Kevin Mark Fischbeck, Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

All right, thank you everyone for joining us here. It's my pleasure to introduce HealthSouth, which is the largest provider of inpatient rehab services in the country. Presenting today, we have Jay Grinney, who's the President and Chief Executive Officer. We also have Mark Tarr, who is Executive Vice President and COO. In the audience as well, we have Mary Ann Arico who is the Chief Investor Relations Officer as well.

But with that, I'll hand it over to Jay.

Jay Grinney, President and Chief Executive Officer

Thank you, Kevin. Good morning, everyone. As Kevin mentioned, HealthSouth is the largest provider of inpatient rehabilitative services in the country. As such, we provide follow-on care for patients who are being discharged from acute care hospitals suffering from a wide range of neurological problems, strokes, hip fractures, and other orthopedic conditions. As you can see from the map, our assets are located throughout the Northeast down into Florida across the Southeast Texas into Arizona. We have two hospitals in California and a lot of growth opportunities we believe out West and in the Midwest.

If you look at the number of hospitals in the country, there are about 1,152 inpatient rehabilitation facilities. We own and operate 99, about 8% of the total assets. Our hospitals tend to be larger and the number of patients we treat in those hospitals tends to be greater. As a result, our market share as a percent of beds is about 18%, in terms of patients served about 23%. Another way that looking at that is one out of every five patients receiving inpatient rehabilitative care in this country gets that care at a HealthSouth hospital.

Over the last several years, we focused a lot on our balance sheet to strengthen the fundamentals of our company. The last two years, we've been very fortunate in taking that leverage ratio down and refocusing the cash flows that we're generating into growth.

We've developed over the last several years a pretty good analytical tool looking at markets where there is a demand for inpatient rehabilitative services, but no supply of beds. We've opened six in the last two years and, in each of those de novos, we've achieved a positive EBITDA within three to six months.

So we're pretty confident in our ability to assess markets, where there is a demand. Some of those markets, we are able to secure a foothold before competitors, and other markets, we're in taking market share primarily from other providers that tend to be a further away geographically than the site of that new hospital.

That growth continues. We have several hospitals that we are currently constructing or in some phase of development. We have a new hospital in Ocala that we'll open up at the end of this year. We just broke ground on a joint venture hospital in Stuart, Florida, partner there with Martin Health, which is the largest acute care provider in Martin County.

We have land in suburb of Denver. We have land that we purchased outside of Phoenix. Both of those hospitals will begin later this year. And then we have two certificates of needs, they are in the final stages of litigation, one in Williamson County, Tennessee, the other in Middletown, Delaware. Both of those are being litigated, challenged. We are in the final stages and we expect to receive final certificates of need for those two hospitals by the end of the year. Once we have those in hand, we will begin the process of construction on those two hospitals as well.

So as we look out into 2013, we definitely have three new hospitals opening up, possibly five, and then what we've provided in terms of guidance going forward is the ability to open at least four new hospitals a year for the foreseeable future and/or secure acquisitions of other rehabilitation providers.

Inpatient rehabilitation is a relatively small component of total Medicare spending. So even though 80% of our patients are Medicare, the spending on inpatient rehabilitation services by Medicare has actually leveled off over the last several years and, as I mentioned, as a fairly de minimus amount of total spending. So as you think about the proverbial Medicare cost curve that everyone has focused on bending and as you look at the other post-acute services, inpatient rehabilitation's cost curve has been bent.

And I think that that's in large part because of the regulations that have been imposed on the industry over the last several years, most notably the 60% Rule previously referred to as the 75% Rule, which was modified at the end of 2007 and permanently adjusted to the 60% threshold. Since then, CMS has issued a report basically saying that the intent of the regional legislation was achieved at the 60% threshold. So despite the fact that from time to time in President Obama's deficit reduction plan and his DOA budget earlier this year, that keeps coming up. We believe that that issue has been litigated and has absolutely been put to bed.

One measure of our confidence in that is when we were able to get the 75% threshold set at 60%, we had over 60 original co-sponsors in the Senate sponsoring to build to set that threshold at 60%. We had 242 members of the House who served as original co-sponsors not signed on as once the bill was introduced, but original co-sponsors of the bill. So I think there's a lot of understanding in Congress that there is a need for inpatient rehabilitative services and that the 60% Rule is meeting all of the original parameters when the rule was reset at the end of 2007.

And just as an aside, when we meet with members of Congress, oftentimes there's a little bit of hesitancy. They're not quite sure what inpatient rehabilitation is all about, and then we mention Congresswoman Giffords and the progress that she's had in her rehabilitative care, and then when we're meeting with members of the Senate, we make the same reference with Senator Kirk from Illinois. Their eyes light up and they get it. They understand what we do and the value of that service as a provider in the continuum.

We reported first quarter results couple of weeks ago. We are very pleased with those results. Discharges were up 6% on an aggregate basis, same store up 5% and we have pricing just over 2% generating top line growth of just under 6.5%.

EBITDA grew 8%. We continue to manage our hospitals in a very disciplined manner, providing high quality care on a cost effective basis, which is basically what we are all want, right. The government wants that, employers want that, we want that as well. And we're very proud of the fact that we're able to achieve that double objective of high quality and cost effective care.

Earnings per share was $0.40 a share, compared to $0.57 last year. As a reminder, last year there was a one-time benefit, non-cash benefit of $0.27 that was in the $0.57. You take that out, EPS grew on a normalized basis 33%.

I think the story for HealthSouth is the fact that we generate significant free cash flow last year, about $240 million. We anticipate that that will continue to grow. We have multiple opportunities for investing that free cash flow. Our first objective is to continue exploiting the growth opportunity that we see in the inpatient rehabilitation space. The demand for inpatient rehabilitative care is growing about 2% to 2.5% per year and that's being driven by the demographic shift as the baby boom generation gets into the over 65 and then progresses through into the 70's and 80's. The average age of our patient is 72 years old, so you can see the early portion of that baby boom generation is just now hitting 65.

As we look out over the several years, we expect that there's going to significant demand for the services that we provide. Again as a reminder, the services are provided for neurological conditions, strokes, hip fractures, conditions that typically one experiences in their later years. And so we feel pretty confident that there is a built-in demand for those services.

We add beds to hospitals that are added in your capacity, about 80 to 100 each year. Our de novo model is 40 beds, all private rooms, so you can see that just in the bed addition alone we're adding 2.5 hospitals per

year. On top of that, we see very nice growth with the de novos. We've said we're going to target at least four per year. I've already talked about 2013 having upwards of five new hospitals that we'll be opening and then we're always looking for acquisition opportunities in the rehab arena.

There are not a lot of other free standing rehabilitation hospitals, but there are a lot of units out there, many of which are dealing with reimbursement issues as we all are and trying to accommodate that. Oftentimes, those acute care hospitals look to exit or to joint venture their rehabilitative services and, to an increasing extent, we are there to help them in that regard.

We have debt repayment here as a free cash flow option, but quite frankly with our leverage at 2.7 times, we feel that additional debt repayment does not make sense at this point. Fortunately, our capital structure is designed in such a way that should the reimbursement environment change dramatically for the worse and we had to go back to looking at ways to reduce our overall obligations, we'd be able to do so. And we'd be able to continue to trim down debt.

But again, at this point 2.5 times, we feel very good about the leverage ratio and clearly as our EBITDA continues to grow, there will be that inevitable corresponding deleveraging that occurs through the EBITDA growth.

Finally, we have a couple of authorizations out there, $125 million to buy back some of our preferred. In the first quarter, we bought $25 million of that. We also have a $125 million authorization to buy back our common stock. We have not purchased any of our shares at this point. And then we are always keeping in mind that there's the opportunity to provide a cash dividend either regular or recurring. We don't believe that it makes sense to consider recurring at this time, however, given the uncertainty in the reimbursement environment over the next several years.

So as we look at HealthSouth and we look at the advantages that we think we have in our industry and as a potential source of investing for you, we're in a very attractive sector of healthcare growing at 2%, 2.5%. We are the largest provider in that space. We have a clear advantage from an efficiency standpoint. Our cost structure is very, very efficient, but we're also able to provide above industry, significantly above the industry outcomes in terms of patient care. The effectiveness of our cost structure is seen as we saw in being able to leverage the operating platform to achieve significant EBITDA growth.

Another important characteristic that we think is very important is that we own a lot of our assets. We think that that gives us a lot of flexibility going forward. Last thing we would want to have today is to have every single one of our hospitals owned by someone else where that lease payment is going to be going up, 3%, 4%, 5% inexorably every single year is just another form of debt that you can't manage, you can't prepay and is a significant burden on, I believe, on any healthcare provider.

We've got the strong financial platform that I mentioned before. We're generating significant free cash flow and, as I just highlighted a moment ago, we believe we have really terrific opportunities for investing that free cash flow for the benefit of our shareholders.

And so with that, I will open it up for questions.

Kevin Mark Fischbeck, Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Any questions?

QUESTION AND ANSWER SECTION

Q – [Inaudible]

A – Jay Grinney – HealthSouth Corp.: Question is what would the margins be for the industry under sequestration? And I don't know what that would be, but first of all, we do have for those of you who are interested, we put out an investor reference book on a quarterly basis and in that we have a lot of information so I may be referring to some of those pages. Mary Ann Arico has some of the information there.

Right now if you look on page 24 of that document, you can see for all inpatient rehabilitation facilities, the margin in 2010 was 8.8%. MedPAC is projecting that that's going to go down to 8.4% and that is without sequestration. And that compares to skilled nursing, which is above 15% home care, which is above 15% hospice care, which is above 15%. So we feel that our margins, while our company's margins are very strong and we're very proud of that, the fact that the industry is really in that below 10% range, and we expect that that 8.4% will probably be pushed downward with sequestration.

Q – Kevin Fischbeck – Merrill Lynch, Pierce, Fenner & Smith, Inc.: Okay, usually the way that I start off my questioning with pretty much from other companies is talk about, given the fact that we have sequestration next year we're probably going to have a debt ceiling bill, though even if you believe that IRF's are not unduly targeted, it feels like everybody is going to see less inflationary rates going forward. I mean I guess the volume focus is clearly how you deal with it in part, but how else can you kind of deal with the reimbursement pressures that seem inevitable?

A – Jay Grinney – HealthSouth Corp.: Well, I mean typically the way we've done it, and ironically as luck would have it, anticipating the question, you can see that we have a pretty good track record of growing despite regulatory barriers that are in post 2010, there was a new set of coverage requirements that the entire industry had to absorb. When you go back to 2008 and 2009, in that time period for those of you may not remember there was an 18-month period where there was the reimbursement for inpatient rehabilitation providers was reduced. So we had an update in the fourth quarter of 2007. It was reduced back to that level then in the second quarter of 2008 and it remained flat for 18 months. And to put it into perspective, in the BBA back in 1997 when there was the first round of significant cuts to providers, that was a 12-month 0% update.

So our industry was one of the few where, for 18 months, we went with no update and what we were able to do is grow our way past that. EBITDA grew. Margins expanded. Earnings per share grew. So we have the ability to continue to take market share. If we needed to get into our cost structure, we have opportunities there. But quite frankly our focus has always been on growing our business, taking market share and recognizing that when there is reimbursement pressure on us, with our margins as they are, that pressure is considerably greater on the balance of the providers who don't have the cushion and don't have the wherewithal to manage through difficult times.

And so we do believe that in the world of increased reimbursement pressure, there are going to be winners and there are going to be losers. There are going to be those who have provided and anticipated that kind of environment, have low amount of debt, have the ability and a track record of taking market share and we'll be able to continue to provide that care because one thing that I think investors are missing is the demand for healthcare is not going away. And there may be reimbursement pressures on the system, but the demand is not going to go away. Somebody is going to have to provide that care. And we all focused on the fact that we look at the publicly traded companies, Select and us and the acute care hospitals. We kind of judge what's going on and we fail to or we forget that that represents maybe 10%, 15% of the industry.

The rest in the industry is really struggling right now. So, if there is additional reimbursement pressure from Washington, and I think there is going to be, that will hurt everyone, but it will disproportionately hurt those who are struggling today to have an even positive margin. So, I think that the ability to take market share, the demonstrated ability to do that is really where we feel very confident that we'll be able to move through the next 12 to 18 months and come out the other side very strong.

Q – [Inaudible]

A – Jay Grinney – HealthSouth Corp.: Question is do we have opportunities to work with large systems, and the answer is yes. What we're seeing, and I'm sure Bob, you're seeing the same thing as we are, many of the acute care hospitals are today acknowledging and lot of them are the not-for-profits, I just mentioned, that are struggling. They don't have the investment income to supplement what they weren't getting on the bottom line from an operation standpoint. They're looking out and they're saying, next year we've got the third year of the pay for Obamacare.

So the compounded effect of reduced payments is starting to be felt. Then they're looking on and they're saying, on top of that we have got sequestration, so we got another 2% haircut coming off of our Medicare revenue stream. And then beyond that, they're thinking we've got debt ceiling, deficit reduction. We don't know exactly what it's going to be, but we got to believe that Medicare spending is going to be in the mix somehow. And they're starting to realize that they can't continue to be all things to all people.

They can't have their core business, acute care, the heart program, the surgery program, the oncology program and continue to support, on a high quality basis, the full range of sub acute and post acute services. So what we're seeing and we're very excited about this is just in the early phases we're seeing more of the not for profit systems coming forward and saying, we'd like to talk to you about potentially being a partner with us to provide inpatient rehabilitative care. Most of those are in markets where we don't have a presence. So as we think about the growth opportunities, it's very exciting for us because we can enter new markets and mitigate the risk of doing so by aligning ourselves with a very strong acute care partner.

And then additionally, downstream and maybe this happens three years, five years, 10 years maybe it never happens, but if we move into a bundle, there are capitated or accountable care organization environment, however you want to describe it, just capitated care, we're then entering these markets with a partner we're already built-in to whatever configuration might be called for in that new world order.

So it's very exciting for us to be able to come in and provide what we think is our value proposition, first and foremost on the quality side, then on the cost effective side, and then on the ability to put our balance sheet to work, to help build facilities where there is a need for those facilities.

A – Mark Tarr – HealthSouth Corp.: Keep in mind almost a third of our existing portfolio of hospitals are partnerships with acute systems, so we know how to do that model pretty well.

A – Jay Grinney – HealthSouth Corp.: So we've got partnership in St. Louis with Barnes-Jewish; in Nashville with Vanderbilt; Charlottesville, Virginia with the University of Virginia; University of Missouri. We got one I just mentioned, the system down in Martin, Stuart, Florida, Martin County, Martin Health. So that is something that we're seeing more activity in that arena and we think that there are going to be some opportunities for us to win some of those RFPs.

Q – Kevin Fischbeck – Merrill Lynch, Pierce, Fenner & Smith, Inc.: We've seen some other providers in the post acute care sector talk about trying to expand the services to be a one-stop shop peripheral source to payers. I mean, how do you view that strategy? Would you guys pursue something like that down the road?

A – Jay Grinney – HealthSouth Corp.: Kevin, we certainly were looking at that back in 2008, 2009, especially when in the Affordable Care Act, the marker was set out there that the industry or Medicare was going to move the industry towards accountable care organizations. And I think most of us in the provider space thought, okay, if Medicare is going to move us in that direction, we better get ready. Our thought was in that kind of an environment we might be better served to have more than one service to come to the accountable care organization with.

The proposed rules came out. The final rules came out. If you remember initially, Don Berwick was saying several hundred providers would be participating. This was going to be transformative for the entire industry and we're going to see a revolution in the way the industry was structured and care was provided.

Marilyn Tavenner two years ago got up at a conference in Nashville said she'd be very happy with 100, and she was blasted from the left. She corrected herself. She would as she needed to do politically and what do we have 35 hospitals that are in some kind of ACO. So she was right. In fact, she was more than right. I think that the industry is very reluctant to jump back into that capitated environment.

So to be able to provide all things to all people really only make sense if there is a business purpose. The ACOs kind of created that potential for that purpose to exist, if there are synergies you might be able to then make a business case for that. So do we see in the near-term, a need for or a demand for providing all of those services or additional services to be responsive to ACOs? No.

Longer term, if you're thinking and I don't know what the investment horizon for everybody in this room is, but I suspect it's probably not five years and longer, no offense, but you look five years, 10 years down the road, yes, we can definitely see this company expanding into other post acute services. Home care would be a great adjunct to what we do. Frankly, long-term acute care in our view is a very important component of the healthcare continuum.

Unfortunately, some of our friends in CMS view it differently. I think it's a jump ball whether or not the patient criteria are going to come out and be favorable, we don't' know. But once we get that clarity, I think we'll be in a better position to evaluate does it make sense to potentially get back into the long term acute space, maybe expand into homecare. Whatever we do, we believe we need to do it on a market-centric basis.

To be able to say, okay, we're going to be providing the full range and then make huge bets and have that double the size of our portfolio where we now have to build out that full continuum across twice as many markets does not many any sense. To have home health in North Dakota and rehab in Florida adds zero value. If you have home care and rehab in Florida, that makes sense. So the acquisitions that we would be looking for would be more regional in nature and then look to build out across that market.

Q – Kevin Fischbeck – Merrill Lynch, Pierce, Fenner & Smith, Inc.: You kind of laid out your capital priorities and it's pretty clear that you're adding beds, doing your own development to kind of the first uses of capital. Beyond that, how much kind of free cash flow do you feel like you're generating right now for acquisition, share repurchase and how do you think about where that extra capital goes to?

A – Jay Grinney – HealthSouth Corp.: Well, last year it was $240 million. We fully expect to grow that this year. EBITDA will grow. We are stepping up a little bit on our maintenance CapEx. As I think everybody knows, post acute providers were not eligible for high tech payments so we've made the investment and made the decision to invest in an electronic clinical information system. We're literally starting it this week as we're rolling it out across all of our hospitals. It will take several years to do that.

So, we're stepping up our maintenance CapEx, but beyond that, the amount of free cash flow that this company is going to generate over the next several years is pretty significant. And I outlined where I think those growth opportunities are going to be. Certainly today, we have more than enough free cash flow to invest in those growth opportunities and then, as we look at the environment going forward, if we need to pay down debt because the environment is much more challenging from a reimbursement standpoint, we have the ability to do that and we also have then the ability to address our capital structure along with three areas that I talked about in addition to debt repayment.

Q – Kevin Fischbeck – Merrill Lynch, Pierce, Fenner & Smith, Inc.: How do you think about buying back stock versus buying the preferred?

A – Jay Grinney – HealthSouth Corp.: We have both of them on the list. The preferred is a very illiquid, asset. It's hard to get a hold of. We like the fact that that has a couple of benefits. Number one, it reduces the cash obligation of the company and it also reduces the share comp. So that has frankly a very attractive return associated with that. And then as I said, we do have the authorization for a stock buyback and certainly, we'll be considering dividend for any excess cash flow.

Kevin Mark Fischbeck, Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Okay. Thank you very much.

Jay Grinney, President and Chief Executive Officer

All right. Thank you.