

## Kindred Healthcare

Initiating Credit Coverage with Overweight; Buy on the 8-1/4% Notes

- Kindred Healthcare (KND) is one of the largest healthcare service providers, with LTM revenues of \$6.1 billion.** Two things have historically made it a difficult credit for many investors. First, about half of its revenues are obtained from long term acute care (LTAC) hospitals, the reimbursement of which Medicare has long suggested should change. Second, a sale-leaseback many years ago means KND has 'double leverage' via unusually high rents.
- We think it's a good time to Overweight Kindred.** Most importantly, it seems KND will not have to contend with any transformative changes to Medicare reimbursement for the next several years. Medicare took skilled nursing (SNF) payments down sharply a year ago, and it has delayed the 25% rule for LTACs an additional year to 2013, "pending results of an on-going research initiative to re-define the role of LTCHs in the Medicare program." Visibility of 2013 is reasonable, helped by preliminary guidance this month. FCF looks to be adequate, albeit sensitive to small changes in margins.
- Management wants to increase the percent of assets it owns vs. leases.** After some back and forth with Ventas, its largest landlord, KND now plans to let the leases lapse for 54 SNFs with annual revenues of approximately \$550 million. These are generally older assets (average age of 41 years). Between below-average margins and capex required for upkeep the FCF impact of this shrinkage should be minimal.
- KND 8-1/4% have underperformed since issued in May 2011.** Bonds are a little below par while the market and single-Bs have tightened 40bps and 60bps, respectively. But now that we have anniversaried a full year of lower SNF payments and CMS has said it will review patient criteria, business risk seems much reduced.
- We initiate credit coverage with an Overweight rating on Kindred and a Buy on the 8-1/4% unsecured notes.**

Table 1: KND Bond

Coupon	Amt (\$mn)	Description	Maturity	Rating	Market Data as of 26-Sep-12			
					Price	YTW	STW	Rec
8.250%	\$550.0	Sr Unsecured	1-Jun-19	B3/B-	\$98.00	8.65%	768bp	Buy

Source: J.P. Morgan and Bloomberg.

See page 10 for analyst certification and important disclosures.

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## Overweight

Moody's: B1      Outlook: Stable  
S&P: B+      Outlook: Stable  
The above ratings are at the corporate level

Ticker

**KND**

### Healthcare

**David Common, CFA** <sup>AC</sup>

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**Jared Feeney, CFA**

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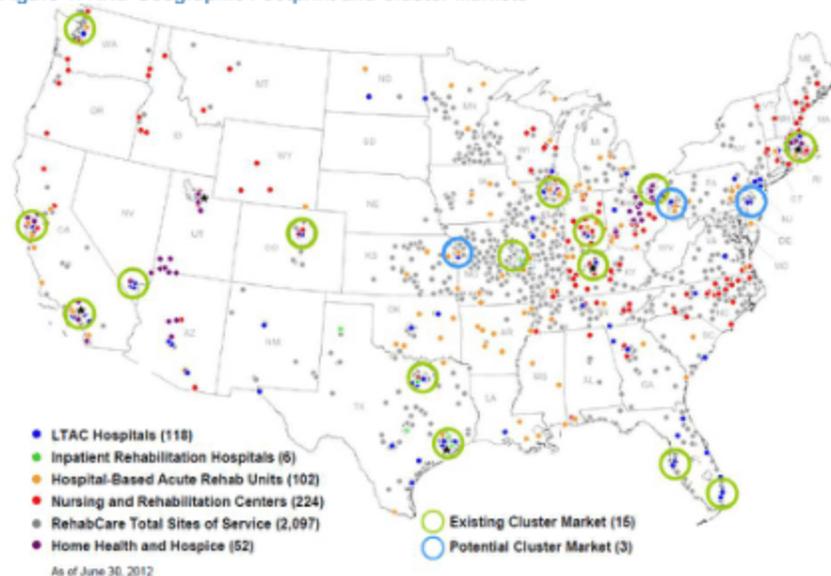
J.P. Morgan Securities LLC

## Company Background

Kindred Healthcare (KND) is a post acute care provider, with LTM revenues of \$6.1 billion and Adjusted EBITDAR of \$846 million. KND acquired RehabCare in June 2011 for \$1.3 billion, and obtained 32 long term acute care hospitals, five inpatient rehabilitation facilities, approximately 1,200 rehabilitation therapy sites of service, and 102 hospital-based inpatient rehabilitation units.

The company's strategy is focused on the development of cluster market service offerings across the U.S., providing care across the post acute care spectrum, from the highest acute (LTACs) to the lowest acute (home health). Today, KND has 15 cluster markets and has three potential cluster markets.

Figure 1: KND Geographic Footprint and Cluster Markets



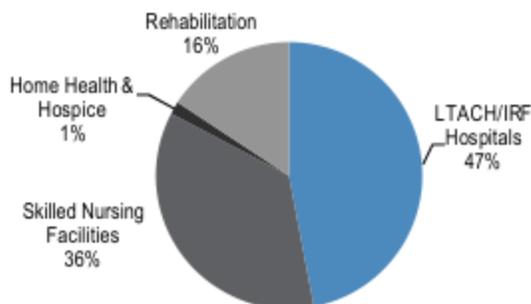
Source: Company reports.

The company has five reportable segments, including the following:

- Hospitals** – Consists of the company's long-term acute care hospitals as well as its inpatient rehabilitation facilities. As of June 30, 2012, the company operated 118 LTAC hospitals and six IRFs in 26 states. In May, the company renewed (for 10 years) a lease (with Ventas) for 10 LTAC hospitals that was set to expire in April 2013. These LTACs generated \$276 million in revenues for FY 2011. Revenues and EBITDAR (pre-corp) for the last 12 months were \$2.9 billion and \$573 million for this division.
- Nursing Center (SNFs)** – Consists of the company's transitional care, nursing and rehabilitation, and skilled nursing centers. As of June 30, 2012, the company operated 224 SNFs, and six assisted living facilities in 27 states. In February, the company decided not to renew leases for 54 of its SNFs, which generated approximately \$550 million in revenues for FY 2011. The current lease expires in April 2013 (though the company has provided Ventas additional flexibility with accelerating the transfer of those assets to new operators). Revenues and EBITDAR (pre-corp) for the last 12 months were \$2.2 billion and \$294 million for this division.

- **Rehabilitation (RehabCare)** – Consists of the company’s contract therapy services in hospitals and long-term care settings. Revenues and EBITDAR (pre-corp) for the last 12 months were \$969 million and \$142 million.
- **Home Health and Hospice (PeopleFirst)** – Provides the aforementioned services from 52 locations in eight states under the “PeopleFirst” brand. The company has been keenly focused on expanding these capabilities. Revenues and EBITDAR (pre-corp) for the last 12 months were \$99 million and \$9 million.

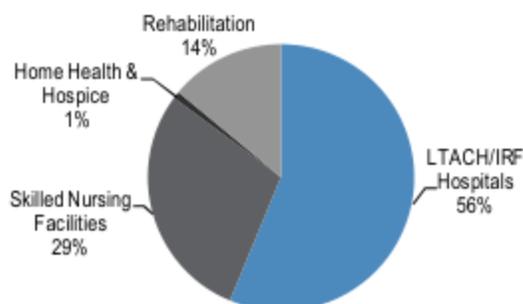
Figure 2: Revenue Mix



Source: Company reports.

The hospital segment is higher-margined than the other segments, highlighting that LTAC business conditions are still the number one driver of results.

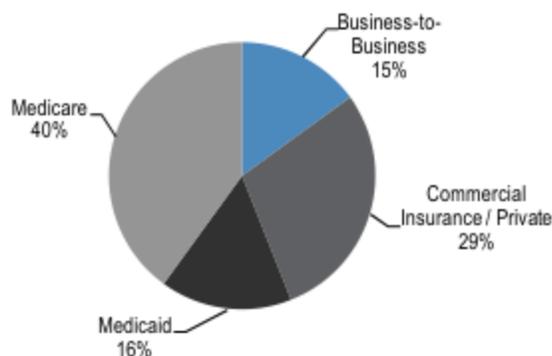
Figure 3: EBITDAR (Pre-Corporate) Mix



Source: Company reports.

Over 60% of the company’s revenues are exposed to government reimbursement, which has been under increased scrutiny (see Recent Credit Profile below). Note that the “Business-to-Business” payor below is from the company’s rehabilitation division (contract therapy services).

Figure 4: Payor Mix



Source: Company reports.

## History – Separation from Ventas

- 1985: Company was founded as Vencare Inc, an operator of LTACHs.
- 1989: Company went public and changed its name to Vencor, Inc (based on its early focus on ventilator-dependent patients).
- 1995: Vencor made a \$1.6 billion acquisition to acquire Hillhaven Corporation, an operator of more than 300 SNFs.
- 1997: Balanced Budget Act changes SNF reimbursement from cost-plus to a prospective payment schedule (PPS) leading to uncertainty in future margins.
- 1998: Vencor split into two companies, in an attempt to unlock shareholder value by “REIT-ing” the company. Ventas, which took with it the real estate assets, became a REIT and Vencor become the operating company.
- 1999: The decline in SNF payment rates exceeded management’s expectations, and cost-save opportunities turned out to be lower. Vencor filed for Chapter 11 bankruptcy protection, but got about a 20% rent reduction from VTR to reflect the non-arm’s length nature of the original lease arrangement.

As part of the bankruptcy reorganization, Vencor changed its name to Kindred Healthcare.

## Recent Credit Profile

### CMS Rate Reduction for SNFs

In July 2011, CMS announced the final SNF rates for FY 2012, an average 11.1% reduction for all SNFs. This rate correction was made to address the spike in reimbursement associated with the introduction of the RUGS-IV (Resource Utilization Groups Version 4) payment schedule. Under the new payment system, the government saw a significant increase in reimbursement, due to a shift in utilization among the therapy modes under the new RUGS-IV that differed significantly from CMS projections. As a result, CMS decided to implement a correction for fiscal 2012.

Following the cut, KIND appeared to have underestimated the impact over the course of several quarters, increasing the annual revenue impact estimate (to both its SNF and contract therapy businesses) from the midpoint of \$102 million in August 2011 to \$150 million in February 2012.

Despite underestimating the revenue headwind, it has been largely offset by cost savings. While management had first anticipated \$55 million in synergies for 2012 associated with the RehabCare acquisition, the company has since realized \$70 million through 2Q12. Further, the company expects to realize \$50-\$55 million in cost savings from SG&A reductions over the course of 2012. Management expects 4Q12 to be the first quarter where the full impact of the RehabCare synergies and the SG&A reductions will be evident.

### RehabCare Acquisition

KND acquired RehabCare in June 2011 for \$1.3 billion (about 8x pre-synergies EBITDA), and obtained 32 long term acute care hospitals, five inpatient rehabilitation facilities, approximately 1,200 rehabilitation therapy sites of service, and 102 hospital-based inpatient rehabilitation units. As noted above, while management had first anticipated \$55 million in synergies for 2012 associated with the RehabCare acquisition, the company has since realized \$70 million through 2Q12.

## Future Credit Profile

### Acquisition Growth

The company plans to “aggressively” expand home health and hospice services in its cluster markets, services that management sees as “higher-margin growth business.” Today, the business is at about a \$200 million run rate (post recent acquisitions including IntegraCare discussed below). As KND recently indicated, organic growth rates in home health and hospice are in the 6%-8% range, compared to 2%-3% in LTACHs, and about flat in SNFs. The higher growth rates, in conjunction with the company focused on delivering care across the post acute care continuum, will likely lead to significant expansion in home health and hospice, resulting in a change to the revenue mix in the future. KND expects to be able to grow the home health and hospice business organically (including de novos) by approximately 10% a year, with an additional \$75-\$100 million of growth per year via acquisitions.

Earlier this month, KND acquired IntegraCare, a home health and hospice provider predominantly located in northern Texas, for \$71 million (1.0x revenues) plus a possible \$4 million cash earn-out. The company generates \$71 million in revenues and EBITDA of approximately \$9 million. Management expects additional organic growth opportunities through expansion into KND’s existing Houston market. Paul Diaz indicated at a recent investor conference that he would like to make five more deals like IntegraCare over the next 18 months.

### LTACHs Get Relief

In August, CMS announced the final rates for LTACHs, resulting in a +1.7% update for fiscal 2013. KND management indicated that the net effect (before sequestration) for the company will be a “slight” decline in reimbursement for its facilities.

In any case, these rates and the one-year extension of the 25% rule appeared to positively surprise many investors, with KND’s equity rising 19% on the day after the proposal in April. Earlier this year, MedPAC recommended no update in rates, with many investors fearing the possibility of CMS incorporating the full impact of budget neutrality (3.9% cut that was set to go into effect in calendar year 2013), and

the expiration of the very short stay outlier and 25% rule moratoria. Ultimately, the following is the final update for fiscal 2013:

- 1.3% budget neutrality phase-in (3.75% over three years).
- A payment reduction for very short stay outliers of 0.5%.
- One-year extension of the 25% rule, “pending results of an on-going research initiative to re-define the role of LTCHs in the Medicare program.”

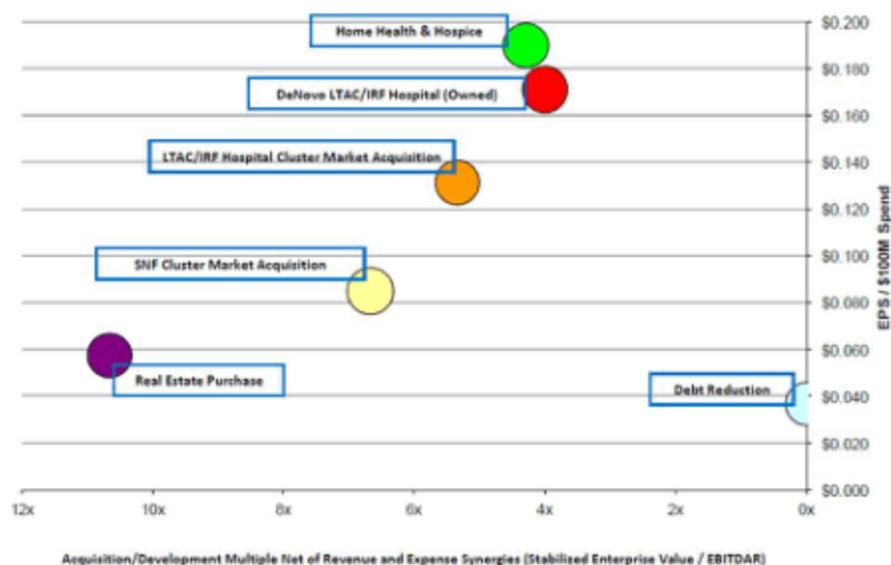
The announcement of a 1.7% net increase for LTACHs is a win for the industry, as the outcome was arguably at least a 6% swing, from the context of what the rate could have been with the full impact of budget neutrality in place. Furthermore, the delay in the 25% rule is a positive for those with significant exposure to hospital-in-hospital (HIH) facilities, the full impact of which (while challenging to estimate given the number of assumptions) could be in the \$50 million context for some of the HIH operators, but the impact to KND would likely be materially lower.

It's also possible that the 25% rule could be eliminated in entirety. CMS states that it has delayed the rule “pending results of an on-going research initiative to re-define the role of LTCHs in the Medicare program.” We believe that this research initiative is likely referring to patient criteria. Our sense was that industry-sponsored ‘criteria’ had been sufficiently diluted that they came nowhere near CBO’s score of the cost to replace. But even if we don’t know the details, the fact that CMS is considering this is a win in itself for the industry. As discussed at an investor presentation earlier this month, KND believes the criteria bill will score \$500 million to \$1 billion in savings. With the upcoming election taking center stage, we figured ‘criteria’ would only have an opportunity for inclusion in Congress’s “lame duck” session.

### Real Estate – More Ownership, Less Leasing

In recent years, KND has developed a greater interest in developing its asset base, reacquiring leased assets when compelling value propositions present themselves. As noted by management this month, the company has purchased previously leased real estate for approximately \$76 million, which includes three LTACHs. Recently, management has addressed its view on acquiring real estate, which per the figure below, is the most expensive decision with respect to capital allocation. Given this and the other materially more accretive opportunities, we would expect the company to focus less on repurchasing its rented assets and continue to build out its franchises (especially home health and hospice; see low multiple and high EPS accretion; further discussed above).

Figure 5: KND's Capital Investment Opportunity Set



Source: Company reports.

## SNF Divestitures

As mentioned above, in February, the company decided not to renew rental contracts for 54 of its SNFs, which generated approximately \$550 million in revenues for FY 2011. The current contract for these facilities expires in April 2013 (though the company has provided Ventas additional flexibility with accelerating the transfer of those assets to new operators).

## 2013 Guidance

Earlier this month, KND reaffirmed 2012 guidance and introduced preliminary guidance for 2013. Please see the guidance below:

Table 2: KND Guidance

\$mm (ex - EPS)	2012		2013
	Updated	Previous	New
Revenues	6.2 billion	No change	5.9 billion
EBITDAR	868 to 884	No change	806 to 825
Rent	432	No change	389
D&A	201	No change	190
Interest Exp.	107	No change	110
EPS	1.35 to 1.55 per share	No change	1.20 to 1.40 per share
CF from Ops.	260 to 280	240 to 260	230 to 250
Routine Capex	135 to 145	125 to 135	120 to 130
Discretionary FCF	85 to 90	No change	90

Source: Company reports.

The guidance for 2013 assumes a reduction in revenues due to Medicare reimbursement rate reductions of \$90-\$100 million (due to LTACH budget neutrality phase-in and sequestration). We would expect sequestration and budget neutrality to result in revenue reductions of approximately \$65 million and \$30 million, respectively. Further, it assumes that the results of the 54 SNFs (whose rental agreements expire in April 2013 and are not being renewed) are classified as discontinued operations as of January 1, 2013.

## Kindred Healthcare, Inc.

KND

FINANCIAL SUMMARY (\$ mn)

Fiscal year-end December	Actual Full Year FYE 2009	Actual Full Year FYE 2010	Actual 1Q11 31-Mar-11	Actual 2Q11 30-Jun-11	Actual 3Q11 30-Sep-11	Actual 4Q11 31-Dec-11	Actual Full Year FYE 2011	Actual 1Q12 31-Mar-12	Actual 2Q12 30-Jun-12	Estimate 3Q12 30-Sep-12	Estimate 4Q12 31-Dec-12	Estimate Full Year FYE 2012	Estimate Full Year FYE 2013	Actual LTM 30-Jun-12
<b>Income statement data</b>														
<b>Total revenues</b>	<b>\$4,270</b>	<b>\$4,360</b>	<b>\$1,192</b>	<b>\$1,293</b>	<b>\$1,514</b>	<b>\$1,523</b>	<b>\$5,522</b>	<b>\$1,580</b>	<b>\$1,536</b>	<b>\$1,523</b>	<b>\$1,562</b>	<b>\$6,202</b>	<b>\$5,891</b>	<b>\$6,153</b>
y/y growth		2.1%	9.4%	19.5%	43.8%	34.1%	26.7%	32.5%	18.8%	2.6%	2.6%	12.3%	-5.0%	31.6%
Salaries, wages and benefits	\$2,483	\$2,506	\$679	\$765	\$901	\$911	\$3,256	\$945	\$907	\$896	\$901	\$3,650	\$3,434	\$3,664
Supplies	\$333	\$342	\$90	\$97	\$108	\$108	\$402	\$111	\$108	\$107	\$109	\$436	\$412	\$435
Rent	\$348	\$357	\$91	\$96	\$106	\$107	\$399	\$108	\$108	\$107	\$109	\$432	\$389	\$428
Other operating expenses	\$886	\$949	\$259	\$287	\$305	\$313	\$1,164	\$311	\$313	\$316	\$323	\$1,263	\$1,257	\$1,242
Impairment charges	\$0	\$0	\$0	\$0	\$27	\$103	\$129	\$1	\$0	\$0	\$0	\$1	\$0	\$130
<b>Total Operating expense</b>	<b>\$4,051</b>	<b>\$4,154</b>	<b>\$1,120</b>	<b>\$1,245</b>	<b>\$1,446</b>	<b>\$1,541</b>	<b>\$5,351</b>	<b>\$1,476</b>	<b>\$1,436</b>	<b>\$1,426</b>	<b>\$1,444</b>	<b>\$5,782</b>	<b>\$5,492</b>	<b>\$5,899</b>
% of total revenues	94.9%	95.3%	93.9%	96.3%	95.5%	101.2%	96.9%	93.4%	93.5%	93.6%	92.4%	93.2%	93.2%	95.9%
<b>Adjusted EBITDAR</b>	<b>\$578</b>	<b>\$574</b>	<b>\$171</b>	<b>\$182</b>	<b>\$211</b>	<b>\$201</b>	<b>\$764</b>	<b>\$215</b>	<b>\$219</b>	<b>\$207</b>	<b>\$231</b>	<b>\$873</b>	<b>\$800</b>	<b>\$846</b>
EBITDAR Margin	13.5%	13.2%	14.4%	14.1%	13.9%	13.2%	13.8%	13.6%	14.3%	13.6%	14.8%	14.1%	13.6%	13.7%
Y/Y Growth		-0.6%	17.8%	23.1%	70.9%	27.4%	33.2%	25.4%	20.6%	-1.6%	15.2%	14.1%	-8.3%	41.0%
<b>Adjusted EBITDA</b>	<b>\$229</b>	<b>\$217</b>	<b>\$80</b>	<b>\$86</b>	<b>\$105</b>	<b>\$94</b>	<b>\$365</b>	<b>\$107</b>	<b>\$112</b>	<b>\$101</b>	<b>\$122</b>	<b>\$441</b>	<b>\$411</b>	<b>\$418</b>
EBITDA Margin	5.4%	5.0%	6.7%	6.7%	6.9%	6.2%	6.6%	6.8%	7.3%	6.6%	7.8%	7.1%	7.0%	6.8%
Y/Y Growth		-5.6%	39.8%	46.7%	209.6%	40.9%	68.7%	33.9%	29.7%	-4.4%	29.5%	20.8%	-6.8%	74.7%
Adjustments	\$10	\$11	\$7	\$38	\$37	\$112	\$194	\$3	\$12	\$3	\$3	\$22	\$12	\$165
EBITDA	\$219	\$206	\$73	\$48	\$68	(\$18)	\$171	\$104	\$100	\$98	\$119	\$419	\$399	\$253
EBITDA Margin	5.1%	4.7%	6.1%	3.7%	4.5%	-1.2%	3.1%	6.6%	6.5%	6.4%	7.6%	6.8%	6.8%	4.1%
Depreciation and amortization	\$126	\$122	\$33	\$38	\$47	\$48	\$166	\$49	\$50	\$49	\$51	\$199	\$191	\$194
EBIT	\$94	\$84	\$40	\$10	\$22	(\$67)	\$5	\$55	\$50	\$48	\$68	\$221	\$208	\$60
EBIT Margin	2%	2%	3%	1%	1%	-4%	0%	3%	3%	3%	4%	4%	4%	1%
Net Interest Expense	(\$8)	(\$7)	(\$6)	(\$23)	(\$26)	(\$26)	(\$81)	(\$27)	(\$27)	(\$28)	(\$28)	(\$109)	(\$111)	(\$105)
Other	\$16	\$13	\$3	\$3	\$3	\$3	\$12	\$3	\$3	\$0	\$0	\$6	\$0	\$12
EBT	\$102	\$90	\$38	(\$10)	(\$1)	(\$90)	(\$63)	\$31	\$26	\$20	\$40	\$118	\$96	(\$34)
Income taxes	\$39	\$34	\$16	(\$3)	(\$2)	(\$17)	(\$7)	\$13	\$11	\$7	\$14	\$45	\$34	\$4
Income tax rate	38%	38%	41%	34%	163%	19%	11%	41%	41%	35%	35%	38%	35%	-13%
<b>Income from continuing operations</b>	<b>\$63</b>	<b>\$56</b>	<b>\$22</b>	<b>(\$7)</b>	<b>\$1</b>	<b>(\$73)</b>	<b>(\$56)</b>	<b>\$19</b>	<b>\$15</b>	<b>\$13</b>	<b>\$26</b>	<b>\$73</b>	<b>\$63</b>	<b>(\$38)</b>
Income (loss) from discontinued operations, net of income tax	\$1	\$1	(\$0)	\$1	\$1	\$1	\$3	\$0	(\$0)	\$0	\$0	\$0	\$0	\$2
Gain (loss) on divestiture of operations	(\$23)	(\$30)	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>Net income</b>	<b>\$40</b>	<b>\$56</b>	<b>\$22</b>	<b>(\$6)</b>	<b>\$2</b>	<b>(\$72)</b>	<b>(\$54)</b>	<b>\$19</b>	<b>\$15</b>	<b>\$13</b>	<b>\$26</b>	<b>\$73</b>	<b>\$63</b>	<b>(\$36)</b>
Loss attributable to noncontrolling interests	\$0	\$0	\$0	\$0	(\$0)	\$0	\$0	(\$0)	\$0	\$0	\$0	(\$0)	\$0	(\$0)
<b>Income (loss) attributable to Kindred</b>	<b>\$40</b>	<b>\$56</b>	<b>\$22</b>	<b>(\$6)</b>	<b>\$2</b>	<b>(\$72)</b>	<b>(\$53)</b>	<b>\$18</b>	<b>\$16</b>	<b>\$13</b>	<b>\$26</b>	<b>\$73</b>	<b>\$63</b>	<b>(\$36)</b>
Basic shares outstanding	38.3	38.7	39.0	43.2	51.3	51.3	46.3	51.6	51.7	51.7	51.7	51.7	52.7	51.7
Basic EPS - continuing ops.	\$1.05	\$1.46	\$0.57	(\$0.13)	\$0.03	(\$1.40)	(\$1.16)	\$0.35	\$0.30	\$0.25	\$0.51	\$1.41	\$1.19	(\$0.71)
Diluted shares outstanding	38.5	38.6	39.5	43.2	51.4	51.3	46.3	51.6	51.7	51.7	51.7	51.7	52.7	51.7
Diluted EPS - continuing ops.	\$1.04	\$1.46	\$0.56	(\$0.13)	\$0.03	(\$1.40)	(\$1.16)	\$0.35	\$0.30	\$0.25	\$0.51	\$1.41	\$1.19	(\$0.71)
<b>Cash flow analysis</b>														
Net Income (loss)	40	56	22	(6)	2	(72)	(54)	19	15	13	26	73	63	(36)
Depreciation and amortization	126	122	33	38	47	48	166	49	50	49	51	199	191	194
Provision for doubtful accounts	29	24	6	8	8	13	35	7	6	7	7	28	28	34
Other	43	33	2	(43)	27	115	102	2	(6)	6	6	9	-	138
Working capital	(5)	(25)	(16)	7	(17)	(69)	(95)	(80)	(13)	19	34	(39)	(45)	(178)
<b>Cash flow from operating activities</b>	<b>234</b>	<b>210</b>	<b>46</b>	<b>5</b>	<b>67</b>	<b>36</b>	<b>154</b>	<b>(3)</b>	<b>53</b>	<b>95</b>	<b>124</b>	<b>269</b>	<b>236</b>	<b>152</b>
Maintenance Capex	(102)	(109)	(25)	(34)	(37)	(38)	(133)	(22)	(29)	(45)	(45)	(140)	(125)	(125)
<b>Discretionary FCF</b>	<b>132</b>	<b>101</b>	<b>22</b>	<b>(29)</b>	<b>30</b>	<b>(2)</b>	<b>21</b>	<b>(26)</b>	<b>24</b>	<b>50</b>	<b>80</b>	<b>129</b>	<b>111</b>	<b>27</b>
Discretionary Capex	(44)	(68)	(11)	(14)	(44)	(18)	(88)	(11)	(12)	(9)	(9)	(40)	(25)	(85)
<b>Free Cash Flow</b>	<b>88</b>	<b>33</b>	<b>11</b>	<b>(43)</b>	<b>(14)</b>	<b>(20)</b>	<b>(67)</b>	<b>(36)</b>	<b>12</b>	<b>42</b>	<b>71</b>	<b>89</b>	<b>86</b>	<b>(58)</b>

Source: JPMorgan and Company Reports

## Kindred Healthcare, Inc.

## FINANCIAL SUMMARY (\$ mn)

	Actual Full Year FYE 2009	Actual Full Year FYE 2010	Actual 1Q11 31-Mar-11	Actual 2Q11 30-Jun-11	Actual 3Q11 30-Sep-11	Actual 4Q11 31-Dec-11	Actual Full Year FYE 2011	Actual 1Q12 31-Mar-12	Actual 2Q12 30-Jun-12	Estimate 3Q12 30-Sep-12	Estimate 4Q12 31-Dec-12	Estimate Full Year FYE 2012	Estimate Full Year FYE 2013	Actual LTM 30-Jun-12
<b>Balance sheet data</b>														
Cash and cash equivalents	\$16	\$17	\$19	\$52	\$34	\$42	\$42	\$40	\$38	\$61	\$151	\$151	\$229	\$38
<b>Total Sr Sec debt</b>	<b>\$148</b>	<b>\$366</b>	<b>\$351</b>	<b>\$890</b>	<b>\$949</b>	<b>\$999</b>	<b>\$999</b>	<b>\$1,114</b>	<b>\$1,104</b>	<b>\$1,106</b>	<b>\$1,104</b>	<b>\$1,104</b>	<b>\$1,096</b>	<b>\$1,104</b>
Senior debt	\$148	\$366	\$351	\$1,440	\$1,499	\$1,549	\$1,549	\$1,664	\$1,654	\$1,656	\$1,654	\$1,654	\$1,646	\$1,654
<b>Total debt</b>	<b>\$148</b>	<b>\$366</b>	<b>\$351</b>	<b>\$1,440</b>	<b>\$1,499</b>	<b>\$1,549</b>	<b>\$1,549</b>	<b>\$1,664</b>	<b>\$1,654</b>	<b>\$1,656</b>	<b>\$1,654</b>	<b>\$1,654</b>	<b>\$1,646</b>	<b>\$1,654</b>
Shareholder's equity	\$967	\$1,032	\$1,056	\$1,379	\$1,390	\$1,321	\$1,321	\$1,337	\$1,352	\$1,365	\$1,392	\$1,465	\$125	\$1,352
<b>Total capitalization</b>	<b>\$1,114</b>	<b>\$1,397</b>	<b>\$1,406</b>	<b>\$2,819</b>	<b>\$2,886</b>	<b>\$2,869</b>	<b>\$2,869</b>	<b>\$3,001</b>	<b>\$3,006</b>	<b>\$3,021</b>	<b>\$3,045</b>	<b>\$3,118</b>	<b>\$1,771</b>	<b>\$3,006</b>
Net Debt	\$131	\$348	\$332	\$1,388	\$1,464	\$1,507	\$1,507	\$1,624	\$1,616	\$1,575	\$1,503	\$1,503	\$1,417	\$1,616
<b>Credit Statistics</b>														
EBITDA / Interest Expense	29.1x	30.5x	20.8x	8.0x	5.9x	4.5x	4.5x	3.9x	4.0x	3.8x	4.0x	4.0x	3.7x	4.0x
EBITDA - CapEx / Interest Expense	10.6x	5.6x	4.3x	2.0x	1.8x	1.8x	1.8x	1.7x	2.0x	2.1x	2.4x	2.4x	2.3x	2.0x
Senior Secured Debt/EBITDA	0.6x	1.7x	1.5x	3.3x	2.8x	2.7x	2.7x	2.8x	2.6x	2.7x	2.5x	2.5x	2.7x	2.6x
Total Debt/EBITDA	0.6x	1.7x	1.5x	5.4x	4.4x	4.2x	4.2x	4.2x	4.0x	4.0x	3.8x	3.8x	4.0x	4.0x
Net Debt/EBITDA	0.6x	1.6x	1.4x	5.2x	4.3x	4.1x	4.1x	4.1x	3.9x	3.8x	3.4x	3.4x	3.4x	3.9x
LTM Rent Implied Debt (8x)	\$2,786	\$2,859	\$2,884	\$2,938	\$3,067	\$3,194	\$3,194	\$3,326	\$3,421	\$3,430	\$3,452	\$3,452	\$3,110	\$3,421
Adjusted Debt	\$2,934	\$3,235	\$3,235	\$4,378	\$4,566	\$4,743	\$4,743	\$4,990	\$5,075	\$5,086	\$5,106	\$5,106	\$4,756	\$5,075
LTM EBITDAR	\$578	\$574	\$600	\$634	\$721	\$764	\$764	\$808	\$846	\$842	\$873	\$873	\$800	\$846
Adjusted Debt / Adjusted EBITDAR	5.1x	5.6x	5.4x	6.9x	6.3x	6.2x	6.2x	6.2x	6.0x	6.0x	5.9x	5.9x	5.9x	6.0x
Discretionary FCF as % of total debt	89.2%	27.6%	43.2%	3.6%	2.8%	1.3%	1.3%	NM	1.6%	2.8%	7.8%	7.8%	6.8%	1.6%
Total FCF as % of total debt	59.6%	9.1%	22.9%	NM	NM	NM	NM	NM	NM	NM	5.4%	5.4%	5.2%	NM
Senior Secured Debt/Cap	13%	26%	25%	32%	33%	35%	35%	37%	37%	37%	36%	36%	37%	37%
Total Debt/Cap	13%	26%	25%	51%	52%	54%	54%	55%	55%	55%	54%	53%	53%	55%
Net Debt/Cap	12%	25%	24%	49%	51%	53%	53%	54%	54%	52%	49%	48%	50%	54%

Source: JPMorgan and Company Reports

## CAPITALIZATION

(\$ mn)	Actual 30-Jun-12	Actual Leverage	Adjusted Leverage	PF 30-Jun-12	Actual Leverage	Adjusted Leverage
Cash	\$38			\$38		
\$650mm ABL due 2016 (L+275)	\$404			\$308		
\$700mm TLB due 2018 (L+375, 1.50% flr)	\$693			\$693		
\$100mm TLB-1 due 2018 (L+375, 1.50% flr)	\$0			\$100		
Capital lease obligations	\$2			\$2		
Other	\$4			\$4		
<b>Sr Sec debt</b>	<b>\$1,104</b>	<b>2.6x*</b>	<b>5.4x*</b>	<b>\$1,108</b>	<b>2.7x*</b>	<b>5.4x*</b>
8.250% Sr Nts due 2019	\$550			\$550		
<b>Total debt</b>	<b>\$1,654</b>	<b>4.0x*</b>	<b>6.0x*</b>	<b>\$1,658</b>	<b>4.0x*</b>	<b>6.0x*</b>
Net Debt	\$1,616	3.9x*		\$1,620		
Shareholder's equity	\$1,352					
<b>Total capitalization</b>	<b>\$3,006</b>					

Source: JPMorgan and Company Reports

## ASSET COVERAGE

(\$ mn)	Current 26-Sep-12
Stock price (USD)	\$11.43
Shares outstanding	51.7
Market value of equity	\$591
Gross debt	\$1,654
Cash	(\$38)
<b>Enterprise value</b>	<b>\$2,207</b>
EV/LTM EBITDA	5.3x
EV/2012E EBITDA	5.0x
Sr Sec Debt/EV	50%
Total Debt/EV	75%

Source: JPMorgan and Company Reports

## ASSET COVERAGE (Lease Adjusted)

(\$ mn)	Current 26-Sep-12
Stock price (USD)	\$11.43
Shares outstanding	51.7
Market value of equity	\$591
Rent implied debt (8x)	\$3,421
Gross debt	\$1,654
Cash	(\$38)
<b>Enterprise value</b>	<b>\$5,628</b>
EV/LTM EBITDAR	6.7x
EV/2012E EBITDAR	6.4x
Sr Sec Debt/EV	80%
Total Debt/EV	90%

Source: JPMorgan and Company Reports

## LIQUIDITY

(\$ mn)	Actual 30-Jun-12
Cash	\$38
\$650mm ABL due 2016 (L+275)	\$650
Credit usage	(\$404)
Letters of credit	(\$9)
Net Rev. Avail.	\$237
<b>Liquidity</b>	<b>\$275</b>

Source: JPMorgan and Company Reports

## DEBT AMORTIZATION SCHEDULE

(\$ mn)	Actual 30-Jun-12
2012	\$4
2013	\$7
2014	\$7
2015	\$11
2016	\$411
Thereafter	\$1,212

Source: JPMorgan and Company Reports

Note: Excludes capital lease obligations

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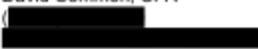
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