Erin Blum, Goldman Sachs

Okay, we'll get started with the next presentation. The next company we have is HealthSouth and from HealthSouth we have Ed Fay, who is SVP, Treasurer; and also Andy Price, and I'm sorry I don't remember your title.

Andrew L. Price, Chief Accounting Officer & Senior Vice President

Chief Accounting Officer.

Erin Blum, Goldman Sachs

Chief Accounting Officer. Sorry about that. Go ahead.

Edmund M. Fay, Treasurer & Senior Vice President

Thanks, Erin, and thanks for joining us today. Before we get started let me just remind everybody about our Reg FD disclosure for forward-looking statements and non-GAAP measurements.

HealthSouth is the largest owner and operator in the inpatient rehabilitation industry. Our portfolio consists of 99 hospitals. We're geographically dispersed over a large portion of the country, and as you can see from the bottom left we are growing the franchise. We have a couple of CON applications, Certificates of Need applications that are pending. We're going to open a new facility in Ocala, Florida in December of this year, and then we think we'll be able to open right now anyway, we think we'll be able to open three more facilities over the course of 2013.

Over the last four quarters, we've discharged 120,000 patients from our hospitals. Our hospitals are all free-standing facilities. The average size is 68 beds. And the prototype that we build today is a 40-bed model with expanded – expandable capabilities. So these are larger than other hospitals that are in this industry.

We do also provide home health and outpatient in all of our markets and home health in certain of our markets, as an extension of our care post-discharge from our rehab facilities.

From the market share table here in the bottom center of the page, you can see that one of the significant strengths of our company is our scale. We have 8% of all the IRFs, that's the industry acronym for rehab hospital, we have 8% of all the IRFs in the country. We have 18% of the beds and we've served 23% of all the patients. And that is reflection of the company's scale but not just at the corporate level but also at the facility level, because we have bigger facilities we're able to treat our patients on a more efficient basis than other providers in the industry.

A typical HealthSouth patient is someone who's been discharged from an acute care facility, who has suffered some sort of debilitating either illness or an injury. Common conditions that we treat are people who are recovering, who have the aftereffects of a stroke; people with neurological conditions or disorders, or some other type of traumatic injury. They'll come to our facility having been referred and admitted by a physician and spend just a little bit under two weeks there on average. And while they're there, they will be receiving intensive multi-disciplinary therapy from a team of therapists and nurses who are working in tandem with physicians in order to help that person recover and regain a healthy independence.

We also have case managers working in our facilities. The case managers help from the preadmission process through the communication that has to go on between the multi-disciplinary team, the clinical team, and that patient, and finally helping the patient have a smooth discharge to home.

So all of these functions that are performed in our hospital are really meant to help a patient regain independence. And that's what makes rehab a, maybe not uniquely, but it is noticeably a results-oriented business. The patients who come to us are scored upon admission, what we call the functional or what the industry calls the Functional Independence Measurement scale, the FIM scale. And after their stay with us they're scored again on that same scale.

Now that scale would measure a person's independence along a variety of capacities including your cognitive abilities, physical, occupational and then when we measure them again we're measuring for the gain. And so as you can see from the green bar on this chart, the HealthSouth results that we've achieved, and this is from the first quarter so this is our most recent data, shows that our FIM gains exceed that that are expected in the industry. So on a clinical basis, the type of performance that we're seeing in our hospitals is superior to what the industry would expect. And in addition looking at that right hand of the page, that LOS, that's the length of stay efficiency, that's a measure of the speed, if you will, with which the patient is recovering. How much are they getting in terms of that independence gain on a per day basis. So on both of those we're scoring better than what the industry shows and really that's a trend that's been in place for several years.

We have a lot of best practice initiatives that we put in place in our company. We call them – we brand them internally our TeamWorks initiatives. I had mentioned the case management role a little while ago. We've been going through a TeamWorks initiative around that function to improve the patient experience and get better outcomes for our patients. Really the first TeamWorks initiative that we had was our sales and marketing initiative, we put it in place in late 2007 into 2008 and the results that we've gotten from that sales and marketing effort have been sustained. And as you can see in the upper right-hand corner, we have seen 5.2% discharge growth over that four-year period and that's been resulting in also strong revenue growth and good EBITDA growth. We are very scrutinizing of our expense line so, and particularly our staffing models are constantly being reviewed and supply chain management's also been a great source of efficiency for us over the years.

We also have on this chart our trailing four quarters numbers and if you look at those figures, it should be pretty obvious that the financial performance has been sustained even into the first quarter of 2012. We did release our earnings just late last week and we were very pleased with what we saw here in the first quarter of 2012. 6% discharge growth 5% of that did come on a same-store basis and that discharge growth led to 6.4% revenue growth, which we translated into 8.1% EBITDA or $9.5 million year-over-year. We did have a slight benefit, we called that out on the call last week. We had a slight benefit from the fact that there was one extra day in the quarter this year due to the leap year, but still even taking that into consideration we were pleased with how we got off to a good start for the year.

Let me just go back for one second, just to talk about the income from continuing ops. You can see that continuing ops line has not been as consistent and there's been a lot of legacy numbers that have flowed through the income statement line there. But the large credit you see in 2010, that occurred when we released the valuation allowance against our net operating loss carry-forward. We took a significant credit at that point in time. Ever since then we're reporting our earnings on an after-tax basis at a 40% rate, but we are still a marginal cash taxpayer. We pay about $7 million to $10 million a year. That and state taxes in various states that we're operating where we do not have an NOL.

Well, the tax refunds that we've gotten over the last several years along with the NOL status that we enjoy today, they're not the only sources of strong cash flow that we've had. They've been a significant source, but not the only source of funds that we've been able to apply to this balance sheet in order to achieve the rapid deleveraging that you can see depicted here. We were levered well over six times. If you went back to 2007, today we're as of the end of 2011, we got down below three times and we're still down below that level here in the first quarter of 2012.

The free cash flows that you see depicted on the other page have been both a source and an affect of that deleveraging process. We've been bringing down our debt burden and obviously our debt servicing costs have been following in tandem with that and that has produced very significant returns for the company. It's

probably one of the more significant financial accomplishments the company has seen. We've actually taken our debt down by just a little bit less than $800 million over the last several years.

This is a snapshot of our current capital structure. We have gone through a couple of significant refinancings over the last 18 months. And what we've accomplished in that – a couple of the goals that we had and that we still have for our capital structure is one, we like to have a low level of leverage. That makes us comfortable when we think about an uncertain reimbursement environment. We don't know of any specific reimbursement negative outlook – negative implications for reimbursement other than what's already enshrined in law through Budget Control Act that was passed last August, namely the 2% reduction that's going to come from sequestration. But still we like to be positioned in the event that something adverse were to happen in the reimbursement side obviously when the government is running $1 trillion deficit every year, you really cannot predict what the long-term future might look like.

The other thing we like about our capital structure is that our maturities are well-spaced. We don't look at any particular wall of refinancings. The – all of these maturities are well-sized and easily manageable for the company, and in addition we don't really face any maturities of note until 2016.

And finally what we like is the liquidity profile of the company. We have a revolver that offers us ample liquidity, and we like that for the possibility of either adverse development from the cash inflow side or just to be opportunistic in the event that acquisition opportunities arise, we'll be able to be nimble and go after those.

A couple of items that I want to point out. When we talk about free cash flow we have said as a company, we believe we can grow free cash flow somewhere between 12% and 17%. That's sort of a multi-year target. We think we can get there when we think about the discharge growth we'll get from our same-store facilities, the development opportunities we have, the bed expansions, the effect of expense management I mentioned, the reduced debt service cost and net operating losses, all those variables go into consideration when we come up with this expected growth in free cash, that is a multi-year target. In 2011 we did grow free cash year-over-year by 34%, so we can obviously be outside either above or below on that range in any given year.

A couple of items that are worth noting on free cash for this year. We'll be impacted and it has already been impacted by a slight increase in working capital. That bumped up by about $10 million, and probably – I'm sorry, about $30 million, and it could be bumped up by another $10 million still over the rest of the year.

Also maintenance CapEx is higher this year than it had been last year. We're projecting that it will be higher because we're making some significant investments in the company. We're rolling out a clinical information system. We have it implemented already in three hospitals. This year we're going to convert 12 hospitals, plus a new hospital we're building in Florida will also be going on this system. So it's a very significant investment. It's really a big milestone for the company rolling out this system. We think all told we'll have maintenance CapEx about $35 million higher this year than last year.

So the company generated $243 million of free cash during 2011. This year is going to be another strong year for free cash and at least to a question that we get a lot, which is, what are you going to do with all the funds that you've generated – pardon me, the primary thing we want to accomplish is reinvesting in the business that we know best which is inpatient rehabilitation. We'll be doing more bed expansions this year. We think we'll be able to make another $20 million to $25 million investments in that.

I mentioned the hospital that we'll be building in Ocala, Florida. Next year we'll be opening one in Stuart, Florida. There's also a project we have going on in Littleton, Colorado. So we have certainly some investments we're going to make there. Those alone will cost us between $90 million and $95 million this year. If we had some opportunities to close acquisitions this year that would be added into that.

In addition, we could after having deployed the sufficient cash in our growth opportunities, we could be looking at redeploying cash back to our investors. We have in years past obviously paid down debt. That

remains an option for us although we don't feel compelled to do so, given our current leverage. We can also repurchase shares. We have an authorization in place that was put there in the fourth quarter of last year. We've not transacted under that yet, but during the first quarter we did buy back 25 million shares of our preferred stock, and that's something which we could look at opportunistically in the future.

So just putting all of this together. What we like about our business, we like our position in our business. We like the industry that we're in. We like our market share. We believe the patient demand is going to be there regardless what the reimbursement environment ends up looking like in the future. We are very cost-conscious people who are scrutinizing our staffing levels and our supply chain at all times. We control the vast majority of our real estate portfolio. We like the balance sheet that we have now. We think that it allows us to have an outward focus where we can think about growth investments.

We can think about clinically reinvesting in our business so that patients and physicians feel confident about sending business in our direction, and we think that the strong cash flow generation that we have seen in recent years is going to continue and that we will be able to prudently reinvest those dollars in a fashion that's going to make our investors happy.

Unverified Participant

Great. Thank you.

Edmund M. Fay, Treasurer & Senior Vice President

You want me to sit over here?

Unverified Participant

You sit there, so I can at look at both of you. Thanks. I'll start by talking about the regulatory and reimbursement environment. So a clarification question on the call, I guess it was last week, someone had asked well is there going to be just a notice rather than a proposed rule and I guess it was Jay, that confirmed that yeah you're hearing it would be a notice. What is the significance of that? I don't know.

Edmund M. Fay, Treasurer & Senior Vice President

Well, the significance is that, and that is what we're hearing, the significance is that, if there's a proposed rule there implication is there are a lot of things out there that need comment from experts in the industry. And so perhaps there's some experimental ideas, there's some changes that are being proposed. When we hear that there's simply going to be a notice coming late July or early August, I think the default assumption is this rule will be, here's your pricing update, here's your reduction as per the Affordable Care Act, here's your productivity adjustments, so here's your update and otherwise probably not a whole lot of significant new developments on the front. So it's incremental clarity for us on the regulatory front that we shouldn't expect anything disruptive, if you will.

Unverified Participant

It's kind of strange that that's the exception rather than the rule, that there's not something disruptive. Anyway...

Edmund M. Fay, Treasurer & Senior Vice President

No news is good news in this case.

Unverified Participant

I'm curious if you have any thoughts on the LTAC proposal that was out last week. I'm sure you guys look at that even though you sold your LTACs but do you see that as indicating any sort of shift in attitude towards post acute care by CMS?

Edmund M. Fay, Treasurer & Senior Vice President

Well, we are not in the LTAC business, it's just so everyone here is aware, we were in the LTAC business. We did have six hospitals. We sold five of them and then we closed a fifth facility that we had in Houston. So we don't pay as close attention to it as we did. I think that the indication here is that at least there's going to be maybe more of a cautious, more of a gradual approach to questions of what should be done here with regard to dealing with the whole question of LTACs. Obviously, patient criteria has just been such an important issue to try to nail down. We have very clear patient criteria and I think it's one of the things, when I say we, I should be clear, inpatient rehabilitation facilities, have fairly clear patient criteria both on medical necessity and obviously also on the types of patients who are compliant.

And those sorts of defined boundaries work well for CMS. The undefined nature of the LTAC businesses has caused some of them to sort of raise an eyebrow at the industry. I think that it's fair to say that the recent proposal is at least an indication that they're willing to say, the costs here are relatively stable, there is a lot of other balls up in the air right now and we can afford to take something of a gradual approach to how we're going to think about the LTAC industry.

Unverified Participant

Okay, fair enough. And then you mentioned sequestration. I'm wondering how you handicap the chance that sequestration gets replaced with something more thoughtful than just a 2% cut?

Edmund M. Fay, Treasurer & Senior Vice President

Will sequestration is going to impact the industry starting in January of 2013. It's hard to imagine a scenario where something is done to derail sequestration between now and the election. When we get out past the election and you have a lame-duck session of Congress, I'm not sure the scenario that gets us to an idea that people are willing to lift it without replacing it with more – in other words, no one's going to say let's change the CBO projections, let's have more indebtedness. So sequestration, we don't really foresee that it would go away without something else supplanting it.

That something thoughtful could come out of a lame-duck Congress seems unlikely, so – and it would have to happen relatively soon thereafter. We're going to have debt ceiling discussion. We're going to [indiscernible] (18:09) fix issue there to deal with there as well. Are they just going to kick the can down the road a little bit and then leave it for the new administration or the new Congress, the new Senate in 2013? That's when we would expect maybe something more thoughtful, maybe something more comprehensive could get done. It is hard to picture that happening in 2012, late 2012 and into January 2013.

Unverified Participant

Okay, that's helpful.

Edmund M. Fay, Treasurer & Senior Vice President

Our default assumption is that sequestration is, we're planning as if that law is going to stand.

Unverified Participant

Okay, that's fair. And then I guess it was back in the fall when President Obama had made some proposals as part of his idea of what should be done to cut the budget and you guys held a conference call at that time and you said that you thought there'd be $16 million of offsetting cost savings. So what always confuses me about that is if you think you have things that you can save money on, why don't you just do them anyway? And why was it related to having a Medicare cut?

Edmund M. Fay, Treasurer & Senior Vice President

Yeah, that's a good question. What Erin is referring to is that in the President's – I won't call it the budget proposal, but his proposal for living within our means, which came out in September of last year, he in the $3.5 trillion plan had certain proposals that related to inpatient rehabilitation. One of them was the instatement of the 75% rule. I can't really call it a reinstatement because although it has been law in times past, it was actually never effectively implemented.

There's never been a time when rehab hospitals have been asked to operate at a compliance threshold of 75% and, in fact, many of them, obviously the units in particular, would find themselves in a position where they simply didn't have the volume to support their businesses at all. And so there was a strong lobbying of Congress on behalf of the inpatient facilities in 2007 saying, we won't be able to live with this law and Congress, with a very strong majority, passed a law that took 75% back down to 60%. And that's been the regulatory environment in which inpatient rehab facilities have been functioning since then.

The President comes out with a proposal in September of last year and says of the $3.5 trillion of cuts that I'm looking for over the next ten years here's one it's called the 75% rule. It's going to save $3 billion. We were able to at least score that one because we could estimate what would the impact look like? And what we did in order to estimate that is we took the hospitals where we would not be in compliance with that rule and we said, well in order to get in compliance with it I have to take my compliant cases and say they're going to be my denominator. What can I gross up with non-compliant in order to stay into the 75% proportion in total? So our assumption when we came up with that 16% savings number, which offset a hypothetical $42 million revenue cut, it was a volume-related revenue cut. And so what we said is, well with less volume, we will have less staffing, less supply needs. And so that was – it was a variable costs.

Unverified Participant

Get it.

Edmund M. Fay, Treasurer & Senior Vice President

Right. So.

Unverified Participant

A big light bulb went on.

Edmund M. Fay, Treasurer & Senior Vice President

Okay.

Unverified Participant

Thank you. And then does anybody have questions on reimbursement or anything that they want to ask now? No. So then, to talk a little bit about the first quarter, so the very strong discharge growth. You talked about how it was driven by these sort of 15-month to 18-month old beds that you have been adding in facilities and so I'm wondering what does the pipeline of maturing beds look like for you? So was there just a big group of facilities that were at that age or should we expect that help to continue for the next few quarters?

Edmund M. Fay, Treasurer & Senior Vice President

Yeah. So our discharge growth, I mentioned earlier, was 6% year-over-year. 5% of that was same store. The first thing we explained about our volume growth was the leap year. Adding a day, we sort of triangulated using a variety of methods trying to estimate what was the extra day and how much was it worth. And regardless of how we did it, we came up with something a little bit more than 1%, was the incremental volume growth of having 91 days rather than 90 days in the quarter. So we said, well our same facility growth was 5%, but without that day, maybe it's a little bit more like 4%.

The growth that we saw, we can't just attribute it to one thing or another because really it was strong across the franchise. What we do see is that some of the hospitals that we opened in 2010 – we were relatively busy in 2010. We opened – I'm sorry, we acquired a hospital in Las Vegas, our Desert Canyon facility. We acquired a hospital in Houston, that's our Sugar Land facility. We did a joint venture in Bristol, Virginia. We opened a de novo in Loudoun County. We did an end market consolidation in Fort Smith, Arkansas. So all of these transactions were still, even though they were in our same-store account because we had held them for more than 12 months, we were still getting some fairly significant momentum out of those. And then in addition to that, we had our bed expansions. They've been additive to our volume growth as well, but then it's really the whole franchise. It was a solid quarter and really all the geographies, if you will, were pulling their weight.

Unverified Participant

Okay and then one of the other factors in the quarter was the slightly higher bad debt percentage because of the additional medical claims reviews. So as you go through the experience of that, how has your experience been in terms of those claims being accepted? And then at what point do you think about being a little less conservative on your allowance?

Edmund M. Fay, Treasurer & Senior Vice President

I'd like Andy to take this question.

Andrew L. Price, Chief Accounting Officer & Senior Vice President

Well we've been going through this claims review process primarily with our biggest intermediary over the last four years. Recently several of our other intermediaries have started doing the same thing. It's primarily focused on a couple of specific diagnoses codes. But what we've seen over the years is that it has ebbed and flowed, but in 2011 and into the first quarter of 2012 it has increased slightly primarily because of a slowdown in adjudication.

These claims go through an ALJ process for adjudication. The backlog of claims has increased as more intermediaries have joined this process. So we've seen a slowdown of payments, and that's primarily what we're seeing leading to the increase in bad debt expense. Historically, and we've said this in our public filings, we collect around 60% thus far.

Unverified Participant

Okay. Does anybody in the audience have anything that they want to – last chance .

QUESTION AND ANSWER SECTION

<Q So on the Home Health, is that just an incidental business? Or how does that fit into the larger kind of your business offerings.

<A – Edmund Fay – HealthSouth Corp.>: It is an extension of the care that we're offering out of our facilities. The patients who are coming to our Home Health business it's really not a home health nursing business. It's much more home health therapy, and so it's an extension of the care post-discharge where we continue to take care of those patients. It is not a presence – it's not a business we have a presence in, in all of our geographies. It's in certain markets that we have that.

<Q>: Is that something you'd look to expand over time? Or is it just purely just incidental and just purely an extension of specific geographies, then?

<A – Edmund Fay – HealthSouth Corp.>: I think that there are strategic reasons why it would make sense as an extension of that care for those patients. So it's a logical extension and what we have been considering is that possibility. Now we're focused on investing in inpatient rehabilitation. We think there's plenty of opportunity there, but the Home Health side is something which depending on what the reimbursement environment looks like, what the regulatory environment looks like, we could consider that. But it's not something that's on the table for us today. We like the relatively small business that we have in it right now, and we think that it's been very successful in the markets where we're doing it, but for the time being were not likely to dramatically expand that presence.

<Q>: Okay, great. Thanks.

<Q>: You have, you've done a very impressive job of de-leveraging over the last few years. And sometimes it strikes me that the rating agencies have been a little harsh on you with the B+/ B1 rating. Is there – what's your view on that and where that's going?

<A – Edmund Fay – HealthSouth Corp.>: Yeah. I would have said a year and a half ago when our bonds were still rated CCC+, I probably would have used the word harsh, but right now I wouldn't see it that way. They do have us as a corporate family rating as B1/B+. We're on positive outlook from both agencies. We've been there since May. They both publish materials where they say, well, if you get on our adjusted basis through four and a half times or through four times depending on the agency we're talking about, then we'll consider you for an upgrade. Well, I believe we're there, I believe that we're well inside of the thresholds that both of them have established.

So obviously rating agencies sort of move at their own pace, and they want to take a very long view. I think they probably see the line from B+ into the BB world as being a little bit brighter than going just from B to B+. And so they're probably being a little bit cautious. But I couldn't predict when they might do it, but I believe we've done everything that would justify BB. We don't manage to a rating. We manage the way we think the business ought to be managed, and then we'll take the rating that we get, but we do think that where we are today and given our discipline around we manage the balance sheet, we do think that we are deserving of an upgrade to BB.

<Q>: Okay. Thank you.

<Q>: Right. I'm going to squeeze in one more quick one which is, what are your conversations with your equity holders like in regards to how you should use the free cash flow that you're generating? What are they pushing for?

<A – Edmund Fay – HealthSouth Corp.>: I think that equity holders who – when we have conversations with them, they have in general, even if they're not always pleased with what the stock price is doing, I think we've been getting a fundamental vote of confidence in our approach to things. They like the conservative balance sheet. We don't hear a whole lot of people saying, lever this up or give me a dividend. Reinvest in the business. Grow the inpatient. You're doing well with that. We definitely hear that message coming through loud and clear. And we intend to keep on doing that. So we think we're more or less in sync with our important shareholders in that regard.

<Q>: Great. Thank you. Thank you for being here.

Edmund M. Fay, Treasurer & Senior Vice President

Thanks, Erin.