of termination, plus (i) an amount equal to Mr. Anderson’s base salary in effect on the date of termination for the remainder of the initial three-year term or two years, whichever is greater (which would be up to $874,500 if terminated during the first year of the term, or $583,000 if terminated after the first year of the term); (ii) an amount equal to the maximum amount of incentive compensation he could earn for the fiscal year in which the termination occurs; and (iii) full vesting of all outstanding stock options and restricted stock held by Mr. Anderson. The value of

Mr. Anderson's unvested stock options and unvested restricted stock at September 30, 2015 was approximately $22,000. If Mr. Anderson voluntarily terminates his employment other than for good reason, if we terminate Mr.

Anderson's employment for cause, or if Mr. Anderson's employment is terminated due to his death or disability, Mr. Anderson will be entitled to receive salary and accrued vacation through the date of termination only. However, in the event Mr. Anderson's employment is terminated due to his death or disability, he will also be entitled to receive (i) a pro-rata portion of the amount of incentive compensation he would earn for the fiscal year in which the termination occurs if the results of operations of Amtech for such fiscal year were annualized, and (ii) full vesting of all outstanding stock options and rest

Noncompetition

Mr. Anderson agreed that during the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries. He also agreed that for a period of two years after the end of the term of his employment agreement he would not engage in certain activities in which he would be competing with us or our subsidiaries and he would not own, directly or indirectly, more than a 5% interest in entities which compete with us or our subsidiaries.

Change in Control

In the event that Mr. Anderson's employment with us is terminated either (i) by us for any reason other than for cause during a "pending change in control" (as that term is defined in Mr. Anderson's employment agreement) of our Company or within one year following the occurrence of a "change in control" (as that term is defined in Mr. Anderson's employment agreement), or (ii) by Mr. Anderson for good reason within one year following the occurrence of a change in control of our Company, then Mr. Anderson will be entitled to receive within 30 days of the date of termination of his employment (provided, however, if such 30 day period begins in one calendar year and ends in another calendar year, Mr. Anderson will not have the right to designate the calendar year of payment), in lieu of the severance payment otherwise payable, (i) an amount equal to three years of his base salary in effect on the date of termination of his employment, (ii) the maximum amount of the incentive compensation which he could earn for the fiscal year in which the termination occurs, and (iii) full vesting of all outstanding stock options and restricted stock he holds.

Other Compensatory Arrangements

On November 17, 2015, upon the recommendation of the Compensation and Stock Option Committee, the Board approved stock option grants for certain named executive officers. Mr. Whang received a grant of an option to purchase 50,000 shares of the Company's common stock. Mr. Pentinga received a grant of an option to purchase 50,000 shares of the Company's common stock. Mr. Anderson received a grant of an option to purchase 35,000 shares of the Company's common stock. The options granted have an exercise price of $5.25 (the closing price of the Company's common stock on November 16, 2015) and will vest on the first four (4) anniversaries of the grant date.
On November 17, 2015, the Company granted Mr. van der Wansem an option to purchase 6,000 shares of the Company's common stock. The options granted to Mr. van der Wansem have an exercise price of $5.25 and will vest on the first three (3) anniversaries of the grant date.

Compensation Policies and Practices as Related to Risk Management

The Compensation and Stock Option Committee does not believe the Company's compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the Company. The Compensation and Stock Option Committee has determined that the Company's executive compensation program does not encourage unnecessary or excessive risk taking as a result of the following factors:

- As discussed elsewhere in this Proxy Statement, our executive officer compensation includes a balanced mix of cash and equity.
- Base salaries do not encourage risk taking as they are fixed in amount.
- Performance-based cash bonus awards under the non-equity incentive plan focus on achievement of short-term or annual goals. Although this may seem to encourage the taking of short-term risks at the expense of long-term results, these bonuses in actuality represent only a portion of the executive officers' total compensation opportunities, and the Compensation and Stock Option Committee believes that the non-equity incentive plan awards appropriately balance risk and the desire to focus executives on specific short-term individual and financial goals important to the Company's success.

- Discretionary cash bonuses are awarded at the discretion of the Compensation and Stock Option Committee, which allows the Compensation and Stock Option Committee to evaluate whether the executives are engaging in activities that create risks prior to awarding any such cash bonuses. This discretion mitigates the likelihood that executives will engage in

activities that create risk, and allows the Compensation and Stock Option Committee the ability to refrain from rewarding any such risk-taking.

- Compensation provided to the executive officers in the form of long-term equity awards is important to help further align executives' interests with those of the Company's shareholders. The Compensation and Stock Option Committee believes that these awards do not encourage unnecessary or excessive risk taking because the ultimate value of the awards is tied to the Company's stock price over the long-term. In addition, the awards are subject to long-term vesting schedules to help ensure that executives have significant value tied to long-term stock price performance.