John Rex, J.P. Morgan

I'm John Rex from J.P. Morgan. I cover the healthcare facility stocks and managed-care stocks also for J.P. Morgan and we're pleased to have presenting next with us the HealthSouth. Jay Grinney, the CEO, will be making the comments on the stand. With him also are Mark Tarr and Doug Coltharp and I see Mary Ann here in front as many of you know. So, I'll go ahead and turn the time over to Jay.

Jay Grinney, President and Chief Executive Officer

Great. Thank you. Good morning everyone. For those of you who need to have a copy of the presentation, Mary Ann has it. We also have copies of our Investor Reference Book which contains a lot of additional information on the company. Obligatory comments and I will jump into the presentation.

For those of you who may not be completely familiar with HealthSouth, we're the largest provider of inpatient rehabilitative care and services in the country. We have about 8% of the total facilities. But because our hospitals are larger than the average inpatient rehabilitation facility, we tend to see more patients that through with them gives us a significant leverage and significant size in the market. We got about 18% of the beds. Those beds tend to be occupied at a higher rate than average. And so, from a patient's serve standpoint, we serve about 23% of all patients going into an inpatient rehabilitation facility.

Well, we've got 99 hospitals scattered throughout the United States, a lot of concentration in the northeast down into the southeast through the southwest. We're entering new markets as we speak. We open a new hospital in Cincinnati in the fourth quarter at Drake Rehabilitation Hospital. It's a new facility for us. We also open a brand new hospital, our fourth, in Houston in the Cypress Fairbanks region of that market.

We have a couple of CON's that are on their way. One in Ocala, another in Stuart, Florida which is a Martin County. We're building that in partnership with Martin Memorial. And then, we have two additional Certificates of Need that have been approved and both of those are being contested and we're fighting those in court. We hope to get those resolved in the first or second quarter of 2012 and then begin construction on those two hospitals.

One is in Middletown, Delaware, a new state for us. And then, the additional hospital would be in Williamson County which would supplement our rehabilitation hospital in that market that we have in partnership with Vanderbilt.

In addition to the inpatient rehabilitation hospitals, we also have a number of outpatient satellite clinics that serve patients who've been discharged on an outpatient basis and then 25 home-based services that are to facilitate the continuum of care for patients being discharged from our hospitals who still require some therapy, be it physical therapy, occupational therapy, or a speech therapy on an outpatient basis.

We are specialized provider of rehabilitative services. So, that means that our hospitals serve exclusively patients who have been discharged from an acute care facility and need some kind of follow on care. The kinds of conditions that the patients at our hospitals are recovering from includes stroke. You can see that is along with neurological conditions that create a debilitating condition. Those are really the top two conditions treated in our hospitals but we also have a number of orthopedic-related hip fractures, spinal cord injuries, brain injuries. We treated a fair number of amputees and a certain number of burn patients.

So, patients that have been in an acute episode, they've been in an acute care hospital. They are ready to be discharged but they're not quite ready to go home and to live in an independent manner. And, what we do is we take those patients. They are referred to us by physicians. They are admitted by a physician and then for typically two weeks, they are under our care and each patient receives a minimum of three hours of intensive therapy per day.

A 24 hour a day and 7 day a week nursing care to provide that transition from the acute care environment to the home environment and we're very pleased with the outcomes that we're able to achieve in our hospitals.

2011 was a great year for us. It continues the trend that we started in 2008 in terms of focusing on our business plan which was really looking at strengthening the balance sheet, growing our inpatient core business, and then adding new facilities through development efforts.

And you can see that one of the first things that we did was get to rid of some non-core assets. We have six long term acute care hospitals. We sold five of those. We closed the sixth. Now, the proceeds of that sale went to them and pay down our most expensive debt. We had some 10-3/4 notes that were callable. We call that along with additional cash on hand. We paid down about $250 million of long term debt in 2011.

But, we also implemented our next phase of what we refer to as TeamWorks and that's just our internal monitor for the whole process of standardizing best practices within our company and we focus this time on the Care Management. So, it's everything from patient selection to patient admission to patient orientation to care coordination to discharge planning. All of that was standardized across all of our hospitals using best practices. It was a process that took about a year to develop and then another 6-9 months to implement. We've completed that.

The results of which are show up in our Patient Satisfaction scores improvement, the outcome improvement, and then the improvement in our pricing because every patient that we are able to discharge directly home and if it's not, then readmit it into an acute care hospital and enhances our reimbursement.

We also completed the piloting of our new Clinical Information System which we will then begin implementing across all of our hospitals in 2012 and we're very pleased with the results of this platform. It is rehabilitation specific and we think it will give our hospitals the opportunity not only to enhance the care within our hospitals but also to then provide and share clinical information as needed and as appropriate across the continuum and specifically up to referral hospitals.

And then as I mentioned that previously we open two new hospitals, one in Cypress, Texas and then the other in Cincinnati. Those accomplishments are reflected in very strong financial and operational results although we haven't reported on the full year of the fourth quarter in any detail.

You can see through the first 9 months. Discharges were up very, very solidly both for the 9 months and the quarter. You'll look at how that translated into revenue growth. 8% for the quarter. Almost 9% for the first 9 months. Again, the leverage that we got from improving the outcomes translated into improved pricing from our Medicare book which then resulted in that very solid top-line growth. EBITDA went up 15% both for the quarter and for the first 9 months.

To get a better understanding on the earnings per share, I think you need to look at the footnote. For those of you who may not be familiar with the company, last December we reversed an allowance that we had on our deferred tax asset. We had huge NOLs. We reversed that allowance last year and the net effect as you see in the footnote for 2011 was $0.19 per share additional cost this year because of the tax effect and then the $0.23 for the first 9 months. So, if you do a little math you can see that on a normalized basis, EPS growth was significant and was actually greater than what we've saw in the EBITDA growth.

So, that was the first 9 months. What do we will look like for the fourth quarter? Again, we're not providing any detailed information today. But what we can tell you is that we've had a very strong quarter. Revenues are going be up 5%. We had some very strong comps year over year on a volume standpoint. Despite that, we're at the high end of what we had previously guided at 2%. Same-store was most about 1.7% for the hospitals that were in operation for 12 months. And then, the revenue per

discharge number, again, tracking with what we had seen throughout most of 2011 up 4%. We continue to do a great job of managing our expenses. Our salary and wages and benefits are less than 50% for the quarter and bad debt which is a number that we've talked about a lot. It's still very, very low but tracking it about 1.2%. We also took down $73 million of long term debt in the quarter. If you take that and you look at where we are guiding for EBITDA at the 450 range that puts our leverage down to about 2.7%.

So, we continue to deleverage with balance sheet. We still believe that that's a prudent approach to take especially in this environment where there's still a fair degree of uncertainty with respect to what's gonna be happening in Washington.

We also took some of the cash and we were able to buy a lease hospital in Morgantown, West Virginia. And, in so doing, we now have control of that asset which reduces some of the lease expense going forward.

So, with all of that as we look at the fourth quarter and how we ended up the first 9 months, we are increasing our guidance. We're tightening the range a little bit. There's still some adjustments obviously that we'll be doing between now and the time we close. Looking at some of the accruals for professional liability, for some of our benefit expenses. There's going be tax numbers that we're going have to finalize but obviously on an EBITDA basis, we've got a pretty good idea. It's going be somewhere in that 455 to 488 which shows a pretty significant EBITDA growth year over year. From an EPS standpoint, we're also raising the guidelines there to $1.22 to $1.25. You can read the consideration.

Just keep in mind that from an EPS standpoint, there's still some noise in our numbers but that noise level is going to significantly reduce in 2012. A lot of the noise was related to the early extinguishment of the debt and the deleveraging that we have embraced over the last several years.

We feel pretty good about where we are right now with the balance sheet. We don't see and anticipate any additional deleveraging in terms of reducing our debt. That's still a possibility but that's not a high priority for us going into 2012 given what we now know to be the operating environment and given the fact that, you know, we're at that level where we feel pretty comfortable. We can redeploy that cash in ways that I'll talk about in just a minute.

So, we've had for awhile a business model that said, you know, we could grow volumes somewhere in the 2.5% to 3.5% range. That volume growth would be a function of same-store growth, bed additions in our existing hospitals, and then in any new hospitals that we would be bringing on. Excluded in that would be any acquisitions of free standing inpatient rehabilitation facilities. That growth coupled with the pricing and the expense management, we felt pretty comfortable would allow us to grow EBITDA somewhere in the 5% to 8% range and generate free cash flow in the 12% to 17% range.

As we look out over the next several years and even considering what could happen in Washington with respect to SGR fix, we know that the sequestration restoration begins in 2013 and taking all of those factors into consideration. We still feel very comfortable in reiterating that business model. 5% to 8% EBITDA growth. 12% to 17% free cash flow growth.

And, you know that the business model is dependent on being able to deploy that free cash flow which is really in our view is really the story for HealthSouth. If you want to take one thing away from this session, it is that this company generates a significant amount of free cash flow. Many of the actions that we've taken over the last several years have allowed us to get into a position today at a time when the overall operating environment is very tenuous to be in a very, very strong position. To a: continue to grow our core business but b: also be positioned longer term to consider other growth opportunities that may be in front of us.

So, just to put it into perspective, you know, we had said before that we thought free cash flow would be in the 210 range. We're now saying that it's going be at least $225 million as you think about the 2012

and beyond. You've heard us talk about the 12% to 17% free cash flow growth.

To give you some perspective on what's some of the cash requirements are going be, we've outlined it for you here what maintenance CapEx is going be. What we think the cash interest expense is going be on a go forward basis? As you know, we've got the NOL's that have require us to tax effect our EPS numbers but from a cash standpoint, we're only paying $5 million to $8 million in cash taxes. So, that's going be a draw and then we have the dividend on the preferred $26 million a year.

Just want to point that the maintenance CapEx is stepping up in 2012 as we roll up the Clinical Information System that I mentioned a moment ago. And, as we look to a couple of major facility renovations that had been programmed out over the last several years.

So, let's go back to that business model and let's focus now just a minute on how are we going use this significant amount of free cash flow. And, we've talked about this on several occasions. We're only going to take it a moment and break it down a little bit more.

Growth is still where we believe about the highest and best use of most of that free cash flow is going to go, in bed additions, new hospitals, and in acquisitions. With that, we're going be looking at both the combination of bringing some of that back to shareholders and looking at our balance sheet both from a debt reduction perspective but on a limited basis, looking at those hospitals that are leased. The leases are running out and we are able to then buy those hospitals.

So, as we look at the growth perspective, we've talked about bed expansions in the past. Our hospitals are positioned in markets with a significant amount of inherent growth. The overall industry is growing about 2% per year. Our hospitals tend to be in larger Medicare markets with growth rates that are slightly ahead of that. So, you can see that that is going to allow us to continue to provide services in growth areas in order to keep on top of that and we are expecting to add anywhere from 80 to 100 beds per year at a cost between $20 million and $25 million.

And, thinking about that in terms of just, you know, what does that mean in terms of capacity? That's about adding just the bed additions and additional two hospitals per year because the average number of beds in our portfolio is about 40 beds. So, all of our new hospitals that we're building, 40 bed hospitals. Adding 80 to 100 new beds in existing is the same as adding at least two hospitals in the existing portfolio.

We've also talked about our de novo strategy. We had put that on a slow walk basis in the third and fourth quarter because of some of the dislocation in the market and some of the uncertainty coming out of Washington. We feel a little more comfortable as we look forward that certainly in 2012, very comfortable that we can recharge that de novo strategy and are doing that.

We have one hospital that will open in 2012. That's our new hospital in Ocala but we will be starting the construction on at least four additional hospitals that will be opening throughout 2013.

And then acquisitions, of course, will be pursued. It's very difficult to know with any certainty how many of those we will be able to secure. Those acquisitions will be for inpatient rehabilitation stand-alone hospitals or inpatient rehabilitation units in existing competitors where we are able to buy the business, bring that in into our existing portfolio, and accommodate that new patient volume on a very, very profitable basis.

We're also going be looking at ways to reward the shareholders. Obviously in today's market, the phenomenal results that we've been able to accomplish over the last four years have not been recognize in the market. We've grown our EBITDA. We've grown our EPS. We've grown our free cash flow year after year after year. And, the stock is basically at the same level as it was 2-1/2 to 3 years ago.

A lot of recent reasons for that but, you know, we look at the company going forward. We're going be

looking at alternative ways to redeploy that cash so that we can bring value to our shareholders, you know. Clearly, there's going to be some shareholder distribution opportunities either share buyback. We have $125 million program in place or potential dividends either on a one time or special basis. We are looking forward to sizable recovery from E&Y. I don't know when that's going to be but clearly that cash would need to be brought back to the shareholders in some meaningful way.

And then if it makes sense because of the external environment to pay down additional debt, we will do that. I will tell you today that's not the top priority for the company as we look at the environment going into 2012. It's something that we monitor. We look at it. But, it's not a top priority.

The top two priorities are going be looking at how can we continue to grow this core business and then how do we bring additional value to shareholders through some kind of distribution back to our shareholder base.

So, as we look at the company, you know, we think we're in a great position. We've got a very strong track record of growth, consistent, strong, solid growth over the last several years. I know people are concerned about the healthcare environment. We're certainly paying attention to that but the demand for healthcare services is not going away.

The demand is not going away and for those of you who've been around for any period of time, there have been gloom and doom days in the past where the prognosticators were claiming that the end of healthcare was near because of some change going on in Washington and there are going be changes. There's no question, there are going be changes.

The real question is who's going to be able to benefit from those changes? Who's prepared to address those changes? And, we believe that we are one of those companies. We have not over leverage the balance sheet. We haven't sold off all of our assets to get some additional cash. And now, we're faced with huge leases that we have to jump over year over year over year. We don't have that in our portfolio.

We have a very strong operating platform. We're best in class in our industry and we've got above market rates of growth in terms of volumes and we're generating significant free cash flow and we've got a lot of flexibility with the respect to how are we going to invest that free cash flow over the next several years. So, we're very pleased to be here today.

We're very proud of our track record and we look forward to answering any questions that you may have in the breakout session. Thank you.