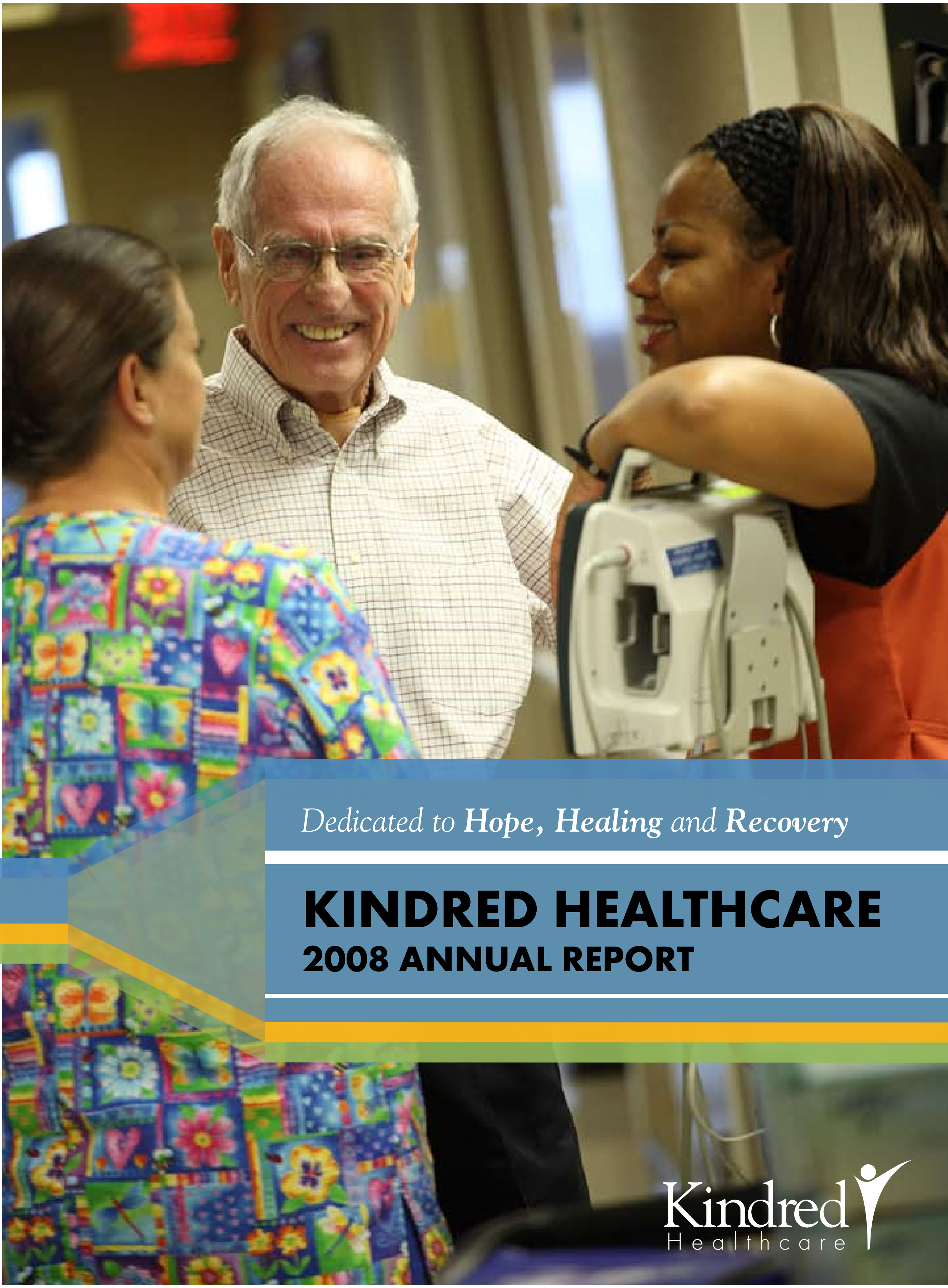

*Dedicated to **Hope, Healing** and **Recovery***

KINDRED HEALTHCARE
2008 ANNUAL REPORT

Kindred Healthcare

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share amounts)

	Year ended December 31,	
Operating results:	**2008**	**2007**
Revenues	$4,151,396	$4,179,891
Net income (loss):		
Income from continuing operations *(a)*	$58,893	$39,648
Discontinued operations, net of income taxes:		
Loss from operations	(1,832)	(9,497)
Loss on divestiture of operations	(20,776)	(77,021)
Net income (loss)	$36,285	$(46,870)
Diluted earnings (loss) per common share:		
Income from continuing operations	$1.51	$0.99
Discontinued operations:		
Loss from operations	(0.05)	(0.23)
Loss on divestiture of operations	(0.53)	(1.93)
Net income (loss)	$0.93	$(1.17)
Diluted shares (000)	38,906	39,983
Cash flows from operations	$183,079	$163,383
Financial position:	**Dec. 31, 2008**	**Dec. 31, 2007**
Cash and cash equivalents	$140,795	$32,877
Working capital	477,365	383,705
Total assets	2,181,761	2,079,552
Long-term debt	349,433	275,814
Stockholders' equity	914,975	862,124

(a) Included certain items that, in the aggregate, increased net income by approximately $2.8 million or $0.07 per diluted share for the year ended December 31, 2008 and reduced net income by approximately $23.8 million or $0.59 per diluted share for the year ended December 31, 2007.

ABOUT THE COVER

John suffered broken bones, fractured ribs and a punctured lung in an accident on his farm in Brandenburg, Kentucky. He was transferred to a short-term acute care hospital where he stayed in the Intensive Care Unit for seven weeks. At one point, termination of life support was recommended. John was then admitted to Kindred Hospital Louisville at Jewish Hospital. When he left our hospital 42 days later, he was walking, breathing, swallowing and eating. "They gave me my life back," he said. "Because I didn't have one until Kindred got me off the vent."

Kindred Healthcare, Inc. is a healthcare services company, based in Louisville, Kentucky, with annual revenues of over $4 billion and approximately 53,700 employees in 40 states. At December 31, 2008, Kindred through its subsidiaries provided healthcare services in 655 locations, including 82 long-term acute care hospitals, 228 skilled nursing centers and a contract rehabilitation services business, People*first* rehabilitation services, which served 345 non-affiliated facilities. Kindred's mission is to promote healing, provide hope, preserve dignity and produce value for each patient, resident, family member, customer, employee and shareholder we serve. For more information, go to **www.kindredhealthcare.com.**

KINDRED HEALTHCARE'S MISSION

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

Dear Shareholders,

Nearly eight years ago, Kindred Healthcare emerged from bankruptcy protection in great part thanks to the hard work, dedication and leadership of Eddie Kuntz, our Chairman, our management team and the unwavering support of our Board. Today we celebrate Kindred Healthcare being ranked first in *Fortune* magazine's list of Most Admired Companies among Health Care: Medical Facilities. The participants in *Fortune* magazine's survey of Most Admired Companies ranked us not only Number 1 among our peers, but Number 1 in people management, use of corporate assets, financial soundness and social responsibility. Since beginning this journey, we have made significant progress in a number of areas:

- Employee turnover is down company wide from 81% in 2001 to 38% in 2008.

- The quality of services in our nursing and rehabilitation centers has significantly improved and we have received more Quality Awards from the American Health Care Association ("AHCA") than any other provider in the country.

- Our hospitals successfully worked through several years of significant regulatory changes. Through these difficult times, we continued to improve our clinical outcomes, exceeding national benchmarks, and mitigated much of the financial impact of the reimbursement changes.

- People*first* Rehabilitation was established as a separate division in 2004, and has grown from $228 million in revenues to $427 million last year with operating income of $38 million.

- And, in July 2007 we successfully spun-off our institutional pharmacy business in a tax-free transaction to shareholders creating PharMerica Corporation ("PharMerica"), now a Fortune 1,000 company with almost $2 billion in annual revenues.

Progress in 2008

We continued to achieve success in 2008 on a number of fronts despite a difficult economic environment. More importantly, fiscal 2008 provided further evidence to support our fundamental management philosophy: If we take care of our people, and focus on quality and customer service, our business results will follow.

Operational and financial highlights for the year include:

- Our employee turnover and retention rates improved in all three operating divisions;

- Quality and customer service metrics continued to improve across all divisions. In our Health Services Division, we improved our federal and state survey results, showed improvements in recognized quality indicators, and 51 of our nursing and rehabilitation centers received AHCA Quality Awards. In our Hospital Division, our vent pneumonia and blood stream infection rates continued to exceed national benchmarks. And in People*first* Rehabilitation, our therapists achieved additional improvements in the functional outcomes of over 115,000 patients discharged from our care.

- We reported solid revenue gains in each of our three operating divisions in 2008. Excluding our former pharmacy division that was spun-off in July 2007, our consolidated 2008 revenues of $4.2 billion grew a solid 8%;

- Diluted earnings per share from continuing operations totaled $1.51, significantly better than our expectations at the beginning of the year;

- Routine, information technology, facility modernization and hospital development capital spending totaled $149 million in 2008, all of which was financed through internal sources;

- Operating cash flows for 2008 grew 12% to $183 million;

- Cash levels at December 31, 2008 increased to $141 million, and together with the remaining unborrowed capacity under our revolving credit facility of $151 million at the end of the year, provides significant financial flexibility in a difficult credit environment. The credit facility, with its favorable pricing, financial covenants and other terms, is scheduled to expire in July 2012.

In our Hospital Division, thanks to our continued efforts to educate referral sources on the quality, clinical capabilities and cost effectiveness of our services, we increased our admissions significantly, particularly our managed care business. Despite the positive admissions growth, declining length of stay, cost management issues and weakness in certain newer facilities negatively impacted our hospital operating results for 2008. As we move into 2009, we have renewed our efforts to better control variable costs and are leveraging our management resources to improve the operations of our underperforming hospitals.

In our Health Services Division, stable reimbursement rates, growth in managed care and Medicare admissions, and quality-driven reductions in professional liability costs resulted in strong financial performance. Our investments in staffing, training and the modernization of our physical plants are also paying off, as we continue to enhance our capabilities to serve short-stay rehabilitation patients and higher acuity longer term residents. Our overall admissions growth was strong in 2008, which improved our occupancy to 89% from 87.8% in 2007.

People*first* Rehabilitation continued its growth beyond the Kindred portfolio of hospitals and nursing centers by signing 67 new contracts with non-affiliated customers. In 2008, approximately 37% of our People*first* revenues were derived from non-affiliated customers, up from 32% in 2007. Further growth in volumes and revenues helped to offset declines in our operating margins from wage rate pressures associated with a competitive marketplace for therapists and the start-up costs associated with non-affiliated customer contract growth.

We also have made great progress over the past few years in the recruitment, retention and development of our people. Our commitment to our employees is the key driver of our ongoing efforts to improve our clinical outcomes and customer service. Our investments in employee orientation, continuing clinical education, leadership development and employee recognition programs have helped to make Kindred an employer of choice in many of our local markets.

As a provider of healthcare services, we also are committed to providing cost-effective, quality patient care. For example, we recently renegotiated our pharmacy services agreement with PharMerica resulting in anticipated cost reductions of approximately $10 million per year during 2009 and 2010, and saw continued improvement in our professional liability underwriting results, reducing aggregate expenses by approximately $3 million from 2007.

Despite the turmoil in the financial markets, we remain committed to growing and repositioning our operations and believe further opportunities exist for the expansion of our services. During 2008, we continued to execute our strategic development plan as reflected by the following:

- We opened a new hospital with 70 licensed beds;
- We have five hospitals containing 208 licensed beds currently under development, one of which will become operational in 2009 and the remainder in 2010; and
- We further repositioned our hospital portfolio by divesting three underperforming long-term acute care hospitals.

We expect that the general economic environment will be difficult in 2009. We also anticipate that healthcare reform will be a central focus of lawmakers at both the federal and state levels. As the largest diversified provider of post-acute care services in the United States, we believe that Kindred, and other post-acute providers, will be an important part of improving the efficiency and effectiveness of our nation's healthcare delivery system and we welcome your insights as we prepare to engage in this ongoing policy process.

Our focus on the quality of care provided to our patients and residents, our commitment to taking care of our employees, and our efforts to effectively use and preserve our capital resources have positioned us well for the future.

Finally, the work performed on a daily basis by our 53,700 dedicated employees will continue to drive our success and create value for our patients, residents and shareholders. On behalf of them, and on behalf of our Board of Directors, we thank you for your continued support.

Sincerely,

Paul J. Diaz
President and Chief Executive Officer

Executive Officers

Paul J. Diaz
President and Chief Executive Officer

Edward L. Kuntz
Executive Chairman

Frank J. Battafarano
Chief Operating Officer

Richard A. Lechleiter
Executive Vice President and Chief Financial Officer

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

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

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

Christopher M. Bird
President, People*first* Rehabilitation Division

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

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

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

M. Suzanne Riedman
Senior Vice President and General Counsel

Corporate Information

Annual Meeting
The annual meeting of shareholders will be held at the Company's corporate headquarters, 680 South Fourth Street, Louisville, Kentucky, on May 20, 2009. Formal notice of the meeting, together with instructions on how to access the Company's proxy statement and form of proxy, is sent to each holder of common stock.

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

Directors

Edward L. Kuntz
Executive Chairman

Joel Ackerman
Former Managing Director
Warburg Pincus LLC

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

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

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

Paul J. Diaz
President and Chief Executive Officer

Garry N. Garrison
Former Senior Vice President
Dynamic Healthcare Solutions, Inc.

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

John H. Klein
Chairman and Chief Executive Officer
DAVA Pharmaceuticals, Inc.

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

Eddy J. Rogers, Jr.
Partner
Andrews Kurth LLP

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

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Telephone: 1.800.622.6757
Email: shareholder.inquiries@nationalcity.com

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