HealthSouth ANNUAL REPORT 2015

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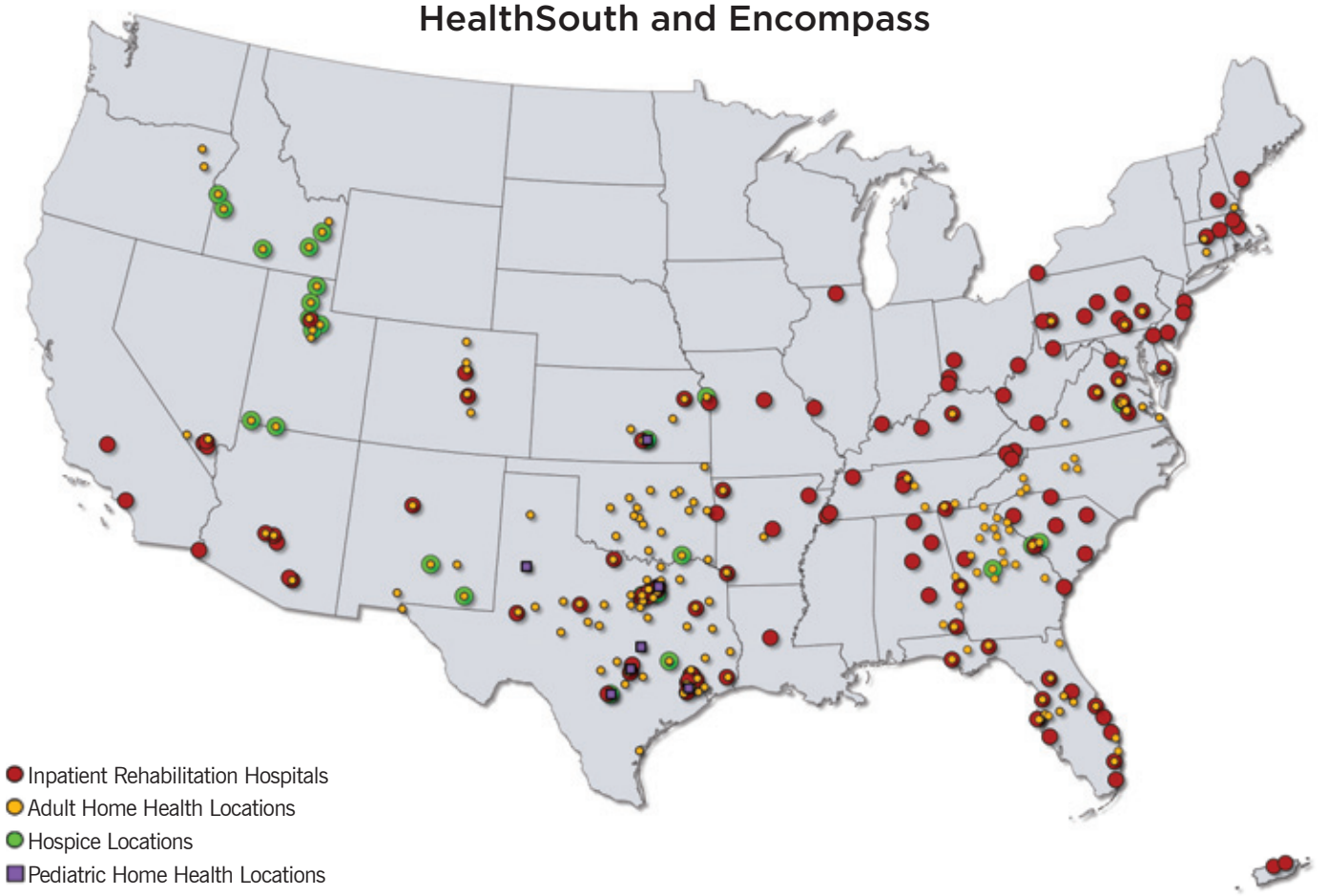
A Higher Level of Care®

Modern Healthcare

BEST PLACES TO WORK™ 2015

HealthSouth and Encompass



Inpatient Rehabilitation
Portfolio - As of December 31, 2015

121 Inpatient Rehabilitation Hospitals

- 33 operate as joint ventures with acute care hospitals

29 Number of States (plus Puerto Rico)

~ 27,100 Employees

IRF Marketshare
10% of IRFs
21% of Licensed Beds
28% of Medicare Patients Served

Encompass Home Health and Hospice
Portfolio - As of December 31, 2015

179 Home Health Locations

7 Pediatric Home Health Locations

27 Hospice Locations

23 Number of States

~ 7,600 Employees

Home Health and Hospice Marketshare
4th largest provider of Medicare-certified skilled home health services

HEALTHSOUTH®

Dear Valued Stockholder:

2015 was a transformational year for HealthSouth. We began the year with an expanded service offering resulting from our joint venture with Encompass Home Health and Hospice which laid the foundation for our Company's current and long-term success by extending the continuum of care for our patients to include home-based services. During the course of the year, we capitalized on opportunities to build upon this foundation, extending the geographic reach of our facility-based and home-based offerings through the acquisitions of Reliant Hospital Partners and CareSouth Health System. We also enhanced the clinical collaboration between our inpatient rehabilitation hospitals and home health agencies with the objective of improving patient outcomes and satisfaction. We remain committed to the philosophy that providing high-quality care for our patients, offering an attractive work environment for our employees, and adhering to highly ethical business practices is the clearest path to long-term shareholder value.

Over the past year, we have made great strides in our focus on quality, human capital, growth, and financial performance. We are pleased to share with you some of the key highlights and accomplishments we achieved in each of these categories in 2015:

QUALITY

- HealthSouth's success is built on the quality of care provided to each and every patient. Our focus on providing high-quality rehabilitative care allowed us to treat more than 200,000 patients across the post-acute care continuum through our inpatient rehabilitation hospitals and home health and hospice agencies.
- HealthSouth far exceeded the Uniform Data System for Medical Rehabilitation (UDSmr®) national benchmarks for discharge back to the community. This means we returned more patients back to the community than the national expected average.
- As a result of our Comfort, Professionalism and Respect and TeamWorks initiatives, we have seen improvements in our Press Ganey patient satisfaction metrics and look forward to continuing that progress in 2016.
- Based on the national quality star rating system for the home health industry, 97% of Encompass home health agencies were three stars or better compared to 72% nationally in quality performance, while 99% of Encompass home health agencies were three stars or better compared to 92% nationally in patient satisfaction.
- In addition, the 30-day hospital readmission rate for Encompass was much lower than the national average.

HUMAN CAPITAL

- We continued to focus on ensuring a productive and engaged workforce across all of our hospitals, home health and hospice agencies, and at our corporate headquarters, and we were honored that both HealthSouth and Encompass were included in *Modern Healthcare's* 2015 Best Places to Work. This award is exceptionally meaningful for us because employee responses count for the majority of the overall rating. Maintaining our reputation as an employer of choice will continue to be a top priority for us moving forward.

GROWTH

- We continued to pursue a strategic growth plan for our inpatient rehabilitation and home health and hospice sectors, making 2015 an exciting year across the HealthSouth footprint. Our December 2014 acquisition of Encompass Home Health and Hospice, now the fourth largest provider of Medicare-certified skilled home health services in the United States, fueled our strong entry into the home health and hospice market, and we anticipate additional market share growth in 2016. Presently, Encompass is composed of 179 adult home health locations, 7 pediatric home health locations, and 27 hospice locations, and its footprint spans 23 states. The synergy and strategic alignment between Encompass and HealthSouth is illustrated best

HEALTHSOUTH®

when considering that 60% of our inpatient rehabilitation hospitals are located within 30 miles of an Encompass location.

- Additionally, we grew Encompass' portfolio through the acquisition of CareSouth, which operates 44 home health and 3 hospice locations in 7 states across the southeast and mid-atlantic regions of the United States. The addition of CareSouth strengthened our market share in the key states of Florida and Virginia.
- Our inpatient rehabilitation hospital portfolio was expanded with the acquisition of Reliant, which was comprised of 902 beds across 11 inpatient rehabilitation hospitals within Texas, Massachusetts, and Ohio. We also purchased Cardinal Hill Rehabilitation Hospital in Lexington, Kentucky and initiated joint ventures for hospitals in Savannah, Georgia; Jackson, Tennessee; Westerville, Ohio; Hot Springs, Arkansas; Broken Arrow, Oklahoma; and Bryan, Texas. Additionally, we added 85 beds at our existing inpatient rehabilitation hospitals. Within the inpatient rehabilitation industry, HealthSouth's national market share at year-end comprised 10% of inpatient rehabilitation facilities, 21% of licensed beds, and 28% of Medicare patients served.

FINANCIAL PERFORMANCE

- Strong revenue and volume growth in both segments yielded Adjusted EBITDA of $682.5 million in 2015, an increase of 18.2% over 2014.
- Adjusted free cash flow increased 25% to $389.0 million.
- We have significant flexibility with how we choose to invest our cash and return capital to shareholders.
- Throughout 2015, we facilitated the funding of our development pipeline through a combination of cash on hand, new senior notes, and an amended and expanded credit facility.
- We increased the quarterly dividend on our common stock to $0.23 per share, an increase of 9.5%.
- We repurchased approximately $47 million of our common stock in the open market.

Our success in 2015 resulted from the dedication and hard work of our 34,700 employees. Our Company is extremely fortunate to employ industry-leading clinicians and professionals who provide the highest levels of service and care to our patients and who are supported by the service-oriented professionals in our corporate office.

Although 2015 was a year marked by many significant milestones, it also stood as a reminder of the challenges we face in pursuing our multi-faceted objectives. Our inpatient hospitals experienced a significant increase in the number of patients treated, but a shift in our payor mix resulted in lower than anticipated profitability for this incremental volume. Additionally, after several years of managing the costs associated with our employees' group medical benefits to below industry norms, in 2015 we experienced a substantial increase in expenses, as did many other companies. Finally, we continue to seek solutions to the continuation of prepayment claims denials and the resulting backlog of Medicare accounts receivable awaiting resolution in the lengthy administrative law judge process. We are prepared to meet these challenges and those that undoubtedly will arise in 2016.

As we reflect on the past year and focus on 2016, we would like to thank our shareholders for their continued support. We have been diligent in our efforts to strengthen our financial performance and offerings as a company. Our focus in 2016 will be on completing the integration of the assets acquired during 2015, continuing to enhance clinical collaboration between our hospital-based and home-based service offerings, and generating superior financial results.

Sincerely,

Leo I. Higdon Jr.
Chairman
Board of Directors

Jay Grinney
President
Chief Executive Officer

HEALTHSOUTH®

April 5, 2016

Dear Fellow Stockholder:

I am pleased to invite you to attend our 2016 Annual Meeting of Stockholders of HealthSouth Corporation, to be held on Thursday, May 5, 2016, at 11:00 a.m., central time, at our corporate headquarters at 3660 Grandview Parkway, Birmingham, Alabama.

We will review our 2015 performance, discuss our outlook for 2016, and respond to any questions you may have. We will also consider the items of business described in the Notice of Annual Meeting of Stockholders and Internet Availability of Proxy Materials and in the Proxy Statement accompanying this letter. The Proxy Statement contains important information about the matters to be voted on and the process for voting, along with information about HealthSouth, its management and its directors.

Every stockholder's vote is important to us. Even if you plan to attend the annual meeting in person, *please promptly vote* by submitting your proxy by phone, by internet or by mail. The "Commonly Asked Questions" section of the Proxy Statement and the enclosed proxy card contain detailed instructions for submitting your proxy. If you plan to attend the annual meeting in person, you must provide proof of share ownership, such as an account statement, and a form of personal identification in order to be admitted to the meeting.

On behalf of the directors, management and employees of HealthSouth, thank you for your continued support of and ownership in our company.

Sincerely,

Leo I. Higdon, Jr.
Chairman of the Board of Directors

HEALTHSOUTH CORPORATION

Notice of Annual Meeting of Stockholders
and
Internet Availability of Proxy Materials

TIME	11:00 a.m., central time, on Thursday, May 5, 2016
PLACE	HEALTHSOUTH CORPORATION Corporate Headquarters 3660 Grandview Parkway, Suite 200 Birmingham, Alabama 35243 Directions to the annual meeting are available by calling Investor Relations at 1-205-968-6400
ITEMS OF BUSINESS	• To elect ten directors to the board of directors to serve until our 2017 annual meeting of stockholders. ➢ **The board of directors recommends a vote FOR each nominee.** • To ratify the appointment by HealthSouth's Audit Committee of PricewaterhouseCoopers LLP as HealthSouth's independent registered public accounting firm. ➢ **The board of directors recommends a vote FOR ratification.** • To approve, on an advisory basis, the compensation of the named executive officers as disclosed in HealthSouth's Definitive Proxy Statement for the 2016 annual meeting. ➢ **The board of directors recommends a vote FOR the approval of the compensation of our named executive officers.** • To approve the 2016 Omnibus Performance Incentive Plan. ➢ **The board of directors recommends a vote FOR the approval of the 2016 Omnibus Performance Incentive Plan.** • To transact such other business as may properly come before the annual meeting and any adjournment or postponement.
RECORD DATE	You can vote if you are a holder of record of HealthSouth common on March 8, 2016.
PROXY VOTING	Your vote is important. Please vote in one of these ways: • Via internet: Go to http://www.proxyvote.com and follow the instructions. You will need to enter the control number printed on your proxy card; • By telephone: Call toll-free 1-800-690-6903 and follow the instructions. You will need to enter the control number printed on your proxy card; • In writing: Complete, sign, date and promptly return your proxy card in the enclosed envelope; or • Submit a ballot in person at the annual meeting of stockholders.

Important Notice Regarding the Availability of Proxy Materials
For the Stockholders Meeting to be Held on May 5, 2016

HealthSouth's Proxy Statement on Schedule 14A, form of proxy card, and 2015 Annual Report (including the 2015 Annual Report on Form 10-K) are available at http://www.proxyvote.com after entering the control number printed on your proxy card.

Patrick Darby

Birmingham, Alabama
April 5, 2016

Patrick Darby
Secretary

HEALTHSOUTH CORPORATION
PROXY STATEMENT

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HEALTHSOUTH CORPORATION
PROXY STATEMENT

INTRODUCTION

The annual meeting of stockholders of HealthSouth Corporation, a Delaware corporation ("HealthSouth," or also "we," "us," "our," or the "Company"), will be held on May 5, 2016, beginning at 11:00 a.m., central time, at our principal executive offices located at 3660 Grandview Parkway, Birmingham, Alabama 35243. We encourage all of our stockholders to vote at the annual meeting, and we hope the information contained in this document will help you decide how you wish to vote at the annual meeting.

COMMONLY ASKED QUESTIONS

Why did I receive these proxy materials?

We are furnishing this proxy statement in connection with the solicitation by our board of directors of proxies to be voted at our 2016 annual meeting and at any adjournment or postponement. At our annual meeting, stockholders will act upon the following proposals:

(1) to elect ten directors to the board of directors to serve until our 2017 annual meeting of stockholders;
(2) to ratify the appointment by the Audit Committee of our board of directors of PricewaterhouseCoopers LLP as our independent registered public accounting firm;
(3) to approve, on an advisory basis, the compensation of the named executive officers, as disclosed in this proxy statement for the 2016 annual meeting;
(4) to approve the 2016 Omnibus Performance Incentive Plan; and
(5) to transact such other business as may properly come before the 2016 annual meeting of stockholders and any adjournment or postponement.

These proxy solicitation materials are being sent to our stockholders on or about April 5, 2016.

What do I need to attend the meeting?

Attendance at the 2016 annual meeting of stockholders is limited to stockholders. Registration will begin at 10:30 a.m. central time and each stockholder will be asked to present a valid form of personal identification. Cameras, recording devices and other electronic devices will not be permitted at the meeting. Additional rules of conduct regarding the meeting will be provided at the meeting.

Who is entitled to vote at the meeting?

The board of directors has determined that those stockholders who are recorded in our record books as owning shares of our common stock as of the close of business on March 8, 2016, are entitled to receive notice of and to vote at the annual meeting of stockholders. As of February 16, 2016, there were 89,777,044 shares of our common stock issued and outstanding. Your shares may be (1) held directly in your name as the stockholder of record or (2) held for you as the beneficial owner through a stockbroker, bank or other nominee, or both. Our common stock is our only class of outstanding voting securities. Each share of common stock is entitled to one vote on each matter properly brought before the annual meeting.

What is the difference between holding shares as a stockholder of record and as a beneficial owner?

Most of our stockholders hold their shares through a stockbroker, bank or other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially.

Stockholder of Record. If your shares are registered directly in your name with our transfer agent, Computershare Trust Company, N.A., you are considered, with respect to those shares, the stockholder of record, and these proxy materials are being sent directly to you by us. As the stockholder of record, you have the right to grant your voting proxy directly to us or to vote in person at the meeting. We have enclosed a proxy card for you to use.

Beneficial Owner. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by your broker, bank, or nominee which is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker on how to vote and are also invited to attend the meeting. However, because you are not the stockholder of record, you may not vote these shares in person at the meeting unless you obtain a signed proxy from the record holder giving you the right to vote the shares. Your broker, bank, or nominee has enclosed or provided a voting instruction card for you to use in directing the broker or nominee how to vote your shares. If you do not provide the stockholder of record with voting instructions, your shares will constitute broker non-votes. The effect of broker non-votes is more specifically described in "What vote is required to approve each item?" below.

How can I vote my shares in person at the meeting?

Shares held directly in your name as the stockholder of record may be voted in person at the annual meeting. Submitting your proxy by telephone, by internet or by mail will in no way limit your right to vote at the annual meeting if you later decide to attend in person.

Shares held beneficially in street name may be voted in person by you only if you obtain a signed proxy from the record holder giving you the right to vote the shares. Owners of shares held in street name that expect to attend and vote at the meeting should contact their broker, bank or nominee as soon as possible to obtain the necessary proxy.

Even if you currently plan to attend the annual meeting, we recommend that you also submit your proxy as described below so your vote will be counted if you later decide not to attend the meeting.

How can I vote my shares without attending the meeting?

Whether you hold shares directly as the stockholder of record or beneficially in street name, you may direct your vote without attending the meeting. You may vote by granting a proxy or, for shares held in street name, by submitting voting instructions to your broker, bank, or nominee.

Please refer to the summary instructions below and those included on your proxy card or, for shares held in street name, the voting instruction card included by your broker, bank, or nominee. The internet and telephone voting procedures established for our stockholders of record are designed to authenticate your identity, to allow you to give your voting instructions, and to confirm those instructions have been properly recorded. Internet and telephone voting for stockholders of record will be available 24 hours a day, and will close at 11:59 p.m. eastern time on May 4, 2016. The availability of internet and telephone voting for beneficial owners will depend on the voting processes of your broker, bank or other holder of record. Therefore, we recommend that you follow the voting instructions you receive.

- BY INTERNET – If you have internet access, you may submit your proxy from any location in the world by following the "internet" instructions on the proxy card. Please have your proxy card in hand when accessing the website.
- BY TELEPHONE – If you live in the United States, Puerto Rico, or Canada, you may submit your proxy by following the "telephone" instructions on the proxy card. Please have your proxy card in hand when you call.
- BY MAIL – You may do this by marking, signing, and dating your proxy card or, for shares held in street name, the voting instruction card included by your broker, bank, or nominee and mailing it in the accompanying enclosed, pre-addressed envelope. If you provide specific voting instructions, your shares will be voted as you instruct. If you do not have the pre-addressed envelope available, please mail your completed proxy card to: Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

If you cast your vote in any of the ways set forth above, your shares will be voted in accordance with your voting instructions unless you validly revoke your proxy. We do not currently anticipate that any other matters will be presented for action at the annual meeting. If any other matters are properly presented for action, the persons named on

your proxy will vote your shares on these other matters in their discretion, under the discretionary authority you have granted to them in your proxy.

Can I access the proxy statement and annual report on the internet?

Yes. This proxy statement, the form of proxy card and our Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K") are available at http://www.proxyvote.com. If you are a stockholder of record and would like to access future Company proxy statements and annual reports electronically instead of receiving paper copies in the mail, there are several ways to do this. You can mark the appropriate box on your proxy card or follow the instructions if you vote by telephone or the internet. If you choose to access future proxy statements and annual reports on the internet, you will receive a proxy card in the mail next year with instructions containing the internet address for those materials. Your choice will remain in effect until you advise us otherwise. If you have internet access, we hope you make this choice. Receiving future annual reports and proxy statements via the internet will be simpler for you, will save the Company money and is friendlier to the environment.

A copy of our 2015 Form 10-K and the proxy materials are also available without charge from the "Investors" section of our website at http://investor.healthsouth.com. **The 2015 Form 10-K and the proxy materials are also available in print to stockholders without charge and upon request, addressed to HealthSouth Corporation, 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243, Attention: Corporate Secretary.**

Rules adopted by the Securities and Exchange Commission permit the Company to provide stockholders with proxy materials electronically instead of in paper form, even if they have not made an election to receive the material electronically. If we decide to take advantage of this electronic delivery alternative in the future, stockholders will receive a Notice of Internet Availability of Proxy Materials with instructions on how to access the materials on the internet.

Can I change my vote after I submit my proxy?

Yes. Even after you have submitted your proxy, you may change your vote at any time prior to the close of voting at the annual meeting by:

- filing with our corporate secretary at 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243 a signed, original written notice of revocation dated later than the proxy you submitted;
- submitting a duly executed proxy bearing a later date;
- voting by telephone or internet on a later date; or
- attending the annual meeting and voting in person.

In order to revoke your proxy, we must receive an original notice of revocation of your proxy at the address in the first bullet above sent by U.S. mail or overnight courier. You may not revoke your proxy by any other means. If you grant a proxy, you are not prevented from attending the annual meeting and voting in person. However, your attendance at the annual meeting will not by itself revoke a proxy you have previously granted; you must vote in person at the annual meeting to revoke your proxy.

If your shares are held by a broker, bank or other nominee, you may revoke your proxy by following the instructions provided by your broker, bank, or nominee.

All shares that have been properly voted and not revoked will be voted at the annual meeting.

What is "householding" and how does it affect me?

In accordance with notices previously sent to stockholders, we are delivering one annual report that includes a proxy statement in a single envelope addressed to all stockholders who share a single address unless they have notified us they wish to "opt out" of the program known as "householding." Under this procedure, stockholders of record who have the same address and last name receive only one copy of proxy materials. Householding is intended to reduce our printing and postage costs and material waste. WE WILL DELIVER A SEPARATE COPY OF THE ANNUAL REPORT OR PROXY STATEMENT PROMPTLY UPON WRITTEN OR ORAL REQUEST. You may request a separate copy by contacting our corporate secretary at 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243, or by calling 1-205-967-7116.

If you are a beneficial stockholder and you choose not to have the aforementioned disclosure documents sent to a single household address as described above, you must "opt-out" by writing to: Broadridge Financial Solutions, Inc., Householding Department, 51 Mercedes Way, Edgewood, New York 11717, or by calling 1-866-540-7095, and we will cease householding all such disclosure documents within 30 days. If we do not receive instructions to remove your account(s) from this service, your account(s) will continue to be householded until we notify you otherwise. If you own shares in nominee name (such as through a broker), information regarding householding of disclosure documents should have been forwarded to you by your broker.

Is there a list of stockholders entitled to vote at the meeting?

A complete list of stockholders entitled to vote at the meeting will be open for examination by our stockholders for any purpose germane to the meeting, during regular business hours at the meeting place, for ten days prior to the meeting.

What constitutes a quorum to transact business at the meeting?

Before any business may be transacted at the annual meeting, a quorum must be present. The presence at the annual meeting, in person or by proxy, of the holders of a majority of the shares of all of our capital stock outstanding and entitled to vote on the record date will constitute a quorum. At the close of business on February 16, 2016, 89,777,044 shares of our common stock were issued and outstanding. Proxies received but marked as abstentions and broker non-votes will be included in the calculation of the number of shares considered to be present at the annual meeting for purposes of a quorum.

What is the recommendation of the board of directors?

Our board of directors unanimously recommends a vote:

- **"FOR" the election of each of our ten nominees to the board of directors;**
- **"FOR" the ratification of the appointment of PricewaterhouseCoopers LLP as HealthSouth's independent registered public accounting firm;**
- **"FOR" the approval of the compensation of our named executive officers, as disclosed in this proxy statement pursuant to the compensation disclosure rules of the Securities and Exchange Commission; and**
- **"FOR" the approval of the 2016 Omnibus Performance Incentive Plan.**

With respect to any other matter that properly comes before the annual meeting, the proxy holders will vote in accordance with their judgment on such matter.

What vote is required to approve each item?

The vote requirements for the proposals are as follows:

- Each nominee for director named in Proposal One will be elected if the votes for the nominee exceed 50% of the number of votes cast with respect to such nominee. Votes cast with respect to a nominee will include votes to withhold authority but will exclude abstentions and broker non-votes.
- The ratification of the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm will be approved if the votes cast for the proposal exceed those cast against the proposal. Broker non-votes will not be counted as votes cast for or against the proposal.
- The 2016 Omnibus Performance Incentive Plan will be approved if the votes cast for the proposal exceed those cast against the proposal plus abstentions. Broker non-votes will not be counted as votes cast for or against the proposal.

Please note that "say-on-pay," Proposal Three, is only advisory in nature and has no binding effect on the Company or our board of directors. Our board of directors will consider Proposal Three approved if the votes cast in favor of that proposal exceed the votes cast against it. Broker non-votes will not be counted as votes cast for or against the proposal.

A "broker non-vote" occurs when a bank, broker or other holder of record holding shares for a beneficial owner does not vote on a particular proposal because that holder does not have discretionary voting power for that particular item and has not received instructions from the beneficial owner. If you are a beneficial owner, your bank, broker or

other holder of record is permitted to vote your shares on the ratification of the independent registered public accounting firm even if the record holder does not receive voting instructions from you. Absent instructions from you, the record holder may not vote on any "nondiscretionary" matter including a director election, an equity compensation plan, a matter relating to executive compensation, certain corporate governance changes, or any stockholder proposal. In that case, without your voting instructions, a broker non-vote will occur. An "abstention" will occur at the annual meeting if your shares are deemed to be present at the annual meeting, either because you attend the annual meeting or because you have properly completed and returned a proxy, but you do not vote on any proposal or other matter which is required to be voted on by our stockholders at the annual meeting. You should consult your broker if you have questions about this.

The affirmative vote of at least a majority of our issued and outstanding shares present, in person or by proxy, and entitled to vote at the annual meeting will be required to approve any stockholder proposal validly presented at a meeting of stockholders. Under applicable Delaware law, in determining whether any stockholder proposal has received the requisite number of affirmative votes, abstentions will have the same effect as a vote against any stockholder proposal. Broker non-votes will be ignored. There are no dissenters' rights of appraisal in connection with any stockholder vote to be taken at the annual meeting.

What does it mean if I receive more than one proxy or voting instruction card?

It means your shares of common stock are registered differently or are in more than one account. Please provide voting instructions for all proxy and voting instruction cards you receive.

Where can I find the voting results of the meeting?

We will announce preliminary voting results at the meeting. We will publish the voting results in a Current Report on Form 8-K to be filed with the SEC no later than four business days following the end of the annual meeting. If preliminary results are reported initially, we will update the filing when final, certified results are available.

Who will count the votes?

A representative of Broadridge Financial Solutions, Inc., acting as the inspector of election, will tabulate and certify the votes.

Who will pay for the cost of this proxy solicitation?

We are making this solicitation and will pay the entire cost of preparing, assembling, printing, mailing, and distributing these proxy materials. If you choose to access the proxy materials or vote over the internet, however, you are responsible for internet access charges you may incur. In addition to the mailing of these proxy materials, the solicitation of proxies or votes may be made in person, by telephone, or by electronic communication by our directors, officers and employees, who will not receive any additional compensation for such solicitation activities. We will request banks, brokers, nominees, custodians, and other fiduciaries who hold shares of our stock in street name, to forward these proxy solicitation materials to the beneficial owners of those shares and we will reimburse the reasonable out-of-pocket expenses they incur in doing so.

Who should I contact if I have questions?

If you hold our common stock through a brokerage account and you have any questions or need assistance in voting your shares, you should contact the broker or bank where you hold the account. If you are a registered holder of our common stock and you have any questions or need assistance in voting your shares, please call our Investor Relations department at 1-205-968-6400. As an additional resource, the SEC website has a variety of information about the proxy voting process at www.sec.gov/spotlight/proxymatters.shtml.

NO PERSON IS AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION OTHER THAN THOSE CONTAINED IN THIS PROXY STATEMENT, AND, IF GIVEN OR MADE, SUCH INFORMATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED. THE DELIVERY OF THIS PROXY STATEMENT WILL, UNDER NO CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY SINCE THE DATE OF THIS PROXY STATEMENT.

ITEMS OF BUSINESS REQUIRING YOUR VOTE

Proposal 1 – Election of Directors

Director Nominees

Our board of directors currently consists of ten members and, based on the recommendation of the Nominating/ Corporate Governance Committee, proposes that each of the ten nominees listed below be elected at the annual meeting as members of our board of directors, to serve until our 2017 annual meeting of stockholders.

Each director nominee named in Proposal One will be elected if the votes for that nominee exceed 50% of the number of votes cast with respect to that nominee. Votes cast with respect to a nominee will include votes to withhold authority but will exclude abstentions and broker non-votes. If a nominee becomes unable or unwilling to accept the nomination or election, the persons designated as proxies will be entitled to vote for any other person designated as a substitute nominee by our board of directors. We have no reason to believe that any of the following nominees will be unable to serve. Below we have provided information relating to each of the director nominees proposed for election by our board of directors, including a brief description of why he or she was nominated.

Name of Nominee	Age	Current Roles	Date Became Director
John W. Chidsey *	53	Member of Audit Committee (Chairman) and Finance Committee	10/2/2007
Donald L. Correll *	65	Member of Audit Committee and Finance Committee	6/29/2005
Yvonne M. Curl *	61	Member of Compensation Committee (Chairperson) and Compliance/Quality of Care Committee	11/18/2004
Charles M. Elson *	56	Member of Finance Committee (Chairman) and Nominating/ Corporate Governance Committee	9/9/2004
Jay Grinney	65	President and Chief Executive Officer	5/10/2004
Joan E. Herman *	62	Member of Compensation Committee and Compliance/ Quality of Care Committee (Chairperson)	1/25/2013
Leo I. Higdon, Jr. *	69	Chairman of the Board of Directors; Member of Compensation Committee and Nominating/Corporate Governance Committee	8/17/2004
Leslye G. Katz *	61	Member of Audit Committee and Finance Committee	1/25/2013
John E. Maupin, Jr. *	69	Member of Nominating/Corporate Governance Committee (Chairman) and Compliance/Quality of Care Committee	8/17/2004
L. Edward Shaw, Jr. *	71	Member of Compensation Committee and Nominating/ Corporate Governance Committee	6/29/2005

*Denotes independent director.

There are no arrangements or understandings known to us between any of the nominees listed above and any other person pursuant to which that person was or is to be selected as a director or nominee, other than any arrangements or understandings with persons acting solely as directors or officers of HealthSouth.

John W. Chidsey

Mr. Chidsey currently serves as an executive board member of HotSchedules LLC, formerly known as Red Book Connect, LLC. HotSchedules is a provider of comprehensive cloud-based technology with expertise in hiring, training, scheduling, back office and standardization for use by small businesses. From the time of the October 2010 sale of Burger King Holdings, Inc. to 3G Capital until April 18, 2011, Mr. Chidsey served as co-chairman of the board of directors of Burger King Holdings, Inc. Prior to the sale, he served as chief executive officer and a member of its board from April 2006, including as chairman of the board from July 2008. From September 2005 until April 2006, he served as president and chief financial officer. He served as president, North America, from June 2004 to September 2005, and as executive vice president, chief administrative and financial officer from March 2004 until June 2004. Prior to joining Burger King, Mr. Chidsey served as chairman and chief executive officer for two corporate divisions of Cendant Corporation: the Vehicle Services Division that included Avis Rent A Car, Budget Rent A Car Systems, PHH and Wright Express and the Financial Services Division that included Jackson Hewitt and various membership and insurance

companies. Prior to joining Cendant, Mr. Chidsey served as the director of finance of Pepsi-Cola Eastern Europe and the chief financial officer of PepsiCo World Trading Co., Inc. Mr. Chidsey currently serves on the board of directors of Norwegian Cruise Line Holdings Ltd. and on the governing board of the privately held company, Instawares Holdings, LLC. He also serves on the Board of Trustees for Davidson College in Davidson, North Carolina.

Mr. Chidsey has extensive experience in matters of finance, corporate strategy and senior leadership relevant to large public companies. Mr. Chidsey is a certified public accountant and a member of the Georgia Bar Association. He qualifies as an "audit committee financial expert" within the meaning of SEC regulations.

Donald L. Correll

Mr. Correll is chief executive officer and co-founder of KWP Capital, LLC, a firm that identifies, invests in, advises, and manages water and wastewater infrastructure assets and operations. Mr. Correll served as the president and chief executive officer and a director of American Water Works Company, Inc., the largest and most geographically diversified provider of water services in North America, from April 2006 to August 2010. Between August 2003 and April 2006, Mr. Correll served as president and chief executive officer of Pennichuck Corporation, a publicly traded holding company which, through its subsidiaries, provides public water supply services, certain water related services, and certain real estate activities, including property development and management. From 2001 to 2003, Mr. Correll served as an independent advisor to water service and investment firms on issues relating to marketing, acquisitions, and investments in the water services sector. From 1991 to 2001, Mr. Correll served as chairman, president and chief executive officer of United Water Resources, Inc., a water and wastewater utility company. He currently serves as a director, member of the audit committee, and chairman of the leadership development and compensation committee of New Jersey Resources Corporation. He also serves on the board of the the Northeast Power Coordinating Council, Inc.

Mr. Correll has extensive experience in matters of accounting, finance, corporate strategy and senior leadership relevant to large public companies. He is a certified public accountant and has experience with a major public accounting firm. Mr. Correll qualifies as an "audit committee financial expert" within the meaning of SEC regulations.

Yvonne M. Curl

Ms. Curl is a former vice president and chief marketing officer of Avaya, Inc., a global provider of next-generation business collaboration and communications solutions, which position she held from October 2000 through April 2004. Before joining Avaya, Ms. Curl was employed by Xerox Corporation beginning in 1976, where she held a number of middle and senior management positions in sales, marketing and field operations, culminating with her appointment to corporate vice president. Ms. Curl currently serves as a director of Nationwide Mutual Insurance Company. In the past five years, she has also served as director of Charming Shoppes, Inc., a specialty apparel retailer, and Welch Allyn, Inc. (private).

Ms. Curl has proven senior executive experience with broad operational experience in sales, marketing, and general management through her previous roles with large public companies as described above. Having served on several compensation committees on the board of directors of public companies, she has experience in the development and oversight of compensation programs and policies.

Charles M. Elson

Mr. Elson holds the Edgar S. Woolard, Jr. Chair in Corporate Governance and has served as the director of the John L. Weinberg Center for Corporate Governance at the University of Delaware since 2000. Mr. Elson has served on the National Association of Corporate Directors' Commissions on Director Compensation, Executive Compensation and the Role of the Compensation Committee, Director Professionalism, CEO Succession, Audit Committees, Governance Committee, Strategic Planning, Director Evaluation, Risk Governance, Role of Lead Director, Strategy Development, and Board Diversity. He was a member of the National Association of Corporate Directors' Best Practices Council on Coping with Fraud and Other Illegal Activity. He served on that organization's Advisory Council. He currently serves as a director of Bob Evans Farms, Inc . In addition, Mr. Elson serves as vice chairman of the American Bar Association's Committee on Corporate Governance and as a member of a standing advisory committee for the Public Company Accounting Oversight Board. Mr. Elson has been Of Counsel to the law firm of Holland & Knight LLP from 1995 to the present.

Mr. Elson has extensive knowledge of and experience in matters of corporate governance through his leadership roles with professional organizations dedicated to the topic as described above. Through his other professional roles, Mr. Elson is in a unique position to monitor and counsel on developments in corporate governance.

Jay Grinney

Mr. Grinney was named our president and chief executive officer on May 10, 2004. From June 1990 to May 2004, Mr. Grinney served in a number of senior management positions with HCA, Inc., or its predecessor companies, in particular, serving as president of HCA's Eastern Group from May 1996 to May 2004, president of the Greater Houston Division from October 1993 to April 1996 and as chief operating officer of the Houston Region from November 1992 to September 1993. Before joining HCA, Mr. Grinney held several executive positions during a nine-year career at the Methodist Hospital System in Houston, Texas. He currently serves as a director of Energen Corporation, a diversified energy holding company engaged in the development, acquisition, exploration and production of oil, natural gas and natural gas liquids and is a member of its audit and compensation committees. He also serves as a director of Coca-Cola Bottling Company United, Inc.

Mr. Grinney, as president and chief executive officer of the Company, directs the strategic, financial and operational management of the Company and, in this capacity, provides unique insights into the detailed operations of HealthSouth. He also has the benefit of more than 25 years of experience in the operation and management of large, sophisticated, multi-site, publicly traded healthcare companies.

Joan E. Herman

Ms. Herman has served as the president and chief executive officer of Herman & Associates, LLC, a healthcare and management consulting firm, since 2008. Herman & Associates provides services to healthcare providers, pharmacy benefit managers, managed care organizations, and private equity firms. From 1998 to 2008, she served in a number of senior management positions, including president and chief executive officer for two corporate divisions, at Anthem, Inc. (f/k/a WellPoint, Inc.), a leading managed healthcare company that offers network-based managed care plans. Prior to joining Anthem, she served in a number of senior positions at Phoenix Life Insurance Company for 16 years, lastly as senior vice president of strategic development. Ms. Herman currently serves on the board of directors for Convergys Corporation, a provider of customer management and business support system solutions for which she serves on the audit and nominating and governance committees. In the past five years, she has served as a director of MRV Communications, Inc. and Qualicorp SA, a publicly traded company in Brazil. In addition, she currently serves on the boards of directors of DentalPlans.com and AARP Services Inc., both privately held companies.

Ms. Herman has extensive experience leading large complex businesses, including in the healthcare and insurance industries. With Anthem, she gained experience dealing with government reimbursement issues as well as state and federal healthcare and insurance regulators. She has further demonstrated her leadership and character through senior involvement in various community and charity organizations, such as the American Red Cross – Los Angeles region and the Venice Family Clinic Foundation, where she serves on the board of directors.

Leo I. Higdon, Jr.

Mr. Higdon was unanimously elected to serve as chairman of our board of directors on May 1, 2014. He served as president of Connecticut College from July 1, 2006 to December 31, 2013. He served as the president of the College of Charleston from October 2001 to June 2006. Between 1997 and 2001, Mr. Higdon served as president of Babson College in Wellesley, Massachusetts. He also served as dean of the Darden Graduate School of Business Administration at the University of Virginia. His financial experience includes a 20-year tenure at Salomon Brothers, where he became vice chairman and member of the executive committee, managing the Global Investment Banking Division. Mr. Higdon also serves as the lead independent director of Eaton Vance Corp., a provider of investment management and advisory services, and as a director of Citizens Financial Group, Inc.

As a result of his 20 years of experience in the financial services industry combined with his strategic management skills gained through various senior executive positions, including in academia, and service on numerous boards of directors, Mr. Higdon has extensive experience with strategic and financial planning and the operations of large public companies.

Leslye G. Katz

From January 2007 to December 2010, Ms. Katz served as senior vice president and chief financial officer of IMS Health, Inc., a provider of information, services, and technology for clients in the pharmaceutical and healthcare industries. Prior to that, she served as vice president and controller for five years. From July 1998 to July 2001, Ms. Katz served as senior vice president and chief financial officer of American Lawyer Media, Inc., a privately held legal media and publishing company. Prior to joining American Lawyer Media, Ms. Katz held a number of financial management

positions with The Dun & Bradstreet Corporation, followed by two years as vice president and treasurer of Cognizant Corporation, a spin-off from D&B. Ms. Katz currently serves as a director and member of the audit and compensation committees of ICF International, Inc., a provider of management, technology, and policy consulting and implementation services to government and commercial clients, and as chair of the board of directors of My Sisters' Place, a not-for-profit provider of shelter, advocacy, and support services to victims of domestic violence.

Ms. Katz has extensive experience in financial management at companies serving the healthcare and pharmaceutical industries, as well as expertise in mergers and acquisitions, treasury, financial planning and analysis, SEC reporting, investor relations, real estate, and procurement. She has further demonstrated her leadership and character in her service with a community charity. She qualifies as an "audit committee financial expert" within the meaning of SEC regulations.

John E. Maupin, Jr.

In July 2014, Dr. Maupin retired as president and chief executive officer of the Morehouse School of Medicine located in Atlanta, Georgia, a position he held from July 2006. Prior to joining Morehouse, Dr. Maupin held several other senior administrative positions including president and chief executive officer of Meharry Medical College from 1994 to 2006, executive vice president and chief operating officer of the Morehouse School of Medicine from 1989 to 1994, chief executive officer of Southside Healthcare, Inc. from 1987 to 1989, and Deputy Commissioner of Health of the Baltimore City Health Department from 1984 to 1987. Dr. Maupin currently serves as a director of LifePoint Hospitals, Inc., VALIC Companies I & II, a group retirement investment fund complex, and Regions Financial Corp. Dr. Maupin also serves on the boards of the America's Promise Alliance and the Development Authority of Fulton County.

Dr. Maupin has extensive management and administrative experience with healthcare organizations as described above. He has diverse executive leadership experience in public health, ambulatory care, government relations, and academic medicine. He also has a distinguished record as a health policy expert and advisor, having served on numerous national advisory boards and panels. Additionally, he has demonstrated his leadership and character through involvement, including board roles, in community, healthcare, and scientific advisory organizations as well as through his service as an officer in the U.S. Army Reserve for more than 28 years.

L. Edward Shaw, Jr.

From March 2006 to July 2010, Mr. Shaw served on a part-time basis as a senior managing director of Richard C. Breeden & Co., and affiliated companies engaged in investment management, strategic consulting, and governance matters. He has served as general counsel of both Aetna, Inc. from 1999 to 2003 and The Chase Manhattan Bank from 1983 to 1996, where, in addition to his legal role, his responsibilities included a wide range of strategic planning, risk management, compliance and public policy issues. From 1996 to 1999, he served as chief corporate officer of the Americas for National Westminster Bank PLC. In 2004, Mr. Shaw was appointed independent counsel to the board of directors of the New York Stock Exchange dealing with regulatory matters. Mr. Shaw also currently serves as a director of MSA Safety Inc. and as a director of Covenant House, the nation's largest privately funded provider of crisis care to children. In the past five years, he has served as a director of H&R Block, Inc.

Mr. Shaw has a wide ranging legal and business background, including senior leadership roles, in the context of large public companies as described above with particular experience in corporate governance, risk management and compliance matters. He also has significant experience in the healthcare industry as a result of his position with Aetna.

Board Recommendation

The board of directors unanimously recommends that you vote "FOR" the election of all ten director nominees.

Proposal 2 – Ratification of Appointment of Independent Registered Public Accounting Firm

Appointment of PricewaterhouseCoopers LLP

In accordance with its charter, the Audit Committee selected the firm of PricewaterhouseCoopers LLP to be our independent registered public accounting firm for the 2016 audit period, and with the endorsement of the board of directors, recommends to our stockholders that they ratify that appointment. The Audit Committee will reconsider the appointment of PricewaterhouseCoopers LLP for the next audit period if such appointment is not ratified. Representatives of PricewaterhouseCoopers LLP are expected to attend the annual meeting and will have the opportunity to make a statement if they desire, and are expected to be available to respond to appropriate questions.

The Audit Committee recognizes the importance of maintaining the independence of our independent registered public accounting firm, both in fact and appearance. Consistent with its charter, the Audit Committee has evaluated PricewaterhouseCoopers LLP's qualifications, performance, and independence, including that of the lead audit partner. The Audit Committee reviews and approves, in advance, the audit scope, the types of non-audit services, if any, and the estimated fees for each category for the coming year. For each category of proposed service, PricewaterhouseCoopers LLP is required to confirm that the provision of such services does not impair their independence. Before selecting PricewaterhouseCoopers LLP, the Audit Committee carefully considered that firm's qualifications as an independent registered public accounting firm for the Company. This included a review of its performance in prior years, as well as its reputation for integrity and competence in the fields of accounting and auditing. The Audit Committee has expressed its satisfaction with PricewaterhouseCoopers LLP in all of these respects. The Audit Committee's review included inquiry concerning any litigation involving PricewaterhouseCoopers LLP and any proceedings by the SEC against the firm. In this respect, the Audit Committee has concluded that the ability of PricewaterhouseCoopers LLP to perform services for HealthSouth is in no way adversely affected by any such investigation or litigation.

Pre-Approval of Principal Accountant Services

The Audit Committee of our board of directors is responsible for the appointment, oversight, and evaluation of our independent registered public accounting firm. In accordance with our Audit Committee's charter, our Audit Committee must approve, in advance of the service, all audit and permissible non-audit services provided by our independent registered public accounting firm. Our independent registered public accounting firm may not be retained to perform the non-audit services specified in Section 10A(g) of the Securities Exchange Act of 1934, as amended. The Audit Committee has concluded that provision of the non-audit services described in that section is not compatible with maintaining the independence of PricewaterhouseCoopers LLP.

The Audit Committee has established a policy regarding pre-approval of audit and permissible non-audit services provided by our independent registered public accounting firm, as well as all engagement fees and terms for our independent registered public accounting firm. Under the policy, the Audit Committee must approve the services to be rendered and fees to be charged by our independent registered public accounting firm. Typically, the Audit Committee approves services up to a specific amount of fees. The Audit Committee must then approve, in advance, any services or fees exceeding those pre-approved levels, except for *de minimis* services with billings not greater than the lessor of $50,000 or 5% of previously approved amounts, which are subject to subsequent approval by the Audit Committee and other requirements. The Audit Committee may delegate general pre-approval authority to a subcommittee of which the chairman of the Audit Committee is a member, provided that any delegated approval is limited to services with fees of no more than 5% of previously approved amounts. All requests or applications for services to be provided by our independent registered public accounting firm must be submitted to specified officers who may determine whether such services are included within the list of pre-approved services. All requests for services that have not been pre-approved must be accompanied by a statement that the request is consistent with the independent registered public accounting firm's independence from HealthSouth.

Principal Accountant Fees and Services

With respect to the audits for the years ended December 31, 2015 and 2014, the Audit Committee approved the audit services to be performed by PricewaterhouseCoopers LLP, as well as certain categories and types of audit-related and permitted non-audit services. In 2015 and 2014, all audit, audit-related, and other fees were approved in accordance with SEC pre-approval rules. The following table shows the aggregate fees paid or accrued for professional services rendered by PricewaterhouseCoopers LLP for the years ended December 31, 2015 and 2014, with respect to various services provided to us and our subsidiaries.

	For the Year Ended December 31,	
	2015	2014
	(In Millions)	
Audit fees[1]	$ 4.0	$ 2.8
Audit-related fees[2]	0.2	0.1
Total audit and audit-related fees	4.2	2.9
Tax fees[3]	0.1	0.1
All other fees[4]	0.1	0.5
Total fees	$ 4.4	$ 3.5

(1) *Audit Fees* – Represents aggregate fees paid or accrued for professional services rendered for the audit of our consolidated financial statements and internal control over financial reporting for each year presented; fees for professional services rendered for the review of financial statements included in our Form 10-Qs, and fees for professional services normally provided by our independent registered public accounting firm in connection with statutory and regulatory engagements required by various partnership agreements or state and local laws in the jurisdictions in which we operate or manage hospitals.

(2) *Audit-Related Fees* –Represents aggregate fees paid or accrued for assurance and related services that are reasonably related to the performance of audit services and traditionally are performed by our independent auditor, such as work in connection with registered offerings of securities.

(3) *Tax Fees* – Represents fees for all professional services, including tax compliance, advice and planning, provided by our independent auditor's tax professionals but not including any services related to the audit of our financial statements.

(4) *All Other Fees* – Represents fees for all other products and services provided by our independent registered public accounting firm that do not fall within the previous categories. More specifically, for 2015, these fees represent amounts paid or due to our independent auditor for due diligence work associated with acquisitions and miscellaneous services and products.

Board Recommendation

The board of directors and the Audit Committee unanimously recommend that you vote "FOR" ratifying the appointment of PricewaterhouseCoopers LLP as HealthSouth's independent registered public accounting firm for the 2016 audit period.

Proposal 3 – Advisory Vote on Executive Compensation

We seek your advisory vote on our executive compensation programs. The Company asks that you support the compensation of our named executive officers as disclosed under the heading "Executive Compensation," including the "Executive Summary" section, beginning on page 33 and the accompanying tables and related narrative disclosure. This proposal, commonly referred to as a "say-on-pay" proposal, gives stockholders the opportunity to express their views on the named executive officers' compensation as required under Section 14A of the Securities Exchange Act. This vote is not intended to address any specific item of compensation, but rather the overall compensation of the named executive officers and the philosophy, policies and practices described in this proxy statement.

As described under the heading "Compensation Discussion and Analysis" on page 33, the Company provides annual and long-term compensation programs as well as the other benefit plans, to attract, motivate, and retain the named executive officers, each of whom is critical to the Company's success, and to create a remuneration and incentive program that aligns the interests of the named executive officers with those of stockholders. The board of directors believes the program strikes the appropriate balance between utilizing responsible, measured pay practices and effectively incentivizing the named executive officers to dedicate themselves fully to value creation for our stockholders. At the 2015 annual meeting, 98.9% of stockholders voting on the say-on-pay proposal approved our executive compensation on an advisory basis.

You are encouraged to read the information detailed under the heading "Executive Compensation" beginning on page 33 for additional details about the Company's executive compensation programs.

The board of directors strongly endorses the Company's executive compensation program and recommends that the stockholders vote in favor of the following resolution:

"RESOLVED, that the Company's stockholders approve, on an advisory basis, the compensation of the named executive officers, as disclosed in the HealthSouth Corporation Definitive Proxy Statement for the 2016 annual meeting of stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the 2015 Summary Compensation Table and the other related tables and disclosure."

This say-on-pay vote is advisory, and therefore not binding on the Company, the compensation committee or the board of directors. The board of directors and its compensation committee value the opinions of our stockholders and to the extent there is any significant vote against the named executive officer compensation as disclosed in this proxy statement, we will consider stockholders' concerns and the compensation committee will evaluate whether any actions are necessary to address those concerns. The board of directors has elected to hold the say-on-pay advisory vote annually until further notice. The next advisory vote is expected to be in connection with the 2017 annual meeting of stockholders.

Board Recommendation

The board of directors unanimously recommends a vote "FOR" the approval of the compensation of our named executive officers, as disclosed in this proxy statement pursuant to the compensation disclosure rules of the Securities and Exchange Commission.

Proposal 4 - Approval of 2016 Omnibus Performance Incentive Plan

In order to provide a sufficient pool of equity for us to operate our compensation program, our board of directors has adopted, subject to stockholder approval at the Annual Meeting, the HealthSouth Corporation 2016 Omnibus Performance Incentive Plan, or the "2016 Plan," to provide for issuance of up to 14 million shares of our common stock related to awards granted after the 2016 Plan is approved by stockholders. The 2016 Plan will replace the existing HealthSouth Corporation Amended and Restated 2008 Equity Incentive Plan, or the "2008 Plan," previously approved by our stockholders on May 5, 2011, as our primary incentive compensation plan. If the 2016 Plan is approved and effective, we will not grant or issue new equity awards under the 2008 Plan or any other currently effective equity plan after May 9, 2016.

If approved, the 2016 Plan would be effective May 9, 2016. The 2016 Plan will terminate on the tenth anniversary of the Effective Date, unless terminated earlier by the board of directors, but awards granted prior to such date may extend beyond that date. If the 2016 Plan is not approved by our stockholders, no awards will be made under it, and we will likely not have enough shares remaining under the 2008 Plan to grant an appropriate amount of equity awards going forward.

The stockholder approved incentive compensation plan serves a critical role in our compensation program that emphasizes performance-based, "at risk" compensation. Our compensation philosophy calls for a competitive program of compensation for the Company's senior management that aligns management's interests with those of long-term stockholders. Equity awards are the simplest, most direct way to align management and employee interests with those of stockholders. Because the shares available for equity awards are limited, in order to balance compensation principles with stockholder interests in limiting dilution, we generally limit equity awards to management positions (as opposed to broad-based awards). As a general rule, the more senior or highly compensated the position, the larger the portion of the total incentive opportunity that is provided in equity. Both the equity and cash incentive awards provided for in the 2016 Plan allow our board of directors and the Compensation Committee to structure our compensation program to strengthen the commitment of employees to the company, motivate them to faithfully and diligently perform their responsibilities, and attract and retain competent and dedicated individuals whose efforts will result in the long-term growth and profitability of the company. See "Executive Compensation Philosophy" beginning on page 37 for additional discussion.

While the use of equity incentives is an important part of our compensation program, we are mindful of our responsibility to our stockholders to exercise judgment in granting equity awards. The Compensation Committee with the assistance of its independent consultant annually reviews the Company's overhang, or the total of outstanding equity awards and shares available for future equity awards under the compensation plans as a percentage of fully diluted shares outstanding, the fair value transfer, or the accounting value of shares granted as a percentage of market capitalization, and the run rate, or the shares granted as a percentage of the weighted average shares outstanding, relative to a peer group of healthcare companies. In the 2015 review of our overhang, fair value transfer, and run rate prepared by the Compensation Committee's independent consultant, we were below the median of the peer group for each metric.

Although our future run rate will depend upon and be influenced by a number of factors, such as the number of plan participants, the price per share of our common stock and the methodology used to establish the equity award mix, the 14 million shares of common stock reserved for issuance in the 2016 Plan would enable us to continue to utilize equity awards as an important component of our overall compensation program and help meet our objectives to attract, retain and motivate talented employees. In determining the share reserve, we considered an analysis of our overhang percentage and historic average run rate relative to a peer group of healthcare companies. The results of the analysis performed by the Compensation Committee's independent consultant indicated our overhang at December 31, 2015 was 7.7% and annual average run rate for the three-year period ending December 31, 2015 was 1.2%, each of which was less than the median number for the peer group.

As of February 29, 2016, our pro forma overhang (including the 14 million shares under the 2016 Plan) would be 16.6% based on 90,287,264 shares of our common stock issued and outstanding and the following awards outstanding under the 2008 Plan and other incentive plans or programs:

Type of Award	Number of Awards	Weighted Average Exercise Price ($)	Weighted Average Remaining Life (years)
Non-qualified stock options[1]	2,008,317	21.83	4.75
SARs[1]	245,952	137.95	6.08
Restricted stock awards[2]	1,080,815	n/a	n/a

(1) No outstanding Options and SARs have dividend or equivalent rights.

(2) This does not include 2015 and 2016 performance-based stock awards that have not yet completed their performance period. All restricted stock awards have dividend or equivalent rights.

Highlights and a summary of the 2016 Plan are set forth below and are qualified in their entirety by reference to the full text of the 2016 Plan, a copy of which is attached as Appendix B to this proxy statement.

Highlights of the 2016 Plan

The 2016 Plan includes a number of provisions that our board of directors believes are consistent with the interest of stockholders and sound corporate governance, including:

Supports pay and performance linkage and encourages stock ownership: Our cash and equity incentive programs are performance-based in large part, and the Compensation Committee's intent is to continue this design for annual awards. The intent is to provide an incentive for our senior management to enhance stockholder value. In addition, equity-based awards further align the interest of participants with our stockholders and provide a vehicle to assist executives in achieving our stock ownership guidelines. See "Equity Ownership Guidelines for Management" on page 48 for additional discussion.

No repricings: Except in connection with a corporate transaction involving the Company, the 2016 Plan prohibits the repricing of stock options or stock appreciation rights, or "SARs," without the approval of stockholders. This prohibition applies to lowering the exercise price of stock options or SARs, canceling and granting replacement stock options or SARs with a lower exercise price and the repurchase of underwater stock options or SARs for cash.

No discount stock option or SARs: The exercise price of all stock options or SARs must be equal to or greater than the fair market value of our stock on the date of grant.

Minimum vesting periods: Generally, time-vested restricted stock or restricted stock units granted to employees must vest over no less than three years and performance-based awards must have a minimum one-year performance period.

No liberal share counting for options and SARs: The 2016 Plan prohibits the reuse of shares underlying stock options tendered as full or partial payment upon exercise of a stock option or the reuse of shares not issued in settlement of a SAR. In addition, shares withheld to satisfy tax withholding upon the lapse of restrictions on exercise of stock options or SARs may not be reused. Unused shares authorized under the 2008 Plan and not associated with previously issued awards are not being carried forward and will not be available for awards under the 2016 Plan.

Awards are subject to clawback: Awards granted are subject to our compensation recoupment policy. See "Compensation Recoupment Policy" on page 48 for additional discussion.

No award transferability for value: The 2016 Plan prohibits the transfer of awards to a third party for cash or other value.

Non-employee director compensation limits: The 2016 Plan provides for annual limits to cash and equity grants to non-employee directors.

Summary of the 2016 Plan

Purpose. The purpose of the 2016 Plan is to promote the Company's success and enhance the value of the Company by linking the personal interests of its employees, officers, and directors to those of its stockholders, and by providing participants with an incentive for outstanding performance.

Eligibility. The 2016 Plan permits the grant of equity and cash incentive awards to employees, officers, and directors of the Company and its affiliates as selected by the Compensation Committee. As of February 18, 2016, approximately 290 people participated in the 2008 Plan.

Aggregate Shares. Subject to adjustment as provided in the 2016 Plan, the aggregate number of shares of common stock reserved and available for issuance pursuant to awards granted under the 2016 Plan is 14,700,000. Each share of stock subject to an award, other than a stock option or SAR, shall reduce the number of shares of stock available for awards by 2.65 shares. The number of shares of stock available for awards shall be reduced by one share for each stock option or SAR award. Except in the case of shares not delivered when settling stock options and SARs, the 2016 Equity Plan allows the Company to add back to the number of shares available for issuance the same number of shares that were previously reserved for issuance in connection with a related award (including awards under the 2008 Plan outstanding as of December 31, 2015 or issued after that date) but were forfeited, canceled, or otherwise never issued to the recipient. The closing price of our common stock on February 29, 2016 was $35.23. If the 2016 Plan is approved and effective, we will not grant or issue new equity awards under the 2008 Plan or any other currently effective equity plan after May 9, 2016.

Minimum Vesting Requirements. Except with respect to awards (other than an option or a SAR) accounting for not greater than 5% of the aggregate number of shares of common stock reserved and available for awards or as set forth below under "Acceleration upon Certain Events," any award of stock granted under the 2016 Plan will either (1) be subject to a minimum vesting period of three years (which may include graduated vesting within such three-year period) or one year if the vesting is based on performance criteria, or (2) be granted solely in exchange for foregone cash compensation.

Oversight and Administration. The Compensation Committee will administer the 2016 Plan. The Compensation Committee has the authority to designate participants; determine the type or types of awards to be granted to each participant and the number, terms and conditions thereof; delegate authority to management with respect to non-executive awards (in which case any authorized actions taken by the delegate(s) shall be treated as actions of the Compensation Committee); and make all other decisions and determinations that may be required under the 2016 Plan. The board of directors may at any time choose to administer the 2016 Plan (for example, awards to the chief executive officer), in which case the board will have the same authority otherwise given to the Compensation Committee under the 2016 Plan. See "Compensation Discussion and Analysis" beginning on page 33 for more information on how the current incentive compensation programs are administered.

Permissible Awards. The 2016 Plan authorizes the granting of awards in any of the following forms:

Stock Options. The Compensation Committee is authorized to grant incentive stock options or non-qualified stock options for our common stock under the 2016 Plan. The terms of an incentive stock option must meet the requirements of Section 422 of the Internal Revenue Code of 1986, as amended. No more than one million incentive stock options may be issued under the 2016 Plan. The exercise price of an option may not be less than the fair market value (as defined in the 2016 Plan) of the underlying stock on the date of grant, and no option may have a term of more than 10 years. Participants may elect to exercise stock options by means of a cashless exercise or a net settlement.

Stock Appreciation Rights. The Compensation Committee may also grant stock appreciation rights or SARs. These provide the holder the right to receive the excess, if any, of the fair market value of one share of common stock on the date of exercise, over the base price of the stock appreciation right as determined by the Compensation Committee, which will not be less than the fair market value of one share of common stock on the grant date. SARs may be payable in cash or shares of common stock or a combination thereof. No SAR may be exercised more than 10 years from the grant date.

Restricted Stock Awards. The Compensation Committee may make awards of restricted stock to participants, which will be subject to such restrictions on transferability and other restrictions as the Compensation Committee may impose (including, without limitation, limitations on the right to vote restricted stock or the right to receive dividends, if any, on the restricted stock). Customarily, our restricted stock has been granted voting rights prior to vesting.

Restricted Stock Units. The Compensation Committee may make awards of restricted stock units, which will be subject to such restrictions on transferability and other restrictions as the Compensation Committee may impose. Upon lapse of such restrictions, shares of common stock or cash may be issued to the participant in settlement of the restricted stock units.

Performance Awards. The Compensation Committee may grant performance awards that are designated in cash, shares of common stock, restricted stock, or restricted stock units. The Compensation Committee will have the complete discretion to determine the number of performance awards granted to any participant and to set performance goals and other terms or conditions to payment of the performance awards in its discretion which, depending on the extent to which they are met, will determine the number and value of performance awards that will be paid to the participant.

Cash Awards. The Compensation Committee is authorized to confer rights to participants to receive cash subject to the achievement of one or more specified performance goals or such other terms and conditions as may be selected by the Compensation Committee.

Dividend Equivalents. The Compensation Committee is authorized to grant dividend equivalents to participants subject to such terms and conditions as may be selected by the Compensation Committee. Dividend equivalents entitle the participant to receive payments equal to dividends declared and paid with respect to all or a portion of the shares of common stock subject to an award other than a stock option or a SAR. Dividend equivalents associated with a performance-based award will only be paid to the extent the underlying award is earned and vested.

Other Stock-Based Awards. The Compensation Committee may, subject to limitations under applicable law and the provisions of the 2016 Plan, grant to participants such other awards that are payable in, valued in whole or in part by reference to, or otherwise based on or related to shares of common stock as deemed by the Compensation Committee to be consistent with the purposes of the 2016 Plan, including, without limitation, shares of common stock awarded purely as a bonus and not subject to any restrictions or conditions, convertible or exchangeable debt securities, other rights convertible or exchangeable into shares of common stock, and awards valued by reference to book value of shares of common stock or the value of securities of or the performance of specified parents or subsidiaries. The Compensation Committee will determine the terms and conditions of any such awards, subject to the minimum vesting requirements discussed above.

Performance Goals. Options and SARs granted under the 2016 Plan are intended to qualify as performance-based awards that are fully deductible by HealthSouth without regard to the $1 million deduction limit imposed by Section 162(m) of the Code. The Compensation Committee may designate any other award under the 2016 Plan (such as, for example, a cash incentive bonus or restricted stock award) as a qualified performance-based award that is intended to be fully deductible under Section 162(m). If an award is so designated, the Compensation Committee must establish determinable performance goals for the award based on one or more performance criteria, which may be expressed in terms of company-wide objectives or in terms of objectives that relate to the performance of a division, affiliate, region, department or function within HealthSouth or an affiliate. Performance criteria may be specified in absolute terms, in percentages, maintenance of a specific level or in terms of growth from period to period or growth rates over time, as well as measured relative to an established or specially created index of other companies. Performance criteria for qualified performance-based awards under Section 162(m) will be limited to specified levels or changes in the following metrics which may or may not be calculated in accordance with generally accepted accounting principles in the United States:

- earnings (including but not limited to per share measures);
- profit (including but not limited to net profit, gross profit, operating profit, economic profit or other profit measures);
- net or operating income;
- revenue (net or gross);
- stock price or performance;
- stockholder return;
- return measures (including but not limited to return on assets, capital, equity or revenue);
- EBITDA (earnings before interest, taxes, depreciation and amortization) or EBIT measures;
- operating, EBITDA or profit margins;
- market share;

- expenses (including but not limited to expense management, expense efficiency ratios or other expense measures);
- business expansions or consolidation (including but not limited to new locations, acquisitions, divestitures and closures);
- internal rate of return;
- planning accuracy;
- year-over-year patient volume growth;
- year-over-year changes in expense line items;
- cash flow measures (including but not limited to free cash flow);
- prevention of failures of internal controls or compliance; and
- quality of care metrics (including but not limited to PEM Score, functional improvement measures, patient satisfaction and other metrics tracked by Medicare or Medicaid).

For a qualified performance-based award, the Compensation Committee must establish such goals at the beginning of the period for which such performance goal relates (or such later date as may be permitted under applicable tax regulations) and, except as set forth below under "Acceleration upon Certain Events," the Compensation Committee may not increase any award or waive the achievement of any specified goal. In the Compensation Committee's discretion, the performance measured for a specific goal may be adjusted for unusual, nonrecurring, unexpected, or unbudgeted events or effects if those types of equitable adjustments meet criteria established in advance by the Compensation Committee. Any payment or settlement of a qualified performance-based award will be conditioned upon the Compensation Committee receiving written certification that the performance goals and any other material conditions were satisfied, and reflecting such certification in the Compensation Committee's minutes. However, nothing in the 2016 Plan prevents the Compensation Committee from issuing awards that are not fully deductible.

Award Limits. No individual (including any individual who is likely to be a "covered employee" for purposes of Section 162(m) of the Code) may be granted options or SARs in excess of 1,000,000 associated shares during any two consecutive plan years. For qualified performance-based awards under Section 162(m), no individual may be granted more than 1,000,000 of any of the following during any two consecutive plan years: performance shares, restricted stock shares, restricted stock units or shares associated with other stock-based awards. For qualified performance-based awards under Section 162(m), no individual may be granted more than $10,000,000 of either performance units or other cash awards during any two consecutive plan years. These limitations apply separately to each type of award. For example, an individual may be granted 1,000,000 options and 1,000,000 SARs during the same two-year period.

Non-Employee Director Compensation Limits. The maximum value of the equity awards granted to any non-employee director in any plan year shall not exceed $300,000. The maximum aggregate amount of the cash awards, including retainer and other fees, granted to any non-employee director in any plan year also shall not exceed $300,000. Accordingly, the aggregate value of all awards granted to a non-employee director in any plan year shall not exceed $600,000; provided, however, these limits will not apply to any compensation resulting from non-preferential dividends or dividend equivalents associated with outstanding equity awards.

Limitations on Transfer; Beneficiaries. No award will be assignable or transferable by a participant other than by will or the laws of descent and distribution or, except in the case of an incentive stock option, pursuant to a qualified domestic relations order; provided, however, that the Compensation Committee may (but need not) permit other transfers where the Compensation Committee concludes that such transferability does not result in accelerated taxation, does not cause any option intended to be an incentive stock option to fail to qualify as such, and is otherwise appropriate and desirable. No award may be transferred for value. A participant may, in the manner determined by the Compensation Committee, designate a beneficiary to exercise the rights of the participant and to receive any distribution with respect to any award upon the participant's death.

Acceleration upon Certain Events. Unless otherwise provided in an award agreement, if a participant is terminated by the company without "cause" or by the participant for "good reason" (as such terms are defined in the 2016 Plan) within 24 months after a change in control of HealthSouth (as defined in the 2016 Plan) or if the surviving company following a change in control does not assume existing awards or substitute equivalent awards, all outstanding options and SARs will become fully vested and exercisable and all restrictions (other than performance goals) on other outstanding awards will lapse. For a change in control event, the Compensation Committee also may (but need not) waive or modify any performance goals tied to awards. In the event of death or disability, a participant's awards (other than options and SARs) vest immediately and performance goals may, in the Compensation Committee's discretion, be

waived or modified except in the case of qualified performance-based awards. In the event of retirement, a participant's awards generally vest on a pro rata basis for the completed portion of the original vesting/performance period and performance goals may, in the Compensation Committee's discretion, be waived or modified except in the case of qualified performance-based award. Beginning in 2013, performance-based awards granted to Mr. Grinney provide for vesting of the full award at retirement subject to actual performance status over the original two-year performance period and releasing of the resulting shares earned after one more year. The Compensation Committee may accelerate the vesting provisions and/or waive the forfeiture provisions applicable to any awards (other than qualified performance-based awards) for any other reason; provided, however, its discretion shall be limited to the death, disability or retirement of a participant, although the Compensation Committee may exercise discretion for any reason with respect to awards of up to 5% of the shares available for awards.

Adjustments. In the event of an extraordinary cash dividend, stock-split, a stock dividend, or a combination or consolidation of the outstanding common stock into a lesser number of shares, the authorization limits under the 2016 Plan will automatically be adjusted proportionately, and the shares then subject to each award will automatically be adjusted proportionately without any change in the aggregate purchase price. In the event the common stock will be changed into or exchanged for a different number or class of shares of stock or securities of HealthSouth or of another corporation, the authorization limits under the 2016 Plan will automatically be adjusted proportionately, and there will be substituted for each such share of common stock, the number or class of shares into which each outstanding share of common stock will be so exchanged, all without any change in the aggregate purchase price.

Amendment, Modification and Termination. The Compensation Committee shall have the power to amend, suspend or terminate the 2016 Plan at any time, provided that any termination shall not affect outstanding awards under the 2016 Plan at the time of termination. However, an amendment shall be contingent on approval of HealthSouth's stockholders to the extent required by law or by the rules of any applicable stock exchange. The Compensation Committee may also amend any outstanding award in whole or in part from time to time. Any such amendment that the Compensation Committee determines, in its sole discretion, to be necessary or appropriate to conform the award to, or otherwise satisfy, any legal requirement, may be made retroactively or prospectively and without the approval or consent of the participant, make adjustments in the terms and conditions of an award in recognition of an unusual or non-recurring event affecting the company or the financial statements of the company in order to prevent the dilution or enlargement of the benefits intended to be made available pursuant to the award. All other amendments or adjustments to awards may be made by the Compensation Committee with the consent of the affected participants.

Certain Federal Tax Effects. This summary is intended to provide a general description of the current federal income tax treatment of awards provided under the 2016 Plan. Tax laws are subject to change.

Nonqualified Stock Options. There will be no federal income tax consequences to the optionee or to HealthSouth upon the grant of a nonqualified stock option under the 2016 Plan. When the optionee exercises a nonqualified option, however, he or she will recognize ordinary income in an amount equal to the excess of the fair market value of the common stock received upon exercise of the option at the time of exercise over the exercise price, and HealthSouth will be allowed a corresponding federal income tax deduction. Any gain that the optionee realizes when he or she later sells or disposes of the option shares will be short-term or long-term capital gain, depending on how long the shares were held.

Incentive Stock Options. There typically will be no federal income tax consequences to the optionee or to HealthSouth upon the grant or exercise of an incentive stock option. If the optionee holds the option shares for the required holding period of at least two years after the date of grant and one year after exercise, the difference between the exercise price and the amount realized upon sale or disposition of the option shares will be long-term capital gain or loss, and HealthSouth will not be entitled to a federal income tax deduction. If the optionee disposes of the option shares in a sale, exchange, or other disqualifying disposition before the required holding period ends, he or she will recognize taxable ordinary income in an amount equal to the excess of the fair market value of the option shares at the time of exercise over the exercise price, and HealthSouth will be allowed a federal income tax deduction equal to such amount. While the exercise of an incentive stock option does not result in current taxable income, the excess of the fair market value of the option shares at the time of exercise over the exercise price will be an item of adjustment for purposes of determining the optionee's alternative minimum taxable income.

Stock Appreciation Rights. A participant receiving a SAR will not recognize income, and HealthSouth will not be allowed a tax deduction, at the time the award is granted. When the participant exercises the SAR, the amount of cash and the fair market value of any shares of common stock received will be ordinary income to the participant and HealthSouth will be allowed a corresponding federal income tax deduction at that time.

Restricted Stock. Unless a participant makes an election to accelerate recognition of the income to the date of grant as described below, the participant will not recognize income, and HealthSouth will not be allowed a tax deduction, at the time a restricted stock award is granted. When the restrictions lapse, the participant will recognize ordinary income equal to the fair market value of the common stock as of that date (less any amount he or she paid for the stock), and HealthSouth will be allowed a corresponding federal income tax deduction at that time, subject to any applicable limitations under Code Section 162(m). If the participant files an election under Code Section 83(b) within 30 days after the date of grant of the restricted stock, he or she will recognize ordinary income as of the date of grant equal to the fair market value of the stock as of that date (less any amount paid for the stock), and HealthSouth will be allowed a corresponding federal income tax deduction at that time, subject to any applicable limitations under Section 162(m). Any future appreciation in the stock will be taxable to the participant at capital gains rates. However, if the stock is later forfeited, the participant will not be able to recover the tax previously paid pursuant to the Section 83(b) election.

Restricted Stock Units. The recipient will not recognize income, and HealthSouth will not be allowed a tax deduction, at the time a restricted stock unit award is granted. Upon issuance of shares of common stock in settlement of a restricted stock unit award, the recipient will recognize ordinary income equal to the fair market value of the common stock as of that date (less any amount he or she paid for the stock), and HealthSouth will be allowed a corresponding federal income tax deduction at that time, subject to any applicable limitations under Section 162(m).

Performance Awards. A participant generally will not recognize income, and HealthSouth will not be allowed a tax deduction, at the time performance awards are granted. When the participant receives or has the right to receive payment of cash or shares under the performance award, the cash amount or the fair market value of the shares of stock will be ordinary income to the participant, and HealthSouth will be allowed a corresponding federal income tax deduction at that time, subject to any applicable limitations under Section 162(m).

Tax Withholding. Participants are responsible for making arrangements to ensure all taxes required to be withheld are withheld in connection with any award. The Company has the right to retain from the payment under, or settlement of, an award the number of shares of stock or a portion of the value of the award equal in value to the amount of any required withholdings. At the Compensation Committee's discretion, the participant may elect to satisfy the withholding requirement in the same manner.

New Plan Benefits Table

The value, number of units and type of equity to be awarded under future long-term incentive programs depend on a number of factors, including, but not limited to, HealthSouth's performance, its goals and objectives, individual performance and the discretion of the Compensation Committee. Accordingly, it is not possible to determine at this time the grants that will be awarded to any participant under the 2016 Plan.

The Compensation Committee approved certain equity grants as part of the 2015 long-term incentive and director compensation programs. Although the annual grants described in the following table were made under the 2008 Plan, the Compensation Committee would likely have granted similar values and types of awards under the proposed 2016 Plan had that plan been in effect at the time of the grants.

2015 Participants - Name and Position	Dollar Value ($)	Number of Units[1]	
Jay Grinney, President and Chief Executive Officer	5,499,993	170,540	(2)
Douglas E. Coltharp, EVP and Chief Financial Officer	787,487	24,418	(3)
John P. Whittington, EVP, General Counsel and Secretary	790,568	24,513	(4)
Mark J. Tarr, EVP and Chief Operating Officer	1,250,045	38,760	(5)
Edmund M. Fay, Treasurer and Senior Vice President	258,066	5,832	(6)
Dexanne B. Clohan, M.D., Chief Medical Officer	—	—	(7)
Andrew L. Price, Chief Accounting Officer	257,491	5,819	(8)
Cheryl B. Levy, Chief Human Resources Officer	345,017	7,797	(9)
April Anthony, Chief Executive Officer and President, Encompass	—	—	
Executive Group	9,188,668	277,679	(10)
Non-Executive Director Group	1,627,533	38,389	(11)
Non-Executive Officer Employee Group	15,130,491	341,932	(12)

[1] Except as noted below for the Non-Executive Director Group, number of units granted was based on an assumed option value of $15.47 (Black-Scholes method) and on stock value of $44.25 (20-day average closing price preceding the February 2015 board meeting). The number of performance share units included assume target performance for the two-year objectives described beginning on page 45.

[2] Represents 24,859 shares of restricted stock, 71,105 options and 74,576 performance share units.

[3] Represents 3,559 shares of restricted stock, 10,181 options and 10,678 performance share units.

[4] Represents 3,573 shares of restricted stock, 10,220 options and 10,720 performance share units.

[5] Represents 5,650 shares of restricted stock, 16,160 options and 16,950 performance share units.

[6] Represents 2,332 shares of restricted stock and 3,500 performance share units.

[7] Did not receive equity because of pending retirement.

[8] Represents 2,328 shares of restricted stock and 3,491 performance share units.

[9] Represents 3,119 shares of restricted stock and 4,678 performance share units.

[10] Represents 45,420 shares of restricted stock, 107,666 options and 124,593 performance share units.

[11] Represents restricted stock units granted based on the close price of our common stock on the grant dates.

[12] Represents 116,879 shares of restricted stock and 225,053 performance share units.

Board Recommendation

The board of directors unanimously recommends a vote "FOR" the approval of the 2016 Omnibus Performance Incentive Plan.

CORPORATE GOVERNANCE AND BOARD STRUCTURE

Corporate Governance

Corporate Governance Guidelines

The board of directors has adopted Corporate Governance Guidelines, which provide, among other things, that each member of our board of directors will:

- dedicate sufficient time, energy, and attention to ensure the diligent performance of his or her duties;
- comply with the duties and responsibilities set forth in the Corporate Governance Guidelines and in our Bylaws;
- comply with all duties of care, loyalty, and confidentiality applicable to directors of publicly traded Delaware corporations; and
- adhere to our Standards of Business Conduct, including the policies on conflicts of interest.

Our Nominating/Corporate Governance Committee oversees and periodically reviews the Guidelines, and recommends any proposed changes to the board of directors for approval.

Code of Ethics

We have adopted Standards of Business Conduct, our "code of ethics," that applies to all employees, directors and officers, including our principal executive officer, principal financial officer, and principal accounting officer or controller, or persons performing similar functions. The purpose of the code of ethics is to promote:

- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- full, fair, accurate, timely and understandable disclosure in periodic reports required to be filed by us;
- compliance with all applicable rules and regulations that apply to us and our officers and directors;
- prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
- accountability for adherence to the code.

We will disclose any future amendments to, or waivers from, certain provisions of these ethical policies and standards for officers and directors on our website as noted below promptly following the date of such amendment or waiver. Upon written request to our corporate secretary, we will also provide a copy of the code of ethics free of charge.

Corporate Website

We maintain a "Corporate Governance" section on our website where you can find copies of our principal governance documents, including our code of ethics. Our "Corporate Governance" section is located at http://investor.healthsouth.com and includes the following documents, among others:

- Charter of the Company
- Bylaws of the Company
- Charter of the Audit Committee
- Charter of the Compensation Committee
- Charter of the Compliance/Quality of Care Committee
- Charter of the Finance Committee
- Charter of the Nominating/Corporate Governance Committee
- Standards of Business Conduct
- Corporate Governance Guidelines

Board Policy on Majority Voting for Directors

A director nominee will be elected if the votes "for" that person exceed 50% of the votes cast, including "withhold authority" votes but excluding "abstention" votes and broker non-votes, in the election with respect to that person. In addition, we have adopted a policy whereby any incumbent director nominee who receives a greater number of "withhold authority" votes than votes "for" his or her election will tender his or her resignation for consideration by the Nominating/ Corporate Governance Committee unless it is a contended election in which case the incumbent director nominee must receive the votes required by our Bylaws. The Nominating/Corporate Governance Committee will recommend to the board of directors whether to accept or reject the offer of resignation.

Role of the Board in Oversight of the Company's Risks

We maintain a comprehensive enterprise risk management program designed to identify potential events and conditions that may affect the Company and to manage risks to avoid materially adverse effects on the Company. Our management, including an executive risk committee, is responsible for the design and implementation of the enterprise risk management program. The Audit Committee of the board of directors, pursuant to its charter, is responsible for reviewing and evaluating our policies and procedures relating to risk assessment and management. The full board of directors monitors the enterprise risk management program by way of regular reports from our senior executives on management's risk assessments and risk status as well as our risk response and mitigation activities. The full board also monitors the Company's strategic risks by way of regular reports. Individual committees monitor, by way of regular reports, the risks that relate to the responsibilities of that committee.

The Compensation Committee reviews and considers our compensation policies and programs in light of the board of directors' risk assessment and management responsibilities on an annual basis. In 2014, our human resources department in consultation with Mercer (US) Inc. prepared and presented to the Compensation Committee a risk assessment report that addressed the incentive compensation structure, plans, and processes at all levels of the Company. The assessment included, among other things, a review of pay mix (fixed v. variable, cash v. equity and short v. long-term), performance metrics, target setting, performance measurement practices, pay determination, mitigation practices such as the Compensation Recoupment Policy, and overall governance and administration of pay programs. After reviewing this report and making inquiries of management, the Compensation Committee determined we have no compensation policies and programs that give rise to risks reasonably likely to have a material adverse effect on us.

Annual Evaluation of the Performance of the Board

On an annual basis, members of the board complete an evaluation of the performance of the board and its members as well as each committee on which the respective members serve. The board may, and does on occasion, obtain the advice and assistance of outside advisors in performing the evaluation. Results are reviewed by the Nominating/ Corporate Governance Committee which then shares those results and any follow up recommendations with all members of the board.

Communications to Directors

Stockholders and other parties interested in communicating directly to the board of directors, any committee, or any non-employee director may do so by writing to the address listed below:

HEALTHSOUTH CORPORATION
BOARD OF DIRECTORS
3660 GRANDVIEW PARKWAY, SUITE 200
BIRMINGHAM, ALABAMA 35243
ATTENTION: [Addressee*]

*** Including the name of the specific addressee(s) will allow us to direct the communication to the intended recipient.**

All communications received as set forth in this paragraph will be opened by the office of our general counsel for the sole purpose of determining whether the contents represent a message to our directors. Any contents that are not in the nature of advertising, promotions of a product or service, or patently offensive material will be forwarded promptly to the addressee. In the case of communications to the board of directors or any group or committee of directors, the general counsel's office will make sufficient copies of the contents to send to each director who is a member of the group or committee to which the envelope is addressed.

Board Structure and Director Nominations

Board Structure and Meetings

Our business, property, and affairs are managed under the direction of our board of directors. Our Corporate Governance Guidelines provide for a non-executive chairman of the board to set the agenda for, and preside over, board meetings, coordinate the work of the committees of our board of directors and perform other duties delegated to the chairman by our board of directors. The non-executive chairman also presides over independent sessions generally held at each board meeting. The board of directors adopted this structure to promote decision-making and governance independent of that of our management and to better perform the board's monitoring and evaluation functions. On May 1, 2014, the board unanimously elected Mr. Higdon as chairman. Members of our board of directors are kept informed of our business through discussions with our chief executive officer and other officers, by reviewing materials provided to them, by visiting our offices, and by participating in meetings of the board of directors and its committees.

The board of directors met six times during 2015. Each member of the board of directors attended 75% or more of the meetings of the board of directors and of the committees on which he or she served that were held during the period for which he or she was a director or committee member, respectively. In addition, it is our policy that directors are expected to attend the annual meeting of stockholders. The members of the board of directors generally hold a meeting the same day and location as the annual meeting of stockholders. All members of our board of directors attended the annual meeting in 2015.

Criteria for Board Members

In evaluating the suitability of individual candidates and nominees, the Nominating/Corporate Governance Committee and the board of directors consider relevant factors, including, but not limited to: a general understanding of marketing, finance, corporate strategy and other elements relevant to the operation of a large publicly-traded company in today's business environment, senior leadership experience, an understanding of our business, educational and professional background, and character. The Nominating/Corporate Governance Committee also considers the following attributes or qualities in evaluating the suitability of candidates and nominees to our board of directors:

- *Integrity*: Candidates should demonstrate high ethical standards and integrity in their personal and professional dealings.
- *Accountability*: Candidates should be willing to be accountable for their decisions as directors.
- *Judgment*: Candidates should possess the ability to provide wise and thoughtful counsel on a broad range of issues.
- *Responsibility*: Candidates should interact with each other in a manner which encourages responsible, open, challenging and inspired discussion. Directors must be able to comply with all duties of care, loyalty, and confidentiality applicable to directors of publicly traded Delaware corporations.
- *High Performance Standards*: Candidates should have a history of achievements which reflects high standards for themselves and others.
- *Commitment and Enthusiasm*: Candidates should be committed to, and enthusiastic about, their performance for the Company as directors, both in absolute terms and relative to their peers. Directors should be free from conflicts of interest and be able to devote sufficient time to satisfy their board responsibilities.
- *Financial Literacy*: Candidates should be able to read and understand fundamental financial statements and understand the use of financial ratios and information in evaluating the financial performance of the Company.
- *Courage*: Candidates should possess the courage to express views openly, even in the face of opposition.

Although there is no formal policy on diversity of nominees, both the board of directors and the Nominating/Corporate Governance Committee believe that diversity of skills, perspectives and experiences as represented on the board as a whole, in addition to the primary factors, attributes or qualities discussed above, promotes improved monitoring and evaluation of management on behalf of the stockholders and produces more creative thinking and solutions. The Nominating/Corporate Governance Committee considers the distinctive skills, perspectives and experiences that candidates diverse in gender, ethnic background, geographic origin and professional experience offer in the broader context of the primary evaluation described above.

Director Nomination Process

Internal Process for Identifying Candidates

The Nominating/Corporate Governance Committee has two primary methods for identifying director nominees. First, on a periodic basis, the committee solicits ideas for possible candidates from members of the board of directors, senior level executives, and individuals personally known to the members of the board. Second, the committee may from time to time use its authority under its charter to retain, at the Company's expense, one or more search firms to identify candidates (and to approve such firms' fees and other retention terms).

Proposals for Director Nominees by Stockholders

The Nominating/Corporate Governance Committee will consider written proposals from stockholders for director nominees. In considering candidates submitted by stockholders, the Nominating/Corporate Governance Committee will take into consideration the needs of the board of directors and the qualifications of the candidate. In accordance with our Bylaws, any such nominations must be received by the Nominating/Corporate Governance Committee, c/o the corporate secretary, not less than 90 days nor more than 120 days prior to the anniversary date of the immediately preceding annual meeting of stockholders; provided, however, that in the event the annual meeting is called for a date that is not within 30 days before or after such anniversary date, a nomination, in order to be timely, must be received not later than the close of business on the tenth day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure of the date of the annual meeting was made, whichever first occurs. The Nominating/Corporate Governance Committee received no nominee recommendations from stockholders for the 2016 annual meeting. Stockholder nominations for our 2017 annual meeting of stockholders must be received at our principal executive offices on or after January 7, 2017 and not later than February 6, 2017.

Stockholder nominations must include the information set forth in Section 3.4 of our Bylaws and be accompanied by a written consent of each proposed nominee to being named as a nominee and to serving as a director if elected. A stockholder providing notice of a nomination must update and supplement the notice so that the information in the notice is true and correct as of the record date(s) for determining the stockholders entitled to receive notice of and to vote at the annual meeting. Any stockholder that intends to submit a nomination for the board of directors should read the entirety of the requirements in Section 3.4 of our Bylaws which can be found in the "Corporate Governance" section of our website at http://investor.healthsouth.com.

Our Bylaws provide for reimbursement of certain reasonable expenses incurred by a stockholder or a group of stockholders in connection with a proxy solicitation campaign for the election of one nominee to the board of directors. This reimbursement right is subject to conditions including the board of director's determination that reimbursement is consistent with its fiduciary duties. Following the annual meeting, we will reimburse certain expenses that a nominating stockholder, or group of nominating stockholders, has incurred in connection with nominating a candidate for election to our board of directors if the conditions set out in Section 3.4(c) of our Bylaws are met. If those conditions are met and the proponent's nominee is elected, we will reimburse the actual costs of printing and mailing the proxy materials and the fees and expenses of one law firm for reviewing the proxy materials and one proxy solicitor for conducting the related proxy solicitation. If those conditions are met and the proponent's nominee is not elected but receives 40% or more of all votes cast, we will reimburse the proportion of those qualified expenses equal to the proportion of votes that the nominee received in favor of his or her election to the total votes cast. In all cases, reimbursement will only be made if the nominating stockholders are liable for such expenses regardless of the outcome of the election of directors or receipt of reimbursement from us and no party to which such amounts are payable is an affiliate or associate of any of the nominating stockholders. In no event may the amount paid to a nominating stockholder exceed the amount of corresponding expenses incurred by us in soliciting proxies in connection with the election of directors. Further, we will not reimburse expenses in the event that our board of directors determines that any such reimbursement is not in our best interests, would result in a breach of our board's fiduciary duties, would render us insolvent or cause us to breach a material obligation. For additional detail, please read Section 3.4(c) of our Bylaws which can be found in the "Corporate Governance" section of our website at http://investor.healthsouth.com.

Evaluation of Candidates

The Nominating/Corporate Governance Committee will consider all candidates duly identified and will evaluate each of them, including incumbents, based on the same criteria. If, after the committee's initial evaluation, a candidate meets the criteria for membership, the chair of the Nominating/Corporate Governance Committee will interview the candidate and communicate the chair's evaluation to the other members of the committee, the chairman of the board and the chief executive officer. Later reviews will be conducted by other members of the committee and senior management. Ultimately, background and reference checks will be conducted and the committee will meet to finalize its list of recommended candidates for the board's consideration. The candidates recommended for the board's consideration will be those individuals the committee believes will create a board of directors that is, as a whole, strong in its collective knowledge of, and diverse in skills and experience with respect to, accounting and finance, management and leadership, vision and strategy, business operations, business judgment, crisis management, risk assessment, industry knowledge, corporate governance and global markets.

Director Independence

Review of Director Independence

On an annual basis, our board of directors undertakes a review of the independence of the nominees as independent directors based on our Corporate Governance Guidelines. The board assesses whether any transactions or relationships exist currently or during the past three years existed between any director or any member of his or her immediate family and the Company and its subsidiaries, affiliates, or our independent registered public accounting firm. The board examines whether there were any transactions or relationships between any director or any member of his or her immediate family and members of the senior management of the Company or their affiliates. The board further considers whether there are any charitable contributions to not-for-profit organizations for which our directors or immediate family members serve as executive officers. In connection with this determination, each director and executive officer completes a questionnaire which requires disclosure of any transactions with the Company in which the director or executive officer, or any member of his or her immediate family, has a direct or indirect material interest. There were no such director-related transactions or contributions in 2015.

Determination of Director Independence

Each of John W. Chidsey, Donald L. Correll, Yvonne M. Curl, Charles M. Elson, Joan E. Herman, Leo I. Higdon, Jr., Leslye G. Katz, John E. Maupin, Jr. and L. Edward Shaw, Jr. is an independent director in accordance with our Corporate Governance Guidelines. Mr. Grinney, who is our chief executive officer, is not independent. Each of our directors other than Mr. Grinney also satisfies the definition of independence contained in Rule 303A.02 of the listing standards for the New York Stock Exchange. Additionally:

- each member of the Audit Committee, the Compensation Committee, and the Nominating/Corporate Governance Committee was an independent director under our Corporate Governance Guidelines and otherwise meets the qualifications for membership on such committee imposed by the NYSE and other applicable laws and regulations;
- each member of the Audit Committee had accounting or related financial management expertise and was financially literate, and otherwise meets the audit committee membership requirements imposed by the NYSE, our Corporate Governance Guidelines, and other applicable laws and regulations; and each of Mr. Chidsey, Mr. Correll, and Ms. Katz qualifies as an "audit committee financial expert" within the meaning of SEC regulations; and
- each member of the Compliance/Quality of Care Committee and the Finance Committee was an independent director under our Corporate Governance Guidelines.

Standards of Director Independence

Under the listing standards adopted by the NYSE, a director will be considered "independent" and found to have no material relationship with the Company if during the prior three years:

- the director has not been an employee of the Company or any of its subsidiaries, and no immediate family member of the director has been an executive officer of the Company;
- neither the director nor an immediate family member of the director has received more than $120,000 in a twelve-month period during the last three years in direct compensation from the Company other than

director and committee fees and pension or other forms of direct compensation for prior service (provided such compensation is not contingent in any way on future service);

- neither the director nor an immediate family member of the director has been affiliated with or employed by a present or former internal or external auditor of the Company;
- neither the director nor an immediate family member of the director has been employed as an executive officer of another company where any of the Company's present executives serve on that company's compensation committee; and
- the director has not been an executive officer or employee, and no immediate family member of the director has been an executive officer, of a company that makes payments to or receives payments from the Company for property or services in an amount which, in any single fiscal year, exceeded the greater of $1 million or 2% of such other company's consolidated gross revenues.

Committees of the Board of Directors

Committee Memberships and Meetings

Our board of directors has the following five standing committees, each of which is governed by a charter and reports its actions and recommendations to the board of directors: Audit Committee, Compensation Committee, Compliance/Quality of Care Committee, Finance Committee, and Nominating/Corporate Governance Committee. The following table shows the number of meetings and the membership of each board committee as of December 31, 2015.

	Audit	Compensation	Compliance/ Quality of Care	Finance	Nominating/ Corporate Governance
Number of Meetings in 2015:	7	6	5	11	6
John W. Chidsey	Chair			X	
Donald L. Correll	X			X	
Yvonne M. Curl		Chair	X		
Charles M. Elson				Chair	X
Joan E. Herman		X	Chair		
Leo I. Higdon, Jr.		X			X
Leslye G. Katz	X			X	
John E. Maupin, Jr.			X		Chair
L. Edward Shaw, Jr.		X			X

Audit Committee

We have a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The Audit Committee's purpose, per the terms of its charter, is to assist the board of directors in fulfilling its responsibilities to the Company and its stockholders, particularly with respect to the oversight of the accounting, auditing, financial reporting, and internal control and compliance practices of the Company. The specific responsibilities of the Audit Committee are, among others, to:

- assist the board of directors in the oversight of the integrity of our financial statements and compliance with legal and regulatory requirements, the qualifications and independence of our independent auditor, and the performance of our internal audit function and our independent auditor;
- appoint, compensate, replace, retain, and oversee the work of our independent auditor;
- at least annually, review a report by our independent auditor regarding its internal quality control procedures, material issues raised by certain reviews, inquiries or investigations relating to independent audits within the last five years, and relationships between the independent auditor and the Company;
- review and evaluate our quarterly financial statements and annual audited financial statements with management and our independent auditor, including management's assessment of and the independent auditor's opinion regarding the effectiveness of the Company's internal control over financial reporting prior to the filing of those financial statements with the SEC;
- discuss earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies with management;

- discuss policies with respect to risk assessment and risk management;
- set clear hiring policies for employees or former employees of our independent auditor; and
- appoint and oversee the activities of our Inspector General who has the responsibility to identify violations of Company policy and law relating to accounting or public financial reporting, to review the Inspector General's periodic reports and to set compensation for the Inspector General and its staff.

In connection with its duties, the committee reviews and evaluates, at least annually, the performance of the committee and its members and may obtain the advice and assistance of outside advisors, including consultants and legal and accounting advisors.

Compensation Committee

The Compensation Committee's purpose and objectives are to oversee our compensation and employee benefit objectives, plans and policies and to review and approve, or recommend to the independent members of the board of directors for approval, the individual compensation of our executive officers in order to attract and retain high-quality personnel to better ensure our long-term success and the creation of long-term stockholder value. The specific responsibilities of the Compensation Committee are, among others, to:

- review and approve our compensation programs and policies, including our benefit plans, incentive compensation plans and equity-based plans; amend or recommend that the board of directors amend such programs, policies, goals or objectives; and act as (or designate) an administrator for such plans as may be required;
- review and recommend to the board of directors corporate goals and objectives relevant to the compensation of the chief executive officer and evaluate the performance of the chief executive officer in light of those goals and objectives;
- review and approve corporate goals and objectives relevant to the compensation of the other executive officers and evaluate the performance of those executive officers in light of those goals and objectives;
- determine and approve, together with the other independent directors, the base compensation level and incentive compensation level for the chief executive officer;
- determine and approve the compensation levels for the other executive officers;
- review and discuss with management the Company's Compensation Discussion and Analysis, and recommend inclusion thereof in our annual report or proxy statement;
- review and approve (or recommend to the board of directors in the case of the chief executive officer) employment arrangements, severance arrangements and termination arrangements and change in control arrangements to be made with any executive officer of the Company; and
- review and recommend to the board of directors fees and retainers for non-employee members of the board and non-employee members and chairpersons of committees of the board.

In connection with its duties, the committee reviews and evaluates, at least annually, the performance of the committee and its members and may obtain the advice and assistance of outside advisors, including consultants and legal and accounting advisors. The Compensation Committee has the sole authority to set the compensation for, and to terminate the services of, its advisors. As discussed in further detail in the table on page 38, the Compensation Committee engaged the independent compensation consultant, Frederic W. Cook & Co., Inc., to assist it in its review and evaluation of executive compensation practices. The Compensation Committee has reviewed the independence of Frederic W. Cook & Co. and of each individual employee of the firm with whom it works. Frederic W. Cook & Co. does not perform other services for the Company, and the total fees paid to Frederic W. Cook & Co. during fiscal 2015 did not exceed $120,000. The Compensation Committee has determined Frederic W. Cook & Co. has no conflict of interest in providing advisory services.

Compliance/Quality of Care Committee

The Compliance/Quality of Care Committee's function is to assist our board of directors in fulfilling its fiduciary responsibilities relating to our regulatory compliance and cyber risk management activities and to ensure we deliver quality care to our patients. The committee is primarily responsible for overseeing, monitoring, and evaluating our compliance with all of its regulatory obligations other than tax and securities law-related obligations and reviewing the quality of services provided to patients at our facilities. The primary objectives and responsibilities of the Compliance/Quality of Care Committee are to:

- ensure the establishment and maintenance of a regulatory compliance program and the development of a comprehensive quality of care program designed to measure and improve the quality of care and safety furnished to patients;
- appoint and oversee the activities of a chief compliance officer with responsibility for developing and implementing our regulatory compliance program, which is subject to our annual review, and approve, and perform, or have performed, an annual evaluation of the performance of the chief compliance officer and the compliance office;
- oversee the cyber risk management program developed by the chief information officer and designed to monitor, mitigate and respond to cyber risks, threats, and incidents;
- review and approve annually the quality program description and the performance of the chief medical officer and the quality of care program;
- review periodic reports from the compliance officer, including an annual regulatory compliance report summarizing compliance-related activities undertaken by us during the year, and the results of all regulatory compliance audits conducted during the year;
- review periodic reports from the chief information officer, including developments in cyber threat environment and cyber risk mitigation efforts; and
- review periodic reports from the chief medical officer regarding the Company's efforts to advance patient safety and the quality of our medical and rehabilitative care.

In connection with its duties, the committee reviews and evaluates, at least annually, the performance of the committee and its members and may obtain the advice and assistance of outside advisors, including consultants and legal and accounting advisors.

Finance Committee

The purpose and objectives of the Finance Committee are to assist our board of directors in the oversight of the use and development of our financial resources, including our financial structure, investment policies and objectives, and other matters of a financial and investment nature. The specific responsibilities of the Finance Committee are to review, evaluate, and make recommendations to the board of directors regarding the Company's:

- capital structure and proposed changes thereto, including significant new issuances, purchases, or redemptions of our securities;
- plans for allocation and disbursement of capital expenditures;
- credit rating, activities with credit rating agencies, and key financial ratios;
- long-term financial strategy and financial needs;
- unusual or significant commitments or contingent liabilities; and
- plans to manage insurance and asset risk.

In addition to its other responsibilities, the committee oversees our major activities with respect to mergers, acquisitions and divestitures. The committee also reviews and evaluates, at least annually, the performance of the committee and its members. In connection with its duties, the committee may obtain the advice and assistance of outside advisors, including financial and legal advisors.

Nominating/Corporate Governance Committee

The purposes and objectives of the Nominating/Corporate Governance Committee are to assist our board of directors in fulfilling its duties and responsibilities to us and our stockholders, and its specific responsibilities include, among others, to:

- assist the board of directors in determining the appropriate characteristics, skills and experience for the individual members of the board of directors and the board of directors as a whole and create a process to allow the committee to identify and evaluate individuals qualified to become board members;
- make recommendations to the board regarding the composition of each standing committee of the board, to monitor the functioning of the committees of the board and make recommendations for any changes, review annually committee assignments and the policy with respect to rotation of committee memberships and/or chairpersonships, and report any recommendations to the board;
- review the suitability for each board member's continued service as a director when his or her term expires, and recommend whether or not the director should be re-nominated;
- assist the board in considering whether a transaction between a board member and the Company presents an inappropriate conflict of interest and/or impairs the independence of any board member;
- recommend nominees for board membership to be submitted for stockholder vote at each annual meeting of stockholders, and to recommend to the board candidates to fill vacancies on the board and newly-created positions on the board; and
- develop and recommend to the board Corporate Governance Guidelines for the Company that are consistent with applicable laws and listing standards and to periodically review those guidelines and to recommend to the board such changes as the committee deems necessary or advisable.

The committee reviews and evaluates, at least annually, the performance of the committee and its members. In connection with its duties, the committee may obtain the advice and assistance of outside advisors, including consultants and legal advisors.

Compensation of Directors

In 2015, we provided the following annual compensation to directors who are not employees:

Name	Fees Earned or Paid in Cash ($)[1]	Stock Awards ($)[2]	Option Awards ($)[3]	All Other Compensation ($)[4]	Total ($)
John W. Chidsey	115,000	145,036	—	41,175	301,211
Donald L. Correll	95,000	145,036	—	43,665	283,701
Yvonne M. Curl	108,709	145,036	—	43,665	297,410
Charles M. Elson	105,000	145,036	—	43,665	293,701
Joan E. Herman	101,484	145,036	—	9,522	256,042
Leo I. Higdon, Jr.	195,000	145,036	—	43,665	383,701
Leslye G. Katz	95,000	145,036	—	9,522	249,558
John E. Maupin, Jr.	105,000	145,036	—	43,665	293,701
L. Edward Shaw, Jr.	100,975	145,036	—	43,665	289,676

(1) The amounts reflected in this column are the retainer and chairperson fees earned for service as a director for 2015, regardless of when such fees are paid.

(2) Each non-employee director received an award of restricted stock units with a grant date fair value, computed in accordance with Accounting Standards Codification 718, *Compensation – Stock Compensation*, of $145,036 (3,416 units). These awards are fully vested in that they are not subject to forfeiture; however, no shares underlying a particular award will be issued until after the date the director ends his or her service on the board. As of December 31, 2015, each director held the following aggregate RSU awards: Mr. Chidsey – 49,875, Mr. Correll – 52,800, Ms. Curl – 52,800, Mr. Elson – 52,800, Ms. Herman – 12,590, Mr. Higdon – 52,800, Ms. Katz – 12,590, Dr. Maupin – 52,800, and Mr. Shaw – 52,800. There were no other outstanding stock awards.

(3) Other than Mr. Grinney, whose option awards are disclosed under the table entitled "Outstanding Equity Awards at December 31, 2015," no other directors had option awards outstanding at year end.

(4) The amounts reflected in this column represent the value of additional RSUs granted as dividend equivalents in connection with the payment of dividends on our common stock during 2015 as required by the terms of the original grants.

Our non-employee directors receive an annual cash retainer of $95,000. In addition to the cash retainer, the following table sets forth the chairperson fees paid to compensate for the enhanced responsibilities and time commitment associated with the positions.

Chair Position	Fees Earned or Paid in Cash ($)
Chairman of the Board	100,000
Audit Committee	20,000
Compensation Committee	15,000
Compliance/Quality of Care Committee	10,000
Finance Committee	10,000
Nominating/Corporate Governance Committee	10,000

Our non-employee directors may elect to defer all or part of their cash fees under our Directors' Deferred Stock Investment Plan. Elections are made prior to the beginning of the applicable year, and directors can only withdraw their participation effective before the beginning of the next year. Under the plan, amounts deferred by non-employee directors are promptly invested in our common stock by the plan trustee at the market price at the time of the payment of the fees. Stock held in the deferred accounts is entitled to any dividends paid on our common stock, which dividends are promptly invested in our common stock by the plan trustee at the market price. Fees deferred under the plan and/or the acquired stock are held in a "rabbi trust" by the plan trustee. Accordingly, the plan is treated as unfunded for federal tax purposes. Amounts deferred and any dividends reinvested under the plan are distributed in the form of our common stock upon termination from board service for any reason. Distributions generally will commence within 30 days of leaving the board. As of December 31, 2015, the number of shares held in the plan were: Dr. Maupin's 2,007 shares, Mr. Chidsey's 37,738 shares, and Mr. Shaw's 13,871 shares.

In addition, under our 2008 Equity Incentive Plan, each non-employee member of the board of directors receives a grant of restricted stock units valued at approximately $120,000. In February 2015, the board of directors approved a change in the grant date from February to the date of the annual meeting of stockholders to align with the annual term of office for directors. To accommodate the delay in the grant date of the director award, the board approved a pro rated award of restricted stock units for the period of service in 2015 preceding the annual meeting date. This one-time stub period grant in February 2015 had a value of approximately $25,000. When dividends are paid on our common stock, the directors receive the equivalent in restricted stock units based on the number of restricted stock units held and the value of the stock. The restricted stock units held by each director will be settled in shares of our common stock following the director's departure from the board.

In furtherance of the goal to align the interests of our management with those of our stockholders, we have equity ownership guidelines for senior management and members of the board of directors. Each non-employee director should own equity equal in value to at least $300,000 within five years of appointment or election to the board. As of February 16, 2016, all of our non-employee directors have satisfied the guidelines.

Mr. Grinney, who is the only director that is also an employee, receives no additional compensation for serving on the board.

Indemnification and Exculpation

We indemnify our directors and officers to the fullest extent permitted by Delaware law. Our certificate of incorporation also includes provisions that eliminate the personal liability of our directors for monetary damages for breach of fiduciary duty as a director, except for liability:

- for any breach of the director's duty of loyalty to us or our stockholders;
- for acts or omissions not in good faith or that involved intentional misconduct or a knowing violation of law;
- under Section 174 of the Delaware law (regarding unlawful payment of dividends); or
- for any transaction from which the director derives an improper personal benefit.

We believe these provisions are necessary to attract and retain qualified people who will be free from undue concern about personal liability in connection with their service to us.

AUDIT COMMITTEE REPORT

The board of directors has the ultimate authority for effective corporate governance, including the role of oversight of the management of the Company. The Audit Committee's purpose is to assist the board of directors in fulfilling its responsibilities to the Company and its stockholders by overseeing the accounting and financial reporting processes, the qualifications and selection of the independent registered public accounting firm engaged by the Company, and the performance of the Company's Inspector General, internal auditors and independent registered public accounting firm. The Audit Committee members' functions are not intended to duplicate or to certify the activities of management or the Company's independent registered public accounting firm.

In its oversight role, the Audit Committee relies on the expertise, knowledge and assurances of management, the internal auditors, and the independent registered public accounting firm. Management has the primary responsibility for establishing and maintaining effective systems of internal and disclosure controls (including internal control over financial reporting), for preparing financial statements, and for the public reporting process. PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, is responsible for performing an independent audit of the Company's consolidated financial statements, for expressing an opinion on the conformity of the Company's audited financial statements with generally accepted accounting principles in the United States, and for expressing its own opinion on the effectiveness of the Company's internal control over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002. In this context, the Audit Committee:

- reviewed and discussed with management and PricewaterhouseCoopers LLP the fair and complete presentation of the Company's consolidated financial statements and related periodic reports filed with the SEC (including the audited consolidated financial statements for the year ended December 31, 2015, and PricewaterhouseCoopers LLP's audit of the Company's internal control over financial reporting);
- discussed with PricewaterhouseCoopers LLP the matters required to be discussed by Statement on Auditing Standards No. 61, as amended (AICPA, Professional Standards, Vol. 1, AU Section 380), as adopted by the Public Company Accounting Oversight Board (the "PCAOB") in Rule 3200T; and
- received the written disclosures and the letter from PricewaterhouseCoopers LLP required by PCAOB Rule 3526 (Communication with Audit Committees Concerning Independence) and discussed with PricewaterhouseCoopers LLP its independence from the Company and its management.

The Audit Committee also discussed with the Company's internal auditors and PricewaterhouseCoopers LLP the overall scope and plans for their respective audits; reviewed and discussed with management, the internal auditors, and PricewaterhouseCoopers LLP the significant accounting policies applied by the Company in its financial statements, as well as alternative treatments and risk assessment; and met periodically in executive sessions with each of management, the internal auditors, and PricewaterhouseCoopers LLP.

The Audit Committee was kept apprised of the progress of management's assessment of the Company's internal control over financial reporting and provided oversight to management during the process.

Based on the reviews and discussions described above, the Audit Committee recommended to the board of directors, and the board of directors approved, that the audited consolidated financial statements for the year ended December 31, 2015, and management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2015, be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 for filing with the SEC. The Audit Committee has selected PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for 2016.

Audit Committee
John W. Chidsey (Chairman)
Donald L. Correll
Leslye G. Katz

COMPENSATION COMMITTEE MATTERS

Scope of Authority

The Compensation Committee acts on behalf of the board of directors to establish the compensation of our executive officers, other than the chief executive officer, and provides oversight of the Company's compensation philosophy for senior management. The Compensation Committee reviews and recommends to the board of directors for final approval the compensation of the chief executive officer and the non-employee directors. The Compensation Committee also acts as the oversight committee and administrator with respect to our equity compensation, bonus and other compensation plans covering executive officers and other senior management. In overseeing those plans, the Compensation Committee may delegate authority for day-to-day administration and interpretation of the plans, including selection of participants, determination of award levels within plan parameters, and approval of award documents, to officers of the Company. However, the Compensation Committee may not delegate any authority under those plans for matters affecting the compensation and benefits of the executive officers. The Compensation Committee may also delegate other responsibilities to a subcommittee comprised of no fewer than two of its members, provided that it may not delegate any power or authority required by any applicable law or listing standard to be exercised by the committee as a whole.

Compensation Committee Interlocks and Insider Participation

None of the current members of our Compensation Committee is an officer or employee of the Company. None of our current executive officers serves or has served as a member of the board of directors or compensation committee of any other company that had one or more executive officers serving as a member of our board of directors or Compensation Committee.

Compensation Committee Report

The Compensation Committee reviewed and discussed with management the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K, and, based upon such review and discussions, the Compensation Committee recommended to the board of directors that the Compensation Discussion and Analysis be included in this proxy statement and incorporated by reference in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Compensation Committee
Yvonne M. Curl (Chairperson)
Joan E. Herman
Leo I. Higdon, Jr.
L. Edward Shaw, Jr.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

In this section we present the key components of our executive compensation program. We examine why we compensate our executives in the manner we do and how these philosophies guide the individual compensation decisions for our named executive officers, or "NEOs." Our 2015 compensation decisions were directed by our board of directors and its Compensation Committee, which we refer to as the "Committee" in this section only. For the fiscal year ended December 31, 2015, our NEOs were:

Name	Title
Jay Grinney	President and Chief Executive Officer
Douglas E. Coltharp	Executive Vice President and Chief Financial Officer
Mark J. Tarr	Executive Vice President and Chief Operating Officer
John P. Whittington	Executive Vice President, General Counsel and Secretary
Cheryl B. Levy	Chief Human Resources Officer

EXECUTIVE SUMMARY

Strategy and Business Overview

HealthSouth is one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through our network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. This structure allows us to provide a continuum of facility-based and home-based post-acute services to our patients and their families, which we believe will become increasingly important as coordinated care delivery models, such as accountable care organizations and bundled payment arrangements, become more prevalent.

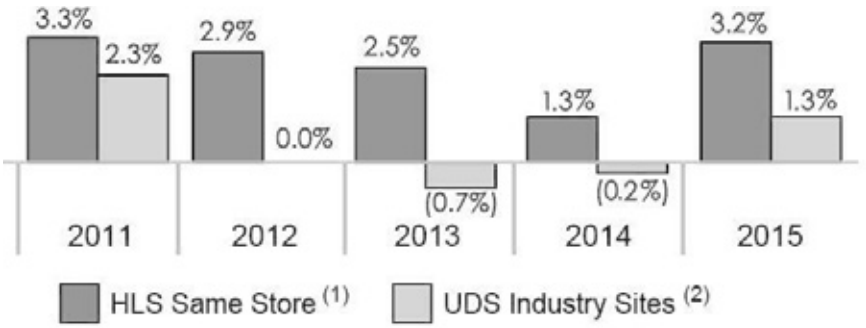
2015 Business Highlights and Recent Track Record

In 2015, we continued to successfully execute our business strategy:

- ✓ Net operating revenues increased by 31.5% over 2014 due primarily to strong volume growth in both of our operating segments and included the effects of our acquisitions of Encompass, Reliant, and CareSouth.
- ✓ Total inpatient rehabilitation facility, or "IRF," patient discharges and same-store discharges grew 10.9% and 3.2%, respectively.
- ✓ Our functional outcomes for IRF patients continued to outpace the industry average, and they did so while we continued to increase our market share throughout 2015.
- ✓ Our hospitals treated more patients and enhanced outcomes in a highly cost-effective manner.
- ✓ We completed the acquisition of the operations of Reliant Health Partners, LLC which included 11 IRFs with a total of 902 beds in Texas, Massachusetts, and Ohio.
- ✓ Additionally, we continued our development efforts through construction of a de novo hospital in Franklin, Tennessee and the acquisition of Cardinal Hill Rehabilitation Hospital in Lexington, Kentucky. We began operating a joint venture hospital in Savannah, Georgia and entered into new joint ventures in Jackson, Tennessee; Westerville, Ohio; Broken Arrow, Oklahoma; Hot Springs, Arkansas; and Bryan, Texas.
- ✓ Patient quality of care for our home health business continues to be well above the national average while 30-day readmission rates are well below the national average.
- ✓ We acquired the home health and hospice agency operations of CareSouth Health System, Inc. adding a portfolio of 44 home health and 3 hospice locations in 7 states.
- ✓ Additionally, we opened four home health locations and two hospice locations and acquired ten home health locations and two hospice locations.
- ✓ We increased our quarterly cash dividend by 9.5% from $0.21 per share to $0.23 per share, and we repurchased 1.4 million shares of our common stock.

Our success in 2015 continued to build upon our success in prior years. We have achieved a consistent track record of superior performance.

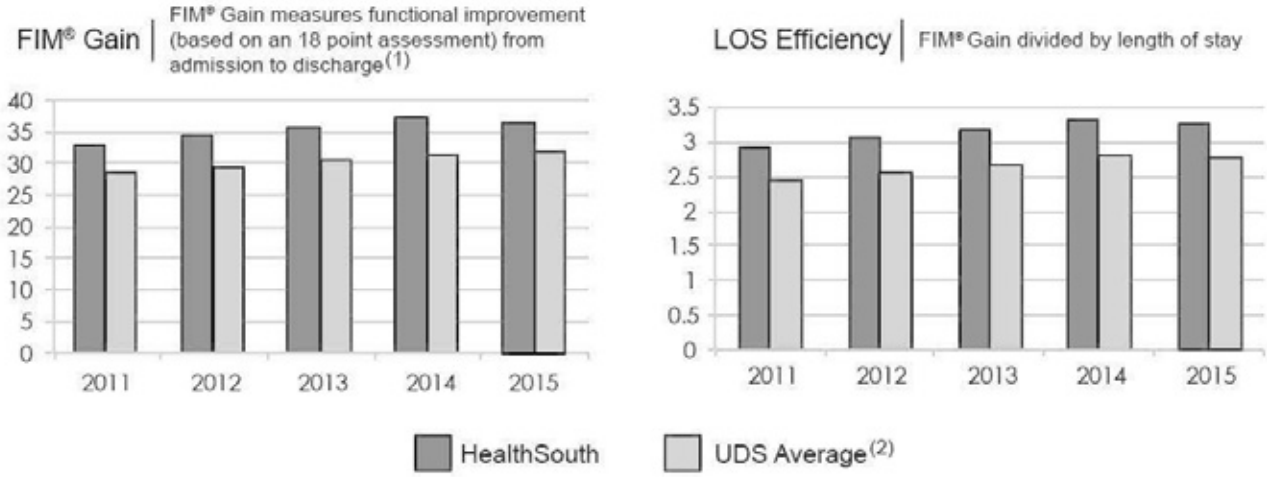
✓ **Our same-store IRF patient discharge volume growth has consistently outpaced competitors'.**



(1) Includes consolidated HealthSouth inpatient rehabilitation hospitals classified as same store during that time period.

(2) Data provided by Uniform Data System for Medical Rehabilitation, a division of UB Foundation Activities, Inc., a data gathering and analysis organization for the rehabilitation industry; represents ~70% of industry, including HealthSouth sites.

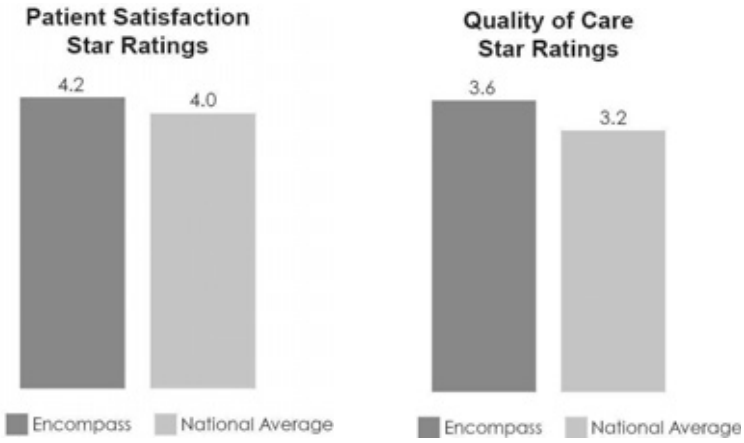
✓ **The functional improvement of our IRF patients has outpaced that of patients across the industry.**



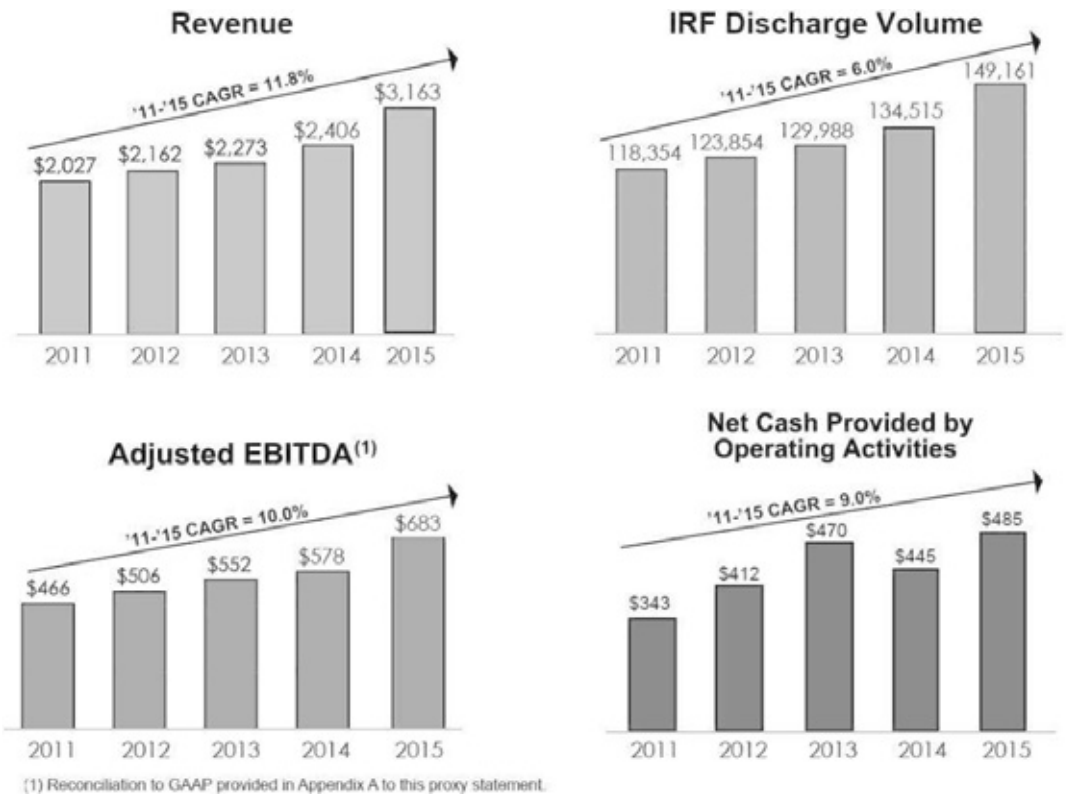
(1) FIM® is a registered trademark of Uniform Data System for Medical Rehabilitation, a division of UB Foundation Activities, Inc.

(2) The UDS average is the risk-adjusted average of a patient mix pulled from the UDS nation (including HealthSouth) that is similar to the HealthSouth actual patient mix. Cases are placed into CMGs by admitting impairment code, functional status at admission, and sometimes age.

✓ **The patient satisfaction and quality of care of our home health patients has outpaced the industry.**



✓ **We have posted strong growth rates across key operational metrics.**



Operating Performance and Executive Compensation

We utilize performance objectives in our compensation plans which we believe will, over time, lead to enhanced stockholder value. Over the past several years, we established a track record of strong results from operations, and these results, as highlighted above, continued in 2015. Healthcare always has been a highly regulated industry. Successful healthcare providers are those who provide high-quality, cost-effective care and have the ability to adjust to changes in the regulatory and operating environments. We believe we have the necessary capabilities — scale, infrastructure, capital structure, and management — to adapt to changes and continue to succeed in a highly regulated industry, and we have a proven track record of doing so.

While we have demonstrated industry-leading volume growth and outcomes that have contributed to consistently solid and improving operating results for years, our executive compensation, as reported in the Summary Compensation Table on page 51, has remained relatively steady, and "realizable pay," has reflected linkage between delivered executive compensation and total shareholder return, or "TSR." As our share price has moved, so too has the ultimate value of prior years' equity awards, which furthers the long-term alignment between our TSR and realizable pay.

For purposes of this discussion, we define "realizable pay" for a given year as:

- Actual base salary; plus
- Actual short-term incentive(s) earned in that year; plus
- Value of stock options where the December 31, 2015 share price exceeds the exercise price; plus
- Value of time-based restricted stock as of December 31, 2015; plus
- Value of performance-based restricted stock as of December 31, 2015 using the target number of shares for awards that have not yet completed the two-year performance period and the attained number of shares for awards that have completed the two-year performance period.

Overview of Executive Compensation Actions in 2015

In February 2015, the Committee considered the total compensation packages, both in whole and by component, of our NEOs to determine appropriateness in light of our executive compensation philosophy, 2014 accomplishments, and 2015 anticipated challenges and took the following actions:

2015 Executive Compensation Actions Summary

Compensation Component	Actions Related to Plans from Prior Years	Actions Related to 2015 Plans
Base Salary	Not applicable.	• NEO base salaries were unchanged from 2014.
Senior Management Bonus Plan ("SMBP")	Approved 2014 SMBP awar ds based on performance compared to targets; awards equaled a weighted average of 85.0% of target opportunity.	• Approved 2015 design with no change in target award opportunity. • Introduced "plan within a plan" design to increase flexibility while supporting deductibility. • Retained adjusted consolidated earnings before interest, tax, depreciation and amortization expenses, or "Adjusted EBITDA," and Program Evaluation Model ("PEM") Score Ranking (defined below) as the corporate performance metrics. • Increased individual objectives maximum achievement opportunity to 200%.
Long-Term Incentive Plan ("LTIP")	Approved 2013 LTIP award payouts based on performance compared to targets for the 2013-2014 performance period; awards reflected 107.5% of target opportunity.	• Approved 2015 design; increased Mr. Grinney's award by $500,000; no change in target award opportunity for all other NEOs. • Retained 2014 design of performance-based restricted stock awards with three metrics: earnings per share, or "EPS," return on invested capital, or "ROIC," and relative total shareholder return, or "TSR."

Response to 2015 Proxy Votes

We believe the 98.9% affirmative vote on our 2015 "say-on-pay" vote signaled to the Committee that our stockholders support our current executive compensation program. In 2015 and 2016, we have made minor changes to our executive compensation program designed to align our plans with our business strategy in an evolving healthcare market while continuing to emphasize performance-based compensation. One such change is the introduction of a "quality scorecard" for our Senior Management Bonus Plan for 2016 focusing our executives on returning patients to their optimal level of independence.

EXECUTIVE COMPENSATION PHILOSOPHY

HealthSouth's executive compensation philosophy is to:

- provide a competitive rewards program for our senior management that aligns management's interests with those of our long-term stockholders;
- correlate compensation with corporate, regional and business unit outcomes by recognizing performance with appropriate levels and forms of awards;
- establish financial and operational goals to sustain strong performance over time;
- place 100% of annual cash incentives and a majority of equity incentive awards at risk by directly linking those incentive payments and awards to the Company's and individual's performance; and
- provide limited executive benefits to members of senior management.

We believe this philosophy will enable us to attract, motivate, and retain talented and engaged executives who will enhance long-term stockholder value.

Pay and Performance

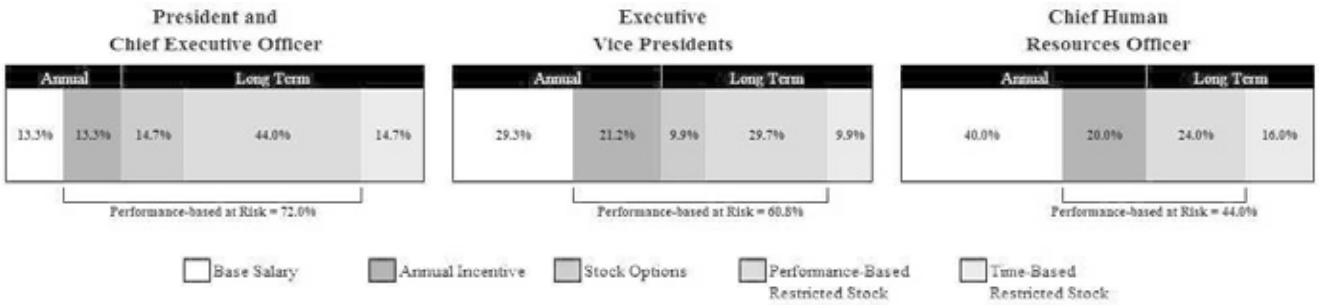
Our executive compensation program is designed to provide a strong correlation between pay and performance. Pay refers to the value of an executive's total direct compensation, or "TDC."

Total Direct Compensation = Base Salary + Annual Cash Incentive + Long-Term Equity Incentives

2015 NEO Target Total Direct Compensation

Named Executive Officer	Base Salary	Target Annual Cash Incentive (% of Base)	Target Long-Term Equity Incentive (% of Base)	Target Total Direct Compensation
Jay Grinney	$1,000,000	100%	550%	$7,500,000
Douglas E. Coltharp	525,000	75%	150%	1,706,250
Mark J. Tarr	625,000	80%	200%	2,375,000
John P. Whittington	527,000	60%	150%	1,633,700
Cheryl B. Levy	345,000	50%	100%	862,500

In 2015, all cash incentive target amounts and a substantial majority of NEO equity award values were dependent on performance measured against certain pre-determined, board-approved objectives. The graphs below reflect: (i) the timeframe (i.e., annual vs. long-term) for our NEOs to realize the value of the various TDC components and (ii) the extent to which our NEOs' 2015 target TDC is performance-based.



Annually, as a "checkup" of pay and performance, Frederic W. Cook & Co. prepares an analysis of the prior year TDC for the NEOs and the reported prior year TDC for the NEOs of our peer companies for the "Healthcare Peer Group" (as identified below). This analysis includes our rankings against the peer group for several key financial and operating performance metrics for one-, three-, and five-year periods. These metrics are grouped into four categories: "growth," "operating performance," "returns," and "investor experience." The Committee has not taken any specific action in response to this information but does consider it in assessing whether the Company is paying for performance – both absolute and relative to peers. During the October 2015 review, for periods ending in 2014, HealthSouth's performance was at or above median for 24 of these metrics while falling below median for just 6 of these metrics. As part of this same comparison, CEO actual TDC fell just below the 60th percentile while the balance of the NEOs, as a group, fell between the 40th and 50th percentile.

Other Best Practices

To ensure the Company has strong corporate governance and risk mitigation, the board of directors also adopted the following best practices related to executive compensation:

- Both our annual and long-term incentive plans have maximum award features;
- Our annual and long-term incentive plans are designed with multiple measures of performance;
- Our annual incentive plan includes both financial and quality metrics;
- Our compensation recoupment, or "claw-back," policy applies to both cash and equity incentives;
- Equity ownership guidelines for our senior executives and directors require our senior executives to retain 50% of their net shares at the time of exercise/vest until their ownership multiple is met;
- Our insider trading policy expressly prohibits hedging or pledging of our stock by our executives and directors;
- Supplemental executive benefits or perquisites are substantially limited to a nonqualified 401(k) plan and, in the case of our chief executive officer, supplemental long-term disability coverage;
- The Committee's independent consultant, Frederick W. Cook & Co., is retained directly by the Committee and performs no other work for the Company;
- Independent sessions are scheduled at every regular meeting of our board and the Committee (no members of management are present at these independent sessions); and
- Our change-of-control compensation arrangements include a "double trigger" requiring generally both a change in control and termination of employment to receive cash benefits and accelerated vesting of equity (for awards granted after December 2014) and do not provide tax gross-ups.

DETERMINATION OF COMPENSATION

Key Participants	Roles and Responsibilities
Compensation Committee	Oversees our compensation and employee benefit objectives, plans, and policies. Reviews and approves (or recommends for approval of the independent directors of our board in the case of the chief executive officer) the individual compensation of the executive officers. The Committee is comprised solely of four independent directors. Its responsibilities, as it relate to the compensation of our NEOs, include: • review and approve the Company's compensation programs and policies, including incentive compensation plans and equity-based plans; • review and approve corporate goals and objectives relevant to the compensation of our NEOs, then (i) evaluate their performance and (ii) determine and approve their base compensation levels and incentive compensation based on this evaluation; and, in the case of our chief executive officer, recommend such to the board for approval; and • review personal benefits provided to our NEOs and recommend any changes to the board. The Committee receives support from the chief human resources officer and her staff and also engages its own executive compensation consultant as described below.
Chief Executive Officer	Makes recommendations to the Committee regarding our executive compensation plans and, for all other NEOs, proposes adjustments to base salaries and awards under our annual incentive compensation and long-term equity-based plans, establishes individual objectives, and reviews with the Committee the performance of the other NEOs on their individual objectives. The chief executive and chief human resources officers regularly attend meetings of the Committee.
Compensation Consultant	Throughout the year, the Committee relies on Frederic W. Cook & Co., Inc. for external executive compensation support. Frederic W. Cook & Co. is retained by, and works directly for, the Committee and attends meetings of the Committee, as requested by the Committee chair. Frederic W. Cook & Co. has no decision making authority regarding our executive compensation. Services provided include: • updates and advice to the Committee on the regulatory environment as it relates to executive compensation matters; • advice on trends and best practices in executive compensation and executive compensation plan design; • market data, analysis, evaluation, and advice in support of the Committee's role; and • commentary on our executive compensation disclosures. Management has separately engaged Mercer (US) Inc. The scope of that engagement includes providing data and analysis on competitive executive and non-executive compensation practices. Mercer data on executive compensation practices was provided to the Committee, subject to review by, and input from, Frederic W. Cook & Co. Mercer also provides a diagnostic tool and support to our assessment of risk related to our compensation practices. Mercer does not directly advise the Committee in determining or recommending the amount or form of executive compensation.

Assessment of Competitive Compensation Practices

The Committee does not employ a strict formula in determining executive compensation. A number of factors are considered in determining executive base salaries, annual incentive opportunities, and long-term incentive awards, including:

- the executive's responsibilities,
- the executive's experience,
- the executive's performance,
- aspects of the role that are unique to the Company,
- internal equity within senior management, and
- competitive market data.

To assess our NEOs' target total direct compensation, the Committee reviews competitive data from two sources:

- compensation survey data noted below, and
- healthcare peer group data - Frederic W. Cook & Co., at the direction of the Committee, assembles data for a targeted group of healthcare industry peers.

The survey data provides a significant sample size, includes information for management positions below senior executives, and includes broader healthcare companies and other industries from which we might recruit for executive positions.

Survey Sources

Mercer Benchmark	Aon Hewitt Total Compensation
Mercer Integrated Health Networks	Towers Watson Executive

For 2015, the healthcare peer group was derived through an annual review of potential peers conducted with the Committee's Compensation Consultant. This peer group provided data for companies similar to us in terms of industry segment, revenue size, and exposure to Medicare as a revenue source, and market capitalization. The Committee believes these data sources provide a comprehensive perspective on competitive pay levels and practices.

Due to reductions in the number of companies meeting the peer group criteria (primarily due to acquisitions), the resulting benchmark data was becoming less reliable and potentially more volatile. For compensation awards granted in 2016, the Committee redefined the peer group to be a subset of the "total shareholder return peer group" (as identified below) composed of all companies in the total shareholder return peer group with revenues between 1/3 and 3 times that of HealthSouth.

2015 Healthcare Peer Group

Amedisys	Kindred Healthcare	Tenet Healthcare
Chemed	Lifepoint Health	Universal Health Services
Community Health Systems	Select Medical Holdings	

2016 Healthcare Peer Group

Acadia Healthcare	The Ensign Group	Mednax
Amedisys*	Envision Healthcare	Quest Diagnostics
Amsurg	Kindred Healthcare*	Select Medical Holdings*
Brookdale Senior Living	LabCorp Holdings	Team Health Holdings
Chemed*	Lifepoint Health*	Universal Health Services*

*Carryovers from 2015 peer group. Community Health Systems and Tenet Healthcare were removed.

The Committee reviews competitive data on base salary levels, annual incentives, and long-term incentives for each executive and the NEO group. In 2015, the Committee reviewed total direct compensation opportunities for our NEOs, while referencing the 50th percentile of both the Mercer survey data and the healthcare peer group data in addition to the assessment factors discussed above. For purposes of competitive analysis of our chief executive officer's compensation, the Committee places emphasis on the healthcare peer group data because other healthcare industry companies provide the most direct comparison. It is important to note the Committee, with input from Frederic W. Cook & Co., recognizes the benchmark data changes from year to year, so the comparison against those benchmarks places emphasis on sustained compensation trends to avoid short-term anomalies. In general, the Committee views compensation 10% above or below the targeted percentile as within a competitive range given year to year variability in the data.

The Committee has considered the appropriate competitive target range to attract and retain the kind of executive talent necessary to successfully achieve our strategic objectives. The Committee's objective is to establish target performance goals that will result in strong performance by the Company. Executives may achieve higher actual compensation for exceptional performance relative to these target performance goals and below-median levels of compensation for performance that is not as strong as expected.

As stated previously, the Committee received from Frederic W. Cook & Co. an analysis of the 2016 Healthcare Peer Group data for 2014 that was included in proxies filed during 2015. Mr. Grinney's target TDC in 2015 fell slightly above the 60th percentile of the healthcare peer group's 2014 target data. The 2015 target TDC for Mr. Tarr, Mr. Coltharp, and Ms. Levy fell below the 50th percentile of the competitive market while the target TDC for Mr. Whittington fell slightly above the 50th percentile. As another test of overall reasonableness, the Committee compared the aggregate target TDC of our NEO group to the aggregate amounts from the companies in the healthcare peer group, and our aggregate target TDC amount was slightly above the 50th percentile.

ELEMENTS OF EXECUTIVE COMPENSATION

Elements of Total Rewards at a Glance

Total Reward Component	Purpose	2015 Actions
Base Salary	Provide our executives with a competitive level of regular income.	No base salary increases for any NEO.
Annual Incentives	Intended to drive Company and individual performance while focusing on annual objectives.	Maintained 2014 targets for all NEOs; retained Adjusted EBITDA and PEM Score Ranking as weighted metrics while shifting more weight to Adjusted EBITDA; raised the maximum award for Individual Objectives component from 100% to 200%.
Long-Term Incentives	Intended to focus executive attention on longer-term strength of the business and align their interests with our stockholders.	Increased target value of Mr. Grinney's award by $500,000; maintained 2014 targets for all other NEOs; continued use of EPS, ROIC and Relative TSR as performance metrics; continued time-based restricted stock and stock options.
Health and Welfare Benefits	Provide our executives with programs that promote health and financial security.	No changes.
Perquisites	Limited to supplemental tax deferral.	No changes.
Change in Control and Severance	Provides business continuity and temporary income during periods of transition.	No changes.

The primary elements of our executive compensation program are:

Base Salary + Annual Cash Incentives + Long-Term Equity Incentives

Base Salary

We provide executives and other employees with base salaries to compensate them with regular income at competitive levels. Base salary considerations include the factors listed under "Assessment of Competitive Compensation Practices" above.

Base salaries for all of the NEOs were determined to be appropriate and competitive and maintained at the current levels to manage fixed expenses.

2015 Fiscal Year-End Annual Base Salary

Jay Grinney	President and Chief Executive Officer	$1,000,000
Douglas E. Coltharp	Executive Vice President and Chief Financial Officer	525,000
Mark J. Tarr	Executive Vice President and Chief Operating Officer	625,000
John P. Whittington	Executive Vice President, General Counsel and Secretary	527,000
Cheryl B. Levy	Chief Human Resources Officer	345,000

Annual Incentives

The 2015 Senior Management Bonus Plan, or "SMBP," was designed to incentivize and reward our NEOs and others for annual performance as measured against pre-determined corporate quantitative and individual objectives intended to improve the Company's performance and promote stockholder value.

In order to provide the Committee with more flexibility in designing SMBP award structures that will result in tax deductible payments, in 2015, the Committee adopted a "plan within a plan" design. First, the award pool is funded if the Company meets the pre-established performance metric which, for fiscal 2015, was 50% of budgeted "as reported" Adjusted EBITDA. Second, assuming the SMBP award pool is funded, the Committee may exercise discretion in determining awards based on our traditional SMBP approach described below. For 2015, the funding threshold was exceeded resulting in a fully funded award pool.

Plan Objectives and Metrics

For 2015, the corporate quantitative objectives of consolidated Adjusted EBITDA[1] and Program Evaluation Model ("PEM") Score Ranking[2] were continued from 2014. The weightings for these two metrics were revised as highlighted below to reflect a greater emphasis on financial performance following the Encompass integration as the PEM Score Ranking has applicability only to the traditional inpatient rehabilitation portion of our business.

2015 SMBP Corporate Quantitative Objective Weighting Changes

Corporate Objective	2014 Weight	2015 Weight	Rationale for Metric
Adjusted EBITDA	70%	80%	Prevalent, industry-relevant measure of profitability
PEM Score Ranking	30%	20%	Key quality metric that evaluates the functional gains of our patients

The weightings and payout ranges for our 2015 corporate quantitative objectives are as follows:

2015 SMBP Corporate Objectives

		Award Range			
		Not Eligible	Threshold	Target	Maximum
Objective	Weight	0%	50%	100%	200%
Adjusted EBITDA	80%	<$638,550,000	$638,550,000	$681,608,000	≥$732,729,000
PEM Score Ranking (% of hospitals at, or above, hospital-specific PEM Score goals)	20%	<60%	60%	70%	≥80%

To reward exceptional performance, the NEOs have the opportunity to receive a maximum payout in the event actual results reach a predetermined level for each objective. Conversely, if attained results are less than threshold for a component of the corporate quantitative objectives, then no payout for that component of corporate quantitative objectives occurs. It is important to note the following:

- performance measures can be achieved independently of each other; and
- as results increase above the threshold, a corresponding percentage of the target cash incentive will be awarded. In other words, levels listed are on a continuum, and straight-line interpolation is used to determine the payout multiple between two payout levels shown in the table above.

[1] For purposes of the 2015 SMBP, Adjusted EBITDA is the same as the measure described in the 2015 Form 10-K, and the results may be adjusted further for certain unusual or nonrecurring unbudgeted items. Adjusted EBITDA is discussed in more detail, including reconciliations to corresponding GAAP financial measures, in Appendix A to this proxy statement. The Committee has established in advance the following four categories of adjustments for these unusual or nonrecurring unbudgeted items: acquisitions and divestitures, changes in capital structure, litigation expenses and settlements, and material legislative changes. The Committee believes these pre-approved categories help the metric to more accurately reflect items within management's control while also minimizing unintended incentives or disincentives associated with the accounting impacts. For 2015, the items adjusted included: the unbudgeted Savannah Rehabilitation Hospital joint venture and the acquisitions of Cardinal Hill Rehabilitation Hospital, Reliant Hospital Partners, LLC and CareSouth Health System, Inc.

[2] For purposes of the 2015 SMBP, Program Evaluation Model ("PEM") Score Ranking is a quality metric that evaluates the functional gains our patients achieve using the FIM® (Functional Improvement Measure) tool and each patient's discharge status (e.g., to home or an acute care hospital). PEM Scores from all HealthSouth hospitals are submitted to the Uniform Data System, or "UDS," database to compare each HealthSouth hospital's performance against the industry. The measurement of the PEM Score Ranking is the aggregation of the Company's year-end, hospital-specific PEM Scores vs. hospital-specific PEM Score goals; each hospital-specific PEM Score and hospital-specific PEM Score goal are stated as a percentile of the national UDS PEM Score database. FIM® is a registered trademark of UDS for Medical Rehabilitation, a division of UB Foundation Activities, Inc.

In addition to corporate quantitative objectives for each NEO, we specify individual, measurable objectives weighted according to importance. The independent members of our board establish Mr. Grinney's individual objectives. Mr. Grinney establishes two to four individual objectives for the other NEOs, subject to review by the Committee. The individual objectives reflect objectives specific to each NEO's position and also corporate objectives. Additionally, if we fail to attain at least achievement of 80% of the target level for Adjusted EBITDA, then no payout for the individual objectives occurs. A formal assessment of each NEO's performance against his or her individual objectives is reviewed and approved by the Committee.

The following table describes each of Mr. Grinney's individual objectives and completion status for 2015:

	Individual Objectives	**Completion Status**
1.	Refresh/update business strategy and plan and obtain support from the Board of Directors.	Achieved.
2.	Meet/exceed targeted growth objectives of both segments: IRF and home health & hospice.	Achieved. IRF: Opened one de novo hospital and acquired 13 hospitals resulting in over 1,200 additional beds. HH&H: Acquired 59 locations.
3.	Pursue acquisition targets that become actionable.	Achieved. IRF: Acquired Reliant in October 2015. HH&H: Acquired CareSouth in November 2015.
4.	Meet or exceed quality of care and patient satisfaction objectives.	Achieved. IRF: 73% of hospitals met or exceeded PEM goals and 65% of hospitals met or exceeded Patient Satisfaction goals. HH&H: Readmission rate 16.0%, national average 16.9%; 80% of patients recommended agency, 79% national average; 84% of patients rated agency 9-10, 84% national average; care of patient 90%, national average 88%.
5.	Successfully integrate IRF and Home Health & Hospice segments.	Achieved.
6.	Maintain trustworthy relationship with investors.	Achieved.
7.	Maintain proactive role with legislators and regulators.	Achieved.
8.	Maintain positive, open, candid relationship with Board.	Achieved.
9.	Provide strong, purposeful direction for the Company.	Achieved.
10.	Maintain a strong, effective senior management team.	Achieved.
11.	Maintain and update succession planning and leadership development for senior management.	Achieved.
12.	Maintain a robust diversity agenda within the Company.	Achieved. Both employee and vendor diversity initiatives recognized by business community with multiple awards.

The individual objectives for the other NEOs were aligned with Mr. Grinney's individual objectives and the Company's quantitative objectives but specifically tailored to the functional responsibilities of that NEO. Accordingly, the ability of each NEO to achieve his or her individual objectives closely mirrored our ability to achieve targeted results for the corporate quantitative objectives. Mr. Grinney attempted to set the individual objectives and target performance levels such that, if an NEO's performance in each of his or her personal objectives met or exceeded the range of reasonable expectations, no less than 75% of the full award for his or her individual objectives would be earned. For 2015, the Committee approved making the overall award levels more competitive during periods of superior performance and to permit recognition for individual contributions that exceed established goals by raising the individual objectives award maximum to 200% (vs. 100% in prior years).

Establishing the Target Cash Incentive Opportunity

Under the SMBP, the Committee first approves a target cash incentive opportunity for each NEO, based upon a percentage of his or her base salary, "Target Cash Incentive Opportunity as a % of Salary" in the table below. This target cash incentive opportunity is established as a result of the Committee's "Assessment of Competitive Compensation Practices" described above. The Committee then assigns relative weightings (as a percentage of total cash incentive opportunity) to the objectives. The relative weightings of the corporate quantitative objectives and individual objectives

take into account the executive's position, with the targets for executives with strategic responsibilities consisting of a higher corporate quantitative objectives weighting.

The table below summarizes the target cash incentive and relative weightings of corporate quantitative and individual objectives for each NEO.

Named Executive Officer	Target Cash Incentive Opportunity as a % of Salary	Weightings		Relative Weighting as a % of Target		
				Quantitative Objectives		
		Corporate Quantitative Objectives	Individual Objectives	Adjusted EBITDA (80%)	PEM Score Ranking (20%)	Individual Objectives
Jay Grinney	100%	80%	20%	64%	16%	20%
Douglas E. Coltharp	75%	80%	20%	64%	16%	20%
Mark J. Tarr	80%	80%	20%	64%	16%	20%
John P. Whittington	60%	80%	20%	64%	16%	20%
Cheryl B. Levy	50%	70%	30%	56%	14%	30%

Assessing and Rewarding 2015 Achievement of Objectives

After the close of the year, the Committee assesses performance against the corporate quantitative and individual objectives for each NEO to determine a weighted average result, or the percentage of each NEO's target incentive that has been achieved, for each objective. The Committee has the discretion to reduce awards. For 2015, results for the corporate quantitative objectives were as follows:

Objective	Target	Actual Result	% of Target Metric Achievement	Weight	Weighted Metric Achievement
Adjusted EBITDA	$681,608	$648,481	61.5%	80%	49.2%
PEM Score Ranking	70.0%	73.4%	134.0%	20%	26.8%
Combined				**100%**	**76.0%**

The cash incentive attributable to individual objectives is determined by multiplying the relative weight of each NEO's individual objectives by the target cash incentive amount and then again by the percentage of the individual objectives achieved by that NEO. As described earlier, individual objective achievement is capped at 200%. The Committee and the other independent members of our board determined Mr. Grinney's individual objectives achievement. The Committee also concurred with Mr. Grinney on the individual objective achievements for the other NEOs.

2015 Individual Objective Achievement

Named Executive Officer	Title	2015
Jay Grinney	President and Chief Executive Officer	100%
Douglas E. Coltharp	Executive Vice President and Chief Financial Officer	150%
Mark J. Tarr	Executive Vice President and Chief Operating Officer	150%
John P. Whittington	Executive Vice President, General Counsel and Secretary	100%
Cheryl B. Levy	Chief Human Resources Officer	135%

The Committee believes the degree of achievement of the quantitative and individual objectives strengthened our position in our industry and promoted the long-term interests of our stockholders, and thus warranted the cash incentive payments listed in the following table. The achievement levels above 100% reflected the additional responsibility and effort in connection with the three significant acquisitions and integrations in the past year. These amounts were paid in February 2016 and are included in the 2015 compensation set out in the Summary Compensation Table on page 51.

2015 Senior Management Bonus Plan Payouts

Named Executive Officer	Corporate Quantitative Objective Portion	Individual Objective Portion	Total Payout
Jay Grinney	$608,000	$200,000	$808,000
Douglas E. Coltharp	239,400	118,125	357,525
Mark J. Tarr	304,000	150,000	454,000
John P. Whittington	192,250	63,240	255,490
Cheryl B. Levy	91,770	69,863	161,633

Long-Term Incentives

To further align management's interests with stockholders, a significant portion of each NEO's total direct compensation is in the form of long-term equity awards. We believe such awards promote strategic and operational decisions that align the long-term interests of management and the stockholders and help retain executives. In support of our performance-driven total compensation philosophy, earned equity values are driven by stock price and financial and operational performance.

For 2015, our equity incentive plan provided participants at all officer levels with the opportunity to earn performance-based restricted stock, or "PSUs," time-based restricted stock, or "RSAs," and, for the chief executive officer and the executive vice presidents, stock options. We believe these awards align all levels of management with stockholders and place a significant portion of TDC at risk. RSAs are included to enhance retention incentives.

The 2015 value of the long-term incentive awards to the NEOs as a percentage of their base salaries remained consistent with 2014 for all NEOs with the exception of Mr. Grinney. The board approved an increase in Mr. Grinney's long-term incentive grant opportunity to $5.5 million (from $5.0 million in 2014) to recognize his sustained performance and the completion of the transformative acquisition of Encompass. The board chose to recognize his performance and the acquisition through increased long-term incentive opportunity because it links Mr. Grinney to ongoing performance and the success of the Encompass integration.

The following table summarizes the 2015 target equity award opportunity levels and forms of equity compensation for each of our NEOs. The values in this table reflect the intended target value approved by the Committee and board. These amounts differ from the equity awards values reported in the Summary Compensation Table on page 51 due to:

- the impact of the Monte Carlo simulation valuation of the relative TSR portion of the PSUs and
- the utilization of a 20-day average stock price to determine the number of shares granted as opposed to the grant date values used for accounting and reporting purposes.

2015 Target Equity Award Opportunity and Equity Compensation Mix (by value)

Named Executive Officer	Title	Total Target Equity Award Opportunity	Options as % of the Award	PSUs as a % of the Award	RSAs as a % of the Award
Jay Grinney	President and Chief Executive Officer	$5,500,000	20%	60%	20%
Douglas E. Coltharp	Executive Vice President and Chief Financial Officer	787,487	20%	60%	20%
Mark J. Tarr	Executive Vice President and Chief Operating Officer	1,250,045	20%	60%	20%
John P. Whittington	Executive Vice President, General Counsel and Secretary	790,569	20%	60%	20%
Cheryl B. Levy	Chief Human Resources Officer	345,017	—	60%	40%

Performance Share Unit Awards in 2015

The Committee determined that performance-based vesting conditions for the majority of restricted stock granted to NEOs are appropriate to further align executives with the interests of stockholders and promote specific performance objectives while facilitating executive stock ownership. Under our equity incentive plan, NEOs may be awarded PSUs, which entitle them to receive a pre-determined range of restricted shares upon achievement of specified performance objectives. PSU awards do not provide for voting rights unless and until restricted stock is earned after the measurement period. In conjunction with the initiation of regular common stock dividends in October 2013, our board of directors awarded dividend equivalent rights on all outstanding PSUs. For 2015 PSUs, dividends accrue when paid on outstanding shares, but the holders of PSUs will not receive the cash payments related to these accrued dividends until the resulting common shares, if any, fully vest.

To recognize his contribution to HealthSouth's turnaround and success since his hire in 2004, beginning with Mr. Grinney's 2014 PSU awards, our board revised the vesting treatment upon his retirement. When Mr. Grinney retires, he will receive his full PSU award subject to performance attainment. Any resulting shares earned will not be released until the final vesting of the award. Our board believes this modified treatment strengthens his noncompete agreement and other restrictive covenants and links Mr. Grinney financially to the success of the CEO transition that would occur upon his retirement.

For the 2015 awards, the number of restricted shares earned will be determined at the end of a two-year performance period based on the level of achievement of the following metrics:

2015 LTIP Objectives

Objective	Weight
Normalized Earnings Per Share ("EPS")[3]	50%
Return on Invested Capital ("ROIC")[4]	30%
Relative Total Shareholder Return ("TSR")[5]	20%

The Committee chose these metrics because the Committee believes they are directly aligned with our stockholders' interests. If restricted shares are earned at the end of the two-year performance period, the participant must remain employed until the end of the following year at which time the shares fully vest.

It is important to note:

- Management provides a report to the Committee that sets out the calculations of the actual results and engages an accounting firm to produce a report on the accuracy of the calculations;
- if results attained are less than the threshold, then no restricted shares are earned for that performance measure in that performance period; and
- as results increase above the threshold, a corresponding percentage of target equity value will be awarded. In other words, levels listed are on a continuum, and straight-line interpolation is used to determine the payout multiple between two payout levels shown in the table above.

[3] For purposes of the 2015 LTIP, EPS is calculated on a weighted-average diluted shares outstanding basis by adjusting net income from continuing operations attributable to HealthSouth for the normalization of income tax expense and certain unusual or nonrecurring unbudgeted items. The Committee has established in advance the following four categories for these unusual or nonrecurring unbudgeted items for Committee consideration: acquisitions and divestitures, changes in capital structure, litigation expenses and settlements, and material legislative changes. The Committee believes these pre-approved categories help the metric to more accurately reflect items within management's control while also minimizing unintended incentives or disincentives associated with the accounting treatment for unbudgeted, discretionary transactions. For the performance period ended December 31, 2015, those items included: consolidation of Fairlawn hospital; acquisition of Quillen Rehabilitation Hospital, Encompass, Cardinal Hill Rehabilitation Hospital, Reliant, and CareSouth, and initiation of the Savannah Rehabilitation Hospital joint venture; impact from unbudgeted debt refinancing transactions; impact from our common stock repurchases; impact from unbudgeted settlements and professional fees for legal matters; and gains or recoveries from the Richard Scrushy verdict. The diluted share count is calculated on the same basis as the diluted shares outstanding in our 2015 Form 10-K and includes shares related to the potential conversion of our convertible senior subordinated notes as well as those associated with restricted stock awards, restricted stock units, and dilutive stock options. The diluted share count for 2015 was adjusted for the impact from our common stock repurchases as noted above. The calculation of normalized earnings per share differs from that of earnings per share used in our earnings releases and publicly available financial guidance. We believe the calculation for compensation purposes for 2015 more accurately represents those matters within the control of management compared to the calculation used in communications with the market.

[4] For purposes of the 2015 LTIP, ROIC is defined as adjusted earnings divided by average total assets on the balance sheet as of December 31, 2014, 2015, and 2016, excluding deferred tax assets and assets from discontinued operations. Both the numerator and the denominator are adjusted for the applicable unusual or nonrecurring unbudgeted items as described in the note above. Adjusted earnings is defined as income from continuing operations attributable to HealthSouth common shareholders before interest expense, excluding government, class action and related settlements, professional fees - accounting, tax, and legal and loss on early extinguishment of debt and adjusted by normalized income tax expense.

[5] For purposes of the 2015 LTIP, relative TSR is calculated by dividing the sum of the change in share price over the two-year period and the per share amount of dividends paid, if any, by the beginning share price for the measurement period. In each case, the share price used is the average for the 60-day period preceding the measurement date.

For 2015, the Committee approved the TSR Peer Group. This group was derived by filtering the healthcare providers of the Russell 3000 index to exclude: insurance, medical device, supply chain, veterinary care and pharmaceutical companies resulting in the following 25 companies:

TSR Peer Group

Acadia Healthcare Company	Envision Healthcare	Quest Diagnostics
Almost Family	Gentiva Health Services	Select Medical Holdings
Amedisys	HCA	Skilled Healthcare Group
Amsurg	IPC-The Hospitalist Company	Team Health
Brookdale Senior Living	Kindred Healthcare	Tenet Healthcare Corporation
Capital Senior Living	Laboratory Corp of America	The Ensign Group
Chemed Corporation	LHC Group	Universal Health Services
Community Health Systems	LifePoint Hospitals	
DaVita HealthCare Partners	MEDNAX	

Summary of 2014 PSU Award Results

The 2014 PSU awards completed their performance period on December 31, 2015. EPS, ROIC, and TSR were the objectives with the following achievement levels:

Objective	Target	Actual Result	% of Target Metric Achievement	Weight	Weighted Metric Achievement
EPS	$4.23	$3.93	85.8%	50%	42.9%
ROIC	14.8%	14.3%	75.0%	30%	22.5%
TSR	50th Percentile	27th Percentile	0.0%	20%	0.0%
Combined				100%	65.4%

Time-Based Restricted Stock Awards in 2015

A portion of the 2015 award value was provided in RSAs to provide retention incentives to our executives and facilitate stock ownership, which further links executives to our stockholders. Under our equity incentive plan, NEOs may be granted RSAs which entitle them to receive a pre-determined number of restricted shares upon completion of a specified service period. The recipients of RSA awards have voting rights and rights to receive dividends. Dividends accrue when paid on outstanding shares, but the holders of RSAs will not receive the cash payments related to these accrued dividends until the resulting common shares fully vest.

For the 2015 RSA award, one-third of the shares awarded vest on the first anniversary of the award, one-third of the shares vest on the second anniversary of the award, and the final third vest on the third anniversary.

Stock Option Awards in 2015

We believe nonqualified stock options remain an appropriate means to align the interests of our most senior executives with our stockholders since they provide an incentive to grow stock price.

Each stock option permits the holder, for a period of ten years, to purchase one share of our common stock at the exercise price, which is the closing market price on the date of issuance. Options generally vest ratably in equal annual increments over three years from the award date. In 2015, the number of options awarded equaled 20% of the total target equity award opportunity approved for the related officer divided by the individual option value determined using the Black-Scholes valuation model.

Equity Award Timing

Our practice is to have the independent members on our board of directors approve, based on recommendations of the Committee, equity awards at the February board meeting which allows time to review and consider our prior year's performance. The number of shares of common stock underlying the PSU, RSA, and stock option awards is determined using the average closing price for our common stock over the 20-day trading period preceding the February board meeting at which the awards are approved. The strike price for the stock option awards is set at the closing price on the second trading day after the filing of our Form 10-K, which is also the date of issuance. This timing for the pricing and issuance of stock options allows for the exercise price to reflect a broad dissemination of our financial results from the prior year.

Executive Compensation Program Changes for 2016

The target TDC opportunity for Mr. Grinney is unchanged for 2016. Effective February 28, Mr. Tarr's and Mr. Coltharp's annual base salaries were increased to $650,000 and $580,000 respectively. The target cash incentive opportunities as a percent of salary for Mr. Tarr, Mr. Coltharp, and Ms. Levy were increased to 85%, 80% and 60%, respectively. The total target equity award opportunity for Ms. Levy was increased to 125% of her annual base salary. These adjustments were approved in light of the following considerations: Mercer market analysis, expansion of the business, additional responsibilities, job performance, tenure, experience and internal equity/differentiation.

For the SMBP Corporate Quantitative Objectives, a "Quality Scorecard" concept was introduced to focus on quality metrics with applicability both inside and outside the traditional inpatient rehabilitation portion of our business. This concept allows us to compartmentalize quality metrics while permitting flexibility to adjust the metrics year-over-year as our business and the healthcare operating environment evolve. For 2016, the metrics within the Quality Scorecard are: Discharge to Community, Acute Transfer, Discharge to Skilled Nursing Facility, and Patient Satisfaction. As a consequence of this renewed quality emphasis, the rebalanced Corporate Quantitative Objectives weights are:

Senior Management Bonus Plan
Corporate Quantitative Objective Weighting Changes

2015		2016	
Corporate Objective	**Weight**	**Corporate Objective**	**Weight**
Adjusted EBITDA	80%	Adjusted EBITDA	70%
PEM Score Ranking	20%	Quality Scorecard	30%

For the LTIP, the number of performance metrics was reduced to two with the elimination of the TSR component to focus the executive team on factors emphasized by our investors which the team can directly impact. The ultimate goal of such change is to improve the shareholder experience. The revised metric weightings are:

2016 LTIP Objectives

Objective	Weight
Normalized Earnings Per Share ("EPS")	60%
Return on Invested Capital ("ROIC")	40%

Benefits

In 2015, our NEOs were eligible for the same benefits offered to other employees, including medical and dental coverage. In addition, our executives are offered annual physicals on a voluntary basis. NEOs are also eligible to participate in our qualified 401(k) plan, subject to the limits on contributions imposed by the Internal Revenue Service. In order to allow deferrals above the amounts provided by the IRS, executives and certain other officers are eligible to participate in a nonqualified deferred 401(k) plan that mirrors the current qualified 401(k) plan. Other than the nonqualified deferred 401(k) plan referenced here, we did not provide our executives with compensation in the form of a pension plan or a retirement plan. Mr. Grinney receives long-term disability coverage above the level offered broadly to our employees.

Perquisite Practices

We do not have any perquisite plans or policies in place for our executive officers. In general, we do not believe such personal benefit plans are necessary for us to attract and retain executive talent. We do not provide tax payment reimbursements, gross ups, or any other tax payments to any of our executive officers. We pay premiums for group-term life insurance and long-term disability insurance for all employees. From time to time, officers and directors may be allowed, if space permits, to have family members accompany them on business flights on our aircraft, at no material incremental cost to us.

OTHER COMPENSATION POLICIES & PRACTICES

Equity Ownership Guidelines for Management and Non-Employee Directors

To further align the interests of our management with those of our stockholders, we have adopted equity ownership guidelines for senior management and members of our board of directors.

Covered individuals have five years to reach their ownership level and upon each tax recognition or option exercise event, a covered officer must hold at least 50% of the after-tax value of the related equity award until ownership levels are achieved. Equity grants to our non-employee directors must be held until the director leaves the board. All of our NEOs and non-employee directors have satisfied the guidelines. Outlined in the table below are the ownership guidelines:

Position	Required Value of Equity Owned
chief executive officer	5 times annual base salary
executive vice president	3 times annual base salary
other executive officers	1.5 times annual base salary
outside director	$300,000

Compensation Recoupment Policy

Our board of directors has approved and adopted a senior management compensation recoupment policy applicable to awards granted and incentive compensation paid after January 1, 2010. The policy provides that if the board has, in its sole discretion, determined that any fraud, illegal conduct, intentional misconduct, or gross neglect by any officer was a significant contributing factor to our having to restate all or a portion of our financial statements, the board may:

- require reimbursement of any incentive compensation paid to that officer,
- cause the cancellation of that officer's restricted or deferred stock awards and outstanding stock options, and
- require reimbursement of any gains realized on the exercise of stock options attributable to incentive awards,

if and to the extent (i) the amount of that compensation was calculated based upon the achievement of the financial results that were subsequently reduced due to that restatement and (ii) the amount of the compensation that would have been awarded to that officer had the financial results been properly reported would have been lower than the amount actually awarded.

Additionally, if an officer is found to have committed fraud or engaged in intentional misconduct in the performance of his or her duties, as determined by a final, non-appealable judgment of a court of competent jurisdiction, and the board determines the action caused substantial harm to HealthSouth, the board may, in its sole discretion, utilize the remedies described above.

Anti-Hedging Policy

The Company prohibits the following transactions for executive officers and directors:

- short-term trading of our securities,
- short sales of our securities,
- transactions in publicly traded derivatives relating to our securities,
- hedging or monetization transactions, such as zero-cost collars and forward sale contracts, and
- pledging of our securities as collateral, including as part of a margin account.

Severance Arrangements

It is not our practice to enter into individual employment agreements with our senior executives. In connection with the acquisition of Encompass Home Health on December 31, 2014, we did enter into an employment agreement with April Anthony who, as Chief Executive Officer and President of Encompass, is one of our executives. To provide our senior executives with competitive levels of security, potential benefits are provided to our senior executives under

our change of control and severance plans. The Committee determined the value of benefits were reasonable, appropriate, and competitive with our healthcare provider peer group. As a condition to receipt of any payment or benefits under either plan, participating employees must enter into a nonsolicitation, nondisclosure, nondisparagement and release agreement. As a matter of policy, payments under either plan do not include "gross ups" for federal taxes payable on amounts paid. Definitions of "cause," "retirement," "change in control," and "good reason" are provided on page 56.

Executive Severance Plan

The goal of the Executive Severance Plan is to help retain qualified, senior officers whose employment is subject to termination under circumstances beyond their control. Our NEOs and all senior vice presidents are participants in the plan, which is an exhibit to our 2015 Form 10-K. Under the plan, if a participant's employment is terminated by the participant for good reason or by HealthSouth other than for cause (as defined in the plan), then the participant is entitled to receive a cash severance payment, health benefits, and the other benefits described below. Voluntary retirement, death, and disability are not payment triggering events. The terms of the plan, including the payment triggering events, were determined by the Committee to be consistent with healthcare industry market data from the Committee's and management's consultants.

The cash severance payment for participants is the multiple (shown in the table below) of annual base salary in effect at the time of the event plus any accrued, but unused, paid time off, and accrued, but unpaid, salary. This amount is to be paid in a lump sum within 60 days following the participant's termination date. In addition, except in the event of termination for cause or resignation for lack of good reason, the participants and their dependents continue to be covered by all life, healthcare, medical and dental insurance plans and programs, excluding disability, for a period of time set forth in the following table.

Position	Severance as Multiple of Annual Base Salary	Benefit Plan Continuation Period
chief executive officer	3x	36 months
executive vice presidents	2x	24 months
other executive officers	1x	12 months

Amounts paid under the plan are in lieu of, and not in addition to, any other severance or termination payments under any other plan or agreement with HealthSouth. As a condition to receipt of any payment under the plan, the participant must waive any entitlement to any other severance or termination payment by us, including any severance or termination payment set forth in any employment arrangement with us.

Upon termination of a participant without cause, or his or her resignation for good reason, a prorated portion of any equity award subject to time-based vesting only that is unvested as of the effective date of the termination or resignation will automatically vest. If any restricted stock awards are performance-based, the Committee will determine the extent to which the performance goals for such restricted stock have been met and what awards have been earned.

Change in Control Benefits Plan

The goal of the Change in Control Benefits Plan is to help retain certain qualified senior officers, maintain a stable work environment, and encourage officers to act in the best interest of stockholders if presented with decisions regarding change in control transactions. Our NEOs and other officers are participants in the plan, which is an exhibit to our 2015 Form 10-K. The terms of the plan, including the definition of a change in control event, were reviewed and updated in December 2014 to be consistent with healthcare industry market data from the Committee's and management's consultants including the adoption of a "double trigger" for the vesting of equity in the event of a change in control for all future awards to executives.

Under the Change in Control Benefits Plan, participants are divided into tiers as designated by the Committee. Messrs. Grinney and our executive vice presidents are Tier 1 participants; Ms. Levy is a Tier 2 participant.

If a participant's employment is terminated within 24 months following a change in control or during a potential change in control, either by the participant for good reason (as defined in the plan) or by HealthSouth without cause, then the participant shall receive a lump sum severance payment. Voluntary retirement is not a payment triggering event. For Tier 1 and 2 participants, the lump sum severance is 2.99 times and two times, respectively, the sum of the highest base salary in the prior three years and the average of actual annual incentives for the prior three years for the participant, plus a prorated annual incentive award for any incomplete performance period. In addition, except in the event of termination

for cause or resignation for lack of good reason, the participant and the participant's dependents continue to be covered by all life, healthcare, medical and dental insurance plans and programs, excluding disability, for a period of 36 months for Tier 1 participants and 24 months for Tier 2 participants.

Incorporating the vesting "double trigger" included in the plan changes from December 2014 referenced above, if a change in control occurs as defined in the plan, outstanding equity awards vest as follows:

Award Date	Stock Options	Restricted Stock
On or Prior to December 31, 2014	Outstanding options vest and, for Tier 1 and 2 participants, all options will remain exercisable for three and two years, respectively.	Restricted stock vests upon change in control.
After December 31, 2014	Outstanding options will only vest if the participant is terminated for good reason or without cause within 24 months of a change in control or if not assumed or substituted and, for Tier 1 and 2 participants, all options will remain exercisable for three and two years, respectively.	Restricted stock will only vest if the participant is terminated for good reason or without cause within 24 months of a change in control or if not assumed or substituted.

Note: For performance-based restricted stock, the Committee will determine the extent to which the performance goals have been met and vesting of the resulting restricted stock will only accelerate as provided above.

With respect to awards issued in and after 2015, the Committee has the authority to cancel an award in exchange for a cash payment in an amount equal to the excess of the fair market value of the same number of shares of the common stock subject to the award immediately prior to the change in control over the aggregate exercise or base price (if any) of the award.

Tax Implications of Executive Compensation

Section 162(m) of the Internal Revenue Code of 1986, as amended, generally limits the tax deductibility of compensation paid to certain highly compensated executive officers in excess of $1 million in the year the compensation otherwise would be deductible by the Company. There is an exception to the limit on deductibility for performance-based compensation that meets certain requirements. The Committee considers the impact of this rule when developing and implementing our executive compensation program in light of the overall compensation philosophy and objectives. The Committee seeks to balance the tax, accounting, EPS, and dilutive impact of executive compensation practices with the need to attract, retain, and motivate highly qualified executives. Although the Committee does design certain components of its executive compensation program to seek full deductibility, the Committee believes the interests of stockholders are best served by not restricting the Committee's discretion and flexibility in crafting compensation programs, even though such programs may result in certain nondeductible compensation expenses. Accordingly, we have not adopted a policy that all compensation must qualify as deductible under Section 162(m) of the Code. Amounts paid under any of our compensation programs, including salaries, bonuses, and awards of options, restricted stock, and other equity-based compensation, may not qualify as performance-based compensation that is excluded from the limitation on deductibility. For example, a portion of our time-based restricted stock awards will likely not be deductible as they vest as a result of the $1 million deduction limit.

Summary Compensation Table

The table below shows the compensation of our 2015 named executive officers for services in all capacities in 2015, 2014, and 2013. For a discussion of the various elements of compensation and the related compensation decisions and policies, including the amount of salary and bonus in proportion to total compensation and the material terms of awards reported below, see "Compensation Discussion and Analysis" beginning on page 33. The Company had no employment agreements or compensation arrangements in effect with its NEOs in 2015, and there are no additional material terms, if any, of each NEO's employment arrangement, except as discussed under "Severance Arrangements" beginning on page 48.

Name and Principal Position	Year	Salary ($)	Stock Awards ($)[1]	Option Awards ($)[2]	Non-Equity Incentive Plan Compensation ($)[3]	All Other Compensation ($)[4]	Total ($)
Jay Grinney	2015	1,000,000	4,666,531	1,074,326	808,000	267,277	7,816,134
President and Chief Executive Officer	2014	1,000,000	4,154,566	999,726	870,000	375,793	7,400,085
	2013	1,000,000	3,853,692	1,034,363	1,284,800	182,542	7,355,397
Douglas E. Coltharp	2015	525,000	668,156	153,825	357,525	56,947	1,761,453
Executive Vice President and Chief Financial Officer	2014	525,000	654,382	157,448	346,500	85,555	1,768,885
	2013	525,000	606,967	162,917	417,312	45,182	1,757,378
Mark J. Tarr	2015	625,000	1,060,629	244,162	454,000	73,434	2,457,225
Executive Vice President and Chief Operating Officer	2014	620,833	997,120	239,931	435,000	97,751	2,390,635
	2013	600,000	693,679	186,183	469,728	53,776	2,003,366
John P. Whittington	2015	527,000	670,778	154,414	255,490	50,011	1,657,693
Executive Vice President, General Counsel and Secretary	2014	527,000	656,833	158,053	278,256	67,714	1,687,856
	2013	527,000	609,265	163,531	409,416	42,524	1,751,736
Cheryl B. Levy	2015	345,000	362,771	—	161,633	25,834	895,238
Chief Human Resources Officer	2014	345,000	358,168	—	153,353	33,715	890,236
	2013	345,000	332,194	—	218,938	17,942	914,074

(1) The stock awards for each year were PSUs and the corresponding amounts shown in this column are the grant date fair values computed in accordance with Accounting Standards Codification Topic 718, *Compensation - Stock Compensation*, assuming the most probable outcome of the performance conditions as of the grant dates (i.e., target performance). The award amounts shown also include the value of RSA grants as part of the long-term incentive plan for the given year. All of the values in this column are consistent with the estimate of aggregate compensation expense to be recognized over the applicable vesting period, excluding any adjustment for forfeitures. The assumptions used in the valuations are discussed in Note 13, *Share-Based Payments*, to the consolidated financial statements in our 2015 Form 10-K.

The values of the PSU awards at the varying performance levels for our current NEOs are set forth in the table below.

Name	Year	Threshold Performance Value ($)	Target Performance Value ($)	Maximum Performance Value ($)
Jay Grinney	2015	1,775,057	3,550,113	7,100,226
	2014	1,559,398	3,118,795	6,237,590
	2013	1,446,517	2,893,033	5,786,066
Douglas E. Coltharp	2015	254,161	508,321	1,016,642
	2014	245,615	491,230	982,460
	2013	227,827	455,654	911,308
Mark J. Tarr	2015	403,444	806,888	1,613,776
	2014	374,273	748,545	1,497,090
	2013	260,375	520,750	1,041,500
John P. Whittington	2015	255,158	510,315	1,020,630
	2014	246,544	493,087	989,174
	2013	228,696	457,391	914,782
Cheryl B. Levy	2015	111,349	222,697	445,394
	2014	107,612	215,224	430,448
	2013	99,811	199,621	399,242

(2) The values of option awards listed in this column are the grant date fair values computed in accordance with ASC 718 as of the grant date. All of the values in this column are consistent with the estimate of aggregate compensation expense to be recognized over the three-year vesting period, excluding any adjustment for forfeitures. The assumptions used in the valuations are discussed in Note 13, *Share-Based Payments*, to the consolidated financial statements in our 2015 Form 10-K.

(3) The amounts shown in this column are bonuses earned under our Senior Management Bonus Plan in the corresponding year but paid in February of the following year.

(4) The items reported in this column for 2015 are described as set forth below. The amounts reflected in the "Dividend Rights" column are the aggregate values of dividends associated with outstanding restricted stock and PSU awards granted prior to February 2014. Because we only initiated a quarterly dividend on our common stock in October 2013, dividend rights were not factored into the grant date fair values for awards granted prior to February 2014. Similarly, the grant date fair values for awards granted prior to the increases in the dividend rate to $0.21 per share in October 2014 and to $0.23 in October 2015 may not have factored in those incremental dividend rights, so the aggregate amount of dividend rights equivalent to those incremental increases is also included in this column.

Cash dividends paid on our common stock in 2015 were, for pre-2014 awards, likewise paid in cash to holders of restricted stock but only accrued to holders of PSU awards. These accrued dividends are only paid if, and to the extent that, shares are earned as result of the PSUs' performance attainment and are not forfeited prior to full vesting. Beginning with awards granted in February 2014, both RSA and PSU awards accrue rights to cash dividends that are only paid if the awards are not forfeited prior to full vesting. The dividend rights paid on or accruing to our equity awards are equivalent in value to the rights of common stockholders generally and are not preferential.

Name	Qualified 401(k) Match ($)	Nonqualified 401(k) Match ($)	Dividend Rights ($)	Long-Term Disability Insurance ($)
Jay Grinney	—	56,100	155,722	55,455
Douglas E. Coltharp	9,000	17,145	30,802	—
Mark J. Tarr	—	31,800	41,634	—
John P. Whittington	9,000	15,158	25,853	—
Cheryl B. Levy	6,878	5,374	13,581	—

For SEC purposes, the cost of personal use of the Company aircraft, if any, is calculated based on the incremental cost to us. To determine the incremental cost, we calculate the variable costs based on usage which include fuel costs on a per hour basis, plus any direct trip expenses such as on-board catering, landing/ramp fees, crew hotel and meal expenses, and other miscellaneous variable costs. Since Company-owned aircraft are used exclusively for business travel, the calculation method excludes the costs which do not change based on incremental non-business usage, such as pilots' salaries, aircraft leasing expenses and the cost of maintenance not related specifically to trips.

Occasionally, our executives are accompanied by guests on the corporate aircraft for personal reasons when there is available space on a flight being made for business reasons. There is no incremental cost associated with that use of the aircraft, except for a pro rata portion of catering expenses and our portion of employment taxes attributable to the income imputed to that executive for tax purposes. There were no such amounts required to be reported for 2015.

Grants of Plan-Based Awards During 2015

Name	Grant Date	Date of Board Approval of Grant	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards[4]			Estimated Future Payouts Under Equity Incentive Plan Awards[2]			All Other Stock Awards: Number of Shares of Stock or Unit[6] (#)	All Other Option Awards: Number of Securities Underlying Options[7] (#)	Exercise or Base Price of Option Awards ($/SH)	Grant Date Fair Value of Stock and Option Awards ($)
			Threshold[3] ($)	Target[4] ($)	Maximum[5] ($)	Threshold (#)	Target (#)	Maximum (#)				
Jay Grinney												
Annual Incentive			400,000	1,000,000	2,000,000	—	—	—	—	—	—	—
PSU	2/19/2015	2/19/2015	—	—	—	37,288	74,576	149,152	—	—	—	3,550,113
Stock options	3/3/2015	2/19/2015	—	—	—	—	—	—	—	71,105	43.14	1,074,326
RSA	2/19/2015	2/19/2015	—	—	—	—	—	—	24,859	—	—	1,116,418
Douglas E. Coltharp												
Annual Incentive			157,500	393,750	787,500	—	—	—	—	—	—	—
PSU	2/19/2015	2/19/2015	—	—	—	5,339	10,678	21,356	—	—	—	508,321
Stock options	3/3/2015	2/19/2015	—	—	—	—	—	—	—	10,181	43.14	153,825
RSA	2/19/2015	2/19/2015	—	—	—	—	—	—	3,559	—	—	159,835
Mark J. Tarr												
Annual Incentive			200,000	500,000	1,000,000	—	—	—	—	—	—	—
PSU	2/19/2015	2/19/2015	—	—	—	8,475	16,950	33,900	—	—	—	806,888
Stock options	3/3/2015	2/19/2015	—	—	—	—	—	—	—	16,160	43.14	244,162
RSA	2/19/2015	2/19/2015	—	—	—	—	—	—	5,650	—	—	253,742
John P. Whittington												
Annual Incentive			126,480	316,200	632,400	—	—	—	—	—	—	—
PSU	2/19/2015	2/19/2015	—	—	—	5,360	10,720	21,440	—	—	—	510,315
Stock options	3/3/2015	2/19/2015	—	—	—	—	—	—	—	10,220	43.14	154,414
RSA	2/19/2015	2/19/2015	—	—	—	—	—	—	3,573	—	—	160,463
Cheryl B. Levy												
Annual Incentive			60,375	172,500	345,000	—	—	—	—	—	—	—
PSU	2/19/2015	2/19/2015	—	—	—	2,339	4,678	9,356	—	—	—	222,697
RSA	2/19/2015	2/19/2015	—	—	—	—	—	—	3,119	—	—	140,074

Footnotes found on next page.

(1) The possible payments described in the three columns above are cash amounts provided for by our 2015 Senior Management Bonus Plan as discussed under "Annual Incentives" beginning on page 41. Final payments under the 2015 program were calculated and paid in February 2016 and are reflected in the Summary Compensation Table under the heading "Non-Equity Incentive Plan Compensation."

(2) Awards which are designated as PSU above are performance share units granted under our 2008 Equity Incentive Plan. As described in "Performance Share Unit Awards in 2015" beginning on page 45, these awards vest and shares are earned based upon the level of attainment of performance objectives for the two-year period from January 1, 2015 ending December 31, 2016 and a one-year time-vesting requirement ending December 31, 2017. Each of the threshold, target and maximum share numbers reported in the three columns assume the three performance objectives are each achieved at that respective level. Upon a change in control, the Compensation Committee will determine the extent to which the performance goals for PSUs have been met and what awards have been earned. The PSUs, and resulting restricted stock, accrue ordinary dividends during the service period, to the extent paid on our common stock, but the holders will not receive the cash payments related to these accrued dividends until the restricted stock resulting from performance attainment fully vests. The Compensation Committee will determine whether the restricted stock will be entitled to any extraordinary dividends, if any are declared and paid.

(3) The threshold amounts in this column assume: (i) the Company reached only threshold achievement on each of the quantitative objectives and (ii) none of the individual objectives were achieved, resulting in payment of the minimum quantitative portion of the bonus. Thus, we would apply the NEO's corporate quantitative objectives percentage (which, for Mr. Grinney as an example, would be 80%) to the target bonus dollar amount. Then, following the procedures discussed under "Assessing and Rewarding 2015 Achievement of Objectives" beginning on page 43, we would multiply this amount by 50% (the threshold payout multiple) to arrive at the amount payable for threshold achievement of the quantitative objectives. No amount would be payable from the amount allocated to achievement of individual objectives.

(4) The target payment amounts in this column assume: (i) the Company achieved exactly 100% of each of the quantitative objectives and (ii) all of the individual objectives were achieved. The target amount payable for each NEO is his or her base salary multiplied by the target cash incentive opportunity percentage set out in the table under "Establishing the Target Cash Incentive Opportunity" on page 42.

(5) The maximum payment amounts in this column assume: (i) the Company achieved at or above the maximum achievement level of each of the quantitative objectives and (ii) the individual achieved 200% of target on individual objectives based on superior performance in connection with significant additional responsibilities in his or her position not contemplated at the beginning of the year, unplanned development transactions, or major unforeseen special projects. Thus, following the procedures discussed under "Assessing and Rewarding 2015 Achievement of Objectives" on page 43, we would multiply the target amount by 200% (the maximum payout multiple) to arrive at the amount payable for maximum achievement.

(6) Awards which are designated as RSA in the first column of this table are time-vesting restricted stock awards granted under our 2008 Equity Incentive Plan that is described on page 60. For these awards, the number of shares of restricted stock set forth will vest in three equal annual installments beginning on the first anniversary of grant, provided that the officer is still employed; a change in control of the Company will also cause these awards to immediately vest in full. This restricted stock accrues ordinary dividends to the extent paid on our common stock, but the holders will not receive the cash payments related to these accrued dividends until the restricted stock fully vests. The Compensation Committee will determine whether the restricted stock will be entitled to any extraordinary dividends, if any are declared and paid.

(7) All stock option grants in 2015 were made under our 2008 Equity Incentive Plan that is described on page 60. These option awards will vest, subject to the officer's continued employment, in three equal annual installments beginning on the first anniversary of grant; a change in control of the Company will also cause these options to immediately vest in full.

Potential Payments upon Termination of Employment

The following table describes the potential payments and benefits under the Company's compensation and benefit plans and arrangements to which the named executive officers currently employed with us would be entitled upon termination of employment by us for "cause" or without "cause" or by the executive for "good reason" or "retirement," as those terms are defined below. As previously discussed, our Change in Control Benefits Plan does not provide cash benefits unless there is an associated termination of employment. Due to the numerous factors involved in estimating these amounts, the actual value of benefits and amounts to be paid can only be determined upon termination of employment. In the event an NEO breaches or violates the restrictive covenants contained in the awards under our 2008 Equity Incentive Plan, the Executive Severance Plan, or the Changes in Control Benefits Plan, certain of the amounts described below may be subject to forfeiture and/or repayment.

For additional discussion of the material terms and conditions, including payment triggers, see "Severance Arrangements" beginning on page 48. An executive cannot receive termination benefits under more than one of the plans or arrangements identified below. Retirement benefits are governed by the terms of the awards under our 2008 Equity Incentive Plan. The following table assumes the listed triggering events occur on December 31, 2015.

Name/Triggering Event	Lump Sum Payments ($)[1]	Continuation of Insurance Benefits ($)	Accelerated Vesting of Equity Awards ($)[2]	Total Termination Benefits ($)
Jay Grinney				
Executive Severance Plan				
Without Cause/For Good Reason	3,000,000	24,350	9,419,027	12,443,377
Disability or Death	—	—	13,107,784	13,107,784
For Cause	—	—	—	—
Change in Control Benefits Plan	7,238,493	24,350	13,260,346	20,523,189
Retirement	—	—	12,172,165	12,172,165
Douglas E. Coltharp				
Executive Severance Plan				
Without Cause/For Good Reason	1,050,000	26,782	1,467,735	2,544,517
Disability or Death	—	—	2,014,992	2,014,992
For Cause	—	—	—	—
Change in Control Benefits Plan	2,622,768	40,173	2,039,020	4,701,961
Retirement	N/A	N/A	N/A	N/A
Mark J. Tarr				
Executive Severance Plan				
Without Cause/For Good Reason	1,250,000	15,222	1,911,551	3,176,773
Disability or Death	—	—	2,767,477	2,767,477
For Cause	—	—	—	—
Change in Control Benefits Plan	3,696,356	22,833	2,800,744	6,519,933
Retirement	N/A	N/A	N/A	N/A
John P. Whittington				
Executive Severance Plan				
Without Cause/For Good Reason	1,054,000	16,233	1,473,316	2,543,549
Disability or Death	—	—	2,022,686	2,022,686
For Cause	—	—	—	—
Change in Control Benefits Plan	2,927,928	24,350	2,046,805	4,999,083
Retirement	—	—	1,462,320	1,462,320
Cheryl B. Levy				
Executive Severance Plan				
Without Cause/For Good Reason	345,000	7,990	692,352	1,045,342
Disability or Death	—	—	997,550	997,550
For Cause	—	—	—	—
Change in Control Benefits Plan	1,243,093	15,980	997,550	2,256,623
Retirement	N/A	N/A	N/A	N/A

(1) The Company automatically reduces payments under the Change in Control Benefits Plan to the extent necessary to prevent such payments being subject to "golden parachute" excise tax under Section 280G and Section 4999 of the Internal Revenue Code, but only to the extent the after-tax benefit of the reduced payments exceeds the after-tax benefit if such reduction were not made ("best payment method"). The lump sum payments shown reflect the application of this best payment method.

(2) The amounts reported in this column reflect outstanding equity awards, the grant date value of which along with accrued dividends and dividend equivalents has been reported as compensation in 2015 or prior years. The value of the accelerated vesting of equity awards listed in this column has been determined based on the $34.81 closing price of our common stock on December 31, 2015. The Committee may, in its discretion, provide that upon a change in control: (x) equity awards be canceled in exchange for a payment in an amount equal to the fair market value of our stock immediately prior to the change in control over the exercise or base price (if any) per share of the award, and (y) each award be canceled without payment therefore if the fair market value of our stock is less than the exercise or purchase price (if any) of the award.

The amounts shown in the preceding table do not include payments and benefits to the extent they are provided on a nondiscriminatory basis to salaried employees generally upon termination of employment. The "Lump Sum Payments" column in the above table includes the estimated payments provided for under the Executive Severance Plan and the Change in Control Benefits Plan, which are described under "Severance Arrangements" beginning on page 48. Additionally, the Executive Severance Plan, the Change in Control Benefits Plan, and awards under the 2008 Equity Incentive Plan provide that as a condition to receipt of any payment or benefits all participants must enter into a nonsolicitation, noncompete, nondisclosure, nondisparagement and release agreement.

As of December 31, 2015, Messrs. Grinney and Whittington were the only named executive officers who qualified for retirement as defined below. However, the potential equity value accelerated upon retirement for the other NEOs, had they been retirement eligible on December 31, 2015, is outlined in the table below.

Named Executive Officer	Accelerated Vesting of Equity Awards Due to Retirement (Assuming Retirement Eligible)($)
Douglas E. Coltharp	1,456,798
Mark J. Tarr	1,897,117
Cheryl B. Levy	692,352

Definitions

"*Cause*" means, in general terms:

(i) evidence of fraud or similar offenses affecting the Company;

(ii) indictment for, conviction of, or plea of guilty or no contest to, any felony;

(iii) suspension or debarment from participation in any federal or state health care program;

(iv) an admission of liability, or finding, of a violation of any securities laws, excluding any that are noncriminal;

(v) a formal indication that the person is a target or the subject of any investigation or proceeding for a violation of any securities laws in connection with his employment by the Company, excluding any that are noncriminal; and

(vi) breach of any material provision of any employment agreement or other duties.

"*Change in Control*" means, in general terms:

(i) the acquisition of 30% or more of either the then-outstanding shares of common stock or the combined voting power of the Company's then-outstanding voting securities; or

(ii) the individuals who currently constitute the board of directors, or the "Incumbent Board," cease for any reason to constitute at least a majority of the board (any person becoming a director in the future whose election, or nomination for election, was approved by a vote of at least a majority of the directors then constituting the Incumbent Board shall be considered as though such person were a member of the Incumbent Board); or

(iii) a consummation of a reorganization, merger, consolidation or share exchange, where persons who were the stockholders of the Company immediately prior to such reorganization, merger, consolidation or share exchange do not own at least 50% of the combined voting power; or

(iv) a liquidation or dissolution of the Company or the sale of all or substantially all of its assets.

"*Good Reason*" means, in general terms:

(i) an assignment of a position that is of a lesser rank and that results in a material adverse change in reporting position, duties or responsibilities or title or elected or appointed offices as in effect immediately prior to the change, or in the case of a Change in Control ceasing to be an executive officer of a company with registered securities;

(ii) a material reduction in compensation from that in effect immediately prior to the Change in Control; or

(iii) any change in benefit level under a benefit plan if such change in status occurs during the period beginning 6 months prior to a Change in Control and ending 24 months after it; or

(iv) any change of more than 50 miles in the location of the principal place of employment.

"*Retirement*" means the voluntary termination of employment after attaining (a) age 65 or (b) in the event that person has been employed for 10 or more years on the date of termination, age 60.

Outstanding Equity Awards at December 31, 2015

	Option Awards[1]					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date[2]	Number of Shares or Units of Stock That Have Not Vested (#)[3]	Market Value of Shares or Units of Stock That Have Not Vested ($)[4]	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)[5]	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)[6]
Jay Grinney									
	150,000	—	—	26.55	2/23/2016	137,854	4,798,698	61,545	2,142,381
	130,000	—	—	23.19	3/2/2017	14,251	496,077	149,152	5,191,981
	170,540	—	—	16.27	2/28/2018	20,912	727,947	—	—
	184,490	—	—	7.85	2/27/2019	24,859	865,342	—	—
	58,810	—	—	14.95	9/2/2019	—	—	—	—
	149,982	—	—	17.30	2/26/2020	—	—	—	—
	129,510	—	—	24.21	2/28/2021	—	—	—	—
	165,089	—	—	21.02	2/27/2022	—	—	—	—
	62,893	31,447	—	24.17	2/21/2023	—	—	—	—
	29,215	58,428	—	31.97	2/24/2024	—	—	—	—
	—	71,105	—	43.14	3/3/2025	—	—	—	—
Douglas E. Coltharp									
	23,501	—	—	24.21	2/28/2021	21,713	755,830	9,695	337,483
	26,132	—	—	21.02	2/27/2022	2,245	78,148	21,356	743,402
	9,906	4,953	—	24.17	2/21/2023	3,294	114,664	—	—
	4,601	9,202	—	31.97	2/24/2024	3,559	123,889	—	—
	—	10,181	—	43.14	3/3/2025	—	—	—	—
Mark J. Tarr									
	12,000	—	—	26.55	2/23/2016	24,815	863,810	14,772	514,213
	20,000	—	—	23.19	3/2/2017	2,565	89,288	33,900	1,180,059
	45,250	—	—	16.27	2/28/2018	5,018	174,677	—	—
	33,100	—	—	7.85	2/27/2019	5,650	196,677	—	—
	10,550	—	—	14.95	9/2/2019	—	—	—	—
	33,331	—	—	17.30	2/26/2020	—	—	—	—
	23,501	—	—	24.21	2/28/2021	—	—	—	—
	26,132	—	—	21.02	2/27/2022	—	—	—	—
	11,321	5,660	—	24.17	2/21/2023	—	—	—	—
	7,012	14,022	—	31.97	2/24/2024	—	—	—	—
	—	16,160	—	43.14	3/3/2025	—	—	—	—

	Option Awards[1]					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date[2]	Number of Shares or Units of Stock That Have Not Vested (#)[3]	Market Value of Shares or Units of Stock That Have Not Vested ($)[4]	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)[5]	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)[6]
John P. Whittington									
	4,333	—	—	25.10	10/19/2016	21,796	758,719	9,731	338,736
	20,000	—	—	23.19	3/2/2017	2,253	78,427	21,440	746,326
	45,250	—	—	16.27	2/28/2018	3,306	115,082	—	—
	33,100	—	—	7.85	2/27/2019	3,573	124,376	—	—
	10,550	—	—	14.95	9/2/2019	—	—	—	—
	26,903	—	—	17.30	2/26/2020	—	—	—	—
	23,501	—	—	24.21	2/28/2021	—	—	—	—
	26,132	—	—	21.02	2/27/2022	—	—	—	—
	9,943	4,972	—	24.17	2/21/2023	—	—	—	—
	4,619	9,237	—	31.97	2/24/2024	—	—	—	—
	—	10,220	—	43.17	3/3/2025	—	—	—	—
Cheryl B. Levy									
	11,000	—	—	24.06	3/15/2017	9,513	331,148	4,247	147,838
	—	—	—	—	—	1,967	68,471	9,356	325,682
	—	—	—	—	—	2,886	100,462	—	—
	—	—	—	—	—	3,119	108,572	—	—

(1) All options shown above vest in three equal annual installments beginning on the first anniversary of the grant date. All per share amounts have been adjusted for the five-for-one reverse stock split that was effective on October 25, 2006.

(2) The expiration date of each option occurs 10 years after the grant date of each option.

(3) The first amount shown in this column is restricted stock awards resulting from the attainment of the related PSU awards' performance objectives during the 2013-2014 performance period. The second, third, and fourth amounts in this column represent the time-based restricted stock granted in 2013, 2014, and 2015 that vests in three equal annual installments beginning on the first anniversary of the grant date.

(4) The market value reported was calculated by multiplying the closing price of our common stock on December 31, 2015, $34.81, by the number of shares set forth in the preceding column.

(5) The PSU awards shown in this column are contingent upon the level of attainment of performance goals for the two-year period from January 1 of the year in which the grant is made. The determination of whether and to what extent the PSU awards are achieved will be made following the close of the two-year period. The first amount for each officer in this column represents the actual number of shares earned over the 2014-2015 performance period as officially determined by the board of directors in February 2016, which shares shall be restricted until January 2, 2017. The second amount for each officer in this column represents the number of shares to be earned assuming achievement of maximum performance during the 2015-2016 performance period on the normalized earnings per share, return on invested capital and relative total shareholder return objectives. The actual number of restricted shares earned at the end of the 2015-2016 performance period may be lower.

(6) The market value reported was calculated by multiplying the closing price of our common stock on December 31, 2015, $34.81, by the number of shares set forth in the preceding column.

Options Exercised and Stock Vested in 2015

The following table sets forth information concerning the exercise of options and the vesting of shares for our named executive officers in 2015.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting	Value Realized on Vesting ($)
Jay Grinney	130,000	1,878,279	216,768	8,614,193
Douglas E. Coltharp	*	—	49,323	2,016,491
Mark J. Tarr	18,029	366,047	65,507	2,722,432
John P. Whittington	*	—	37,338	1,495,046
Cheryl B. Levy	*	—	19,349	798,843

* Did not exercise any stock options in 2015.

Equity Compensation Plans

The following table sets forth, as of December 31, 2015, information concerning compensation plans under which our securities are authorized for issuance. The table does not reflect grants, awards, exercises, terminations, or expirations since that date. All share amounts and exercise prices have been adjusted to reflect stock splits that occurred after the date on which any particular underlying plan was adopted, to the extent applicable.

Equity Plans	Securities to be Issued Upon Exercise	Weighted Average Exercise Price[1]	Securities Available for Future Issuance
Approved by stockholders	3,435,785 [2]	$21.30	4,022,491 [3]
Not approved by stockholders	773,603 [4]	$21.49	—
Total	4,209,388		4,022,491

[1] This calculation does not take into account awards of restricted stock, restricted stock units, or performance share units.

[2] This amount assumes maximum performance by performance-based awards for which the performance has not yet been determined.

[3] This amount represents the number of shares available for future equity grants under the 2008 Equity Incentive Plan approved by our stockholders in May 2011. New grants will not be made after May 9, 2016 if the 2016 Omnibus Performance Incentive Plan is adopted by our stockholders and is effective.

[4] This amount includes 686,773 shares issuable upon exercise of stock options outstanding under the 2005 Equity Incentive Plan and 86,830 restricted stock units issued under the 2004 Amended and Restated Director Incentive Plan.

2004 Amended and Restated Director Incentive Plan

The 2004 Amended and Restated Director Incentive Plan, or the "2004 Plan," provided for the grant of common stock, awards of restricted common stock, and the right to receive awards of common stock, which we refer to as "restricted stock units," to our non-employee directors. The 2004 Plan expired in March 2008 and was replaced by the 2008 Equity Incentive Plan. Some awards remain outstanding. Awards granted under the 2004 Plan at the time of its termination will continue in effect in accordance with their terms. Awards of restricted stock units were fully vested when awarded and will be settled in shares of common stock on the earlier of the six-month anniversary of the date on which the director ceases to serve on the board of directors or certain change in control events. The restricted stock units generally cannot be transferred. Awards are generally protected against dilution upon the issuance of stock dividends and in the event of a stock split, recapitalization, or other major corporate restructuring.

2005 Equity Incentive Plan

The 2005 Equity Incentive Plan, or the "2005 Plan," provided for the grant of stock options, restricted stock, stock appreciation rights, deferred stock, and other stock-based awards to our directors, executives, and other key employees as determined by our board of directors or the Compensation Committee in accordance with the terms of the 2005 Plan and evidenced by an award agreement with each participant. The 2005 Plan expired in November 2008 and was replaced by the 2008 Equity Incentive Plan. Some option awards remain outstanding and are fully vested. Awards granted under the 2005 Plan at the time of its termination will continue in effect in accordance with their terms. The outstanding options have an exercise price not less than the fair market value of such shares of common stock on the date

of grant and an expiration date that is ten years after the grant date. Awards are generally protected against dilution upon the issuance of stock dividends and in the event of a stock split, recapitalization, or other major corporate restructuring.

2008 Equity Incentive Plan

Originally approved in May 2008 by our stockholders, the 2008 Equity Incentive Plan, or the "2008 Plan," provided for the grant of stock options, restricted stock, stock appreciation rights, deferred stock, other stock-based awards and cash-settled awards, including our senior management bonus plan awards, to our directors, executives and other key employees as determined by our board of directors or its Compensation Committee in accordance with the terms of the plan and evidenced by an award agreement with each participant. In May 2011, our stockholders approved the amendment and restatement of the 2008 Plan.

The 2008 Plan now has an expiration date of December 31, 2020, but we do not intend to grant any new awards under this plan if our stockholders approve the 2016 Omnibus Performance Incentive Plan and that plan is effective. Any awards outstanding under the 2008 Plan at the time of its termination will remain in effect in accordance with their terms. The aggregate number of shares of common stock available for issuance in connection with new awards under the 2008 Plan shown above is subject to equitable adjustment upon a change in capitalization of the Company or the occurrence of certain transactions affecting the common stock reserved for issuance under the plan. Any awards under the 2008 Plan must have a purchase price or an exercise price not less than the fair market value of such shares of common stock on the date of grant. Notwithstanding the foregoing, no option may be exercised and no shares of stock may be issuable pursuant to other awards under the 2008 Plan until we comply with our reporting and registration obligations under the federal securities laws, unless an exemption from registration is available with respect to such shares.

Deferred Compensation

Retirement Investment Plan

Effective January 1, 1990, we adopted the HealthSouth Retirement Investment Plan, or the "401(k) Plan," a retirement plan intended to qualify under Section 401(k) of the Internal Revenue Code. The 401(k) Plan is open to all of our full-time and part-time employees who are at least 21 years of age. Eligible employees may elect to participate in the 401(k) Plan as of the first day of employment.

Under the 401(k) Plan, participants may elect to defer up to 100% of their annual compensation (W-2 compensation excluding certain reimbursements, stock awards, and perquisites), subject to nondiscrimination rules under the Code. The deferred amounts may be invested among various investment vehicles, which do not include our common stock, managed by unrelated third parties. We will match 50% of the amount deferred by each participant, up to 6% of such participant's total compensation (subject to nondiscrimination rules under the Code), with the matched amount also directed by the participant. Participants are fully vested in their compensation deferrals. Matching contributions become fully vested after the completion of three years of service.

Generally, amounts contributed to the 401(k) Plan will be paid on a termination of employment, although in-service withdrawals may be made upon the occurrence of a hardship or the attainment of age 59.5. Distributions will be made in the form of a lump sum cash payment unless the participant is eligible for and elects a direct rollover to an eligible retirement plan.

Nonqualified Deferred Compensation Plan

We adopted a nonqualified deferred compensation plan, the HealthSouth Corporation Nonqualified 401(k) Plan, or the "NQ Plan," in 2008 in order to allow deferrals above what is limited by the IRS. All of our named executive officers are eligible to participate in the NQ Plan, the provisions of which follow the 401(k) Plan.

Our NEOs and other eligible employees may elect to defer from 1% to 100% of compensation (W-2 compensation excluding certain reimbursements, stock awards, and perquisites) to the NQ Plan. We will make an employer matching contribution to the NQ Plan equal to 50% of the participant's deferral contributions, up to 6% of such participant's total compensation, less any employer matching contributions made on the participant's behalf to the 401(k) Plan. In addition, we may elect to make a discretionary contribution to the NQ Plan with respect to any participant. We did not elect to make any discretionary contributions to the NQ Plan for 2015. All deferral contributions made to the NQ

Plan are fully vested when made and are credited to a separate bookkeeping account on behalf of each participant. Employer matching contributions vest once the participant has completed three years of service.

Deferral contributions will generally be distributed, as directed by the participant, upon either a termination of service or the occurrence of a specified date. Matching and discretionary contributions are distributed upon termination of service. Distributions may also be elected by a participant in the event of an unforeseen emergency in which case participation in the NQ Plan will be suspended. Distributions will be made in cash in the form of a lump sum payment or annual installments over a two to fifteen year period, as elected by the participant. Any amounts that are payable from the NQ Plan upon a termination of employment are subject to the six month delay applicable to specified employees under section 409A of the Code.

Participants may request, on a daily basis, to have amounts credited to their NQ Plan accounts track the rate of return based on one or more benchmark mutual funds, which are substantially the same funds as those offered under our 401(k) Plan.

The following table sets forth information as of December 31, 2015 with respect to the NQ Plan.

Name	Executive Contributions in Last Fiscal Year ($)[1]	Registrant Contributions in Last Fiscal Year ($)[2]	Aggregate Earnings in Last Fiscal Year ($)[3]		Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last Fiscal Year-End ($)[4]
Jay Grinney	112,200	56,100	(21,162)	[5]	—	1,484,170
Douglas E. Coltharp	130,725	17,145	(8,117)	[6]	—	522,923
Mark J. Tarr	106,000	31,800	41,962	[7]	—	850,327
John P. Whittington	136,893	15,158	(2,389)	[8]	—	1,665,071
Cheryl B. Levy	13,800	5,374	21	[9]	—	120,865

(1) All amounts in this column are included in the 2015 amounts represented as "Salary" and "Non-Equity Incentive Plan Compensation," except $52,200 for Mr. Grinney, $51,975 for Mr. Coltharp, $43,500 for Mr. Tarr, and $47,304 for Mr. Whittington included in the 2014 amounts, in the Summary Compensation Table.

(2) All amounts in this column are included in the 2015 amounts represented as "All Other Compensation" in the Summary Compensation Table.

(3) No amounts in this column are included, or are required to be included, in the Summary Compensation Table.

(4) Other than the amounts reported in this table for 2015, the balances in this column were previously reported as "Salary," "Non-Equity Incentive Plan Compensation" and "All Other Compensation" in our Summary Compensation Tables in previous years, except for the following amounts which represent the aggregate earnings, all of which are non-preferential and not required to be reported in the Summary Compensation Table: $106,696 for Mr. Grinney, $43,898 for Mr. Coltharp, $221,262 for Mr. Tarr, $317,857 for Mr. Whittington, and $21,121 for Mrs. Levy.

(5) Represents earnings and (losses) from amounts invested in the following mutual funds (all of which are provided under the 401(k) Plan): PIMCO Total Return D, Schwab S&P 500 Index, Europacific Growth 4, Schwab Value Advantage, DFA Emerging Markets, Vanguard Wellington Admiral Shares, Vanguard Total Bond Market Index Inst, Dodge & Cox Income, PIMCO Real Return D, and Vanguard Infl Protected Secs In.

(6) Represents earnings and (losses) from amounts invested in the following mutual funds (all of which are provided under the 401(k) Plan): PIMCO Total Return D, Schwab S&P 500 Index, Europacific Growth 4, Schwab Value Advantage, DFA Emerging Markets, Vanguard Wellington Admiral Shares, Vanguard Total Bond Market Index Inst, and Dodge & Cox Income.

(7) Represents earnings and (losses) from amounts invested in the following mutual funds (all of which are provided under the 401(k) Plan): Schwab S&P 500 Index, Europacific Growth 4, Schwab Value Advantage, Mainstay Large Cap Growth R1. DFA Emerging Markets, Vanguard Wellington Admiral Shares, Vanguard Total Bond Market Index Inst, and Dodge & Cox Income.

(8) Represents earnings and (losses) from amounts invested in the following mutual funds (all of which are provided under the 401(k) Plan): Vanguard Total Bond Market Index Inst, Dodge & Cox Income, PIMCO Real Return D, and Vanguard Infl Protected Secs In.

(9) Represents earnings and (losses) from amounts invested in the following mutual funds (all of which are provided under the 401(k) Plan): Schwab S&P 500 Index, Europacific Growth 4, PIMCO Real Return D, Schwab Value Advantage, Columbia Contrarian Core Z, Vanguard Equity-Income, Vanguard Wellington Admiral Shares, Dodge & Cox Income, Vanguard Infl Protected Secs In, Mainstay Large Cap Growth R1, Vanguard Total Bond Market Index Inst, Columbia Acorn Z, Vanguard Mid Cap Index Instl, Fidelity Small Cap Discovery, and Vanguard Small Cap Index Admiral.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Review and Approval of Transactions with Related Persons

For purposes of this section, an executive officer or a member of the board of directors or any family member of an executive officer or board member is referred to as a "related party." The board of directors considers, in consultation with the Nominating/Corporate Governance Committee, whether a transaction between a related party and the Company presents any inappropriate conflicts of interest or impairs the "independence" of any director, or both. Additionally, the following are prohibited unless expressly approved in advance by the disinterested members of the board of directors

- transactions between the Company and any related party in which the related party has a material direct or indirect interest;
- employment by the Company of any sibling, spouse or child of an executive officer or a member of the board of directors, other than as expressly allowed under our employment policies; and
- any direct or indirect investment or other economic participation by a related party in any entity not publicly traded in which the Company has any direct or indirect investment or other economic interest.

Each independent director is required to promptly notify the chairman of the board of directors if any actual or potential conflict of interest arises between such member and the Company which may impair such member's independence. If a conflict exists and cannot be resolved, such member is required to submit to the board of directors written notification of such conflict of interest and an offer of resignation from the board of directors and each of the committees on which such member serves. The board of directors need not accept such offer of resignation; however, the submission of such offer of resignation provides the opportunity for the board of directors to review the appropriateness of the continuation of such individual's membership on the board of directors.

Members of the board of directors must recuse themselves from any discussion or decision that affects their personal, business, or professional interest. The non-interested members of the board of directors will consider and resolve any issues involving conflicts of interest of members of the board of directors.

Transactions with Related Persons

Our policies regarding transactions with related persons and other matters constituting potential conflicts of interest are contained in our Corporate Governance Guidelines and our Standards of Business Conduct which can be found on our website at http://investor.healthsouth.com.

Since January 1, 2015, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are to be a party in which the amount involved exceeds $120,000 and in which any director, executive officer or holder of more than 5% of our voting securities, or an immediate family member of any of the foregoing, had or will have a direct or indirect material interest, except as described below. Additionally, none of our directors, nominees or executive officers is a party to any material proceedings adverse to us or any of our subsidiaries or has a material interest adverse to us or any of our subsidiaries.

The Encompass Ownership Structure

On December 31, 2014, we completed the previously announced acquisition of EHHI Holdings, Inc. ("EHHI") and its Encompass Home Health and Hospice business ("Encompass"). In the acquisition, we acquired, for cash, all of the issued and outstanding equity interests of EHHI, other than equity interests contributed to HealthSouth Home Health Holdings, Inc. ("Holdings"), a subsidiary of HealthSouth and now indirect parent of EHHI, by individual sellers in exchange for shares of common stock of Holdings. These sellers were members of Encompass management, including April Anthony, the chief executive officer of Encompass, who is now an executive officer of HealthSouth. They contributed a portion of their shares of common stock of EHHI, valued at approximately $64.5 million, in exchange for shares of common stock of Holdings. As a result of that contribution, they hold approximately 16.7% of the outstanding common stock of Holdings, while HealthSouth owns the remainder.

HealthSouth and the employee stockholders of Holdings, including Ms. Anthony, are parties to a stockholders' agreement (the "Stockholders' Agreement") that provides for, among other things, restrictions on share transfers, preemptive rights in connection with proposed transfers of shares, customary tag-along and drag-along rights, rights of the stockholders other than HealthSouth to require, in certain circumstances, HealthSouth or its designee to repurchase the

shares of stock held by them, and the right of HealthSouth to purchase the shares of stock held by those stockholders at any time after December 31, 2019, or, prior to December 31, 2017, within 120 days of the termination of any such stockholder's employment with Encompass. The Stockholders' Agreement also provides that certain members of the Encompass management team recommended by the chief executive officer of Encompass and approved by our board's Compensation Committee may receive annual performance-based restricted stock grants under our long-term equity incentive program.

Employment Agreements

As part of the acquisition negotiation, Ms. Anthony and certain other employees of Encompass agreed to and did enter into amended and restated employment agreements, each with an initial term of three years, and related noncompetition/nonsolicitation agreements, pursuant to which they agreed not to compete in the business of providing home health or hospice care services or acquire any companies operating in those businesses during the five years following the closing. In addition to standard salary, bonus and benefit terms, these agreements provide that the officers may participate, at the designation of Ms. Anthony, in HealthSouth's long-term equity incentive program and may receive cash-settled stock appreciation rights tied to the value of Holdings. These agreements also provide for severance benefits, including continuation of base salary and payment of COBRA premiums for up to one year upon termination for good reason or without cause, subject to a release of claims. Ms. Anthony's employment agreement is an exhibit to our 2015 Form 10-K.

Pre-existing Agreement with an Affiliate

At the time of the acquisition, EHHI was party to a client service and license agreement (the "HCHB Agreement") with Homecare Homebase, LLC ("HCHB") for a homecare management software product that includes multiple modules for collecting, storing, retrieving and disseminating home care patient health and health-related information by and on behalf of home health care agencies, point of care staff, physicians, patients and patient family members via hand-held mobile computing devices and desktop computers linked with a website hosted by HCHB. Ms. Anthony along with others created this software product and eventually sold it to HCHB. She currently owns more than 10% of HCHB and is that company's chief executive officer. A term of our negotiated acquisition of EHHI was that Ms. Anthony be allowed to continue to dedicate a portion of her time to her duties with HCHB, which portion may not exceed that time commitment provided for in her pre-existing employment agreement with EHHI and may not materially interfere with her duties and responsibilities to the HealthSouth subsidiary going forward.

The HCHB Agreement continues until terminated by either party. Either party may terminate for a material breach or an insolvency event. We may terminate the HCHB Agreement for convenience upon 90-days notice. Beginning on December 19, 2026, HCHB may terminate the HCHB Agreement for convenience upon two-years notice.

Pursuant to the HCHB Agreement, we pay fees to HCHB based on, among other things, the software modules in use, the training programs, and the number of licensed users. In 2015, the aggregate fees paid to HCHB by EHHI were approximately $2.1 million.

Our board of directors reviewed and approved, as part of the acquisition negotiation and approval, the terms of the HCHB Agreement, the Stockholders' Agreement and Ms. Anthony's continuing employment with HCHB. The board found the terms of the HCHB Agreement are no less favorable to HealthSouth than those that could be obtained in arm's-length dealings by a third party.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of our common stock as of February 16, 2016 (unless otherwise noted), for (1) each person who is known by us to own beneficially more than 5% of the outstanding shares of our common stock, (2) each director, (3) each executive officer named in the Summary Compensation Table, and (4) all of our current directors and executive officers as a group. The address of our directors and executive officers is c/o HealthSouth Corporation, 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243. We know of no arrangements, the operation of which may at a subsequent date result in the change of control of HealthSouth.

Name	Common Shares Beneficially Owned[1]	Percent of Class[2]
Greater Than 5% Beneficial Owners		
Invesco Ltd.	7,051,116 [3]	7.9%
Glenview Capital Management, LLC	6,819,080 [4]	7.6%
The Vanguard Group	6,023,635 [5]	6.7%
Blackrock, Inc	5,274,271 [6]	5.9%
Directors and Executive Officers		
John W. Chidsey	89,007	*
Douglas E. Coltharp	149,055 [7]	*
Donald L. Correll	56,453	*
Yvonne M. Curl	54,190	*
Charles M. Elson	60,213	*
Jay Grinney	2,470,042 [8]	2.7%
Joan E. Herman	13,677	*
Leo I. Higdon, Jr.	55,623	*
Leslye G. Katz	13,677	*
Cheryl B. Levy	88,690 [9]	*
John E. Maupin, Jr.	58,274	*
L. Edward Shaw, Jr.	74,986	*
Mark J. Tarr	451,557 [10]	*
John P. Whittington	409,692 [11]	*
All directors and executive officers as a group	4,204,402 [12]	4.6%

* Less than 1%.

(1) According to the rules adopted by the SEC, a person is a beneficial owner of securities if the person or entity has or shares the power to vote them or to direct their investment or has the right to acquire beneficial ownership of such securities within 60 days through the exercise of an option, warrant or right, conversion of a security or otherwise. Unless otherwise indicated, each person or entity named in the table has sole voting and investment power, or shares voting and investment power, with respect to all shares of stock listed as owned by that person.

(2) The percentage of beneficial ownership is based upon 89,777,044 shares of common stock outstanding as of February 16, 2016.

(3) Based on a Schedule 13G/A filed with the SEC on February 5, 2016, Invesco Ltd. (investment adviser and parent holding company/control person) reported, as of December 31, 2015, sole voting for 6,915,308 shares and sole investment power for 7,051,116 shares. This holder is located at 1555 Peachtree Street NE, Atlanta, GA 30309.

(4) Based on a Schedule 13G/A filed with the SEC on February 16, 2016, Glenview Capital Management, LLC (investment adviser), on behalf of a group including Glenview Capital Management, LLC and Larry Robbins, reported, as of December 31, 2015, sole voting for 0 shares, sole investment power for 0 shares, and shared investment power for 6,819,080 shares. This holder is located at 767 Fifth Avenue, 44th Floor, New York, New York 10153.

(5) Based on a Schedule 13G/A filed with the SEC on February 11, 2016, The Vanguard Group (investment adviser), on behalf of a group including Vanguard Fiduciary Trust Company and Vanguard Investments Australia, Ltd., reported, as of December 31, 2015, sole voting for 201,339 shares, shared voting power for 5,100 shares, sole investment power for 5,822,696 shares, and shared investment power for 200,939 shares. This holder is located at 100 Vanguard Blvd., Malvern, PA 19355.

(6) Based on a Schedule 13G/A filed with the SEC on February 10, 2016, BlackRock, Inc. (parent holding company/control person), on behalf of a group including BlackRock Advisors (UK) Limited, BlackRock Fund Management Ireland Limited, BlackRock Institutional Trust Company, N.A., BlackRock Fund Advisors, BlackRock Asset Management Ireland Limited, BlackRock Asset Management Canada Limited, BlackRock

Advisors, LLC, BlackRock Investment Management, LLC, BlackRock Investment Management (Australia) Limited, BlackRock Investment Management (UK) Ltd, BlackRock (Luxembourg) S.A., BlackRock Fund Management Company S.A., and BlackRock International Limited, reported that, as of December 31, 2015, the group is the beneficial owner of 5,274,271 shares, with sole voting for 5,073,600 shares and sole investment power for 5,274,271 shares. This holder is located at 55 East 52nd Street, New York, New York 10055.

(7) Includes 77,088 shares issuable upon exercise of options.

(8) Includes 1,314,892 shares issuable upon exercise of options.

(9) Includes 11,000 shares issuable upon exercise of options.

(10) Includes 240,255 shares issuable upon exercise of options.

(11) Includes 217,329 shares issuable upon exercise of options.

(12) Includes 1,875,564 shares issuable upon exercise of options.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act, requires our directors, executive officers and, if any, beneficial holders of more than 10% of our common stock to file reports with the SEC regarding their ownership and changes in ownership of our securities. We believe, based on our review of the copies of Forms 3, 4, and 5, and amendments thereto, and written representations of our directors and executive officers, that, during fiscal 2015, our directors and executive officers timely filed all reports that were required to be filed under Section 16(a) except:

- as a result of a clerical error regarding the timing of the tax withholding associated with the vesting of a tranche of restricted stock occurring over a holiday weekend, Messrs. Grinney, Coltharp, Tarr, Whittington, Fay and Price and Ms. Levy and Ms. Clohan reported a January 2, 2015 forfeiture of shares to pay the withholding on January 13, 2015; and
- as a result of the discovery of a system-rejected filing during the EDGAR filing process, Mr. Fay reported the February 24, 2015 forfeiture of shares to pay the tax withholding associated with the vesting of a tranche of restricted stock on March 2, 2015.

EXECUTIVE OFFICERS

The following table lists all of our executive officers. Each of our executive officers will hold office until his or her successor is elected and qualified, or until his earlier resignation or removal.

Name	Age	Position	Since
Jay Grinney	65	President and Chief Executive Officer; Director	5/10/2004
Douglas E. Coltharp	54	Executive Vice President and Chief Financial Officer	5/6/2010
Mark J. Tarr	54	Executive Vice President and Chief Operating Officer	10/1/2007
Patrick Darby	51	Executive Vice President, General Counsel and Secretary	2/18/2016
Cheryl B. Levy	57	Chief Human Resources Officer	2/24/2011
Elissa J . Charbonneau, D.O.	56	Chief Medical Officer	7/1/2015
Andrew L. Price	49	Chief Accounting Officer	10/22/2009
Edmund M. Fay	49	Senior Vice President and Treasurer	3/1/2008
April Anthony	49	Chief Executive Officer and President, Encompass	12/31/2014 (1)

(1) Ms. Anthony was chief executive officer and president, of Encompass Home Health and Hospice at the time of our acquisition and, in connection with the acquisition, entered into an employment agreement with an initial term of three years.

There are no family relationships or other arrangements or understandings known to us between any of the executive officers listed above and any other person pursuant to which he or she was or is to be selected as an officer, other than any arrangements or understandings with persons acting solely as officers of HealthSouth.

Executive Officers Who Are Not Also Directors

Douglas E. Coltharp—Executive Vice President and Chief Financial Officer

Mr. Coltharp was named executive vice president and chief financial officer on May 6, 2010. Prior to joining us, Mr. Coltharp served as a partner at Arlington Capital Advisors and Arlington Investment Partners, LLC, a boutique investment banking firm and private equity firm, from May 2007 to May 2010. Prior to that, he served 11 years as executive vice president and chief financial officer for Saks Incorporated and its predecessor organization. Prior to joining Saks in November 1996, Mr. Coltharp spent approximately 10 years with Nations Bank, N.A. and its predecessors in various positions of increasing responsibilities culminating in senior vice president and head of southeast corporate banking. He currently serves as a member of the board of directors of Under Armour, Inc.

Mark J. Tarr—Executive Vice President and Chief Operating Officer

Mr. Tarr was named executive vice president of our operations on October 1, 2007, to which the chief operating officer designation was added on February 24, 2011. Mr. Tarr joined us in 1993 and has held various management positions with us, including serving as president of our inpatient division from 2004 to 2007, as senior vice president with responsibility for all inpatient operations in Texas, Louisiana, Arkansas, Oklahoma, and Kansas from 1997 to 2004, as director of operations of our 80-bed rehabilitation hospital in Nashville, Tennessee from 1994 to 1997, and as chief executive officer/administrator of our 70-bed rehabilitation hospital in Vero Beach, Florida from 1992 to 1994.

Patrick Darby—Executive Vice President, General Counsel and Secretary

Mr. Darby was named executive vice president, general counsel and secretary effective February 18, 2016. Before joining us, Mr. Darby was a partner of the law firm Bradley Arant Boult Cummings LLP in Birmingham, Alabama, where he practiced from 1990 to 2016, and an adjunct professor at Cumberland School of Law, in Birmingham, Alabama. He is a member of the Birmingham Bar Association, Alabama State Bar, and American Bar Association.

Cheryl B. Levy—Chief Human Resources Officer

Ms. Levy has served as principal human resources officer since March 15, 2007. Prior to joining us, Ms. Levy served as the national director, human resources/recruiting, for KPMG LLP, where she advised clients in such diverse areas as recruitment, compensation, benefits, training, development and employee relations from 1999 to 2007. Prior to joining KPMG, she held senior executive human resources positions at several health services companies including Preferred Care Partners Management Group, LP, a large skilled nursing facility company in Texas. Ms. Levy currently serves on the boards of Girls, Inc., UAB Cancer Advisory Board and American Cancer Society-Birmingham Chapter.

Elissa J. Charbonneau, D.O.—Chief Medical Officer

Dr. Charbonneau, a board-certified physical medicine and rehabilitation physician, was named chief medical officer on July 1, 2015. From January 2015 to June 2015, she served as vice president of medical services at HealthSouth. From 2001 to 2014, she served as medical director of New England Rehabilitation Hospital of Portland, a joint venture between Maine Medical Center and HealthSouth, where she was a staff physician for several years. Dr. Charbonneau received her doctor of osteopathic medicine from New York College of Osteopathic Medicine, a master's degree in natural sciences/epidemiology from the State University of New York at Buffalo, and a bachelor's degree from Cornell University. She is a diplomat of the American Board of Physical Medicine and Rehabilitation and of the American Osteopathic Board of Rehabilitation Medicine. She also serves on the Clinical Practice Guidelines committee of the American Academy of Physical Medicine and Rehabilitation.

Andrew L. Price—Chief Accounting Officer

Mr. Price was named chief accounting officer in October 2009 and has held various management positions with us since joining HealthSouth in June 2004 including senior vice president of accounting and vice president of operations accounting. Prior to joining us, Mr. Price served as senior vice president and corporate controller of Centennial HealthCare Corp, an Atlanta-based operator of skilled nursing centers and home health agencies, from 1996 to 2004, and as a manager in the Atlanta audit practice of BDO Seidman, LLC. Mr. Price is a certified public accountant and member of the American Institute of Certified Public Accountants.

Edmund M. Fay—Senior Vice President and Treasurer

Mr. Fay joined HealthSouth in 2008 as senior vice president and treasurer. Mr. Fay has more than 16 years of experience in financial services specializing in corporate development, mergers and acquisitions, bank treasury management, fixed income and capital markets products. Prior to joining us, he served in various positions at Regions Financial Corporation, including executive vice president of strategic planning/mergers and acquisitions, senior vice president and senior treasury officer, from 2001 to 2008. Prior to 2001, he also held vice president positions at Wachovia Corporation for asset and liability management and at J.P. Morgan & Company, Inc. for global treasury and capital management.

April Anthony—Chief Executive Officer and President, Encompass

Ms. Anthony became an executive officer effective December 31, 2014 upon the acquisition of Encompass Home Health and Hospice by HealthSouth. Ms. Anthony has 23 years of experience in the home health industry. In 1992, she acquired and became chief executive officer of Liberty Health Services. She sold Liberty in 1996 and founded Encompass in 1998, where she has served as chief executive officer since. During her time in the home health industry, Ms. Anthony has overseen the design and development of an industry-leading, comprehensive information platform that allows home health providers, including Encompass, to process clinical, compliance, and marketing information as well as analyze data and trends for management purposes using custom reports on a timely basis. She practiced as a certified public accountant with Price Waterhouse LLP prior to entering the home health industry.

GENERAL INFORMATION

Other Business

We know of no other matters to be submitted at the annual meeting. By submitting the proxy, the stockholder authorizes the persons named on the proxy to use their discretion in voting on any matter brought before the annual meeting.

Annual Report to Stockholders

A copy of our annual report to stockholders for the fiscal year ended December 31, 2015 is being mailed concurrently with this proxy statement to all stockholders entitled to notice of and to vote at the annual meeting. Our annual report to stockholders is not incorporated into this proxy statement and will not be deemed to be solicitation material. A copy of our 2015 Form 10-K is available without charge from the “Investors” section of our website at http://investor.healthsouth.com. Our 2015 Form 10-K is also available in print to stockholders without charge and upon request, addressed to HealthSouth Corporation, 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243, Attention: Investor Relations.

Proposals for 2017 Annual Meeting of Stockholders

Any proposals that our stockholders wish to have included in our proxy statement and form of proxy for the 2017 annual meeting of stockholders must be received by us no later than the close of business on December 6, 2016, and must otherwise comply with the requirements of Rule 14a-8 of the Exchange Act in order to be considered for inclusion in the 2017 proxy statement and form of proxy.

You may also submit a proposal without having it included in our proxy statement and form of proxy, but we need not submit such a proposal for consideration at the annual meeting if it is considered untimely. In accordance with Section 2.9 of our Bylaws, to be timely your proposal must be delivered to or mailed and received at our principal executive offices on or after January 7, 2017 and not later than February 6, 2017; provided, however, that in the event that the annual meeting is called for a date that is not within 30 days before or after anniversary date of this year's annual meeting, your proposal, in order to be timely, must be received not later than the close of business on the tenth day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure of the date of the annual meeting was made, whichever first occurs.

All stockholder proposals must be in the form set forth in Section 2.9 of our Bylaws and must be addressed to HealthSouth Corporation, 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243, Attention: Corporate Secretary. Section 2.9 of our Bylaws requires, among other things, that the proposal must set forth:

(1) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting that business at the annual meeting;
(2) the name and record address of the stockholder giving notice and the beneficial owner, if any, on whose behalf the proposal is being made such person;
(3) the class or series and number of shares of our capital stock which are owned beneficially or of record by that person or persons and any affiliate or associate;
(4) the name of each nominee holder of all shares of our capital stock owned beneficially and the number of such shares of stock held by each nominee holder;
(5) whether and the extent to which any derivative instrument, swap, option, warrant, short interest, hedge or profit interest or other transaction has been entered into by or on behalf of that person or persons, or any affiliate or associate, with respect to a security issued by us;
(6) whether and the extent to which any other transaction, agreement, arrangement or understanding has been made by or on behalf of that person or persons, or any affiliate or associate, that would mitigate loss to, or to manage risk or benefit of price changes for, that person or persons, or any affiliate or associate, or increase or decrease the voting power or pecuniary or economic interest of that person or persons, or any affiliate or associate, with respect to a security issued by us;
(7) a description of all agreements, arrangements or understandings between that person or persons, or any affiliate or associate, and any other person or persons (including their names) in connection with the proposal and any material interest of the other person or persons, or any affiliate or associate, in the business being proposed, including any anticipated benefits;
(8) a representation that the stockholder giving notice intends to appear in person or by proxy at the annual meeting to bring such business before the meeting; and
(9) any other information relating to that person or persons that would be required to be disclosed in a proxy statement with respect to the proposed business to be brought by such person before the annual meeting.

A stockholder proposing business for the annual meeting must update and supplement the notice required by Section 2.9 of our Bylaws so that the information in the notice is true and correct as of the record date(s) for determining the stockholders entitled to receive notice of and to vote at the annual meeting. Any stockholder that intends to submit a proposal should read the entirety of the requirements in Section 2.9 of our Bylaws which can be found in the "Corporate Governance" section of our website at http://investor.healthsouth.com.

Appendix A

Reconciliations of Non-GAAP Financial Measures to GAAP Results

To help our readers understand our past financial performance, our future operating results, and our liquidity, we supplement the financial results we provide in accordance with generally accepted accounting principles in the United States of America ("GAAP") with certain non-GAAP financial measures, including Adjusted EBITDA. Our management regularly uses our supplemental non-GAAP financial measures to understand, manage, and evaluate our business and make operating decisions. We believe Adjusted EBITDA is a measure of our ability to service our debt and our ability to make capital expenditures.

We use Adjusted EBITDA on a consolidated basis as a liquidity measure. We believe this financial measure on a consolidated basis is important in analyzing our liquidity because it is the key component of certain material covenants contained within our credit agreement, which is discussed in more detail in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Liquidity and Capital Resources," and Note 8, *Long-term Debt*, to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K"). These covenants are material terms of the credit agreement. Noncompliance with these financial covenants under the credit agreement — its interest coverage ratio and its leverage ratio — could result in our lenders requiring us to immediately repay all amounts borrowed. If we anticipated a potential covenant violation, we would seek relief from our lenders, which would have some cost to us, and such relief might be on terms less favorable to us than those in our existing credit agreement. In addition, if we cannot satisfy these financial covenants, we would be prohibited under the credit agreement from engaging in certain activities, such as incurring additional indebtedness, paying common stock dividends, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted EBITDA is critical to our assessment of our liquidity.

In general terms, the credit agreement definition of Adjusted EBITDA therein, referred to as "Adjusted Consolidated EBITDA," allows us to add back to consolidated net income interest expense, income taxes, and depreciation and amortization and then add back to consolidated net income (1) all unusual or nonrecurring items reducing consolidated net income (of which only up to $10 million in a year may be cash expenditures), (2) any losses from discontinued operations and closed locations, (3) costs and expenses, including legal fees and expert witness fees, incurred with respect to litigation associated with stockholder derivative litigation, and (4) share-based compensation expense. We also subtract from consolidated net income all unusual or nonrecurring items to the extent they increase consolidated net income.

Under the credit agreement, the Adjusted EBITDA calculation does not include net income attributable to noncontrolling interests and includes (1) gain or loss on disposal of assets, (2) professional fees unrelated to the stockholder derivative litigation, (3) unusual or nonrecurring cash expenditures in excess of $10 million, and (4) pro forma adjustments resulting from debt transactions and development activities. These items may not be indicative of our ongoing performance, so the Adjusted EBITDA calculation presented here includes adjustments for them.

Adjusted EBITDA is not a measure of financial performance under GAAP, and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted EBITDA should not be considered a substitute for net income or cash flows from operating, investing, or financing activities. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. Revenues and expenses are measured in accordance with the policies and procedures described in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Reconciliation of Net Income to Adjusted EBITDA

	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In Millions)				
Net income	$252.8	$281.7	$381.4	$235.9	$254.6
Loss (income) from discontinued operations, net of tax, attributable to HealthSouth	0.9	(5.5)	1.1	(4.5)	(49.9)
Provision for income tax expense	141.9	110.7	12.7	108.6	37.1
Interest expense and amortization of debt discounts and fees	142.9	109.2	100.4	94.1	119.4
Loss on early extinguishment of debt	22.4	13.2	2.4	4.0	38.8
Professional fees—accounting, tax, and legal	3.0	9.3	9.5	16.1	21.0
Government, class action, and related settlements	7.5	(1.7)	(23.5)	(3.5)	(12.3)
Noncash loss on disposal or impairment of assets	2.6	6.7	5.9	4.4	4.3
Depreciation and amortization	139.7	107.7	94.7	82.5	78.8
Stock-based compensation expense	26.2	23.9	24.8	24.1	20.3
Net income attributable to noncontrolling interests	(69.7)	(59.7)	(57.8)	(50.9)	(45.9)
Gain on consolidation of former equity method hospital	—	(27.2)	—	(4.9)	—
Reliant/CareSouth transaction costs	12.3	—	—	—	—
Encompass transaction costs	—	9.3	—	—	—
Adjusted EBITDA	$682.5	$577.6	$551.6	$505.9	$466.2

Reconciliation of Net Cash Provided by Operating Activities to Adjusted EBITDA

	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In Millions)				
Net cash provided by operating activities	$ 484.8	$ 444.9	$ 470.3	$411.5	$ 342.7
Provision for doubtful accounts	(47.2)	(31.6)	(26.0)	(27.0)	(21.0)
Professional fees—accounting, tax, and legal	3.0	9.3	9.5	16.1	21.0
Interest expense and amortization of debt discounts and fees	142.9	109.2	100.4	94.1	119.4
Equity in net income of nonconsolidated affiliates	8.7	10.7	11.2	12.7	12.0
Net income attributable to noncontrolling interests in continuing operations	(69.7)	(59.7)	(57.8)	(50.9)	(47.0)
Amortization of debt-related items	(14.3)	(12.7)	(5.0)	(3.7)	(4.2)
Distributions from nonconsolidated affiliates	(7.7)	(12.6)	(11.4)	(11.0)	(13.0)
Current portion of income tax expense	14.8	13.3	6.3	5.9	0.6
Change in assets and liabilities	147.1	90.1	48.9	58.1	41.4
Net premium paid on bond issuance/redemption	3.9	4.3	1.7	1.9	22.8
Operating cash used in (provided by) discontinued operations	0.7	1.2	1.9	(2.0)	(9.1)
Reliant/CareSouth transaction costs	12.3	—	—	—	—
Encompass transaction costs	—	9.3	—	—	—
Other	3.2	1.9	1.6	0.2	0.6
Adjusted EBITDA	$ 682.5	$ 577.6	$ 551.6	$505.9	$ 466.2

For the year ended December 31, 2015, net cash used in investing activities was $1,129.8 million and resulted primarily from the acquisitions of Reliant and CareSouth. Net cash provided by financing activities during the year ended December 31, 2015 was $639.9 million and resulted primarily from net debt issuances associated with the funding of the Reliant acquisition.

For the year ended December 31, 2014, net cash used in investing activities was $876.9 million and resulted primarily from the acquisition of Encompass. Net cash provided by financing activities during the year ended December 31, 2014 was $434.2 million and resulted primarily from draws under the revolving and expanded term loan facilities of the Company's credit agreement to fund the acquisition of Encompass offset by the redemption of the Company's existing 7.25% Senior Notes due 2018.

For the year ended December 31, 2013, net cash used in investing activities was $226.2 million and resulted primarily from capital expenditures and the acquisition of Walton Rehabilitation Hospital. Net cash used in financing activities during the year ended December 31, 2013 was $312.4 million and resulted primarily from repurchases of common stock as part of the tender offer completed in the first quarter of 2013.

For the year ended December 31, 2012, net cash used in investing activities was $178.8 million and resulted primarily from capital expenditures. Net cash used in financing activities during the year ended December 31, 2012 was $130.0 million and resulted primarily from distributions paid to noncontrolling interests of consolidated affiliates, repurchases of 46,645 shares of the Company's convertible perpetual preferred stock, dividends paid on the Company's convertible perpetual preferred stock, and net principal payments on debt offset by capital contributions from consolidated affiliates.

For the year ended December 31, 2011, net cash used in investing activities was $24.6 million and resulted primarily from capital expenditures, net settlement payments related to interest rate swaps, and purchases of restricted investments offset by proceeds from the sale of five long-term acute care hospitals in August 2011. Net cash used in financing activities during the year ended December 31, 2011 was $336.3 million and resulted primarily from net debt payments, including the optional redemption of the Company’s 10.75% Senior Notes due 2016, distributions paid to noncontrolling interests of consolidated affiliates, and dividends paid on the Company’s convertible perpetual preferred stock.

We also use adjusted free cash flow as an analytical indicator to assess our performance. Management believes the presentation of adjusted free cash flow provides investors an efficient means by which they can evaluate our capacity to reduce debt, pursue development activities, and return capital to our common stockholders. This measure is not a defined measure of financial performance under GAAP and should not be considered as an alternative to net cash provided by operating activities. Our definition of adjusted free cash flow is limited and does not represent residual cash flows available for discretionary spending. Because this measure is not determined in accordance with GAAP and is susceptible to varying calculations, it may not be comparable to other similarly titled measures presented by other companies. See the consolidated statements of cash flows included in the 2015 Form 10-K for the GAAP measures of cash flows from operating, investing, and financing activities.

Reconciliation of Net Cash Provided by Operating Activities to Adjusted Free Cash Flow

	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In Millions)				
Net cash provided by operating activities	$ 484.8	$ 444.9	$ 470.3	$ 411.5	$ 342.7
Impact of discontinued operations	0.7	1.2	1.9	(2.0)	(9.1)
Net cash provided by operating activities of continuing operations	485.5	446.1	472.2	409.5	333.6
Capital expenditures for maintenance	(83.1)	(92.0)	(74.8)	(83.0)	(50.8)
Net settlements on interest rate swaps	—	—	—	—	(10.9)
Dividends paid on convertible perpetual preferred stock	(3.1)	(6.3)	(23.0)	(24.6)	(26.0)
Distributions paid to noncontrolling interests of consolidated affiliates	(54.4)	(54.1)	(46.3)	(49.3)	(44.2)
Unusual and nonrecurring items:					
Net premium paid on bond transactions	4.0	4.3	1.7	1.9	22.8
Encompass transaction costs and related assumed liabilities	17.9	2.0	—	—	—
Reliant/CareSouth transaction costs	10.4	—	—	—	—
Cash paid for professional fees—accounting, tax, and legal	4.1	8.6	7.0	16.1	21.0
Cash paid (received) for government, class action, and related settlements	7.7	2.7	(5.9)	(2.6)	5.7
Income tax refunds related to prior periods	—	—	—	—	(7.9)
Adjusted free cash flow	$ 389.0	$ 311.3	$ 330.9	$ 268.0	$ 243.3

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting a representative in the compensation group in the Human Resources department.

HEALTHSOUTH CORPORATION
2016 OMNIBUS PERFORMANCE INCENTIVE PLAN

ARTICLE 1
PURPOSE

1.1. General. The purpose of the HealthSouth Corporation 2016 Omnibus Performance Incentive Plan (the "***Plan***") is to promote the success, and enhance the value, of HealthSouth Corporation (the "***Company***") and its subsidiaries, by linking the personal interests of their employees, officers and directors to those of Company stockholders and by providing such persons with an incentive for outstanding performance. The Plan is further intended to provide flexibility to the Company by increasing its ability to motivate, attract, and retain the services of employees, officers and directors upon whose judgment, interest, and special effort the successful conduct of the Company's operation is largely dependent. Accordingly, the Plan permits the grant of cash and equity incentive awards from time to time to selected employees, officers and directors.

ARTICLE 2
EFFECTIVE DATE

2.1. Effective Date. The Plan shall be effective as of May 9, 2016 (the "***Effective Date***"), subject to its approval by the stockholders of the Company. Unless terminated earlier by the Board, the Plan shall have a term of ten (10) years commencing upon the Effective Date; provided, however, termination of the Plan shall not cancel any Awards previously granted thereunder and provided further that the applicable provisions of the Plan shall remain in effect according to the terms of such Awards. If the Plan is approved and effective, the Company shall not grant or issue new equity awards under any other currently effective equity plan after the Effective Date.

ARTICLE 3
DEFINITIONS

3.1. Definitions. When a word or phrase appears in the Plan with the initial letter capitalized, and the word or phrase does not commence a sentence, the word or phrase shall generally be given the meaning ascribed to it in this Section or in Section 1.1 unless a clearly different meaning is required by the context. The following words and phrases shall have the following meanings:

(a) "***Award***" means any grant or award of Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Shares, Performance Units, Dividend Equivalents, Other Stock-Based Award, Cash Award, or any other right or interest relating to Stock or cash, granted to a Participant under the Plan.

(b) "***Award Agreement***" means an agreement, contract, other instrument or document or other evidence approved by the Committee evidencing an Award. An Award Agreement may be in an electronic medium, may be solely evidenced by a notation on the Company's books and records, and need not be signed by a representative of the Company or a Participant. An Award Agreement may be in the form of individual award agreements or certificates or a document describing the terms and provisions of an Award or series of Awards under the Plan.

(c) "***Board***" means the Board of Directors of the Company.

(d) "***Cash Award***" means any grant or award that confers the right to receive cash with the amount of such cash subject to achievement of one or more specified Performance Goals and subject to such other restrictions and conditions as may be established by the Committee.

(e) "***Cause***" means a conviction or no contest plea to a felony or moral turpitude crime or an act of dishonesty, moral turpitude, an intentional, negligent, or grossly negligent act detrimental to the best interests of the Company or a Subsidiary, failure to perform assigned duties, poor performance of assigned duties, breach of fiduciary duties to the Company, or violations of Company policies or code of conduct as in effect and amended from time to time, all as determined by the Committee; provided that, if a Participant is a participant in an executive severance plan adopted by the Company, then "Cause" for purposes of the Plan shall have the meaning set forth in such executive severance plan.

(f) "***Change in Control***" means any of the following events:

(i) the acquisition (other than from the Company) by any person, entity or "group" (within the meaning of Section 13(d)(3) or 14(d)(2) of the 1934 Act, but excluding, for this purpose, the Company or its subsidiaries, or any employee benefit plan of the Company or its subsidiaries which acquires beneficial ownership of voting securities of the Company) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the 1934 Act) of 30% or more of either the then-outstanding shares of Common Stock or the combined voting power of the Company's then-outstanding voting securities entitled to vote generally in the election of Directors; or

(ii) during any period of up to 24 consecutive months, individuals who at the beginning of such period constituted the Board (together with any new directors whose election by the Board or whose nomination for election by the stockholders of the Company was approved by a vote of a majority of the directors of the Company then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease to constitute at least a majority of the Board; or

(iii) the Company is liquidated or dissolved or adopts a plan of liquidation or dissolution; or

(iv) the consummation of a merger or consolidation of the Company with or into another person or the merger of another person with or into the Company, or the sale of all or substantially all the assets of the Company (determined on a consolidated basis) to another person, other than a transaction following which (A) in the case of a merger or consolidation transaction, holders of securities that represented 100% of the combined voting power entitled to vote generally in the election of directors of the Company immediately prior to such transaction (or other securities into which such securities are converted as part of such merger or consolidation transaction) own directly or indirectly at least a majority of the combined voting power entitled to vote generally in the election of directors of the surviving person in such transaction immediately after such transaction and (B) in the case of a sale of assets, each transferee is owned by holders of securities that represented at least a majority of the combined voting power entitled to vote generally in the election of directors of the Company immediately prior to such sale.

(g) "***Code***" means the Internal Revenue Code of 1986, as amended from time to time.

(h) "***Committee***" means the Compensation Committee of the Board, or any successor thereto.

(i) "***Company***" means HealthSouth Corporation, a Delaware corporation, or any successor corporation.

(j) "***Covered Employee***" means a covered employee as defined in Code Section 162(m)(3) and authoritative guidance thereunder.

(k) "***Disability***" means, except as otherwise provided in an Award Agreement, a physical or mental condition which is expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months and which renders the Participant incapable of performing the work for which he is employed or similar work, as evidenced by eligibility for and actual receipt of benefits payable under a group disability plan or policy maintained by the Company or any of its Subsidiaries that is by its terms applicable to the Participant.

(l) "***Dividend Equivalent***" means a right granted to a Participant under Article 11.

(m) "***Effective Date***" has the meaning assigned such term in Section 2.1.

(n) "***Full Value Award***" means an Award other than in the form of an Option or SAR which is settled by the issuance of stock.

(o) "***Fair Market Value***" means (i) as of any given date, the closing price at which the shares of stock were traded (or if no transactions were reported on such date on the next preceding date on which transactions were reported) on the New York Stock Exchange on such date, or, if different, the principal exchange or automated quotation system on which such stock is traded, or (ii) should the Committee elect, the average selling price or volume-weighted average price ("***VWAP***") on a given trading day or the VWAP over a series of pre-established trading days preceding or following such given date. If the shares are neither listed on the NYSE or another public exchange nor quoted on an inter-dealer quotation system or if the term is being applied to property other than stock, the amount determined by the Committee in its sole discretion to be the fair market value thereof.

(p) "***Good Reason***" shall mean, when used with reference to any Participant, any of the following actions or failures to act, but in each case only if it occurs while such Participant is employed by the Company and then only if it is not consented to by such Participant in writing:

(i) assignment of a position that is of a lesser rank than held by the Participant prior to the assignment and that results in a material adverse change in such Participant's reporting position, duties or responsibilities or title or elected or appointed offices as in effect immediately prior to the effective date of such change;

(ii) a material reduction in such Participant's total compensation from that in effect immediately prior to the Change in Control. For purposes of this clause (ii), "total compensation" shall mean the sum of base salary, target bonus opportunity and the opportunity to receive compensation in the form of equity in the Company. Notwithstanding the foregoing, a reduction will not be deemed to have occurred hereunder on account of (A) any change to a plan term other than ultimate target bonus opportunity or equity opportunity, (B) the actual payout of any bonus amount or equity amount, (C) any reduction resulting from changes in the market value of securities or other instruments paid or payable to the Participant, or (D) any reduction in the total compensation of a group of similarly situated Participants that includes such Participant; or

(iii) any change in a Participant's status as a participant under any Change in Control compensation plan of the Company if such change in status occurs during the period beginning six (6) months prior to a Change in Control and ending twenty-four (24) months after a Change in Control; or

(iv) any change of more than fifty (50) miles in the location of the principal place of employment of such Participant immediately prior to the effective date of such change.

For purposes of this definition, none of the actions described in clauses (i) through (iv) above shall constitute "Good Reason" if taken for Cause. Additionally, none of the actions described in clauses (i) through (iv) above shall constitute "Good Reason" with respect to any Participant if remedied by the Company within thirty (30) days after receipt of written notice thereof given by such Participant (or, if the matter is not capable of remedy within thirty (30) days, then within a reasonable period of time following such thirty (30) day period, provided that the Company has commenced such remedy within said thirty (30) day period); provided that "Good Reason" shall cease to exist for any action described in clauses (i) through (iv) above on the sixtieth (60th) day following the later of the occurrence of such action or the Participant's knowledge thereof, unless such Participant has given the Company written notice thereof prior to such date.

(q) "***Grant Date***" means the date specified by the Committee on which a grant of an Award shall become effective, which shall not be earlier than the date on which the Committee takes action with respect thereto.

(r) "***Incentive Stock Option***" means an Option that meets the requirements of Section 422 of the Code or any successor provision thereto.

(s) "***Non-Employee Director***" means a director of the Company who is not an employee of the Company or an affiliate.

(t) "***Non-Qualified Stock Option***" means an Option that is not intended to be an Incentive Stock Option.

(u) "***Option***" means a right granted to a Participant under Article 7 of the Plan to purchase Stock at a specified price during specified time periods. An Option under the Plan shall be a Non-Qualified Stock Option or an Incentive Stock Option.

(v) "***Other Stock-Based Award***" means a right, granted to a Participant under Article 13, which relates to or is valued by reference to Stock or other Awards relating to Stock.

(w) "***Parent***" means a corporation which owns or beneficially owns a majority of the outstanding voting stock or voting power of the Company.

(x) "***Participant***" means a person who, as an employee, officer or director of the Company or any Subsidiary, has been granted an Award under the Plan.

(y) "***Performance Objectives***" means the performance goals or objectives, if any, established pursuant to the Plan for Participants who have been granted Awards under the Plan. Performance Objectives may be described in terms of Company-wide objectives or objectives that are related to the performance of the individual Participant or the Subsidiary, division, region, department or function within the Company or Subsidiary in which the Participant is employed. Performance Objectives may be specified in absolute terms, in percentages, or in terms of growth from period to period or growth rates over time, as well as measured relative to an established or specially-created index of Company competitors or peers. Performance Objectives need not be based upon an increase or positive result under a business criterion and could include, for example, the maintenance of the status quo or the limitation of economic losses (measured, in each case, by reference to a specific business criterion). Performance Objectives may be based on any performance criteria, provided that any performance criteria applicable to a Qualified Performance-Based Award shall be limited to specified levels of or changes in the following metrics which may or may not, at the Committee's discretion and as applicable, be calculated in accordance with generally accepted accounting principles in the United States: (1) earnings (including, but not limited to, earnings per share); (2) profit (including, but not limited to, net profit, gross profit, operating profit, economic profit, profit margins or other profit measures); (3) net or operating income; (4) revenue; (5) stock price or performance; (6) stockholder return; (7) return measures (including, but not limited to, return on assets, capital, equity or revenue); (8) EBITDA; (9) operating or EBITDA margins; (10) market share; (11) expenses (including, but not limited to, expense management, expense efficiency ratios or other expense measures); (12) business expansions or consolidation (including but not limited to, acquisitions and divestitures); (13) internal rate of return; (14) planning accuracy (as measured by comparing planned results to actual results); (15) year-over-year patient volume growth; (16) year-over-year changes in expense line items; (17) cash flow measures (including, but not limited to, free cash flow), (18) prevention of failures of internal controls or compliance, and (19) quality of care metrics (including, but not limited to, PEM Score, functional improvement measures, patient satisfaction and other metrics tracked by Medicare or Medicaid). Where applicable, those metrics may be measured on the basis of the consolidated Company, a Subsidiary, or a region or other subdivision of the business of the Company. Except in the case of a Qualified Performance-Based Award (unless and to the extent permitted under Code Section 162(m)), if the Committee determines that a change in the business, operations, corporate structure or capital structure of the Company, or the manner in which it conducts its business, or other events, circumstances or accounting entries that are unusual, nonrecurring or unrelated to the performance of the Participant render the Performance Objectives unsuitable (including, but not limited to, asset write-downs or impairment charges, litigation or claim judgments or settlements, changes in tax laws, material legislation changes, acquisitions and divestures, accounting principles or other laws or provisions affecting reported results, unusual or infrequently occurring items as described in Accounting Standards Codification Topic 225-20 or Accounting Standards Update (ASU) 2015-01 (or any successor pronouncement thereto) and/or management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to stockholders for the applicable year, foreign exchange gains and losses, or any other identifiable event of a nonrecurring or extraordinary nature), the Committee may modify or adjust such Performance Objectives or the related minimum acceptable level of achievement, in whole or in part, as the Committee deems appropriate and equitable. Notwithstanding the foregoing, the calculation of the performance result for any metric may be subject to adjustment for such pre-established items or events if the Committee deems appropriate and equitable.

(z) "***Performance Share***" means a bookkeeping entry that records the equivalent of one share of Stock awarded pursuant to Article 9.

(aa) "***Performance Unit***" means a bookkeeping entry that records a unit equivalent to $1.00 awarded pursuant to Article 9.

(bb) "***Plan***" means the HealthSouth Corporation 2016 Omnibus Performance Incentive Plan, as amended from time to time.

(cc) "***Plan Year***" means the twelve-month period beginning January 1 and ending December 31.

(dd) "***Qualified Performance-Based Award***" means an Award or portion of an Award that is intended to qualify for the Section 162(m) Exemption. The Committee shall designate any Qualified Performance-Based Award as such at the time of grant.

(ee) "***Restricted Stock***" means Stock granted to a Participant under Article 10 that is subject to certain restrictions and to risk of forfeiture.

(ff) "***Restricted Stock Unit***" or "***RSU***" means a bookkeeping entry that records a unit equivalent to one share of Stock awarded pursuant to Article 12.

(gg) "***Retirement***" means, except as otherwise provided in an Award Agreement, the voluntary termination of employment by a Participant after attaining (a) age 65 or (b) in the event that the Participant has been employed by the Company for ten (10) or more years on the date of such termination, age 60.

(hh) "***Section 162(m) Exemption***" means the exemption from the limitation on deductibility imposed by Section 162(m) of the Code that is set forth in Section 162(m)(4)(C) of the Code or any successor provision thereto.

(ii) "***Specified Employee***" means a specified employee as defined in Code Section 409A or authoritative guidance thereunder.

(jj) "***Stock***" means the $.01 par value Common Stock of the Company, and such other securities of the Company as may be substituted for Stock pursuant to Article 16.

(kk) "***Stock Appreciation Right***" or "***SAR***" means a right granted to a Participant under Article 8 to receive a payment equal to the difference between the Fair Market Value of a share of Stock as of the date of exercise of the SAR over the grant price of the SAR, all as determined pursuant to Article 8.

(ll) "***Subsidiary***" means a corporation or other entity in which the Company has a direct or indirect ownership or other equity interest.

(mm) "***1933 Act***" means the Securities Act of 1933, as amended from time to time.

(nn) "***1934 Act***" means the Securities Exchange Act of 1934, as amended from time to time.

ARTICLE 4
ADMINISTRATION

4.1. Committee. The Plan shall be administered by the Compensation Committee of the Board or, at the discretion of the Board from time to time, by the Board. The Committee shall consist of three or more members of the Board. It is intended that the directors appointed to serve on the Committee shall be "non-employee directors" (within the meaning of Rule 16b-3 promulgated under the 1934 Act) and "outside directors" (within the meaning of Code Section 162 (m) and the regulations thereunder) to the extent that Rule 16b-3 and, if necessary for relief from the limitation under Code Section 162(m) and such relief is sought by the Company, Code Section 162(m), respectively, are applicable. However, the mere fact that a Committee member shall fail to qualify under either of the foregoing requirements shall not invalidate any Award made by the Committee which Award is otherwise validly made under the Plan. During any time that the Board is

acting as administrator of the Plan, it shall have all the powers of the Committee hereunder, and any reference herein to the Committee (other than in this Section 4.1) shall include the Board.

4.2. Authority of Committee. The Committee has the exclusive power, authority and discretion to:

(a) Designate Participants;

(b) Determine the type or types of Awards to be granted to each Participant;

(c) Determine the number of Awards to be granted and the number of shares of Stock to which an Award will relate;

(d) Determine the terms and conditions of any Award granted under the Plan, including but not limited to, the exercise price, grant price, or purchase price, any restrictions or limitations on the Award (including forfeiture provisions), any schedule or provisions for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers of vesting or forfeiture provisions, based in each case on such considerations as the Committee in its sole discretion determines;

(e) Determine whether, to what extent, and under what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered;

(f) Prescribe the form of each Award Agreement, which need not be identical for each Participant and which may be in the form of a document evidencing multiple Awards to one or more Participants;

(g) Decide all other matters that must be determined in connection with an Award;

(h) Establish, adopt or revise any rules and regulations as it may deem necessary or advisable to administer the Plan;

(i) Make all other decisions, determinations and interpretations that may be required or authorized under the Plan or as the Committee deems necessary or advisable to administer the Plan;

(j) Amend the Plan or any Award Agreement as provided herein; and

(k) Adopt such modification, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of non-U.S. jurisdictions in which the Company or a Subsidiary may operate, in order to assure the viability of the benefits of Awards granted to Participants located in such other jurisdictions and to meet the objectives of the Plan.

Notwithstanding the above, the Board or the Committee may, by resolution, delegate to officers, employees or directors of the Company or any of its Subsidiaries the authority to determine individuals to be recipients of Awards under the Plan, as well as the authority to determine the number of Shares of Stock to be subject to such Awards and the terms of such Awards; provided however, that such delegation of duties and responsibilities may not be made with respect to the grant of Awards to individuals (a) who are subject to Section 16(a) of the 1934 Act at the Grant Date, or (b) who, as of the Grant Date, are reasonably anticipated to become Covered Employees during the term of the Award. The acts of such delegates shall be treated hereunder as acts of the Committee and such delegates shall report regularly to the Board and the Committee regarding the delegated duties and responsibilities and any Awards so granted.

4.3. Decisions Binding. The Committee's interpretation of the Plan, any Awards granted under the Plan, any Award Agreement and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties.

4.4. Award Agreements. Each Stock-based Award shall be evidenced by an Award Agreement. Each Award Agreement shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

ARTICLE 5
SHARES SUBJECT TO THE PLAN

5.1. Number of Shares. Subject to adjustment as provided in Sections 5.3(a) and 17.1, the aggregate number of shares of Stock reserved and available for Awards under the Plan on or after May 9, 2016 shall be fourteen million (14,000,000) shares. The total number of shares that may be granted as Incentive Stock Options is one million (1,000,000) shares.

5.2. Reduction Ratio. For purposes of Section 5.1, each share of Stock subject to an Award, other than an Option or SAR, shall reduce the number of shares of Stock available for Awards by 2.65 shares (the "***Fungibility Ratio***"). The number of shares of Stock available for Awards shall be reduced by one (1) share for each Option or SAR. If the exercise of the Option or SAR with respect to a share of Stock cancels an associated or tandem SAR or Option, respectively, with respect to such share, the associated or tandem Option and SAR shall, in the aggregate, reduce the available count by one share only. Awards that can be settled only in cash shall not reduce the number of shares of Stock available for issuance under the Plan.

5.3. Share Counting.

(a) The following (as modified by the Fungibility Ratio) shall not reduce, or may be added back to, the number of authorized shares of Stock available for issuance under the Plan:

(1) Common Stock reserved for issuance upon exercise or settlement, as applicable, of Awards granted under the Plan to the extent the Awards expire or are forfeited, canceled or surrendered;

(2) Restricted Stock granted under the Plan, to the extent such Restricted Stock is forfeited under Section 16.8 or is otherwise surrendered to the Company before the restricted period expires;

(3) Awards, to the extent the payment is actually made in cash;

(4) Shares reserved for issuance upon grant of Performance Share or Performance Unit or Other Stock-Based Award, to the extent the number of reserved shares exceeds the number of shares actually issued upon determination of the satisfaction of the related Performance Objectives;

(5) Shares reserved for issuance upon grant of RSUs, to the extent the number of reserved shares exceeds the number of shares actually issued upon settlement of RSUs; and

(6) Shares withheld by, or otherwise remitted to, the Company to satisfy a Participant's tax withholding obligations upon the lapse of restrictions on Full Value Awards granted under the Plan or upon any other payment or issuance of shares under the Plan not prohibited under Section 5.3(b)(2) below.

(b) The following shares of Stock shall not become available for issuance under the Plan:

(1) Shares withheld by, or otherwise remitted to, the Company as full or partial payment of the exercise price of an Option granted under the Plan;

(2) Shares withheld by, or otherwise remitted to, the Company to satisfy a Participant's tax withholding obligations upon the lapse of restrictions on the exercise of Options or SARs granted under the Plan;

(3) Shares not issued upon the settlement of a SAR that settles in shares of Stock;

(4) Shares remaining available for issuance (and not associated with previous grants or awards) under any prior plan of the Company after the Effective Date; and

(5) Shares reacquired by the Company in the open market or otherwise using cash proceeds from the exercise of Options or, after the Effective Date, options under any prior plan.

(c) Substitute Awards granted pursuant to Section 16.10 of the Plan shall not count against the shares of Stock otherwise available for issuance under the Plan under Section 5.1.

(d) Shares reserved for issuance in connection with grants or awards under any prior plan of the Company outstanding as of the Effective Date may be added to the number of authorized shares of Stock available for issuance under the Plan, to the extent such shares would have been added back pursuant to this Section 5.3 had such grants or awards been made under the Plan.

(e) Shares available under a stockholder approved plan of an entity which is acquired by, or merged with and into, the Company (as such shares are appropriately adjusted to reflect the financial effect of the transaction in accordance with relevant legal requirements), shall (subject to applicable stock exchange requirements) be available for the granting of Awards hereunder, and shall not count against the shares of Stock otherwise available for issuance under Section 5.1.

5.4. Annual Award Limits. The following limits (each an "***Annual Award Limit***", and collectively, "***Annual Award Limits***") shall, subject to adjustment as provided in Section 17.1, apply to grants of Awards under the Plan:

(a) Options: The maximum aggregate number of shares of Stock subject to Options which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(b) SARs: The maximum aggregate number of shares of Stock subject to SARs which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(c) Performance Shares: For Awards of Performance Shares that are intended to be Qualified Performance-Based Awards, the maximum aggregate number of shares of Stock subject to Awards of Performance Shares which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(d) Performance Units: The maximum aggregate amount that may be granted to any one Participant in any period consisting of two consecutive Plan Years shall be $10,000,000 of associated bookkeeping entry value. If, after an amount has been earned with respect to a Cash Award, the delivery of such amount is deferred, any additional amount attributable to earnings during the deferral period shall be disregarded for purposes of this limitation.

(e) Cash Awards: For Cash Awards that are intended to be Qualified Performance-Based Awards, the maximum aggregate amount that may be granted to any one Participant in any period consisting of two consecutive Plan Years shall be $10,000,000. If, after an amount has been earned with respect to a Cash Award, the delivery of such amount is deferred, any additional amount attributable to earnings during the deferral period shall be disregarded for purposes of this limitation.

(f) Restricted Stock: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Restricted Stock which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(g) Restricted Stock Units: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Restricted Stock Units which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000 and the associated bookkeeping entry value shall not exceed Fair Market Value (determined on the date of grant) of such number of shares.

(h) Other Stock-Based Awards: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Other Stock-Based Awards which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000 shares or the Fair Market Value of such number of shares (determined on the date of grant).

5.5. Stock Distributed. Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock, Stock held in treasury, or Stock purchased on the open market.

5.6. Minimum Vesting Requirements. Except with respect to Full Value Awards accounting for not greater than 5% of the aggregate number of shares of Stock reserved and available for Awards under Section 5.1 or as otherwise provided in Section 16.6, Full-Value Awards granted under the Plan to an employee shall either (i) be subject to a minimum vesting period of three years (which may include graduated vesting within such three-year period) or one year if the vesting is based on Performance Objectives, or (ii) be granted solely in lieu of cash compensation.

ARTICLE 6
ELIGIBILITY

6.1. General. Awards may be granted only to individuals who are employees, officers or directors of the Company or employees or officers of a Parent or Subsidiary.

ARTICLE 7
STOCK OPTIONS

7.1. General. The Committee is authorized to grant Options to Participants on the following terms and conditions:

(f) Exercise Price. The exercise price per share of Stock at which an Option is granted shall be determined by the Committee, provided that the exercise price for any Option (other than an Option issued as a substitute Award pursuant to Section 16.10) shall not be less than the Fair Market Value as of the Grant Date. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding Options may not be amended to reduce the exercise price or to cancel or replace outstanding underwater Options in exchange for cash, other awards or Options with an exercise price that is less than the exercise price of the corresponding original Options without stockholder approval.

(g) Time and Conditions of Exercise. The Award Agreement shall specify the time or times at which an Option may be exercised in whole or in part. The Award Agreement shall specify the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised. The Committee may waive any exercise provisions at any time in whole or in part based upon factors as the Committee may determine in its sole discretion so that the Option becomes exercisable at an earlier date. The Award Agreement may provide that an Option shall automatically exercise by means of a net settlement on a given date in the event that the expiration date occurs at a time that the participant is prohibited by law or Company policy from trading in security of the Company and such Option is in the money.

(h) Lapse of Option. The Option shall lapse ten years after it is granted, unless an earlier option expiration date is set forth in the Award Agreement, and unless an earlier lapse occurs under Section 16.8. The original term of an Option may not be extended without the prior approval of the Company's stockholders.

(i) Payment. The Award Agreement shall specify the methods by which the exercise price of an Option may be paid, the form of payment, including, without limitation, cash, shares of Stock, or other property (including "cashless exercise" arrangements) and the methods by which shares of Stock shall be delivered or deemed to be delivered to Participants.

(j) Evidence of Grant. All Options shall be evidenced by an Award Agreement between the Company and the Participant. The Award Agreement shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

ARTICLE 8
STOCK APPRECIATION RIGHTS

8.1. Grant of SARs. The Committee is authorized to grant SARs to Participants on the following terms and conditions:

(i) Right to Payment. Upon the exercise of a SAR, the Participant to whom it is granted has the right to receive the excess, if any, of:

(1) The Fair Market Value of one share of Stock on the date of exercise; over

(2) The grant price of the SAR as determined by the Committee, which shall not be less than the Fair Market Value of one share of Stock on the Grant Date except in connection with a SAR issued as a substitute Award pursuant to Section 16.10. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding SARs may not be amended to reduce the exercise price or to cancel or replace outstanding underwater SARs in exchange for cash, other awards or SARs with an exercise price that is less than the exercise price of the corresponding original SARs without stockholder approval.

(j) Other Terms. All awards of SARs shall be evidenced by an Award Agreement. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any SAR shall be determined by the Committee at the time of the grant of the Award and shall be reflected in the Award Agreement.

(k) Freestanding SARs. A SAR which is not granted in tandem with an Option or a similar right granted under any other plan of the Company shall be subject to the following:

(1) Each grant shall specify in respect of each freestanding SAR the grant price of the SAR;

(2) Successive grants may be made to the same Participant regardless of whether any freestanding SAR previously granted to such Participant remain unexercised; and

(3) Each grant shall specify the period or periods of continuous employment of the Participant by the Company or any Subsidiary that are necessary before the freestanding SARs or installments thereof shall become exercisable, and any grant may provide for the earlier exercise of such rights in the event of acceleration under Article 15.

(l) Payment in Cash or Shares. Any grant may specify that the amount payable upon the exercise of a SAR may be paid by the Company in cash, shares of Stock or any combination thereof and may (i) either grant to the Participant or reserve to the Committee the right to elect among those alternatives or (ii) preclude the right of the Participant to receive and the Company to issue shares of Stock or other equity securities in lieu of cash.

(m) Exercise Period. Any grant may specify (i) a waiting period or periods before SARs shall become exercisable and (ii) permissible dates or periods on or during which SARs shall be exercisable. No SAR granted under the Plan may be exercised more than ten years from the Grant Date. The original term of an SAR may not be extended without the prior approval of the Company's stockholders.

ARTICLE 9
PERFORMANCE SHARES OR PERFORMANCE UNITS

9.1. Grant of Performance Shares or Performance Units. The Committee is authorized to grant Performance Shares or Performance Units to Participants on such terms and conditions as may be selected by the Committee. The grant of a Performance Share to a Participant will entitle the Participant to receive at a specified later time a specified number of shares, or the equivalent cash value if the Committee so provides, if the Performance Objectives established by the Committee

are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance Unit to a Participant will entitle the Participant to receive at a specified later time a specified dollar value in cash or other property (including shares) as determined by the Committee, if the Performance Objectives in the Award are achieved or attained and the other terms and conditions thereof are satisfied. All Awards of Performance Shares or Performance Units shall be evidenced by an Award Agreement. The Award Agreement shall specify the number of Performance Shares or Performance Units to which it pertains; provided that such number may be adjusted to reflect changes in compensation or other factors. Further, the Award Agreement shall state that the Performance Shares or Performance Units are subject to all of the terms and conditions of the Plan and such other terms and provisions as the Committee may determine consistent with the Plan. An Award of Performance Shares or Performance Units may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

9.2. Right to Payment. A grant of Performance Shares or Performance Units gives the Participant rights, valued as determined by the Committee, and payable to, or exercisable by, the Participant to whom the Performance Shares or Performance Units are granted, in whole or in part, as the Committee shall establish at grant or thereafter. The Committee shall set Performance Objectives and other terms or conditions to payment of the Performance Shares or Performance Units in its discretion which, depending on the extent to which they are met, will determine the number and value of Performance Shares or Performance Units that will be paid to the Participant.

9.3. Performance Period. The performance period with respect to each Performance Share or Performance Unit shall commence on the date specified in the Award Agreement and may be subject to earlier termination in the event of an acceleration under Article 15.

9.4. Threshold Performance Objectives. Each grant may specify in respect of the specified Performance Objectives a minimum acceptable level of achievement or attainment below which no payment will be made and may set forth a formula for determining the amount of any payment to be made if performance is at or above such minimum acceptable level but falls short of the maximum achievement of the specified Performance Objectives.

9.5. Payment of Performance Shares and Performance Units. Awards of Performance Shares or Performance Units may be payable in cash, Stock, Restricted Stock, or Restricted Stock Units in the discretion of the Committee, and have such other terms and conditions as determined by the Committee and reflected in the Award Agreement. For purposes of determining the number of shares of Stock to be used in payment of a Performance Unit denominated in cash but payable in whole or in part in Stock or Restricted Stock, the number of shares to be so paid will be determined by dividing the cash value of the Award to be so paid by the Fair Market Value of a share of Stock on the date of determination by the Committee of the amount of the payment under the Award.

ARTICLE 10
AWARDS OF RESTRICTED STOCK

10.1. Grant of Restricted Stock. The Committee is authorized to make Awards of Restricted Stock to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. All Awards of Restricted Stock shall be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. Each grant of Restricted Stock shall constitute an immediate transfer of the ownership of Stock to the Participant in consideration of the performance of services, subject to the substantial risk of forfeiture and restrictions on transfer hereinafter referred to.

10.2. Issuance and Restrictions. Restricted Stock shall be subject to such restrictions on transferability as the Committee may impose. Such restrictions may include, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock, and provisions subjecting the Restricted Stock to a continuing risk of forfeiture in the hands of any transferee. These restrictions may lapse separately or in combination at such times, under such circumstances, in such installments, upon the satisfaction of Performance Objectives or otherwise, as the Committee determines at the time of the grant of the Award or thereafter.

10.3. Consideration. Each grant may be made without additional consideration from the Participant or in consideration of a payment by the Participant that is less than the Fair Market Value on the Grant Date.

10.4. Dividends, Voting and Other Ownership Rights. Unless otherwise provided in an Award Agreement or any special Plan document governing an Award, an Award of Restricted Stock shall entitle the Participant to all of the rights

of a stockholder with respect to Restricted Stock (including voting and other ownership rights) throughout the restricted period; provided, dividends (including the proceeds of reinvested dividends) shall be paid with respect to a performance-based Restricted Stock Award only to the extent the underlying Award has vested in accordance with the Plan and the applicable Award Agreement, and all other dividends rights shall be forfeited. Participants may only be entitled to dividends if permissible under the agreements or instruments governing the Company's indebtedness.

10.5. Performance-Based Restricted Stock. Any Award or the vesting thereof of Restricted Stock may be predicated on or further conditioned upon the achievement or attainment of Performance Objectives established by the Committee and may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

10.6. Reinvesting. Any grant may require that any or all dividends (if permitted under the agreements or instruments governing the Company's indebtedness) or other distributions paid on the Restricted Stock during the period of such restrictions be automatically sequestered and reinvested in additional shares of Stock, which may be subject to the same restrictions as the underlying Award or such other restrictions as the Committee may determine.

10.7. Issuance of Restricted Stock. Restricted Stock issued under the Plan following vesting shall be evidenced in a manner authorized by the General Corporation Law of the State of Delaware and may be evidenced in any such manner as the Committee shall determine. If certificates representing shares of Restricted Stock are registered in the name of the Participant, certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock or otherwise must be subject to reasonable precautions intended to prevent unauthorized transfer.

ARTICLE 11
DIVIDEND EQUIVALENTS

11.1. Grant of Dividend Equivalents. The Committee is authorized to grant Dividend Equivalents to Participants with respect to Full Value Awards, and only Full Value Awards, granted hereunder, subject to such terms and conditions as may be selected by the Committee (if permitted under agreements or instruments governing the Company's indebtedness). Dividend Equivalents shall entitle the Participant to receive payments equal to dividends with respect to all or a portion of the number of shares of Stock subject to a Full Value Award, as determined by the Committee. The Committee may provide that Dividend Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional shares of Stock, or otherwise reinvested; provided, dividends (including the proceeds of reinvested dividends) shall be paid or distributed with respect to a performance-based Award only to the extent the underlying Award has vested in accordance with the Plan and the applicable Award Agreement, and all other dividends rights shall be forfeited. An Award of Dividend Equivalents may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 12
RESTRICTED STOCK UNITS

12.1. Grant of RSUs. The Committee is authorized to make Awards of RSUs to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. All Awards of Restricted Stock shall be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. An Award of RSUs may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 13
OTHER STOCK-BASED AWARDS

13.1. Grant of Other Stock-Based Awards. The Committee is authorized, subject to limitations under applicable law and the provisions of the Plan, to grant to Participants such other Awards that are payable in, valued in whole or in part by reference to, or otherwise based on or related to shares of Stock, as deemed by the Committee to be consistent with the purposes of the Plan, including without limitation shares of Stock awarded purely as a "bonus" and not subject to any restrictions or conditions, convertible or exchangeable debt securities, other rights convertible or exchangeable into shares of Stock, and Awards valued by reference to book value of shares of Stock or the value of securities of or the performance of specified Parents or Subsidiaries. The Committee shall determine the terms and conditions of such Awards; provided, if dividend equivalent rights are granted, no payment, distribution or reinvestment of an accrued dividend on an Award shall be made unless and until each applicable Performance Objective, if any, has been achieved or satisfied in accordance with the Plan and the applicable Award Agreement. An Award made pursuant to this Article 13 may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 14
CASH AWARDS

14.1. Grant of Cash Awards. The Committee is authorized to make Cash Awards to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. Cash Awards may be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. The Committee shall determine the terms and conditions of Cash Awards. A Cash Award may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 15
CODE SECTIONS 409A AND 162(m) PROVISIONS

15.1. Code Section 409A. Notwithstanding anything in the Plan or in any Award Agreement to the contrary, to the extent that any amount or benefit that would constitute "nonqualified deferred compensation" (as defined in Section 409A of the Code) to a Participant would otherwise be payable or distributable under the Plan or any Award Agreement solely by reason of the occurrence of a Change in Control or on account of the Participant's Disability or separation from service, such amount or benefit will not be payable or distributable to the Participant by reason of such circumstance unless (i) the circumstances giving rise to such Change in Control, Disability or separation from service meet the description or definition of "change in control event", "disability" or "separation from service", as the case may be, in Section 409A of the Code and the regulations promulgated thereunder, or (ii) the payment or distribution of such amount or benefit would be exempt from the application of Section 409A of the Code by reason of the short-term deferral exemption or otherwise. Any payment or distribution of an amount or benefit that would constitute "nonqualified deferred compensation" (as defined in Section 409A of the Code), which is made on account of separation from service to a Participant who is a Specified Employee (as defined in Section 409A of the Code) may not be made before the date which is six (6) months after the date of the Specified Employee's separation from service if the payment or distribution is not exempt from the application of Section 409A of the Code by reason of the short-term deferral exemption or otherwise. This provision does not prohibit the vesting of any Award or the vesting of any right to eventual payment or distribution of any amount or benefit under the Plan or any Award Agreement. The Plan and all Awards made hereunder are intended to be exempt from the provisions of Section 409A of the Code or, to the extent subject to Section 409A of the Code, comply with Section 409A of the Code and any authoritative guidance thereunder. The Plan and all Awards made hereunder shall be interpreted, construed and administered in accordance with these intentions. Nothing in the Plan shall provide a basis for any person to take action against the Company or any affiliate based on matters covered by Section 409A of the Code, including the tax treatment of any amount paid or Award made under the Plan, and neither the Company nor any of its affiliates shall under any circumstances have any liability to any Participant or his beneficiary or estate for any taxes, penalties or interest due on amounts paid or payable under the Plan, including taxes, penalties or interest imposed under Section 409A of the Code.

15.2. Code Section 162(m). Awards issued to Covered Employees under the Plan generally are intended to be Qualified Performance-Based Awards and shall be interpreted, construed and administered in accordance with this intention. However, the Committee reserves the right to issue Awards that are not fully deductible. Further, because of ambiguities and uncertainties as to the application and interpretation of Code Section 162(m), no assurance can be given, notwithstanding the Committee's efforts, that an Award intended to satisfy the requirements for deductibility does, in fact, do so. Nothing in the Plan shall provide a basis for any person to take action against the Company or any affiliate based on matters covered by Section 162(m) of the Code, including the tax treatment of any amount paid or Award made under the Plan.

ARTICLE 16
PROVISIONS APPLICABLE TO ALL AWARDS

16.1. Term of Award. The term of each Award shall be for the period as determined by the Committee, subject to the terms of the Plan.

16.2. Limits on Transfer.

(a) Except as provided in Section 16.2(b) below, during a Participant's lifetime, his or her Awards shall be exercisable only by the Participant. No Awards may be sold, pledged, assigned, or transferred in any manner other than by will or the laws of descent and distribution; no Awards shall be subject, in whole or in part, to attachment, execution or levy of any kind; and any purported transfer in violation hereof shall be null and void. A Participant may designate a beneficiary in accordance with procedures established by the Committee pursuant to Section 16.3 below.

(b) The Committee may, in its discretion, determine that notwithstanding Section 16.2(a), any or all Awards shall be transferable to and exercisable by such transferees, and subject to such terms and conditions, as the Committee may deem appropriate; provided, however, no Award may be transferred for value (as defined in the General Instructions to Form S-8).

(c) Notwithstanding Sections 16.2(a) and (b), an Award may be transferred pursuant to a domestic relations order that would satisfy Section 414(p)(1)(A) of the Code if such Section applied to an Award under the Plan, but only if the tax consequences flowing from the assignment or transfer are specified in said order, the order is accompanied by signed agreement by both or all parties to the domestic relations order, and, if requested by the Committee, an opinion is provided by qualified counsel for the Participant that the order is enforceable by or against the Plan under applicable law, and said opinion further specifies the tax consequences flowing from the order and the appropriate tax reporting procedures for the Plan.

16.3. Beneficiaries. Notwithstanding Section 16.2, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights under the Plan is subject to all terms and conditions of the Plan and any Award Agreement applicable to the Participant, except to the extent the Plan and Award Agreement otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If no beneficiary has been properly designated or survives the Participant, payment shall be made to the Participant's estate. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Company.

16.4. Stock Certificates. All Stock issued under the Plan is subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal or state securities laws, rules and regulations and the rules of any national securities exchange or automated quotation system on which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate to reference restrictions applicable to the Stock.

16.5. Acceleration Following a Change in Control. Except as otherwise provided in the Award Agreement, upon termination of a Participant's employment by the Company without Cause or by the Participant for Good Reason within twenty-four (24) months following the occurrence of a Change in Control or to the extent the surviving entity does not assume such Awards or substitute in lieu thereof similar awards relating to the stock of such surviving entity having an equivalent then-current value and remaining term, provided that such stock must be listed, quoted, or traded on a national securities exchange or automated quotation system, all outstanding Options, SARs, and other Awards in the nature of rights that may be exercised automatically shall become fully exercisable and all restrictions (other than Performance Objectives) on all outstanding Awards automatically shall lapse. With respect to Performance Objectives applicable to any Award for which the performance period is not complete, the Committee shall have the discretionary authority to determine whether, and if so, the extent to which, (1) the performance period or the Performance Objectives shall be deemed to be satisfied or waived following a Change in Control, and (2) the Performance Objectives shall be modified, adjusted or changed on account of the Change in Control.

16.6. Acceleration for any Other Reason. Regardless of whether an event has occurred as described in Section 16.5 above, and subject to the restrictions on Qualified Performance-Based Awards, the Committee may in its sole discretion at any time accelerate the vesting provisions and/or waive the forfeiture provisions applicable to any Award or determine that all or a portion of a Participant's Options, SARs, and other Awards in the nature of rights that may be exercised shall become fully or partially exercisable, and that all or a part of the restrictions on all or a portion of the outstanding Awards shall lapse, and that any Performance Objectives with respect to any Awards held by that Participant shall be deemed to be wholly or partially satisfied, in each case, as of such date as the Committee may, in its sole discretion, declare. The discretion of the Committee in the preceding sentence shall be limited to the death, disability or Retirement of a Participant; provided,

however that the Committee may exercise such discretion for any reason with respect to Awards of up to five percent (5%) of the shares available for Awards under Section 5.1. The Committee may discriminate among Participants and among Awards granted to a Participant in exercising its discretion pursuant to this Section 16.6. Any such determinations by the Committee shall be final and binding on all parties.

16.7. Effect of Acceleration. If an Award is accelerated under Section 16.5 or 16.6, the Committee may, in its sole discretion, provide (i) that the Award will expire after a designated period of time after such acceleration to the extent not then exercised, (ii) that the Award will be settled in cash rather than Stock, (iii) that the Award will be assumed by another party to the transaction giving rise to the acceleration or otherwise be equitably converted in connection with such transaction, (iv) that the Award may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying stock, as of a specified date associated with the transaction, over the exercise price of the Award, (v) that, in the event of a Change in Control, an Award may be cancelled without payment if Fair Market Value of the underlying Stock, as of a specified date associated with such event, does not exceed the exercise price of the Award or (vi) any combination of the foregoing. The Committee's determination need not be uniform and may be different for different Participants whether or not such Participants are similarly situated.

16.8. Lapse or Forfeiture at or Following Termination of Employment. Except as otherwise provided in an Award Agreement or as otherwise determined by the Committee pursuant to the provisions of Section 16.6, the following lapse and forfeiture provisions shall apply upon a Participant's termination of employment.

(a) Termination for Cause. Any outstanding Award, including, without limitation, Awards that are unvested, vested and unexercised, or subject or not subject to restrictions, shall automatically and immediately lapse and be forfeited if the Participant's employment is terminated by the Company for Cause.

(b) Other Termination-Options and SARs. Upon a Participant's termination for any reason, the unvested portion of any outstanding Options and SARs shall terminate and be forfeited. The vested portion of any outstanding Options and SARs at the time of a Participant's termination for reasons other than for Cause shall continue to be exercisable by the Participant (or the Participant's estate in the event of the Participant's death) during the period set forth in the following chart, but in no event later than ten years from the Grant Date. At the end of such continuing exercise period, the unexercised Options and SARs shall terminate and be forfeited.

Reason for Termination	Continuing Exercise Period
Disability	1 year following termination
Death (Including death during the applicable continuing exercise period following termination for another reason)	1 year following death
Retirement	Lesser of the Original Term of Option or SAR or 3 Years
Reason Other Than Death, Disability, Retirement or Cause	90 days following termination

(c) Other Terminations - Restricted Stock, Performance Shares, Performance Units or other Awards. The following shall apply with respect to outstanding Awards of Restricted Stock, Performance Shares, Performance Units or other Awards which are unvested, unused or otherwise not immediately distributable at the time of a Participant's termination of employment for reasons other than Cause:

(i) If the Participant's employment is terminated by reason of death or Disability, then all restrictions (other than Performance Objectives) shall lapse, and, subject to the attainment of applicable Performance Objectives (which may be waived or modified by the Committee to the extent set forth below), the unearned or unvested portion of the Award shall become immediately vested, earned and nonforfeitable, and shall be distributed to the Participant (or the Participant's beneficiary in the event of

the Participant's death) as soon as reasonably practical following such termination, and in any event within 90 days thereof or of the end of the performance period, as applicable.

(ii) If the Participant's employment is terminated by reason of Retirement, then the restrictions (other than Performance Objectives) shall lapse, and, subject to the attainment of applicable Performance Objectives (which may be waived or modified by the Committee to the extent set forth below), the unearned or unvested portion of the Award shall become partially vested, earned and nonforfeitable according to the following formula: The portion that becomes vested, earned and nonforfeitable shall equal the number of shares of Stock granted as of the Grant Date multiplied by the ratio of (i) the number of full months that have elapsed from the Grant Date to the date of the Participant's Retirement, to (ii), the number of full months contained in the original term of the Award.

(iii) If the Participant's employment is terminated for any reason other than by reason of death, Disability, or Retirement then the restricted, unvested or unearned portion of the Award shall automatically and immediately be cancelled and forfeited.

With respect to any Award subject to Performance Objectives, the Committee shall have the discretion, in the event of a termination described in (i) or (ii) above during the applicable Performance Period, to waive and/or modify the Performance Objectives based on any conditions that the Committee deems reasonable, including but not limited to the formula in (ii) above or the performance status as of the termination date; provided, however, with respect to any Qualified Performance-Based Award and a termination described in (ii) above, the satisfaction of the Performance Objectives shall only be determined based on achievement during the performance period as originally established. Any Restricted Stock resulting from determination of performance pursuant to this paragraph shall vest and all other restrictions thereon shall lapse at the time the performance is determined.

(d) Determinations upon Leaves of Absence. Whether military, government or other service or other leave of absence shall constitute a termination of employment shall be determined in each case by the Committee at its discretion, and any determination by the Committee shall be final and conclusive. The Committee may in its sole discretion take any further action that it deems to be equitable under the circumstances or in the best interests of the Company, including, without limitation, waiving or modifying any limitation or requirement with respect to any Award under the Plan. The period of any leave of absence shall not be credited for vesting purposes unless otherwise determined by the Committee.

(e) Cancellation for Violation of Non-Compete. Without limiting the Committee's discretion to cancel any Award at any time, the Committee shall have full power and authority to cancel an Award if the Participant, while employed by the Company or a Subsidiary or within a period which begins on the date of termination of employment and ends on the date which is one year later, engages in any activity which is in direct competition with the Company or solicits other employees or customers of the Company or its Subsidiaries in a competitive business venture. Whether a Participant has engaged in such conduct shall be determined by the Committee in its sole discretion, taking into account any determination by the Company that the Participant has acted in violation of a non-compete or non-solicitation agreement with or obligation to the Company or a Subsidiary.

16.9. Performance Objectives. The Committee may determine that any Award granted pursuant to the Plan to a Participant (including, but not limited to, Participants who are Covered Employees) shall be determined solely or partially on the basis of Performance Objectives. If a Qualified Performance-Based Award is made on the basis of Performance Objectives, the Committee shall establish objectives prior to the beginning of the period for which such Performance Objectives relate (or such later date as may be permitted under Code Section 162(m) or the regulations thereunder). Any payment of an Award granted with Performance Objectives, including any Qualified Performance-Based Award, shall be conditioned on the determination of the Committee in each case that the Performance Objectives and any other material conditions have been satisfied. The Committee's determination shall be reflected in the Committee's minutes, and shall be based on receipt of a written certification from the Company's Human Resources Department that the Performance Objectives and any other material conditions have been satisfied.

Except in the case of Disability or death of the Participant, or upon the occurrence of a Change in Control, no Qualified Performance-Based Award held by a Covered Employee or by an employee who in the reasonable judgment of the Committee may be a Covered Employee on the date of payment, may be amended, nor may the Committee exercise any discretionary authority it may otherwise have under the Plan with respect to a Qualified Performance-Based Award under the Plan, in any manner to waive the achievement of the applicable Performance Objective or to increase the amount

payable pursuant thereto or the value thereof, or otherwise in a manner that would cause the Qualified Performance-Based Award to cease to qualify for the Section 162(m) exemption. Performance periods established by the Committee for a Qualified Performance-Based Award may be as short as three months and may be any longer period.

If a Participant is promoted, demoted or transferred to a different business unit or function during a performance period, the Committee may determine that the specified Performance Objectives are no longer appropriate and may (i) modify, adjust, change or eliminate the Performance Objectives or the applicable performance period as it deems appropriate to make such criteria and period comparable to the initial Performance Objectives and period, or (ii) make a cash payment to the Participant in an amount determined by the Committee. The foregoing two sentences shall not apply with respect to an Award that is intended to be a Qualified Performance-Based Award if the recipient of such Award (a) was a Covered Employee on the date of the modification, adjustment, change or elimination of the Performance Objective or performance period, or (b) in the reasonable judgment of the Committee, may be a Covered Employee on the date the Award is expected to be paid.

16.10. Substitute Awards. The Committee may grant Awards under the Plan in substitution for stock and stock-based awards held by employees of another entity who become employees of the Company or a Subsidiary as a result of a merger or consolidation of the former employing entity with the Company or a Subsidiary or the acquisition by the Company or a Subsidiary of property or stock of the former employing entity. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances.

ARTICLE 17
CHANGES IN CAPITAL STRUCTURE

17.1. General. In the event an extraordinary cash dividend, stock dividend, stock-split or a combination or consolidation of the outstanding stock of the Company into a lesser number of shares is declared upon the Stock, the authorization limits under Sections 5.1 and 5.4 shall be increased or decreased proportionately, and the shares of Stock then subject to each Award shall be increased or decreased proportionately without any change in the aggregate purchase price therefore; provided if the Committee elects to grant Dividend Equivalents with respect to an extraordinary cash dividend, the associated Awards shall not be adjusted pursuant to this Section. In the event the Stock shall be changed into or exchanged for a different number or class of shares of stock or securities of the Company or of another corporation, whether through reorganization, recapitalization, reclassification, share exchange, spin-off, stock split-up, combination or exchange of shares, merger or consolidation, the authorization limits under Sections 5.1 and 5.4 shall be adjusted proportionately, and there shall be substituted for each such share of Stock then subject to each Award the number and class of shares into which each outstanding share of Stock shall be so exchanged, all without any change in the aggregate purchase price for the shares then subject to each Award.

Notwithstanding anything to the contrary, upon the occurrence or in anticipation of such an event, the Committee may, in its sole discretion, provide (i) that Awards will be settled in cash rather than Stock, (ii) that Awards will be assumed by another party to a transaction or otherwise be equitably converted or substituted in connection with such transaction, (iii) that outstanding Awards may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying Stock, as of a specified date associated with the transaction, over the exercise price of the Award, (iv) that performance targets and performance periods for Awards will be modified consistent with Code Section 162(m) where applicable, or (v) any combination of the foregoing. The Committee's determination need not be uniform and may be different for different Participants whether or not such Participants are similarly situated.

ARTICLE 18
AMENDMENT, MODIFICATION AND TERMINATION

18.1. Amendment, Modification and Termination. The Committee shall have the power to amend, suspend or terminate the Plan at any time, provided that any such termination of the Plan shall not adversely affect Awards outstanding under the Plan at the time of termination. Notwithstanding the foregoing, an amendment will be contingent on approval of the Company's stockholders to the extent required by law or by the rules of any stock exchange or automated quotation system on which the Company's securities are traded or to the extent it relates to the repricing limitations set forth in Sections 7.1(a) or 8.1(a)(2) of the Plan.

18.2. Awards Previously Granted. The Committee may amend any outstanding Award in whole or in part from time to time. Any such amendment which the Committee determines, in its sole discretion, to be necessary or appropriate to conform the Award to, or otherwise satisfy, any legal requirement (including without limitation the

provisions of Code Sections 162(m) or 409A or the regulations or rulings promulgated thereunder, as well as any securities laws and the rules of any applicable securities exchanges), may be made retroactively or prospectively and without the approval or consent of the Participant. Additionally, the Committee may, without the approval or consent of the Participant, make adjustments in the terms and conditions of an Award in recognition of unusual or nonrecurring events affecting the Company or the financial statements of the Company in order to prevent the dilution or enlargement of the benefits intended to be made available pursuant to the Award. Any materially adverse amendments or adjustments to Awards not expressly contemplated in the two preceding sentences may be made by the Committee with the consent of the affected Participant(s).

ARTICLE 19
GENERAL PROVISIONS

19.1. Recoupment. Awards granted hereunder, any Stock and/or cash distributed to a Participant pursuant to the exercise or vesting of an Award, and any proceeds received by a Participant upon the sale of any such Stock, shall be subject to recoupment by the Company pursuant to, and in accordance with, the terms of the Company's Compensation Recoupment Policy, as it may be amended from time to time, which policy is hereby incorporated in the Plan by reference.

19.2. No Rights to Awards. No eligible individual shall have any claim to be granted any Award under the Plan, and neither the Company nor the Committee is obligated to treat eligible individuals uniformly, and determinations made under the Plan may be made by the Committee selectively among eligible individuals who receive, or are eligible to receive, Awards.

19.3. No Stockholder Rights. No Award gives the Participant any of the rights of a stockholder of the Company unless and until shares of Stock are in fact issued to such person in connection with such Award.

19.4. Tax Withholding. Participants shall be responsible to make appropriate provision for all taxes required to be withheld in connection with any Award or the transfer of shares of Stock pursuant to the Plan. The Company or any Parent or Subsidiary shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, and local or foreign taxes (including the Participant's FICA obligation) required by law to be withheld with respect to any taxable event arising as a result of the Plan. Accordingly, the Company shall have the right to retain from the payment under an Award the number of shares of Stock or a portion of the value of such Award equal in value to the amount of any required withholdings. With respect to withholding required upon any taxable event under the Plan, the Committee may, at the time the Award is granted or thereafter, require or permit, including at the Participant's election, that any such withholding requirement be satisfied, in whole or in part, by withholding shares of Stock having a Fair Market Value on the date of withholding equal to the amount required to be withheld for tax purposes, all in accordance with such procedures as the Committee establishes. Additionally, if the Committee so determines, the Participant may deliver to the Company unrestricted shares which have been held by the Participant for at least six (6) months, or any other shorter or longer period as necessary to avoid the recognition of an expense under generally accepted accounting principles, to satisfy any additional tax obligations owed by the Participant. The Company shall have the authority to require a Participant to remit cash to the Company in lieu of the surrender or withholding of shares of Stock for taxes if the surrender or withholding for such purpose would result in adverse tax or accounting implications for the Company.

19.5. No Right to Continued Service. Nothing in the Plan or any Award Agreement shall interfere with or limit in any way the right of the Company or any Parent or Subsidiary to terminate any Participant's employment or status as an officer or director at any time, nor confer upon any Participant any right to continue as an employee, officer or director of the Company or any Parent or Subsidiary, whether for the duration of the Participant's Award or otherwise.

19.6. Unfunded Status of Awards. The Plan is intended to be an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Agreement shall give the Participant any rights that are greater than those of a general creditor of the Company or any Parent or Subsidiary. The Plan is not intended to be subject to the Employee Retirement Income Security Act of 1974.

19.7. Indemnification. To the extent allowable under applicable law, each member of the Committee and the Board and any employee of the Company acting pursuant to delegated authority and any counsel or advisor to

the foregoing persons shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such persons in connection with or resulting from any claim, action, suit, or proceeding to which such person may be a party or in which he may be involved by reason of any action or failure to act under the Plan (except for willful misconduct) and against and from any and all amounts paid by such person in satisfaction of judgment in such action, suit, or proceeding against him provided he gives the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person may be entitled under the Company's Articles of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

19.8. Relationship to Other Benefits. No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, savings, profit sharing, group insurance, welfare or benefit plan of the Company or any Parent or Subsidiary unless provided otherwise in such other plan.

19.9. Expenses. The expenses of administering the Plan shall be borne by the Company and its Parents or Subsidiaries.

19.10. No Fiduciary Relationship. Nothing contained in the Plan, and no action taken pursuant to the provisions of the Plan, shall create or shall be construed to create a trust of any kind, or a fiduciary relationship between the Committee, the Company or its affiliates, or their officers or other representatives or the Board, on the one hand, and the Participant, the Company, its Affiliates or any other person or entity, on the other.

19.11. Fractional Shares. No fractional shares of Stock shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional shares or whether such fractional shares shall be eliminated by rounding up or down.

19.12. Government and Other Regulations. The obligation of the Company to make payment of Awards in Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by government agencies as may be required. The Company shall be under no obligation to register under the 1933 Act, or any state securities act, any of the shares of Stock paid under the Plan. The shares paid under the Plan may in certain circumstances be exempt from registration under the 1933 Act, and the Company may restrict the transfer of such shares in such manner as it deems advisable to ensure the availability of any such exemption. Payment of an Award hereunder may be delayed in the sole discretion of the Committee if the Committee reasonably anticipates that payment of the Award would violate Federal securities law or other applicable law; provided that payment shall be made at the earliest date that the Committee reasonably anticipates that making the payment will not cause such violation.

19.13. Governing Law. To the extent not governed by federal law, the Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of Delaware.

19.14. Additional Provisions. Each Award Agreement may contain such other terms and conditions as the Committee may determine; provided that such other terms and conditions are not inconsistent with the provisions of the Plan.

19.15. Foreign Participants. In order to facilitate the making of any grant or combination of grants under the Plan, the Committee may provide for such special terms for Awards to Participants who are foreign nationals, or who are employed by or perform services for the Company or any Subsidiary outside of the United States of America, as the Committee may consider necessary or appropriate to accommodate differences in local law, tax policy or custom. Moreover, the Committee may approve such supplements to, or amendments, restatements or alternative versions of, the Plan as it may consider necessary or appropriate for such purposes without thereby affecting the terms of the Plan as in effect for any other purpose, provided that no such supplements, amendments, restatements or alternative versions shall include any provisions that are inconsistent with the terms of the Plan, as then in effect, unless the Plan could have been amended to eliminate such inconsistency without further approval by the stockholders of the Company.

19.16. No Limitations on Rights of Company. The grant of any Award shall not in any way affect the right or power of the Company to make adjustments, reclassification or changes in its capital or business structure or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets. The Plan shall not restrict the authority of the Company, for proper corporate purposes, to draft or assume Awards, other than under the Plan, to or with respect to any person. If the Committee so directs, the Company may issue or transfer shares of Stock

to a Subsidiary or a Parent, for such lawful consideration as the Committee may specify, upon the condition or understanding that the Subsidiary or Parent will transfer such shares of Stock to a Participant in accordance with the terms of an Award granted to such Participant and specified by the Committee pursuant to the provisions of the Plan.

19.17. Limitations on Awards Granted to Non-Employee Directors. The maximum Grant Date Fair Market Value, as determined by the Committee, of the equity Awards granted to any Non-Employee Director in any Plan Year shall not exceed $300,000. The maximum aggregate amount, as determined by the Committee, of the Cash Awards granted to any Non-Employee Director in any Plan Year also shall not exceed $300,000. The equity and cash award limits shall be applied separately, so that the aggregate Grant Date Fair Market Value of all Awards granted to a Non-Employee Director in any Plan Year shall not exceed $600,000; provided, however, such limits shall not apply to any compensation resulting from non-preferential dividends or dividend equivalents associated with outstanding equity awards.

19.18. Payment Deferrals. The Committee, either at the time of grant or by subsequent amendment, may require or permit deferral of the payment of Awards under such rules and procedures as it may establish; provided, however, that any Options, SARs, and similar Other Stock-Based Awards that are not otherwise subject to Section 409A of the Code but would be subject to Section 409A of the Code if a deferral were permitted, shall not be subject to any deferral. The Committee also may provide that deferred settlements include the payment or crediting of interest or other earnings on the deferred amounts, or the payment or crediting of Dividend Equivalents where the deferred amounts are denominated in Stock equivalents. Any deferral and related terms and conditions shall comply with Section 409A of the Code and any authoritative guidance thereunder.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
Commission File Number 001-10315

HealthSouth Corporation
(Exact Name of Registrant as Specified in its Charter)

Delaware	**63-0860407**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
3660 Grandview Parkway, Suite 200 **Birmingham, Alabama**	**35243**
(Address of Principal Executive Offices)	**(Zip Code)**

(205) 967-7116
(Registrant's telephone number)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.01 par value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.
Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-Accelerated filer ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes ☐ No ☒

The aggregate market value of common stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $4.0 billion. For purposes of the foregoing calculation only, executive officers and directors of the registrant have been deemed to be affiliates. There were 89,777,044 shares of common stock of the registrant outstanding, net of treasury shares, as of February 16, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

The definitive proxy statement relating to the registrant's 2016 annual meeting of stockholders is incorporated by reference in Part III to the extent described therein.

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NOTE TO READERS

As used in this report, the terms "HealthSouth," "we," "us," "our," and the "Company" refer to HealthSouth Corporation and its consolidated subsidiaries, unless otherwise stated or indicated by context. This drafting style is suggested by the Securities and Exchange Commission and is not meant to imply that HealthSouth Corporation, the publicly traded parent company, owns or operates any specific asset, business, or property. The hospitals, operations, and businesses described in this filing are primarily owned and operated by subsidiaries of the parent company. In addition, we use the term "HealthSouth Corporation" to refer to HealthSouth Corporation alone wherever a distinction between HealthSouth Corporation and its subsidiaries is required or aids in the understanding of this filing. We use the term "Encompass," depending on the context, to refer to our consolidated subsidiary, EHHI Holdings, Inc. ("EHHI"), and its subsidiaries as well as the home health and hospice business operated through various subsidiaries of EHHI.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to, among other things, future events, changes to Medicare reimbursement and other healthcare laws and regulations from time to time, our business strategy, our dividend and stock repurchase strategies, our financial plans, our growth plans, our future financial performance, our projected business results, or our projected capital expenditures. In some cases, the reader can identify forward-looking statements by terminology such as "may," "will," "should," "could," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "targets," "potential," or "continue" or the negative of these terms or other comparable terminology. Such forward-looking statements are necessarily estimates based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Any forward-looking statement is based on information current as of the date of this report and speaks only as of the date on which such statement is made. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. While it is impossible to identify all such factors, factors that could cause actual results to differ materially from those estimated by us include, but are not limited to, the following:

- each of the factors discussed in Item 1A, *Risk Factors*; as well as uncertainties and factors discussed elsewhere in this Form 10-K, in our other filings from time to time with the SEC, or in materials incorporated therein by reference;
- changes in the rules and regulations of the healthcare industry at either or both of the federal and state levels, including those contemplated now and in the future as part of national healthcare reform and deficit reduction such as the reinstatement of the "75% Rule" or the introduction of site neutral payments with skilled nursing facilities for certain conditions, and related increases in the costs of complying with such changes;
- reductions or delays in, or suspension of, reimbursement for our services by governmental or private payors, including our ability to obtain and retain favorable arrangements with third-party payors;
- delays in the administrative appeals process associated with denied Medicare reimbursement claims, including from various Medicare audit programs, and our exposure to the related delay or reduction in the receipt of the reimbursement amounts for services previously provided;
- the ongoing evolution of the healthcare delivery system, including alternative payment models and value-based purchasing initiatives;
- our ability to comply with extensive and changing healthcare regulations as well as the increased costs of regulatory compliance and compliance monitoring in the healthcare industry, including the costs of investigating and defending asserted claims, whether meritorious or not;
- our ability to attract and retain nurses, therapists, and other healthcare professionals in a highly competitive environment with often severe staffing shortages and the impact on our labor expenses from potential union activity and staffing recruitment and retention;
- competitive pressures in the healthcare industry and our response to those pressures;
- changes in our payor mix or the acuity of our patients;
- our ability to successfully complete and integrate de novo developments, acquisitions, investments, and joint ventures consistent with our growth strategy, including realization of anticipated revenues, cost savings, and productivity improvements arising from the related operations;
- any adverse outcome of various lawsuits, claims, and legal or regulatory proceedings, including the ongoing investigations initiated by the U.S. Department of Health and Human Services, Office of the Inspector General;
- increased costs of defending and insuring against alleged professional liability and other claims and the ability to predict the costs related to such claims;
- potential incidents affecting the proper operation, availability, or security of our information systems;
- new or changing quality reporting requirements impacting operational costs or the Medicare reimbursement;
- the price of our common stock as it affects our willingness and ability to repurchase shares and the financial and accounting effects of any repurchases;

- our ability and willingness to continue to declare and pay dividends on our common stock;

- our ability to successfully integrate Encompass Home Health and Hospice, the inpatient rehabilitation hospitals acquired from Reliant Hospital Partners, LLC, and the home health agency operations of CareSouth Health System, Inc., including the realization of anticipated benefits from those acquisitions and avoidance of unanticipated difficulties, costs or liabilities that could arise from the acquisitions or integrations;

- our ability to maintain proper local, state and federal licensing where we and our subsidiaries do business;

- our ability to attract and retain key management personnel, including as a part of executive management succession planning; and

- general conditions in the economy and capital markets, including any instability or uncertainty related to governmental impasse over approval of the United States federal budget, an increase to the debt ceiling, or an international sovereign debt crisis.

The cautionary statements referred to in this section also should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward-looking statements, even though our situation may change in the future. Furthermore, we cannot guarantee future results, events, levels of activity, performance, or achievements.

PART I

Item 1. Business.

Overview of the Company

General

HealthSouth Corporation is one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through its network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. HealthSouth was organized as a Delaware corporation in February 1984. Its principal executive offices are located at 3660 Grandview Parkway, Birmingham, Alabama 35243, and the telephone number of the principal executive offices is (205) 967-7116.

In addition to the discussion here, we encourage the reader to review Item 1A, *Risk Factors*, Item 2, *Properties,* and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, which highlight additional considerations about HealthSouth.

We manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. The table below provides selected operating and financial data for our inpatient rehabilitation hospitals, home health agencies, and hospice agencies. See Note 18, *Segment Reporting,* to the accompanying consolidated financial statements for detailed financial information for each of our segments.

	As of or for the Year Ended December 31,[1]		
	2015	2014	2013
Consolidated data:		(Actual Amounts)	
Inpatient rehabilitation:			
Number of hospitals [2]	121	107	103
Discharges	149,161	134,515	129,988
Outpatient visits	577,507	579,555	652,266
Number of licensed beds	8,404	7,095	6,825
Home health and hospice:			
Number of home health locations [3]	186	25	25
Number of hospice locations	27	—	—
Home health admissions	74,329	7,545	7,403
Home health episodes	137,568	8,236	7,969
Hospice admissions	2,452	—	—
Net operating revenues:		(In Millions)	
Inpatient	$ 2,547.2	$ 2,272.5	$ 2,130.8
Outpatient and other	105.9	104.8	113.6
Total inpatient rehabilitation	2,653.1	2,377.3	2,244.4
Home health	478.1	28.6	28.8
Hospice	31.7	—	—
Total home health and hospice	509.8	28.6	28.8
Net operating revenues	$ 3,162.9	$ 2,405.9	$ 2,273.2

(1) The columns for 2014 and 2013 do not include amounts for Encompass because the acquisition took place on December 31, 2014, as discussed below.

(2) These amounts include 1, 1, and 2 hospitals as of December 31, 2015, 2014, and 2013, respectively, that operate as joint ventures which we account for using the equity method of accounting.

(3) The amount reported as of December 31, 2015 includes 2 locations we account for using the equity method of accounting.

Encompass Acquisition. On December 31, 2014, we completed the acquisition of EHHI Holdings, Inc. ("EHHI") and its Encompass Home Health and Hospice business ("Encompass"), which at the time consisted of 135 home health and hospice locations in 12 states. In the acquisition, we acquired all of the issued and outstanding equity interests of EHHI, other than equity interests contributed to HealthSouth Home Health Holdings, Inc. ("Holdings"), a subsidiary of HealthSouth and now indirect parent of EHHI, by certain sellers in exchange for shares of common stock of Holdings. These certain sellers were members of Encompass management, including April Anthony, the Chief Executive Officer of Encompass. These sellers contributed a portion of their shares of common stock of EHHI in exchange for approximately 16.7% of the outstanding shares of common stock of Holdings. We view Encompass as a partnership that brings together the talent and home care experience of the existing Encompass team with all of the resources and post-acute care experience of HealthSouth.

Reliant Acquisition. On October 1, 2015, we acquired all of the equity interests of the various entities operating 11 free-standing inpatient rehabilitation hospitals with a total of 902 beds in Texas, Massachusetts and Ohio from Reliant Hospital Partners, LLC ("Reliant") and its affiliates. At closing, one Reliant hospital entity had a remaining minority limited partner interest of 0.5%.

Inpatient Rehabilitation

We are the nation's largest owner and operator of inpatient rehabilitation hospitals in terms of patients treated and discharged, revenues, and number of hospitals. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. While our national network of inpatient hospitals stretches across 29 states and Puerto Rico, we are concentrated in the eastern half of the United States and Texas. In addition to our hospitals, we manage three inpatient rehabilitation units through management contracts.

Our inpatient rehabilitation hospitals offer specialized rehabilitative care across a wide array of diagnoses and deliver comprehensive, high-quality, cost-effective patient care services. As participants in the Medicare program, our hospitals must comply with various requirements that are discussed below in the "Sources of Revenues—Medicare Reimbursement—Inpatient Rehabilitation" section. Substantially all (92%) of the patients we serve are admitted from acute care hospitals following physician referrals for specific acute inpatient rehabilitative care. The majority of those patients have experienced significant physical and cognitive disabilities or injuries due to medical conditions, such as strokes, hip fractures, and a variety of debilitating neurological conditions, that are generally nondiscretionary in nature and require rehabilitative healthcare services in an inpatient setting. Our teams of highly skilled nurses and physical, occupational, and speech therapists utilize proven technology and clinical protocols with the objective of restoring our patients' physical and cognitive abilities. Patient care is provided by nursing and therapy staff as directed by physician orders while case managers monitor each patient's progress and provide documentation and oversight of patient status, achievement of goals, discharge planning, and functional outcomes. Our hospitals provide a comprehensive interdisciplinary clinical approach to treatment that leads to a higher level of care and superior outcomes.

Home Health and Hospice

Encompass is the nation's fourth largest provider of Medicare-certified skilled home health services. We transitioned substantially all of our previously existing HealthSouth home health operations to Encompass during 2015. On November 2, 2015, Encompass completed the acquisition of the home health and hospice agency operations (44 home health and 3 hospice locations in 7 states) of CareSouth Health System, Inc. These operations will also be operated under the Encompass trade name. While Encompass's national network of home health and hospice agencies stretches across 23 states, they are concentrated in the Southeast and Texas. As participants in the Medicare program, the Encompass agencies must comply with various requirements that are discussed below in the "Sources of Revenues—Medicare Reimbursement—Home Health" and "—Hospice" sections.

Encompass home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational and speech therapy, medical social work, and home health aide services. Home health patients are typically referred to us following a stay in an acute care or inpatient rehabilitation hospital or other facility, but many patients are referred from primary care settings and specialty physicians without a preceding inpatient stay. Our patients are typically older adults with two or more chronic conditions and significant functional limitations, and require greater than ten medications. Our team of registered nurses, licensed practical nurses, physical, speech and occupational therapists, medical social workers, and home health aides work closely with patients and their families to deliver patient-centered care plans focused on their needs and their goals.

Encompass also provides specialized home care services in Texas and Kansas for pediatric patients with severe medical conditions. Encompass hospice services primarily include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual

support. Our hospice care teams consist of physicians, nurses, social workers, chaplains, therapists, home health aides, and volunteers.

Competitive Strengths

As one of the nation's largest providers of post-acute healthcare services and with our experience in and focus on those services, we believe we differentiate ourselves from our competitors based on, among other things, our broad platform of clinical expertise, the quality of our clinical outcomes, the sustainability of best practices, our financial strength, and the application of technology. We also believe our competitive strengths discussed below give us the ability to adapt and succeed in a healthcare industry facing the uncertainty associated with the efforts to identify and implement workable integrated payment delivery models.

- People. We believe our approximately 34,700 employees, in particular our highly skilled clinical staff, share a steadfast commitment to providing outstanding care to our patients. We also undertake significant efforts to ensure our clinical and support staff receives the education and training necessary to provide the highest quality care in the most cost-effective manner.

- Quality. We have an extensive base of facility-based and home-based clinical experience from which we have developed best practices and protocols. We believe these clinical best practices and protocols, particularly as leveraged with industry leading technology, help ensure the delivery of consistently high-quality rehabilitative healthcare services. We have developed a program called "TeamWorks," which is a series of operations-focused initiatives using identified best practices to reduce inefficiencies and improve performance across a wide spectrum of operational areas. We believe these initiatives have enhanced, and will continue to enhance, patient-employee interactions and coordination of care and communication among the patient, the patient's family, the hospital's treatment team, and payors, which, in turn, improves outcomes and patient satisfaction. One of our primary operating initiatives in 2016 will be a TeamWorks program focused on enhancing coordinated care protocols for our hospitals and home health agencies.

  Our best practices and protocols have helped our hospitals consistently achieve patient outcomes, in terms of functional improvement, that exceed industry averages. Additionally, our hospitals participate in The Joint Commission's Disease-Specific Care Certification Program. Under this program, Joint Commission accredited organizations, like our hospitals, may seek certification for chronic diseases or conditions such as brain injury or stroke rehabilitation by complying with Joint Commission standards, effectively using evidence-based, clinical practice guidelines to manage and optimize patient care, and using an organized approach to performance measurement and evaluation of clinical outcomes. Obtaining such certifications demonstrates our commitment to excellence in providing disease-specific care. As of December 31, 2015, 102 of our hospitals hold one or more disease-specific certifications.

  In home health, Encompass places a significant emphasis on culture and technology for the purpose of furthering clinical excellence and consistency. Encompass has also developed institutional programs to, among other things, create physician-specific custom treatment protocols and provide care transition from inpatient facilities to home for higher acuity patients. As a result of its efforts, Encompass consistently achieves an acute-care readmission rate lower than the industry average along with an average quality of patient care star rating and patient satisfaction levels above the industry average.

- Efficiency and Cost Effectiveness. Our size, technology-enabled business practices, and culture help us provide facility-based and home-based healthcare services on a cost-effective basis. For example, our inpatient rehabilitation hospitals have historically received, on average, a lower per discharge payment from Medicare than the industry average payment while also treating patients with higher average acuity. Specifically, we can leverage our centralized administrative functions, identify best practices, utilize proven staffing models, and take advantage of certain supply chain efficiencies across our extensive platform of operations. At the location level, we also enjoy economies of scale as our hospitals are often larger (more beds) than industry average. Also, Encompass targets a certain patient density in the markets it serves which contributes to a lower cost per visit than competing publicly-held home health providers. In addition, our proprietary management reporting system aggregates data from each of our key business systems into a comprehensive reporting package used by the management teams in our hospitals as well as executive management. This system allows users to analyze data and trends and create custom reports on a timely basis. Likewise, Encompass utilizes Homecare Homebase^{SM}, an industry-leading information system, to provide home-based care with an emphasis on efficiency and cost effectiveness.

With a significant presence in both facility-based and home-based healthcare services, we have the opportunity to take advantage of the broader industry focus on reducing costs. In an effort to mitigate healthcare costs, third-party payors, including Medicare, have increasingly encouraged the treatment of patients in lower-cost care settings. Home health and hospice services, which typically have significantly lower cost structures than facility-based care settings, have increasingly been serving larger populations of higher acuity patients than in the past. These home-based services provide a cost-effective alternative to facility-based care where patient acuities do not require a hospital stay. Lastly, the combination of home health and hospice with our existing inpatient rehabilitative healthcare services provides us with an increased opportunity to participate in more coordinated care delivery models, such as accountable care organizations ("ACOs") and bundled payment arrangements. For additional discussion of our participation in these models, including the Bundled Payments for Care Improvement initiative and the Comprehensive Care for Joint Replacement payment model, see Item 1A, *Risk Factors,* and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview."

- Strong Cash Flow Generation and Balance Sheet. We have a proven track record of generating strong cash flows from operations that have allowed us to successfully implement our growth strategy and make significant shareholder value-enhancing distributions. As of December 31, 2015, we have a flexible balance sheet, no significant debt maturities prior to 2020, and ample availability under our revolving credit facility, which along with the cash flows generated from operations should, we believe, provide sufficient support for our business strategy.

- Technology-Enabled Processes. As a market leader in post-acute healthcare services, we have devoted substantial effort and expertise to leveraging technology to improve patient care and operating efficiencies. We have developed and implemented information technology, such as our rehabilitation-specific electronic clinical information system ("CIS") and our internally developed management reporting system described above, which we then leverage to enhance our clinical and business processes. To date, we have installed the CIS in 83 hospitals, and we expect to complete installation in our existing hospitals by the end of 2017. We believe the CIS will improve patient care and safety, streamline operating efficiencies, and enhance staff recruitment and retention, making it a key competitive differentiator.

  Encompass internally developed, and is now a licensee of, Homecare Homebase, a comprehensive information platform that allows home health providers to process clinical, compliance, and marketing information as well as analyze data and trends for management purposes using custom reports on a timely basis. The Encompass team's knowledge of Homecare Homebase as well as the thorough integration of it into the operating culture allow Encompass to maximize the system's capability to drive superior clinical, operational, and financial outcomes.

  In the context of the evolving healthcare delivery system, we believe our information systems that allow us to collect, analyze, and share information on a timely basis make us an ideal partner for other healthcare providers in a coordinated care delivery environment. Systems such as the CIS set the stage for interoperability with referral sources and health information exchanges. Of note, Encompass has a technology platform designed to manage the entire patient work flow and provide valuable data for health system, payor and ACO partners. Encompass is currently the exclusive preferred home health provider in an ACO serving approximately 20,000 patients and is exploring several other participation opportunities.

Patients and Demographic Trends

Demographic trends, such as population aging, should increase long-term demand for facility-based and home-based post-acute care services. While we treat patients of all ages, most of our patients are 65 and older, and the number of Medicare enrollees is expected to grow approximately 3% per year for the foreseeable future. We believe the demand for facility-based and home-based post-acute care services will continue to increase as the U.S. population ages and life expectancies increase. We believe these factors align with our strengths in, and focus on, post-acute services. In addition, we believe we can address the demand for facility-based and home-based post-acute care services in markets where we currently do not have a presence by constructing or acquiring new hospitals and by acquiring or opening home health and hospice agencies in that extremely fragmented industry.

Strategy

Our 2015 strategy focused on the following priorities:

- continuing to provide high-quality, cost-effective care to patients and improving patient satisfaction in our existing markets;
- achieving organic growth at our existing hospitals, home health agencies, and hospice agencies;
- expanding our services to more patients who require post-acute healthcare services by constructing and acquiring new hospitals in new markets and acquiring and opening home health and hospice agencies in new markets;
- continuing our shareholder value-enhancing strategies such as common stock dividends and repurchases of our common stock; and
- positioning the Company for continued success in the evolving healthcare delivery system. This preparation included continuing the installation of our electronic clinical information system in our hospitals which allows for interfaces with all major acute care electronic medical record systems and health information exchanges and participation in bundling projects and ACOs.

Total hospital discharges grew 10.9% from 2014 to 2015. Our same-store discharges grew 3.2% during 2015 compared to 2014. Although we did not operate Encompass' home health agencies in 2014, those agencies operated by Encompass for more than a year experienced strong admissions growth in 2015. In addition, we entered new inpatient rehabilitation markets and enhanced our geographic coverage in existing markets in 2015 by adding 14 new hospitals with 1,224 licensed beds to our portfolio. We also added a net of 85 licensed beds to our existing hospitals. Likewise, we built upon our December 31, 2014 acquisition of Encompass by adding another 59 home health and 7 hospice locations.

Our quality and outcome measures remained above both inpatient rehabilitation and home health industry averages. Not only did we treat more patients and enhance outcomes, we did so in a cost-effective manner. For additional discussion of the pursuit of our 2015 strategic priorities, including operating results, growth, and shareholder value-enhancing achievements, as well as our 2016 strategy and business outlook, see Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview," "Results of Operations," and "Liquidity and Capital Resources."

Employees

As of December 31, 2015, we employed approximately 27,110 individuals, of whom approximately 16,533 were full-time employees, in our inpatient rehabilitation business and approximately 7,590 individuals, of whom approximately 4,625 were full-time employees, in the Encompass home health and hospice business. We are subject to various state and federal laws that regulate wages, hours, benefits, and other terms and conditions relating to employment. Except for approximately 62 employees at one hospital (about 16% of that hospital's workforce), none of our employees are represented by a labor union as of December 31, 2015. Like most healthcare providers, our labor costs are rising faster than the general inflation rate. In some markets, the lack of availability of medical personnel is a significant operating issue facing healthcare providers. To address this challenge, we will continue to focus on maintaining the competitiveness of our compensation and benefit programs and improving our recruitment, retention, and productivity. Shortage of nurses and other medical personnel, including therapists, may, from time to time, require us to increase utilization of more expensive temporary personnel, which we refer to as "contract labor."

Competition

Inpatient Rehabilitation. The inpatient rehabilitation industry is highly fragmented, and we have no single, similar direct competitor. Our inpatient rehabilitation hospitals compete primarily with rehabilitation units, many of which are within acute care hospitals, in the markets we serve. For a list of our markets by state, see the table in Item 2, *Properties.* Smaller privately held companies compete with us primarily in select geographic markets in Texas and the West. In addition, there are two public companies that are primarily focused on other post-acute care services but also own or operate between 15 and 20 inpatient rehabilitation facilities each, one of which also manages the operations of inpatient rehabilitation facilities as part of its business model. Other providers of post acute-care services may attempt to become competitors in the future. For example, over the past few years, the number of nursing homes marketing themselves as offering certain rehabilitation services has increased even though nursing homes are not required to offer the same level of care, or be licensed, as hospitals. Also, acute care hospitals, including those owned or operated by large public companies or not-for-profits that have dominant positions in specific markets, may choose to expand their post-acute rehabilitation services. The primary competitive factors in any given market include the quality of care and service provided, the treatment outcomes achieved, and the relationship with the acute

care hospitals in the market, including physician-owned providers. However, the previously enacted ban on new, or expansion of existing, physician-owned hospitals should limit to some degree that competitive factor going forward unless Congress acts to repeal the ban. See the "Regulation—Relationships with Physicians and Other Providers" section below for further discussion. Additionally, for a discussion regarding the effects of certificate of need requirements on competition in some states, see the "Regulation—Certificates of Need" section below.

Home Health and Hospice. Similarly, the home health and hospice services industry is highly competitive and fragmented. There are currently more than 12,400 home health agencies and approximately 4,000 hospice agencies nationwide certified to participate in Medicare. Encompass is the fourth largest provider of Medicare-certified skilled home health services in the United States. Encompass' primary competition comes from locally owned private home health companies or acute-care hospitals with adjunct home health services and typically varies from market to market. Providers of home health and hospice services include both not-for-profit and for-profit organizations. There are six public companies, including us, with significant presences in the home health industry, the largest of which operates long-term acute care hospitals, inpatient rehabilitation facilities, nursing centers and assisted living facilities. The primary competitive factors in any given market include the quality of care and service provided, the treatment outcomes achieved, and Encompass's relationship and reputation with the acute care hospitals, physicians or other referral sources in the market. The ability to work as part of an integrated care delivery model with other providers is likely to become an increasingly important factor in competition. Competing companies may also offer varying home care services. Home health providers with scale, which include a number of other public companies, may have competitive advantages, including professional management, efficient operations, sophisticated information systems, brand recognition, and large referral bases. For a list of the Encompass home health markets by state, see the table in Item 2, *Properties.*

Regulatory and Reimbursement Challenges

Healthcare has always been a highly regulated industry. Currently, the industry is facing many well-publicized regulatory and reimbursement challenges. The industry is also facing uncertainty associated with the efforts, primarily arising from initiatives included in the Patient Protection and Affordable Care Act (as subsequently amended, the "2010 Healthcare Reform Laws"), to identify and implement workable coordinated care and integrated payment delivery models. In January 2015, the United States Department of Health and Human Services ("HHS") announced it had set various goals with respect to tying Medicare reimbursements to alternative payment models and value-based purchasing. Specifically, HHS set goals of tying 30 percent of traditional, or fee-for-service, Medicare payments to quality or value through alternative payment models, such as ACOs or bundled payment arrangements, by the end of 2016 and tying 50 percent of payments to those models by the end of 2018. HHS also set goals of tying 85 and 90 percent of traditional Medicare payments to quality or value by the end of 2016 and 2018, respectively, through programs such as those that include financial incentives for reducing acute care hospital readmissions.

Successful healthcare providers are those who provide high-quality, cost-effective care and have the ability to adjust to changes in the regulatory and operating environments. We believe we have the necessary capabilities — scale, infrastructure, balance sheet, and management — to adapt to and succeed in a highly regulated industry, and we have a proven track record of doing so. For more in-depth discussion of the primary challenges and risks related to our business, particularly the changes in Medicare reimbursement (including the impact of announced alternative payment models and value-based purchasing initiatives), increased federal compliance and enforcement burdens, and changes to our operating environment resulting from healthcare reform, see "Regulation" below in this section as well as Item 1A, *Risk Factors,* and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges."

Sources of Revenues

We receive payment for patient care services from the federal government (primarily under the Medicare program), managed care plans and private insurers, and, to a considerably lesser degree, state governments (under their respective Medicaid or similar programs) and directly from patients. Revenues and receivables from Medicare are significant to our operations. In addition, we receive relatively small payments for non-patient care activities from various sources.

We offer discounts from established charges to certain group purchasers of healthcare services that are included in "Managed care and other discount plans" in the tables below, including private insurance companies, employers, health maintenance organizations ("HMOs"), preferred provider organizations ("PPOs") and other managed care plans. Medicare, through its Medicare Advantage program, offers Medicare-eligible individuals an opportunity to participate in a managed care plan. Revenues from Medicare and Medicare Advantage represent approximately 82% of total revenues.

Patients are generally not responsible for the difference between established gross charges and amounts reimbursed for such services under Medicare, Medicaid, and other private insurance plans, HMOs, or PPOs but are responsible to the extent of

any exclusions, deductibles, copayments, or coinsurance features of their coverage. Collection of amounts due from individuals is typically more difficult than from governmental or third-party payors. The amount of these exclusions, deductibles, copayments, and coinsurance has been increasing each year but is not material to our business or results of operations.

The following tables identify the sources and relative mix of our revenues for the periods stated for each of our business segments:

Inpatient Rehabilitation

	For the Year Ended December 31,		
	2015	2014	2013
Medicare	73.2%	73.9%	74.2%
Managed care and other discount plans, including Medicare Advantage	19.0%	18.8%	18.7%
Medicaid	2.5%	1.8%	1.2%
Other third-party payors	2.0%	1.8%	1.8%
Workers' compensation	1.1%	1.2%	1.3%
Patients	0.7%	1.0%	1.1%
Other income	1.5%	1.5%	1.7%
Total	100.0%	100.0%	100.0%

Home Health and Hospice

	For the Year Ended December 31, 2015[1]
Medicare	83.7%
Managed care and other discount plans, including Medicare Advantage	10.7%
Medicaid	5.5%
Other third-party payors	—%
Workers' compensation	—%
Patients	0.1%
Other income	—%
Total	100.0%

(1) We began reporting for our home health and hospice segment in the first quarter of 2015 as a result of the acquisition of Encompass on December 31, 2014. For 2013 and 2014, the home health and hospice business was not material to our consolidated net operating revenues.

Medicare Reimbursement

Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some disabled persons, and persons with end-stage renal disease. Medicare, through statutes and regulations, establishes reimbursement methodologies and rates for various types of healthcare facilities and services. Each year, the Medicare Payment Advisory Commission ("MedPAC"), an independent agency that advises Congress on issues affecting Medicare, makes payment policy recommendations to Congress for a variety of Medicare payment systems including, among others, the inpatient rehabilitation facility prospective payment system (the "IRF-PPS"), the home health prospective payment system ("HH-PPS") and the hospice prospective payment system (the "Hospice-PPS"). Congress is not obligated to adopt MedPAC recommendations, and, based on outcomes in previous years, there can be no assurance Congress will adopt MedPAC's recommendations in a given year. For example, in recent years, Congress has not adopted any of the recommendations on the annual market basket update to Medicare payment rates under the IRF-PPS, which updates are discussed in greater detail below. However, MedPAC's recommendations have, and may in the future, become the basis for subsequent legislative or regulatory action.

The Medicare statutes and regulations are subject to change from time to time. For example, in March 2010, President Obama signed the 2010 Healthcare Reform Laws. With respect to Medicare reimbursement, the 2010 Healthcare Reform Laws provided for certain reductions to healthcare providers' annual market basket updates. In August 2011, President Obama signed

into law the Budget Control Act of 2011, as amended by the American Taxpayer Relief Act of 2012, the Bipartisan Budget Act of 2013, the Protecting Access to Medicare Act of 2014, and the Bipartisan Budget Act of 2015, that provided for an automatic 2% reduction, or "sequestration," of Medicare program payments for all healthcare providers. Sequestration took effect April 1, 2013 and will continue through 2025 unless Congress and the President take further action. Additionally, concerns held by federal policymakers about the federal deficit and national debt levels could result in enactment of further federal spending reductions, further entitlement reform legislation affecting the Medicare program, or both, in 2016 and beyond.

From time to time, Medicare reimbursement methodologies and rates can be further modified by HHS's Centers for Medicare & Medicaid Services ("CMS"). In some instances, these modifications can have a substantial impact on existing healthcare providers. In accordance with Medicare laws and statutes, CMS makes annual adjustments to Medicare payment rates in many prospective payment systems, including the IRF-PPS and HH-PPS, by what is commonly known as a "market basket update." CMS may take other regulatory action affecting rates as well. For example, under the 2010 Healthcare Reform Laws, CMS requires inpatient rehabilitation facilities ("IRFs") to submit data on certain quality of care measures for the IRF Quality Reporting Program. A facility's failure to submit the required quality data results in a two percentage point reduction to that facility's annual market basket increase factor for payments made for discharges in the subsequent Medicare fiscal year. Hospitals began submitting quality data to CMS in October 2012. All of our hospitals met the reporting deadlines occurring on or before December 31, 2014 resulting in no corresponding reimbursement reductions for fiscal years 2015 and 2016. Similarly, home health and hospice agencies are also required to submit quality data to CMS each year, and the failure to do so in accordance with the rules will result in a two percentage point reduction in their market basket update. To date, none of Encompass's home health and hospice agencies have incurred a reduction in their reimbursement rate.

We cannot predict the adjustments to Medicare payment rates Congress or CMS may make in the future. Congress, MedPAC, and CMS will continue to address reimbursement rates for a variety of healthcare settings. Any additional downward adjustment to rates for the types of facilities we operate and services we provide could have a material adverse effect on our business, financial position, results of operations, and cash flows. For additional discussion of the risks associated with our concentration of revenues from the federal government or with potential changes to the statutes or regulations governing Medicare reimbursement, see Item 1A, *Risk Factors,* and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges."

Although reductions or changes in reimbursement from governmental or third-party payors and regulatory changes affecting our business represent one of the most significant challenges to our business, our operations are also affected by other rules and regulations that indirectly affect reimbursement for our services, such as data coding rules and patient coverage rules and determinations. For example, on October 1, 2015, healthcare providers were required to begin using the updated and expanded diagnosis and procedure codes of the International Classification of Diseases 10th Edition ("ICD-10") in connection with Medicare billings. We have not experienced any significant disruptions to the billing process or Medicare payments as result of the implementation of ICD-10. Likewise, Medicare providers like us can be negatively affected by the adoption of coverage policies, either at the national or local level, that determine whether an item or service is covered and under what clinical circumstances it is considered to be reasonable and necessary. For example, current CMS coverage rules require inpatient rehabilitation services to be ordered by a physician and be coordinated by an interdisciplinary team. The interdisciplinary team must meet weekly to review patient status and make any needed adjustments to the individualized plan of care. Qualified personnel must provide the rehabilitation nursing, physical therapy, occupational therapy, speech-language pathology, social services, psychological services, and prosthetic and orthotic services that may be needed. For individual claims, Medicare contractors make coverage determinations regarding medical necessity which can represent more restrictive interpretations of the CMS coverage rules. We cannot predict how future CMS coverage rule interpretations or any new local coverage determinations will affect us.

In the ordinary course, Medicare reimbursement claims made by healthcare providers, including inpatient rehabilitation hospitals as well as home health and hospice agencies, are subject to audit from time to time by governmental payors and their agents, such as the Medicare Administrative Contractors ("MACs") that act as fiscal intermediaries for all Medicare billings and insurance carriers, as well as the OIG, CMS, and state Medicaid programs. In addition to those audits conducted by existing MACs, CMS has developed and instituted various Medicare audit programs under which CMS contracts with private companies to conduct claims and medical record audits. Some contractors are paid a percentage of the overpayments recovered. One type of audit contractor, the Recovery Audit Contractors ("RACs"), began post-payment audit processes in late 2009 for providers in general. The RACs receive claims data directly from MACs on a monthly or quarterly basis and are authorized to review claims up to three years from the date a claim was paid. Beginning May 15, 2015, CMS limited the recovery auditor look back period to six months from the date of service, in cases where the hospital submits the claim within three months of the date of service. The 2010 Healthcare Reform Laws extended the RAC program to Medicare, Parts C and D, and Medicaid. RAC audits initially focused on coding errors. CMS subsequently expanded the program to medical necessity reviews for IRFs.

CMS has also established contractors known as the Zone Program Integrity Contractors ("ZPICs"). These contractors are successors to the Program Safeguard Contractors and conduct audits with a focus on potential fraud and abuse issues. Like the RACs, the ZPICs conduct audits and have the ability to refer matters to the United States Department of Health and Human Services Office of Inspector General (the "HHS-OIG") or the United States Department of Justice. Unlike RACs, however, ZPICs do not receive a specific financial incentive based on the amount of the error.

As a matter of course, we undertake significant efforts through training and education to ensure compliance with coding and medical necessity coverage rules. However, despite our belief that our coding and assessment of patients are accurate, audits may lead to assertions that we have been underpaid or overpaid by Medicare or submitted improper claims in some instances, require us to incur additional costs to respond to requests for records and defend the validity of payments and claims, and ultimately require us to refund any amounts determined to have been overpaid. We cannot predict when or how these audit programs will affect us. For additional discussion of these audits and the risks associated with them, see Item 1A, *Risk Factors*, and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges."

A basic summary of current Medicare reimbursement in our business segments follows:

Inpatient Rehabilitation. As discussed above, our hospitals receive fixed payment reimbursement amounts per discharge under IRF-PPS based on certain rehabilitation impairment categories established by HHS. In order to qualify for reimbursement under IRF-PPS, our hospitals must comply with various Medicare rules and regulations including documentation and coverage requirements, or specifications as to what conditions must be met to qualify for reimbursement. These requirements relate to, among other things, pre-admission screening, post-admission evaluations, and individual treatment planning that all delineate the role of physicians in ordering and overseeing patient care. For example, a physician must admit each patient and in doing so determine that the patient's IRF treatment is reasonable and necessary. Also, each patient admitted to an IRF must be deemed by a physician to be medically stable and able to tolerate a minimum of three hours of therapy per day. Once in an IRF, patients must have nursing care available 24 hours, each day of the week.

Under IRF-PPS, CMS is required to adjust the payment rates based on a market basket index. Beginning in fiscal year 2016, CMS began implementing an inpatient IRF-specific market basket. The annual market basket update is designed to reflect changes over time in the prices of a mix of goods and services provided by rehabilitation hospitals and hospital-based inpatient rehabilitation units. In setting annual market basket updates, CMS uses data furnished by the Bureau of Labor Statistics for price proxy purposes, primarily in three categories: Producer Price Indexes, Consumer Price Indexes, and Employment Cost Indexes. With IRF-PPS, our hospitals retain the difference, if any, between the fixed payment from Medicare and their operating costs. Thus, our hospitals benefit from being cost-effective providers.

Over the last several years, changes in regulations governing inpatient rehabilitation reimbursement have created challenges for inpatient rehabilitation providers. Many of these changes have resulted in limitations on, and in some cases, reductions in, the levels of payments to healthcare providers. For example, in 2004, CMS narrowed its rule, known as the "75% Rule," stipulating that to qualify as an inpatient rehabilitation hospital under the Medicare program a facility must show that a certain percentage of its patients are treated for at least one of a specified and limited list of medical conditions. Under the 75% Rule, any inpatient rehabilitation hospital that failed to meet its requirements would be subject to prospective reclassification as an acute care hospital, with lower acute care payment rates for rehabilitative services. On December 29, 2007, the Medicare, Medicaid and State Children's Health Insurance Program (SCHIP) Extension Act of 2007 (the "2007 Medicare Act") was signed, setting the compliance threshold at 60% instead of 75% and allowing hospitals to continue using a patient's secondary medical conditions, or "comorbidities," to determine whether a patient qualifies for inpatient rehabilitative care under the rule. The modification of the compliance threshold in 2004 significantly reduced the total number of Medicare IRF discharges, but since setting the 60% threshold, the number of discharges has grown. In another example, the 2007 Medicare Act included an elimination of the IRF-PPS market basket adjustment for the period from April 1, 2008 through September 30, 2009 causing a reduction in the pricing of services eligible for Medicare reimbursement, or a Medicare pricing "roll-back," which resulted in a decrease in actual reimbursement dollars per discharge despite increases in costs.

On July 31, 2014, CMS released its notice of final rulemaking for the fiscal year 2015 IRF-PPS. This rule was effective for Medicare discharges between October 1, 2014 and September 30, 2015. The pricing changes in this rule included a 2.9% market basket update that was reduced by 0.2% to 2.7% under the requirements of the 2010 Healthcare Reform Laws, as well as other pricing changes that impact our hospital-by-hospital base rate for Medicare reimbursement. The 2010 Healthcare Reform Laws also require the market basket update to be reduced by a productivity adjustment on an annual basis. The productivity adjustments equal the trailing 10-year average of changes in annual economy-wide private nonfarm business multi-factor productivity. The productivity adjustment effective October 1, 2014 decreased the market basket update by 50 basis points.

On July 31, 2015, CMS released its notice of final rulemaking for fiscal year 2016 IRF-PPS (the "2016 IRF Rule"). The 2016 IRF Rule will implement a net 1.7% market basket increase effective for discharges between October 1, 2015 and September 30, 2016, calculated as follows:

Market basket update	2.4%
Healthcare reform reduction	20 basis points
Productivity adjustment reduction	50 basis points

The 2016 IRF Rule also includes other pricing changes that impact our hospital-by-hospital base rate for Medicare reimbursement. Such changes include, but are not limited to, revisions to the wage index values, changes to designations between rural and urban facilities, and updates to the outlier fixed-loss threshold. The final rule also continues the freeze to the update to the IRF-PPS facility-level rural adjustment factor, low-income patient factor, and teaching status adjustment factors. Based on our analysis which utilizes, among other things, the acuity of our patients over the 12-month period prior to the rule's release and incorporates other adjustments included in the 2016 IRF Rule, we believe the 2016 IRF Rule will result in a net increase to our Medicare payment rates of approximately 1.6% effective October 1, 2015, prior to the impact of sequestration.

Additionally, the 2016 IRF Rule contains changes that could affect us in future years. For example, pursuant to the Improving Medicare Post-Acute Care Transformation Act of 2014 (the "IMPACT Act"), CMS adopted six additional quality reporting measures, the reporting of which beginning on October 1, 2016, will require additional time and expense, and could affect reimbursement beginning October 1, 2017. CMS also adopted an IRF-specific market basket that could, in a given year, result in a higher or lower pricing update than the current market basket methodologies.

Unlike our inpatient services, our outpatient services are primarily reimbursed under the physician fee schedule of Medicare Part B. Medicare reimbursement for outpatient services are subject to an annual outpatient therapy cap and a therapy cap exception process. On October 30, 2015, CMS released its final notice of rulemaking for the payment policies under the physician fee schedule and other revisions to Part B for calendar year 2016. The provisions of this rule, including the updates to the fee schedule, are not material to us.

Home Health. Medicare pays home health benefits for patients discharged from a hospital or patients otherwise suffering from chronic conditions that require ongoing but intermittent skilled care. As a condition of participation under Medicare, patients must be homebound (meaning unable to leave their home without a considerable and taxing effort), require intermittent skilled nursing, physical therapy or speech therapy services, or have a continuing need for occupational therapy, and receive treatment under a plan of care established and periodically reviewed by a physician. The 2010 Healthcare Reform Laws mandate that, prior to certifying a patient's eligibility for the home health benefit, the certifying physician must document that he or she or a qualifying nurse practitioner has had a face-to-face encounter with the patient. Medicare pays home health providers under the HH-PPS for each 60-day period of care for each patient. Payments are adjusted based on each patient's condition and clinical treatment. This is referred to as the case-mix adjustment. In addition to the case-mix adjustment, payments for periods of care may be adjusted for other reasons, including unusually large (outlier) costs, low-utilization patients that require four or fewer visits, and geographic differences in wages. Payments are also made for non-routine medical supplies that are used in treatment. Home health providers receive either 50% or 60% of the estimated base payment for the full 60 days for each patient upon submission of the initial claim. The estimate is based on the patient's condition and treatment needs. The provider receives the remaining portion of the payment after the 60-day treatment period, subject to any applicable adjustments. If a patient remains eligible for care after that period, a new 60-day treatment period may begin. There are currently no limits to the number of home health treatment periods an eligible Medicare patient may receive.

On October 30, 2014, CMS released its notice of final rulemaking for the calendar year 2015 HH-PPS. CMS estimated the rule would cut Medicare payments to home health agencies by 0.3% in 2015. Specifically, while the rule provided for a market basket update of 2.6%, that update was offset by a 2.4% rebasing adjustment reduction (the second year of a four-year phase-in) and a productivity adjustment reduction of 50 basis points.

The final rule also addressed a number of policy proposals. Notably, CMS modified the home health face-to-face encounter documentation requirements, including eliminating the narrative as part of the certification of eligibility and providing more flexibility in procedures for obtaining documentation supporting patient eligibility.

On October 29, 2015, CMS released its notice of final rulemaking for calendar year 2016 for home health agencies under the HH-PPS (the "2016 HH Rule"). Specifically, while the rule provides for a market basket update of 2.3%, that update is offset by a 2.4% rebasing adjustment reduction (the third year of a four-year phase-in), a productivity adjustment reduction of 40 basis points, and a nominal case-mix coding intensity reduction of 90 basis points. The 2016 HH Rule also includes other pricing changes, such as a reduction to the case-mix weights for certain cases, that impact our Medicare reimbursement. Based

on our analysis, we believe the 2016 HH Rule will result in a net decrease to our Medicare home health payment rates of approximately 1.7% effective for episodes ending in calendar year 2016, before sequestration.

As previously noted, the HH-PPS provides that quality reporting requirements must be satisfied in order for agencies to avoid a 2% reduction in their annual HH-PPS payment update percentage. All home health agencies must submit both admission and discharge outcome and assessment information sets, or "OASIS assessments," for a minimum of 70% of all patients with episodes of care occurring during the reporting period starting July 1, 2015. In the 2016 HH Rule, CMS increased the minimum reporting threshold to 80% for episodes occurring between July 1, 2016 and June 30, 2017, and to 90% for episodes occurring from July 1, 2017 and thereafter. We do not expect, based on our agencies' current OASIS submission rates, to experience a material impact from these changes.

In addition, the 2016 HH Rule establishes a Home Health Value-Based Purchasing model in nine states that will include five performance years beginning January 1, 2016 and test whether incentives for better care can improve outcomes in the delivery of home health services. The model would apply a reduction or increase to current Medicare-certified home health agency payments, depending on quality performance, made to agencies in those nine states. For additional discussion of this model, see Item 1A, *Risk Factors*, and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges."

Hospice. Medicare pays hospice benefits for patients with life expectancies of six months or less, as documented by the patient's physician(s). Under Medicare rules, patients seeking hospice benefits must agree to forgo curative treatment for their terminal medical conditions. For each day a patient elects hospice benefits, Medicare pays an adjusted daily rate based on patient location, and payments represent a prospective per diem amount tied to one of four different categories or levels of care: routine home care, continuous home care, inpatient respite care, and general inpatient care. Medicare hospice reimbursements to each provider are also subject to two annual caps, one limiting total hospice payments based on the average annual payment per beneficiary and another limiting payments based on the number of days of inpatient care billed by the hospice provider. There are currently no limits to the number of hospice benefit periods an eligible Medicare patient may receive, and a patient may revoke the benefit at any time.

On July 31, 2015, CMS released its notice of final rulemaking for fiscal year 2016 for hospice agencies under the hospice-PPS (the "2016 Hospice Rule"). The final rule would impact hospice payments between October 1, 2015 and September 30, 2016. Specifically, the rule provides for a market basket update of 2.4%, which was reduced by 30 basis points under the requirements of the 2010 Healthcare Reform Laws and a productivity adjustment of 50 basis points, as well as other pricing changes including a 70 basis point reduction for the final year of a seven-year phase-out of a wage index budget neutrality adjustment factor and a 20 basis point increase to implement a new wage index. The provisions of the 2016 Hospice Rule were not material to us.

For additional discussion of matters and risks related to reimbursement, see Item 1A, *Risk Factors*.

Managed Care and Other Discount Plans

We offer discounts from established charges to certain large group purchasers of healthcare services, including Medicare Advantage, managed care plans, private insurance companies, and third-party administrators. Managed care contracts typically have terms between one and three years, although we have a number of managed care contracts that automatically renew each year (with pre-defined rate increases) unless a party elects to terminate the contract. In 2015, typical rate increases for our inpatient rehabilitation contracts ranged from 2-4% and for our home health and hospice contracts ranged from 0-2%. We cannot provide any assurance we will continue to receive increases in the future. Our managed care staff focuses on establishing and re-negotiating contracts that provide equitable reimbursement for the services provided.

Medicaid Reimbursement

Medicaid is a jointly administered and funded federal and state program that provides hospital and medical benefits to qualifying individuals who are deemed unable to afford healthcare. As the Medicaid program is administered by the individual states under the oversight of CMS in accordance with certain regulatory and statutory guidelines, there are substantial differences in reimbursement methodologies and coverage policies from state to state. Many states have experienced shortfalls in their Medicaid budgets and are implementing significant cuts in Medicaid reimbursement rates. Additionally, certain states control Medicaid expenditures through restricting or eliminating coverage of certain services. Continuing downward pressure on Medicaid payment rates could cause a decline in that portion of our *Net operating revenues*. However, for the year ended December 31, 2015, Medicaid payments represented only 3.0% of our consolidated *Net operating revenues*. In certain states in which we operate we are experiencing an increase in Medicaid patients, likely the result of expanded coverage consistent with

the intent of the 2010 Healthcare Reform Laws. For additional discussion, see Item 1A, *Risk Factors*, "Changes in our payor mix or the acuity of our patients could adversely impact our revenues or our profitability."

Cost Reports

Because of our participation in Medicare, Medicaid, and certain Blue Cross and Blue Shield plans, we are required to meet certain financial reporting requirements. Federal and, where applicable, state regulations require the submission of annual cost reports covering the revenue, costs, and expenses associated with the services provided by inpatient hospital, home health, and hospice providers to Medicare beneficiaries and Medicaid recipients. These annual cost reports are subject to routine audits which may result in adjustments to the amounts ultimately determined to be due to us under these reimbursement programs. These audits are used for determining if any under- or over-payments were made to these programs and to set payment levels for future years. Medicare also makes retroactive adjustments to payments for certain low-income patients after comparing subsequently published statistical data from CMS to the cost report data. We cannot predict what retroactive adjustments, if any, will be made, but we do not anticipate such adjustments would have a material impact on us.

Regulation

The healthcare industry is subject to significant federal, state, and local regulation that affects our business activities by controlling the reimbursement we receive for services provided, requiring licensure or certification of our operations, regulating our relationships with physicians and other referral sources, regulating the use of our properties, and controlling our growth. We are also subject to the broader federal and state regulations that prohibit fraud and abuse in the delivery of healthcare services. As a healthcare provider, we are subject to periodic audits, examinations and investigations conducted by, or at the direction of, government investigative and oversight agencies. Violations of the applicable federal and state healthcare regulations can result in a provider's exclusion from participation in government reimbursement programs and in substantial civil and criminal penalties.

We undertake significant effort and expense to provide the medical, nursing, therapy, and ancillary services required to comply with local, state, and federal regulations, as well as, for most facilities, accreditation standards of The Joint Commission (formerly known as the Joint Commission on Accreditation of Healthcare Organizations) and, for some facilities, the Commission on Accreditation of Rehabilitation Facilities.

We maintain a comprehensive compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. The program is intended to monitor and raise awareness of various regulatory issues among employees and to emphasize the importance of complying with governmental laws and regulations. As part of the compliance program, we provide annual compliance training to our employees and encourage all employees to report any violations to their supervisor or through a toll-free telephone hotline.

Licensure and Certification

Healthcare facility construction and operation are subject to numerous federal, state, and local regulations relating to, among other things, the adequacy of medical care, equipment, personnel, operating policies and procedures, acquisition and dispensing of pharmaceuticals and controlled substances, infection control, maintenance of adequate records and patient privacy, fire prevention, and compliance with building codes and environmental protection laws. Our hospitals are subject to periodic inspection and other reviews by governmental and non-governmental certification authorities to ensure continued compliance with the various standards necessary for facility licensure. All of our inpatient hospitals are currently required to be licensed.

In addition, hospitals must be certified by CMS to participate in the Medicare program and generally must be certified by Medicaid state agencies to participate in Medicaid programs. Once certified by Medicare, hospitals undergo periodic on-site surveys and revalidations in order to maintain their certification. All of our inpatient hospitals participate in the Medicare program.

Encompass agencies are each licensed under applicable law, certified by CMS for participation in the Medicare program, and generally certified by the applicable state Medicaid agencies to participate in those programs.

Failure to comply with applicable certification requirements may make our hospitals and agencies, as the case may be, ineligible for Medicare or Medicaid reimbursement. In addition, Medicare or Medicaid may seek retroactive reimbursement from noncompliant providers or otherwise impose sanctions for noncompliance. Non-governmental payors often have the right to terminate provider contracts if the provider loses its Medicare or Medicaid certification.

The 2010 Healthcare Reform Laws added new screening requirements and associated fees for all Medicare providers. The screening must include a licensure check and may include other procedures such as fingerprinting, criminal background checks, unscheduled and unannounced site visits, database checks, and other screening procedures prescribed by CMS.

We have developed operational systems to oversee compliance with the various standards and requirements of the Medicare program and have established ongoing quality assurance activities; however, given the complex nature of governmental healthcare regulations, there can be no assurance Medicare, Medicaid, or other regulatory authorities will not allege instances of noncompliance. A determination by a regulatory authority that a facility is not in compliance with applicable requirements could also lead to the assessment of fines or other penalties, loss of licensure, exclusion from participation in Medicare and Medicaid, and the imposition of requirements that an offending facility takes corrective action.

Certificates of Need

In some states and U.S. territories where we operate, the construction or expansion of facilities, the acquisition of existing facilities or agencies, or the introduction of new beds or inpatient, home health, and hospice services may be subject to review by and prior approval of state regulatory bodies under a "certificate of need," or "CON," law. As of December 31, 2015, approximately 52% of our licensed beds and 19% of our home health and hospice locations are located in states or U.S. territories that have CON laws. CON laws often require a reviewing agency to determine the public need for additional or expanded healthcare facilities and services. These laws also generally require approvals for capital expenditures involving inpatient rehabilitation hospitals, if such capital expenditures exceed certain thresholds. In addition, CON laws in some states require us to abide by certain charity care commitments as a condition for approving a CON. Any time a CON is required, we must obtain it before acquiring, opening, reclassifying, or expanding a healthcare facility, starting a new healthcare program, or opening a new home health or hospice agency.

We potentially face opposition any time we initiate a CON project or seek to acquire an existing facility, agency, or CON. This opposition may arise either from competing national or regional companies or from local hospitals, agencies, or other providers which file competing applications or oppose the proposed CON project. Opposition to our applications may delay or prevent our future addition of beds, hospitals, or agencies in given markets or increase our costs in seeking those additions. The necessity for these approvals serves as a barrier to entry and has the potential to limit competition, including in markets where we hold a CON and a competitor is seeking an approval. We have generally been successful in obtaining CONs or similar approvals when required, although there can be no assurance we will achieve similar success in the future, and the likelihood of success varies by locality and state.

False Claims

The federal False Claims Act prohibits the knowing presentation of a false claim to the United States government and provides for penalties equal to three times the actual amount of any overpayments plus up to $11,000 per claim. Beginning no later than August 1, 2016, federal civil penalties will be adjusted to account for inflation each year. In addition, the False Claims Act allows private persons, known as "relators," to file complaints under seal and provides a period of time for the government to investigate such complaints and determine whether to intervene in them and take over the handling of all or part of such complaints. Because we perform thousands of similar procedures a year for which we are reimbursed by Medicare and other federal payors and there is a relatively long statute of limitations, a billing error or cost reporting error could result in significant civil or criminal penalties under the False Claims Act. Many states have also adopted similar laws relating to state government payments for healthcare services. The 2010 Healthcare Reform Laws amended the federal False Claims Act to expand the definition of false claim, to make it easier for the government to initiate and conduct investigations, to enhance the monetary reward to relators where prosecutions are ultimately successful, and to extend the statute of limitations on claims by the government. The federal government has become increasingly aggressive in asserting that incidents of erroneous billing or record keeping represent a violation of the False Claims Act. For additional discussion, see Item 1A, *Risk Factors*, and Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements.

Relationships with Physicians and Other Providers

Anti-Kickback Law. Various state and federal laws regulate relationships between providers of healthcare services, including management or service contracts and investment relationships. Among the most important of these restrictions is a federal law prohibiting the offer, payment, solicitation, or receipt of remuneration by individuals or entities to induce referrals of patients for services reimbursed under the Medicare or Medicaid programs (the "Anti-Kickback Law"). The 2010 Healthcare Reform Laws amended the federal Anti-Kickback Law to provide that proving violations of this law does not require proving actual knowledge or specific intent to commit a violation. Another amendment made it clear that Anti-Kickback Law violations can be the basis for claims under the False Claims Act. These changes and those described above related to the False Claims Act, when combined with other recent federal initiatives, are likely to increase investigation and enforcement efforts in the

healthcare industry generally. In addition to standard federal criminal and civil sanctions, including imprisonment and penalties of up to $50,000 for each violation plus tripled damages for improper claims, violators of the Anti-Kickback Law may be subject to exclusion from the Medicare and/or Medicaid programs. In 1991, the HHS-OIG issued regulations describing compensation arrangements that are not viewed as illegal remuneration under the Anti-Kickback Law. Those regulations provide for certain safe harbors for identified types of compensation arrangements that, if fully complied with, assure participants in the particular arrangement that the HHS-OIG will not treat that participation as a criminal offense under the Anti-Kickback Law or as the basis for an exclusion from the Medicare and Medicaid programs or the imposition of civil sanctions. Failure to fall within a safe harbor does not constitute a violation of the Anti-Kickback Law, but the HHS-OIG has indicated failure to fall within a safe harbor may subject an arrangement to increased scrutiny. A violation of the Anti-Kickback Law by us or one or more of our partnerships could have a material adverse effect upon our business, financial position, results of operations, or cash flows. Even the assertion of a violation could have an adverse effect upon our stock price or reputation.

Some of our rehabilitation hospitals are owned through joint ventures with institutional healthcare providers that may be in a position to make or influence referrals to our hospitals. In addition, we have a number of relationships with physicians and other healthcare providers, including management or service contracts. Some of these investment relationships and contractual relationships may not meet all of the regulatory requirements to fall within the protection offered by a relevant safe harbor. Despite our compliance and monitoring efforts, there can be no assurance violations of the Anti-Kickback Law will not be asserted in the future, nor can there be any assurance our defense against any such assertion would be successful.

For example, we have entered into agreements to manage our hospitals that are owned by partnerships. Most of these agreements incorporate a percentage-based management fee. Although there is a safe harbor for personal services and management contracts, this safe harbor requires, among other things, the aggregate compensation paid to the manager over the term of the agreement be set in advance. Because our management fee may be based on a percentage of revenues, the fee arrangement may not meet this requirement. However, we believe our management arrangements satisfy the other requirements of the safe harbor for personal services and management contracts and comply with the Anti-Kickback Law.

Physician Self-Referral Law. The federal law commonly known as the “Stark law” and CMS regulations promulgated under the Stark law prohibit physicians from making referrals for “designated health services” including inpatient and outpatient hospital services, physical therapy, occupational therapy, radiology services, and home health services, to an entity in which the physician (or an immediate family member) has an investment interest or other financial relationship, subject to certain exceptions. The Stark law also prohibits those entities from filing claims or billing Medicare for those referred services. Violators of the Stark law and regulations may be subject to recoupments, civil monetary sanctions (up to $15,000 for each violation and assessments up to three times the amount claimed for each prohibited service) and exclusion from any federal, state, or other governmental healthcare programs. The statute also provides a penalty of up to $100,000 for a circumvention scheme. There are statutory exceptions to the Stark law for many of the customary financial arrangements between physicians and providers, including personal services contracts and leases. However, in order to be afforded protection by a Stark law exception, the financial arrangement must comply with every requirement of the applicable exception.

Under the 2010 Healthcare Reform Laws, the exception to the Stark law that currently permits physicians to refer patients to hospitals in which they have an investment or ownership interest has been dramatically limited by providing that only physician-owned hospitals with a provider agreement in place on December 31, 2010 are exempt from the general ban on self-referral. Existing physician-owned hospitals are prohibited from increasing the physician ownership percentage in the hospital after March 23, 2010. Additionally, physician-owned hospitals are prohibited from increasing the number of licensed beds after March 23, 2010, except when certain market and regulatory approval conditions are met. Currently, we have no hospitals that would be considered physician-owned under this law, except for one hospital recently acquired from Reliant which has an outside limited partner with a 0.5% equity interest.

CMS has issued several phases of final regulations implementing the Stark law. On November 16, 2015, CMS issued a new rule revising, clarifying, and adding two exceptions in order to accommodate delivery and payment system reform, reduce burdens on physicians and other providers, and promote compliance. While the changes are generally expected to help providers comply with the Stark law requirements, the complexity of the law and the associated regulations will remain a challenge for healthcare providers, who do not always have the benefit of significant regulatory or judicial interpretation of these laws and regulations. We attempt to structure our relationships to meet one or more exceptions to the Stark law, but the regulations implementing the exceptions are detailed and complex. Accordingly, we cannot assure that every relationship complies fully with the Stark law.

Additionally, no assurances can be given that any agency charged with enforcement of the Stark law and regulations might not assert a violation under the Stark law, nor can there be any assurance our defense against any such assertion would be successful or that new federal or state laws governing physician relationships, or new interpretations of existing laws governing such relationships, might not adversely affect relationships we have established with physicians or result in the imposition of

penalties on us or on particular HealthSouth hospitals or another of our providers. Even the assertion of a violation could have an adverse effect upon our stock price or reputation.

HIPAA

The Health Insurance Portability and Accountability Act of 1996, commonly known as "HIPAA," broadened the scope of certain fraud and abuse laws by adding several criminal provisions for healthcare fraud offenses that apply to all health benefit programs. HIPAA also added a prohibition against incentives intended to influence decisions by Medicare or Medicaid beneficiaries as to the provider from which they will receive services. In addition, HIPAA created new enforcement mechanisms to combat fraud and abuse, including the Medicare Integrity Program, and an incentive program under which individuals can receive up to $1,000 for providing information on Medicare fraud and abuse that leads to the recovery of at least $100 of Medicare funds. Penalties for violations of HIPAA include civil and criminal monetary penalties. The HHS Office of Civil Rights ("HHS-OCR") began conducting pilot HIPAA audits of healthcare providers in 2015 and will implement a permanent program nationwide in early 2016.

HIPAA and related HHS regulations contain certain administrative simplification provisions that require the use of uniform electronic data transmission standards for certain healthcare claims and payment transactions submitted or received electronically. HIPAA regulations also regulate the use and disclosure of individually identifiable health-related information, whether communicated electronically, on paper, or orally. The regulations provide patients with significant rights related to understanding and controlling how their health information is used or disclosed and require healthcare providers to implement administrative, physical, and technical practices to protect the security of individually identifiable health information that is maintained or transmitted electronically.

With the enactment of the Health Information Technology for Economic and Clinical Health ("HITECH") Act as part of the American Recovery and Reinvestment Act of 2009, the privacy and security requirements of HIPAA have been modified and expanded. The HITECH Act applies certain of the HIPAA privacy and security requirements directly to business associates of covered entities. The modifications to existing HIPAA requirements include: expanded accounting requirements for electronic health records, tighter restrictions on marketing and fundraising, and heightened penalties and enforcement associated with noncompliance. Significantly, the HITECH Act also establishes new mandatory federal requirements for notification of breaches of security involving protected health information. HHS is responsible for enforcing the requirement that covered entities notify any individual whose protected health information has been improperly acquired, accessed, used, or disclosed. In certain cases, notice of a breach is required to be made to HHS and media outlets. The heightened penalties for noncompliance range from $100 to $50,000 per violation for most violations. In the event of violations due to willful neglect that are not corrected within 30 days, penalties start at $50,000 per violation and are not subject to a per violation statutory maximum. All penalties are subject to a $1,500,000 cap for multiple identical violations in a single calendar year. Willful neglect could include the failure to conduct a security risk assessment or adequately implement HIPAA compliance policies.

On January 17, 2013, the HHS-OCR issued a final rule, with a compliance date of September 23, 2013, to implement the HITECH Act and make other modifications to the HIPAA and HITECH regulations. This rule expanded the potential liability for a breach involving protected health information to cover some instances where a subcontractor is responsible for the breaches and that individual or entity was acting within the scope of delegated authority under the related contract or engagement. The final rule generally defines "breach" to mean the acquisition, access, use or disclosure of protected health information in a manner not permitted by the HIPAA privacy standards, which compromises the security or privacy of protected health information. Under the final rule, improper acquisition, access, use, or disclosure is presumed to be a reportable breach, unless the potentially breaching party can demonstrate a low probability that protected health information has been compromised. On the whole, it appears the changes to the breach reporting rules could increase breach reporting in the healthcare industry.

In addition, there are numerous legislative and regulatory initiatives at the federal and state levels addressing patient privacy concerns. Healthcare providers will continue to remain subject to any federal or state privacy-related laws that are more restrictive than the privacy regulations issued under HIPAA. These laws vary and could impose additional penalties. Any actual or perceived violation of privacy-related laws and regulations, including HIPAA and the HITECH Act, could have a material adverse effect on our business, financial position, results of operations, and cash flows.

Available Information

Our website address is www.healthsouth.com. We make available through our website the following documents, free of charge: our annual reports (Form 10-K), our quarterly reports (Form 10-Q), our current reports (Form 8-K), and any amendments to those reports promptly after we electronically file such material with, or furnish it to, the United States Securities and Exchange Commission. In addition to the information that is available on our website, the reader may review and

copy any materials we file with or furnish to the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The reader may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website, www.sec.gov, which includes reports, proxy and information statements, and other information regarding us and other issuers that file electronically with the SEC.

Item 1A. Risk Factors

Our business, operations, and financial position are subject to various risks. Some of these risks are described below, and the reader should take such risks into account in evaluating HealthSouth or any investment decision involving HealthSouth. This section does not describe all risks that may be applicable to us, our industry, or our business, and it is intended only as a summary of certain material risk factors. More detailed information concerning other risk factors as well as those described below is contained in other sections of this annual report.

Reductions or changes in reimbursement from government or third-party payors could adversely affect our Net operating revenues and other operating results.

We derive a substantial portion of our *Net operating revenues* from the Medicare program. See Item 1, *Business*, "Sources of Revenues," for a table identifying the sources and relative payor mix of our revenues. In addition to many ordinary course reimbursement rate changes that the United States Department of Health and Human Services, Centers for Medicare and Medicaid Services ("CMS"), adopts each year as part of its annual rulemaking process for various healthcare provider categories, Congress and some state legislatures have periodically proposed significant changes in laws and regulations governing the healthcare system. Many of these changes have resulted in limitations on the increases in and, in some cases, significant roll-backs or reductions in the levels of payments to healthcare providers for services under many government reimbursement programs. There can be no assurance that future governmental initiatives will not result in pricing roll-backs or freezes or reimbursement reductions.

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act (as subsequently amended, the "2010 Healthcare Reform Laws"). Many provisions within the 2010 Healthcare Reform Laws have impacted or could in the future impact our business, including: (1) Medicare reimbursement reductions, such as reductions to annual market basket updates to providers and reimbursement rate rebasing adjustments; (2) the possible combining, or "bundling," of reimbursement for a Medicare beneficiary's episode of care at some point in the future; (3) implementing a voluntary program for accountable care organizations ("ACOs"); and (4) creating an Independent Payment Advisory Board.

For our inpatient rehabilitation hospitals, these laws include reductions in CMS's annual adjustments to Medicare reimbursement rates by what is commonly known as a "market basket update." In accordance with Medicare laws and statutes, CMS makes market basket updates by provider type. The reductions in the annual market basket updates for our hospitals continue through 2019 for each CMS fiscal year, which for us begins October 1, as follows:

2016	2017-19
0.2%	0.75%

In addition, the 2010 Healthcare Reform Laws require the market basket update for our hospitals to be reduced by a productivity adjustment on an annual basis. The productivity adjustments equal the trailing 10-year average of changes in annual economy-wide private nonfarm business multi-factor productivity. The productivity adjustment in effect for fiscal year (October 1 to September 30) 2016 is a decrease to the market basket update of 50 basis points.

For home health agencies, the 2010 Healthcare Reform Laws directed CMS to improve home health payment accuracy through rebasing home health payments over four years starting in 2014. The rebasing adjustment for calendar year 2016 (the third year of the four-year phase-in) offset the annual market basket update of 2.3% with a 2.4% reduction. CMS is also implementing a case-mix coding intensity reduction of 90 basis points in 2016. In addition, the 2010 Healthcare Reform Laws also require an annual home health productivity adjustment. For calendar year 2016, that adjustment is a decrease to the market basket update of 40 basis points.

For hospice agencies, the 2010 Healthcare Reform laws require, in addition to an annual productivity adjustment, further reduction of the annual market basket update of 30 basis points for fiscal years through 2019. The hospice productivity adjustment for the fiscal year beginning October 1, 2015 was a decrease to the market basket update of 50 basis points.

Other federal legislation can also have a significant direct impact on our Medicare reimbursement. On August 2, 2011, President Obama signed into law the Budget Control Act of 2011, which provided for an automatic 2% reduction of Medicare

program payments. This automatic reduction, known as "sequestration," which began affecting payments received after April 1, 2013, reduced the payments we receive under the inpatient rehabilitation facility prospective payment system (the "IRF-PPS") resulting in a net year-over-year decrease in our *Net operating revenues* of approximately $9 million in 2014. The effect of sequestration on year-over-year comparisons of *Net operating revenues* ceased on April 1, 2014. However, each year through 2025, the reimbursement we receive from Medicare, after first taking into account all annual payment adjustments including the market basket update, will be reduced by sequestration unless it is repealed before then.

Additionally, concerns held by federal policymakers about the federal deficit and national debt levels could result in enactment of further federal spending reductions, further entitlement reform legislation affecting the Medicare program, and/or further reductions to provider payments. For example, on April 16, 2015, the President signed into law the Medicare Access and CHIP (Children's Health Insurance Program) Reauthorization Act, which repealed the statutory mechanism providing for annual automatic adjustments to the Medicare physician fee schedule using a sustainable growth rate formula that has historically resulted in annual deep cuts to physician reimbursement rates, a consequence of which has been the so-called "doc fixes" passed by Congress annually since 2002 to override those automatic adjustments. The primary impact of this act on us is a mandated market basket update of +1.0% in 2018 for rehabilitation hospitals as well as home health and hospice agencies.

In October 2014, the President signed into law the Improving Medicare Post-Acute Care Transformation Act of 2014 (the "IMPACT Act"). The IMPACT Act was developed on a bi-partisan basis by the House Ways and Means and Senate Finance Committees and incorporated feedback from healthcare providers and provider organizations that responded to the Committees' solicitation of post-acute payment reform ideas and proposals. It directs the United States Department of Health and Human Services ("HHS"), in consultation with healthcare stakeholders, to implement standardized data collection processes for post-acute quality and outcome measures. Although the IMPACT Act does not specifically call for the development of a new post-acute payment system, we believe this act will lay the foundation for possible future post-acute payment policies that would be based on patients' medical conditions and other clinical factors rather than the setting where the care is provided. It will create additional data reporting requirements for our hospitals and home health and hospice agencies. The precise details of these new reporting requirements, including timing and content, will be developed and implemented by CMS through the regulatory process that we expect will take place over the next several years. We cannot quantify the potential effects of the IMPACT Act on us.

Each year, the Medicare Payment Advisory Commission ("MedPAC"), an independent agency, advises Congress on issues affecting Medicare and makes payment policy recommendations to Congress for a variety of Medicare payment systems including, among others, the IRF-PPS, the home health prospective payment system ("HH-PPS") and the hospice prospective payment system. MedPAC also provides comments to CMS on proposed rules, including the prospective payment system rules. Congress is not obligated to adopt MedPAC recommendations, and, based on outcomes in previous years, there can be no assurance Congress will adopt MedPAC's recommendations in a given year. However, MedPAC's recommendations have, and may in the future, become the basis for subsequent legislative or regulatory action.

In connection with CMS's final rulemaking for the 2016 HH-PPS, MedPAC recommended, among other things, legislative changes to make the rebasing cuts larger in size to further reduce margins and the overhaul of the HH-PPS to pay providers based on patient characteristics in lieu of the number of therapy services furnished. MedPAC also recommended that CMS not provide for a market basket update in the 2016 IRF-PPS. This year, MedPAC approved recommendations to eliminate the market basket update for each of the IRF-PPS, the HH-PPS and the Hospice-PPS for 2017.

We cannot predict what alternative or additional deficit reduction initiatives, Medicare payment reductions, or post-acute care reforms, if any, will ultimately be enacted into law, or the timing or effect of any initiatives or reductions. Those initiatives or reductions would be in addition to many ordinary course reimbursement rate changes that CMS adopts each year as part of the market basket update rulemaking process for various provider categories. There can be no assurance future governmental action will not result in substantial changes to, or material reductions in, our reimbursements. In any given year, the net effect of the changes may result in a decrease in our reimbursement rate, and that decrease may occur at a time when our expenses are increasing. As a result, there could be a material adverse effect on our business, financial position, results of operations, and cash flows. For additional discussion of how we are reimbursed by Medicare, see Item 1, *Business*, "Regulatory and Reimbursement Challenges" and "Sources of Revenues—Medicare Reimbursement."

In addition, there are increasing pressures, including as a result of the 2010 Healthcare Reform Laws, from many third-party payors to control healthcare costs and to reduce or limit increases in reimbursement rates for medical services. Our relationships with managed care and nongovernmental third-party payors, such as health maintenance organizations and preferred provider organizations, are generally governed by negotiated agreements. These agreements set forth the amounts we are entitled to receive for our services. We could be adversely affected in some of the markets where we operate if we are unable to negotiate and maintain favorable agreements with third-party payors.

The ongoing evolution of the healthcare delivery system, including alternative payment models and value-based purchasing initiatives, in the United States may significantly affect our business and results of operations.

The healthcare industry in general is facing uncertainty associated with the efforts, primarily arising from initiatives such as payment bundling and ACOs included in the 2010 Healthcare Reform Laws, to identify and implement workable coordinated care and integrated payment delivery models. In a coordinated care delivery model, hospitals, physicians, and other care providers are reimbursed in a fashion meant to encourage the provision of coordinated healthcare on a more efficient, patient-centered basis. These providers are then paid based on the overall value of the services they provide to a patient rather than the number of services they provide. While this is consistent with our goal and proven track record of being a high-quality, cost-effective provider, broad-based implementation of a new delivery model would represent a significant evolution or transformation of the healthcare industry, which may have a significant impact on our business and results of operations.

The 2010 Healthcare Reform Laws directed HHS to examine the feasibility of bundling, including conducting a voluntary, multi-year bundling pilot program to test and evaluate alternative payment methodologies. There are four project types or models: acute care only, acute/post-acute, post-acute only (Model 3), and acute and physician services. In the initial non-risk bearing stage of the bundling program (Phase 1), pilot participants received data from CMS on care patterns and engaged in shared learning in how to improve care. The second phase (Phase 2) requires participants, pending contract finalization and completion of the standard CMS program integrity reviews, to take on financial risk for episodes of care.

Eight of our hospitals began participating in Phase 2, the "at-risk" phase, of Model 3 of CMS' voluntary Bundled Payments for Care Improvement ("BPCI") initiative in 2015. We also have several hospitals that have signed participation agreements with acute care providers participating in Model 2 of the BPCI initiative. Ten of Encompass's home health agencies began participating in Phase 2 of Model 3 in 2014. In July 2015, 42 additional home health agencies began participating in Phase 2.

Similarly, CMS has established per the 2010 Healthcare Reform Laws several separate ACO programs, the largest of which is the Medicare Shared Savings Program ("MSSP"), a voluntary ACO program in which hospitals, physicians, and other care providers pursue the delivery of coordinated healthcare on a more efficient, patient-centered basis. Conceptually, ACOs receive a portion of any savings generated above a certain threshold from care coordination as long as benchmarks for the quality of care are maintained. Under the MSSP, there are two different ACO tracks from which participants can choose. The first track allows ACOs to share only in the savings. The second track requires ACOs to share in any savings and losses but offers ACOs a greater share of any savings realized than the first track offers. The ACO rules adopted by CMS are extremely complex and remain subject to further refinement by CMS. According to CMS, there are 477 ACOs serving almost 8.9 million beneficiaries as of January 2016. We continue to evaluate, on a case-by-case basis, appropriate ACO participation opportunities for our hospitals, home health agencies, and patients. To date, we have signed two ACO participation agreements for our hospitals. Encompass has also partnered as the exclusive preferred home health provider with Premier PHC™, an ACO serving approximately 20,000 Medicare patients.

In January 2015, HHS announced it set various goals with respect to tying Medicare reimbursements to alternative payment models and value-based purchasing. Specifically, HHS set goals of tying 30 percent of traditional, or fee-for-service, Medicare payments to quality or value through alternative payment models, such as ACOs or bundled payment arrangements, by the end of 2016 and tying 50 percent of payments to those models by the end of 2018. HHS also set goals of tying 85 and 90 percent of traditional Medicare payments to quality or value by the end of 2016 and 2018, respectively, through programs such as those that include financial incentives for reducing acute care hospital readmissions.

On November 16, 2015, CMS issued its final rule establishing the Comprehensive Care for Joint Replacement ("CJR") payment model. This mandatory model holds acute care hospitals accountable for the quality of care they deliver to Medicare fee-for-service beneficiaries for lower extremity joint replacements (i.e., knees and hips) from surgery through recovery. Through the five-year payment model, healthcare providers in 67 geographic areas would continue to be paid under existing Medicare payment systems. However, the hospital where the joint replacement takes place would be held accountable for the quality and costs of care for the entire episode of care — from the time of the surgery through 90 days after discharge. Depending on the quality and cost performance during the entire episode, the hospital may receive an additional payment or be required to repay Medicare for a portion of the episode costs. As a result, the acute care hospitals are incented to work with physicians and post-acute care providers to ensure beneficiaries receive the coordinated care they need in an efficient manner.

The bundling and ACO initiatives have served as motivating factors for regulators and healthcare industry participants to identify and implement workable coordinated care delivery models. Broad-based implementation of a new delivery model would represent a significant transformation for us and the healthcare industry generally. The nature and timing of the evolution or transformation of the current healthcare system to coordinated care delivery and payment models is uncertain and will likely remain so for some time. The development of new delivery and payment systems will almost certainly take significant time and

expense. Many of the alternative approaches being explored may not work or could change substantially prior to a nationwide implementation.

Additionally, as the number and types of bundling and ACO models increase, the number of Medicare beneficiaries who are treated in one of the models increases. Our willingness and ability to participate in coordinated care delivery and alternative payment models and the referral patterns of other providers participating in those models may affect our access to Medicare patients who would benefit from treatment in inpatient rehabilitation hospitals or from the services Encompass offers. For further discussion of new coordinated care delivery and payment models, the associated challenges, and our efforts to respond to them, see the "Executive Overview—Key Challenges—Changes to Our Operating Environment Resulting from Healthcare Reform" section of Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Other legislative and regulatory initiatives and changes affecting the industry could adversely affect our business and results of operations.

In addition to the legislative and regulatory actions that directly affect our reimbursement rates or further the evolution of the current healthcare delivery system, other legislative and regulatory changes, including as a result of ongoing healthcare reform, affect healthcare providers like us from time to time. The 2010 Healthcare Reform Laws establish the Independent Payment Advisory Board appointed by the President that is charged with presenting proposals to Congress to reduce Medicare expenditures upon the occurrence of Medicare expenditures exceeding a certain level. This board will have broad authority to develop new Medicare policies (including changes to provider reimbursement). In general, unless Congress acts to block the proposals of this board, CMS will implement the policy recommendations. However, due to the market basket reductions that are also part of these laws, certain healthcare providers, such as our inpatient rehabilitation hospitals, will not be subject to payment reduction proposals developed by this board and presented to Congress until 2020. While most of our operations may not be subject to its payment reduction proposals for a period of time, based on the scope of this board's directive to reduce Medicare expenditures and the significance of Medicare as a payor to us, other decisions made by this board may adversely impact our results of operations, including reductions in the payment for home health services. As of December 31, 2015, the Independent Payment Advisory Board members have not been appointed.

The 2010 Healthcare Reform Laws include other provisions that could adversely affect us as well. They include the expansion of the federal Anti-Kickback Law and the False Claims Act that, when combined with other recent federal initiatives, are likely to increase investigation and enforcement efforts in the healthcare industry generally. Changes include increased resources for enforcement, lowered burden of proof for the government in healthcare fraud matters, expanded definition of claims under the False Claims Act, enhanced penalties, and increased rewards for relators in successful prosecutions. CMS may also suspend payment for claims prospectively if, in its opinion, credible allegations of fraud exist. The initial suspension period may be up to P180D days. However, the payment suspension period can be extended almost indefinitely if the matter is under investigation by the HHS Office of Inspector General (the "HHS-OIG") or the United States Department of Justice (the "DOJ"). Any such suspension would adversely impact our financial position, results of operations, and cash flows.

Some states in which we operate have also undertaken, or are considering, healthcare reform initiatives that address similar issues. While many of the stated goals of other federal and state reform initiatives are consistent with our own goal to provide care that is high-quality and cost-effective, legislation and regulatory proposals may lower reimbursements, increase the cost of compliance, decrease patient volumes, and otherwise adversely affect our business. We cannot predict what healthcare initiatives, if any, will be enacted, implemented or amended, or the effect any future legislation or regulation will have on us.

On October 29, 2015, CMS issued a proposed rule relating to requirements for discharge planning for hospitals and home health agencies as called for by the IMPACT Act. The proposed rule would revise the discharge planning requirements applicable to our inpatient rehabilitation hospitals and Encompass home health agencies.

CMS proposes to require hospitals (including inpatient rehabilitation facilities ("IRFs")) to have a discharge planning process that focuses on patients' goals and preferences and on preparing them and, as appropriate, their caregivers, to be active partners in their post-discharge care. For our hospitals, the proposed rule would require development of standardized procedures pertaining to the development and finalization of unique discharge plans for all patients. CMS proposes that discharge instructions must be provided at the time of discharge to patients, or the patient's caregiver or both, who are discharged home or who are referred to other post-acute care services, and that any post-discharge practitioners or providers must receive the patient's discharge instructions at the time of discharge, including the patient's discharge summary within 48 hours of discharge and any test results within 24 hours of availability.

For home health agencies, the proposed rule includes several new requirements. The discharge planning process would require the regular re-evaluation of patients to identify changes requiring modification of the discharge plan. The physician responsible for a patient's plan of care would have to be involved in the ongoing establishment of the discharge plan. Home health agencies must also send certain specified medical and other information to the post-discharge facility or health care practitioner. The proposed rule would likely require the modification of existing discharge forms and reports, and patient visits may need to be extended in order to accommodate patient education. If adopted as proposed, we would expect to incur additional one-time and recurring expenses to comply, but at this time, we cannot predict what the final requirements will be or the timing or effect of those requirements.

Under the authorization granted in the IMPACT Act, in January 2016, CMS released draft specifications for new Medicare spending per beneficiary measures to be tracked and reported by CMS for each IRF, skilled nursing facility, long-term acute care hospital and home health agency. The intent of tracking and publishing this data is to evaluate a given provider's payment efficiency relative to the efficiency of the national median provider in that provider's post-acute segment. CMS believes this measure will encourage improved efficiency and coordination of care in the post-acute setting by holding providers accountable for Medicare resource use during an episode of care. However, the proposed measures do not take into account patient outcomes. CMS has not proposed to compare payment efficiency across provider segments. Per the IMPACT Act, these spending per beneficiary measures must be finalized and effective by October 1, 2016 for IRFs and by January 1, 2017 for home health agencies.

In January 2016, CMS extended a temporary moratorium on the enrollment of new home health agencies and branch locations. CMS established the moratorium in July 2013, and the latest extension is set to expire in July 2016 unless it is again extended. It applies to six metropolitan areas, including Houston and Dallas where Encompass has several locations.

On February 5, 2016, CMS published a notice in the federal register detailing two proposed home health regulatory initiatives: 1) establishment of a new demonstration project under which it would require home health providers to seek prior authorization before submitting claims for services in Florida, Texas, Illinois, Michigan, and Massachusetts and 2) an extension of the Medicare probable fraud pilot. In the demonstration project, CMS proposes to have Medicare contractors collect additional information from home health providers submitting claims in order to determine proper payment or if there is a suspicion of fraud. In the pilot, CMS proposes to collect information from home health agencies, referring physicians and patients in a random national sampling of claims to establish a baseline estimate of probable fraud in Medicare home health billings.

As discussed above, MedPAC makes healthcare policy recommendations to Congress and provides comments to CMS on Medicare payment related issues. Congress is not obligated to adopt MedPAC's recommendations, and, based on outcomes in previous years, there can be no assurance Congress will adopt any given MedPAC recommendation. For example, in January 2016, MedPAC released materials discussing several possible changes, some of which MedPAC has advocated previously, to various post-acute payment systems. One of the possible changes reported on was the development of a unified payment system for all post-acute care in lieu of separate systems for IRFs, skilled nursing facilities, long-term acute care hospitals, and home health agencies. MedPAC expects to issue a report on this in April 2016, including providing details of alternative models that could be used to test a unified payment system, and has stated it would expect IRF payments to decrease under a unified payment system. Another possible change reported on was an increase of outlier payments to be funded by reductions to non-outlier payments rates under the IRF-PPS.

We cannot predict what legislative or regulatory reforms or changes, if any, will ultimately be enacted, or the timing or effect any of those changes or reforms will have on us. If enacted, they may be challenging for all providers and have the effect of limiting Medicare beneficiaries' access to healthcare services and could have an adverse impact on our financial position, results of operations, and cash flows. For additional discussion of healthcare reform and other factors affecting reimbursement for our services, see Item 1, *Business*, "Regulatory and Reimbursement Challenges" and "Sources of Revenues—Medicare Reimbursement."

Quality reporting requirements may negatively impact the Medicare reimbursement we receive.

The focus on alternative payment models and value-based purchasing of healthcare services has, in turn, led to more extensive quality of care reporting requirements. In many cases, the new reporting requirements are linked to reimbursement incentives. For example, under the 2010 Healthcare Reform Laws, CMS established new quality data reporting, effective October 1, 2012, for all IRFs. A facility's failure to submit the required quality data results in a two percentage point reduction to that facility's annual market basket increase factor for payments made for discharges in the subsequent Medicare fiscal year. Hospitals began submitting quality data to CMS in October 2012. All of our hospitals met the reporting deadlines occurring on or before December 31, 2014 resulting in no corresponding reimbursement reductions for fiscal years 2015 and 2016. Similarly, home health and hospice agencies are also required to submit quality data to CMS each year, and the failure to do so in accordance with the rules will result in a two percentage point reduction in their market basket update. To date, none of Encompass's home health and hospice agencies have incurred a reduction in their reimbursement rates.

As noted above, the IMPACT Act mandated that CMS adopt several new quality reporting measures for the various post-acute provider types. For example, CMS recently adopted six additional IRF quality reporting measures, the reporting of which beginning on October 1, 2016 will require additional time and expense and could affect reimbursement beginning October 1, 2017. In healthcare generally, the burdens associated with collecting, recording, and reporting quality data are increasing. Home health providers are now subject to tracking and reporting 79 CMS-sanctioned quality reporting measures.

The 2016 HH Rule establishes a Home Health Value-Based Purchasing model in nine states, which will include five performance years beginning January 1, 2016 and test whether incentives for better care can improve outcomes in the delivery of home health services. The model would apply a reduction or increase to current home health agency payments, depending on quality performance, made to agencies in Massachusetts, Maryland, North Carolina, Florida, Washington, Arizona, Iowa, Nebraska, and Tennessee. Payment adjustments would be applied on an annual basis, beginning at 3% and increasing to 8% in later years of the initiative.

There can be no assurance all of our hospitals and agencies will continue to meet quality reporting requirements in the future which may result in one or more of our hospitals or agencies seeing a reduction in its Medicare reimbursements. Regardless, we, like other healthcare providers, are likely to incur additional expenses in an effort to comply with additional and changing quality reporting requirements.

Compliance with the extensive laws and government regulations applicable to healthcare providers requires substantial time, effort and expense, and if we fail to comply with them, we could suffer penalties or be required to make significant changes to our operations.

Healthcare providers are required to comply with extensive and complex laws and regulations at the federal, state, and local government levels. These laws and regulations relate to, among other things:

- licensure, certification, and accreditation;
- policies, either at the national or local level, delineating what conditions must be met to qualify for reimbursement under Medicare (also referred to as coverage requirements);
- coding and billing for services;
- requirements of the 60% compliance threshold under the 2007 Medicare Act;
- relationships with physicians and other referral sources, including physician self-referral and anti-kickback laws;
- quality of medical care;
- use and maintenance of medical supplies and equipment;
- maintenance and security of patient information and medical records;
- acquisition and dispensing of pharmaceuticals and controlled substances; and
- disposal of medical and hazardous waste.

In the future, changes in these laws or regulations or the manner in which they are enforced could subject our current or past practices to allegations of impropriety or illegality or could require us to make changes in our hospitals, equipment,

personnel, services, capital expenditure programs, operating procedures, and contractual arrangements, as well as the way in which we deliver home health and hospice services. Those changes could also affect reimbursements as well as future training and staffing costs.

In addition to specific compliance-related laws and regulations, examples of regulatory changes that can affect our business, beyond direct changes to Medicare reimbursement rates, can be found from time to time in CMS's annual rulemaking. The final rule for the fiscal year 2010 IRF-PPS implemented new coverage requirements which provided in part that a patient medical record must document a reasonable expectation that, at the time of admission to an IRF, the patient generally required and was able to participate in the intensive rehabilitation therapy services uniquely provided at IRFs. CMS has also taken the position that a patient's medical file must appropriately document the rationale for the use of group therapies, as opposed to one-on-one therapy. As previously noted, the appropriate utilization of group therapy was a focus of recent HHS-OIG work plans. Beginning on October 1, 2015, a new data collection requirement will go into effect that will capture the minutes and mode (individual, group, concurrent, or co-treatment) of therapy by specialty. CMS plans to use this data to potentially support future rulemaking in this area. Additionally, the final rules for the fiscal years 2014 and 2015 IRF-PPS include changes, effective October 1, 2015, to the list of medical conditions, including a reduction in the number of conditions, that will presumptively count toward the 60% compliance threshold to qualify for reimbursement as an inpatient rehabilitation hospital.

Of note, the HHS-OIG each year releases a work plan that identifies areas of compliance focus for the coming year. In recent years, HHS-OIG work plans for IRFs have focused on, among other items, the appropriate utilization of concurrent and group therapy and adverse and temporary harm events occurring in IRFs. The 2016 work plan indicates HHS-OIG will focus on appropriate documentation to support claims by IRFs and the home health agencies. For hospice agencies, the 2016 work plan focuses on reviews of beneficiaries' plans of care and determine whether they meet key requirements and medical records to address concerns that a level of hospice care is being billed when that level of service is not medically necessary.

As the recent HHS-OIG work plans demonstrate, the clarity and completeness of each patient medical file, some of which is the work product of a physician not employed by us, are essential to demonstrating our compliance with various regulatory and reimbursement requirements. For example, to support the determination that a patient's IRF treatment was reasonable and necessary, the file must contain, among other things, an admitting physician's assessment of the patient as well as a post-admission assessment by the treating physician and other information from clinicians relating to the plan of care and the therapies being provided. These physicians exercise their independent medical judgment. We and our hospital medical directors, who are independent contractors, provide training to the physicians we work with on a regular basis regarding appropriate documentation. In connection with subsequent payment audits and investigations, there can be no assurance as to what opinion a third party may take regarding the status of patient files or the physicians' medical judgment evidenced in those files.

On March 4, 2013, we received document subpoenas from an office of the HHS-OIG addressed to four of our hospitals. Those subpoenas also requested complete copies of medical records for 100 patients treated at each of those hospitals between September 2008 and June 2012. The investigation is being conducted by the United States Department of Justice (the "DOJ"). On April 24, 2014, we received document subpoenas relating to an additional seven of our hospitals. The new subpoenas reference substantially similar investigation subject matter as the original subpoenas and request materials from the period January 2008 through December 2013. Two of the four hospitals addressed in the original set of subpoenas have received supplemental subpoenas to cover this new time period. The most recent subpoenas do not include requests for specific patient files. However, in February 2015, the DOJ requested the voluntary production of the medical records of an additional 70 patients, some of whom were treated in hospitals not subject to the subpoenas, and we provided these records.

All of the subpoenas are in connection with an investigation of alleged improper or fraudulent claims submitted to Medicare and Medicaid and requests documents and materials relating to practices, procedures, protocols and policies, of certain pre- and post-admissions activities at these hospitals including, among other things, marketing functions, pre-admission screening, post-admission physician evaluations, patient assessment instruments, individualized patient plans of care, and compliance with the Medicare 60% rule. Under the Medicare rule commonly referred to as the "60% rule," an inpatient rehabilitation hospital must treat 60% or more of its patients from at least one of a specified list of medical conditions in order to be reimbursed at the inpatient rehabilitation hospital payment rates, rather than at the lower acute care hospital payment rates. We are currently unable to predict the timing or outcome of these investigations, and the DOJ has expressly reserved its right to make additional requests.

Although we have invested, and will continue to invest, substantial time, effort, and expense in implementing and maintaining training programs as well as internal controls and procedures designed to ensure regulatory compliance, if we fail to comply with applicable laws and regulations, we could be required to return portions of reimbursements for discharges deemed after the fact to have not been appropriate under the IRF-PPS. We could also be subjected to other liabilities, including (1) criminal penalties, (2) civil penalties, including monetary penalties and the loss of our licenses to operate one or more of our

hospitals, and (3) exclusion or suspension of one or more of our hospitals from participation in the Medicare, Medicaid, and other federal and state healthcare programs, which, if lengthy in duration and material to us, could potentially trigger a default under our credit agreement. Because Medicare comprises a significant portion of our *Net operating revenues*, it is important for us to remain compliant with the laws and regulations governing the Medicare program and related matters including anti-kickback and anti-fraud requirements. As discussed above in connection with the 2010 Healthcare Reform Laws, the federal government has in the last couple of years made compliance enforcement and fighting healthcare fraud top priorities. In the past few years, the DOJ and HHS as well as federal lawmakers have significantly increased efforts to ensure strict compliance with various reimbursement related regulations as well as combat healthcare fraud. The DOJ has pursued and recovered a record amount of taxpayer dollars lost to healthcare fraud. Additionally, the federal government has become increasingly aggressive in asserting that incidents of erroneous billing or record keeping represent a violation of the False Claims Act. Human error and oversight in record keeping and documentation, particularly where those activities are the responsibility of non-employees, are always a risk in business, and the healthcare industry and independent physicians are no different.

Reductions in reimbursements, substantial damages and other remedies assessed against us could have a material adverse effect on our business, financial position, results of operations, and cash flows. Even the assertion of a violation, depending on its nature, could have a material adverse effect upon our stock price or reputation.

Reimbursement claims are subject to various audits from time to time and such audits may negatively impact our operations and our cash flows from operations.

Reimbursement claims made by health care providers, including inpatient rehabilitation hospitals as well as home health and hospice agencies, are subject to audit from time to time by governmental payors and their agents, such as the Medicare Administrative Contractors ("MACs") that act as fiscal intermediaries for all Medicare billings, and insurance carriers, as well as the OIG, CMS and state Medicaid programs. As noted above, the clarity and completeness of each patient medical file, some of which is the work product of a physician not employed by us, is essential to successfully challenging any payment denials. If the physicians working with our patients do not adequately document, among other things, their diagnoses and plans of care, our risks related to audits and payment denials in general are greater. Depending on the nature of the conduct found in such audits and whether the underlying conduct could be considered systemic, the resolution of these audits could have an adverse effect on our financial position, results of operation and liquidity.

With respect to the Medicare program, from which we receive a substantial portion of our revenues, certain of our MACs, under programs known as "widespread probes," have conducted pre-payment claim reviews of our Medicare billings and in some cases denied payment for certain diagnosis codes. A substantial majority of the denials we have encountered in these probes derive from one MAC. In connection with recent probes, this MAC has made determinations regarding medical necessity which represent its uniquely restrictive interpretations of the CMS coverage rules. We have discussed our objections to those interpretations with both the MAC and CMS. We cannot predict what, if any, changes will result from those discussions.

CMS has developed and instituted various audit programs under which CMS contracts with private companies to conduct claims and medical record audits. These audits are in addition to those conducted by existing MACs. Some contractors are paid a percentage of the overpayments recovered. One type of audit contractor, the Recovery Audit Contractors ("RACs"), receive claims data directly from MACs on a monthly or quarterly basis and are authorized to review claims up to three years from the date a claim was paid, beginning with claims filed on or after October 1, 2007. Beginning May 15, 2015, CMS limited the recovery auditor look back period to six months from the date of service in cases where the hospital submits the claim within three months of the date of service.

RAC audits of IRFs initially focused on coding errors, but have subsequently been expanded to medical necessity reviews. In connection with CMS approved and announced RACs audits related to IRFs, we received requests in 2014 and 2013 to review certain patient files for discharges occurring from 2010 to 2014. These post-payment RAC audits are focused on medical necessity requirements for admission to IRFs rather than targeting a specific diagnosis code as in previous pre-payment audits. Medical necessity is an assessment by an independent physician of a patient's ability to tolerate and benefit from intensive multi-disciplinary therapy provided in an IRF setting. To date, the Medicare payments that are subject to these RAC audit requests represent less than 1% of our Medicare patient discharges from 2010 to 2014. We have appealed substantially all RAC denials arising from these audits using the same process we follow for appealing denials of certain diagnosis codes by MACs. CMS has previously operated a demonstration project that expanded the RAC program to include prepayment review of Medicare fee-for-service claims from primarily acute care hospitals. It is unclear whether CMS intends to continue RAC prepayment reviews and if so, what providers and claims would be the focus of those reviews.

CMS has also established contractors known as the Zone Program Integrity Contractors ("ZPICs"). These contractors are successors to the Program Safeguard Contractors and conduct audits with a focus on potential fraud and abuse issues. Like

the RACs, the ZPICs conduct audits and have the ability to refer matters to the HHS-OIG or the DOJ. Unlike RACs, however, ZPICs do not receive a specific financial incentive based on the amount of the error.

Audits may lead to assertions that we have been underpaid or overpaid by Medicare or submitted improper claims in some instances, require us to incur additional costs to respond to requests for records and defend the validity of payments and claims, and ultimately require us to refund any amounts determined to have been overpaid or disallow reimbursement. Additionally, if the MAC discussed above continues to deny a significant number of claims for certain diagnosis codes, we may experience similar difficulties. As a result, we may suffer reduced profitability, and we may have to elect not to accept patients and conditions we believe can benefit from inpatient rehabilitation. We cannot predict when or how these audit programs will affect us.

Our third-party payors may also, from time to time, request audits of the amounts paid, or to be paid, to us. We could be adversely affected in some of the markets where we operate if the auditing payor alleges substantial overpayments were made to us due to coding errors or lack of documentation to support medical necessity determinations.

Delays in the administrative appeals process associated with denied Medicare reimbursement claims may delay or reduce receipt of the related reimbursement amounts for services previously provided.

Ordinary course Medicare pre-payment denials by MACs, as well as denials resulting from widespread probes and audits, are subject to appeal by providers. We have historically appealed a majority of our denials. For claims we choose to appeal to an administrative law judge, we have historically experienced a greater than 70% success rate. However, the appeals adjudication process established by CMS has encountered significant delays in recent years. For example, most of our appeals heard by an administrative law judge in 2015 related to denials received in 2011 and 2012. We believe the process for resolving individual Medicare payment claims that are denied will continue to take in excess of three years. Additionally, the number of new denials far exceeds the number of appeals resolved in recent years as shown in the following summary of our inpatient rehabilitation segment activity:

	New Denials	Collections of Previously Denied Claims	Provision for Doubtful Accounts for Denial Activity
		(In Millions)	
2015	$79.0	$15.0	$20.6
2014	52.5	14.1	14.0

We record our estimates for pre-payment denials, including those resulting from widespread probes, and for post-payment audit denials that will ultimately not be collected in the *Provision for doubtful accounts.* See Note 1, *Summary of Significant Accounting Policies*, "Net Operating Revenues," to the accompanying consolidated financial statements. Given the continuing or increasing delays along with the increasing number of denials in the backlog, we may experience increases in the *Provision for doubtful accounts*, decreases in cash flow as a result of increasing accounts receivable, and/or a shift in the patients and conditions we treat, any of which could have an adverse effect on our financial position, results of operations, and liquidity. Although there is legislation proposed in Congress, the goal of which is to reform and improve the Medicare audit and appeals process, we cannot predict what, if any, legislation will be adopted or what, if any, effect that legislation might have on the audit and appeals process.

Changes in our payor mix or the acuity of our patients could adversely impact our revenues or our profitability.

Many factors affect pricing of our services and, in turn, our revenues. For example, in the inpatient rehabilitation segment, these factors include, among other things, the treating facility's urban or rural status, the length of stay, the payor and its applicable rate of reimbursement, and the patient's medical condition and impairment status (acuity). In 2015, our inpatient rehabilitation segment experienced a shift in payor mix to a slightly larger percentage of Medicaid patients and a shift to a slightly lower average acuity for our patients, both of which adversely affected pricing growth. For additional discussion of these impacts in 2015, see the "Segment Results of Operations—Inpatient Rehabilitation—Net Operating Revenues" section of Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations.* The expansion and growth of Medicaid and insurance exchanges resulting from provisions of the 2010 Healthcare Reform Laws have increased the number of those patients coming to us. Medicaid reimbursement rates are almost always the lowest among those of our payors, and frequently Medicaid patients come to us with other complicating conditions that make treatment more difficult and costly. Similarly, the insurance coverages offered in the exchanges typically reimburse us at rates lower than we receive under other managed care contracts. While it is not anticipated that Medicaid and insurance exchanges will continue to grow at the rate they have in recent years, we cannot predict whether our payor mix will continue to shift to these lower reimbursement rate payors.

In the future, we may also experience shifts in our payor mix or the acuity of our patients that could adversely affect our pricing, revenues or profitability.

We face intense competition for patients from other healthcare providers.

We operate in a highly competitive, fragmented inpatient rehabilitation and home health and hospice industries. Although we are the nation's largest owner and operator of inpatient rehabilitation hospitals in terms of patients treated and discharged, revenues, and number of hospitals, in any particular market we may encounter competition from local or national entities with longer operating histories or other competitive advantages. For example, acute care hospitals, including those owned and operated by large public companies, may choose to expand or begin offering post-acute rehabilitation services. Given that approximately 92% of our hospitals' referrals come from acute care hospitals, that increase in competition might materially and adversely affect our admission referrals in the related markets. There are also large acute care systems that may have more resources available to compete than we have.

In the home health and hospice services industry, our primary competition comes from locally owned private home health companies or acute-care hospitals with adjunct home health services and typically varies from market to market. We compete with a variety of other companies in providing home health and hospice services, some of which, including several large public companies, may have greater financial and other resources and may be more established in their respective communities. Competing companies may offer newer or different services from those we offer or have better relationships with referring physicians and may thereby attract patients who are presently, or would be candidates for, receiving Encompass home health or hospice services. The other public companies have or may obtain significantly greater marketing and financial resources than we have or may obtain. Relatively few barriers to entry exist in most of our local markets. Accordingly, other companies, including hospitals and other healthcare organizations that are not currently providing competing services, may expand their services to include home health services, hospice care, community care services, or similar services.

There can be no assurance this competition, or other competition which we may encounter in the future, will not adversely affect our business, financial position, results of operations, or cash flows. In addition, from time to time, there are efforts in states with certificate of need ("CON") laws to weaken those laws, which could potentially increase competition in those states. Conversely, competition and statutory procedural requirements in some CON states may inhibit our ability to expand our operations. For a breakdown of the CON status of the states and territories in which we have operations, see Item 2, *Properties*.

If we are unable to maintain or develop relationships with patient referral sources, our growth and profitability could be adversely affected.

Our success depends in large part on referrals from physicians, hospitals, case managers and other patient referral sources in the communities served. Referral sources are not contractually obligated to refer patients to us and may refer their patients to other providers. Our growth and profitability depend on our ability to establish and maintain close working relationships with these patient referral sources and to increase awareness and acceptance of the benefits of inpatient rehabilition, home health, and hospice care by our referral sources and their patients. We cannot provide assurance that we will be able to maintain our existing referral source relationships or that we will be able to develop and maintain new relationships in existing or new markets. Our loss of, or failure to maintain, existing relationships or our failure to develop new relationships could adversely affect our ability to grow our business and operate profitably.

We may have difficulty completing investments and transactions that increase our capacity consistent with our growth strategy.

We are selectively pursuing strategic acquisitions of, and in some instances joint ventures with, other healthcare providers. We may face limitations on our ability to identify sufficient acquisition or other development targets and to complete those transactions to meet goals. In the home health industry, there is significant competition among acquirors attempting to secure the acquisition of companies that have a large number of locations. In many states, the need to obtain governmental approvals, such as a CON or an approval of a change in ownership, may represent a significant obstacle to completing transactions. Additionally, in states with CON laws, it is not unusual for third-party providers to challenge initial awards of CONs, the increase in the number of approved beds in an existing CON, or expand or change the area served, and the adjudication of those challenges and related appeals may take multiple years. These factors may increase the cost to us associated with any acquisition or prevent us from completing one or more acquisitions.

We may make investments or complete transactions that could expose us to unforeseen risks and liabilities.

Investments, acquisitions, joint ventures or other development opportunities identified and completed may involve material cash expenditures, debt incurrence, operating losses, amortization of certain intangible assets of acquired companies, issuances of equity securities, and expenses, some of which are unforeseen, that could affect our business, financial position, results of operations and liquidity. Acquisitions, investments, and joint ventures involve numerous risks, including:

- limitations, including state CONs as well as CMS and other regulatory approval requirements, on our ability to complete such acquisitions, particularly those involving not-for-profit providers, on terms, timetables, and valuations reasonable to us;
- limitations in obtaining financing for acquisitions at a cost reasonable to us;
- difficulties integrating acquired operations, personnel, and information systems, and in realizing projected revenues, efficiencies and cost savings, or returns on invested capital;
- entry into markets, businesses or services in which we may have little or no experience;
- diversion of business resources or management's attention from ongoing business operations; and
- exposure to undisclosed or unforeseen liabilities of acquired operations, including liabilities for failure to comply with healthcare laws and anti-trust considerations in specific markets.

In addition to those development activities, we intend to build new, or de novo, inpatient rehabilitation hospitals. The construction of new hospitals involves numerous risks, including the receipt of all zoning and other regulatory approvals, such as a CON where necessary, construction delays and cost over-runs and unforeseen environmental liability exposure. Once built, new hospitals must undergo the state and Medicare certification process, the duration of which may be beyond our control. We may be unable to operate newly constructed hospitals as profitably as expected, and those hospitals may involve significant additional cash expenditures and operating expenses that could, in the aggregate, have an adverse effect on our business, financial position, results of operations, and cash flows.

We may not be able to successfully integrate acquisitions or realize the anticipated benefits of any acquisitions.

We may undertake strategic acquisitions from time to time. For example, we have recently completed the acquisitions of Encompass, the operations of Reliant Hospital Partners, LLC and affiliated entities ("Reliant") and the home care operations of CareSouth Health System, Inc. ("CareSouth"), which are discussed in Item 1, *Business*, "Overview of the Company." Prior to consummation of any acquisition, the acquired business will have operated independently of us, with its own procedures, corporate culture, locations, employees and systems. We will fold those businesses into our existing business as one combined organization, for example utilizing certain common information systems, operating procedures, administrative functions, financial and internal controls and human resources practices. There may be substantial difficulties, costs and delays involved in the integration of an acquired business with our business. Additionally, an acquisition could cause disruption to our business and operations and our relationships with customers, employees and other parties. In some cases, the acquired business has itself grown through acquisitions, as was the case with Encompass, Reliant and CareSouth, and there may be legacy systems, operating policies and procedures, financial and administrative practices yet to be fully integrated. To the extent we are attempting to integrate multiple businesses at the same time, we may not be able to do so as efficiently or effectively as we would prefer. The failure to successfully integrate on a timely basis any acquired business with our existing business could have an adverse effect on our business, financial position, results of operations, and cash flows.

We anticipate our acquisitions, including Encompass, Reliant and CareSouth, will result in benefits including, among other things, increased revenues and an enhanced ability to provide a continuum of facility-based and home-based post-acute healthcare services. However, acquired businesses may not contribute to our revenues or earnings to the extent anticipated, and any synergies we expect may not be realized after the acquisitions have been completed. If the acquired businesses underperform and such underperformance is other than temporary, we may be required to take an impairment charge. Failure to achieve the anticipated benefits could result in the inability to meet the financial ratios and financial condition tests under our credit agreement and diversion of management's time and energy and could have an adverse effect on our business, financial position, results of operations, and cash flows.

Competition for staffing, shortages of qualified personnel, union activity or other factors may increase our labor costs and reduce profitability.

Our operations are dependent on the efforts, abilities, and experience of our medical personnel, such as physical therapists, occupational therapists, speech pathologists, nurses, and other healthcare professionals. We compete with other healthcare providers in recruiting and retaining qualified personnel responsible for the daily operations of each of our locations. In some markets, the lack of availability of medical personnel is a significant operating issue facing all healthcare providers. A shortage may require us to continue to enhance wages and benefits to recruit and retain qualified personnel or to contract for more expensive temporary personnel. We also depend on the available labor pool of semi-skilled and unskilled employees in each of the markets in which we operate.

If our labor costs increase, we may not experience reimbursement rate or pricing increases generally to offset these additional costs. Because a significant percentage of our revenues consists of fixed, prospective payments, our ability to pass along increased labor costs is limited. In particular, if labor costs rise at an annual rate greater than our net annual market basket update from Medicare or we continue to experience a shift in our payor mix to lower rate payors such as Medicaid, our results of operations and cash flows will be adversely affected. Conversely, decreases in reimbursement revenues, such as with sequestration, may limit our ability to increase compensation or benefits to the extent necessary to retain key employees, in turn increasing our turnover and associated costs. Union activity is another factor that may contribute to increased labor costs. We currently have a minimal number of union employees, so an increase in labor union activity could have a significant impact on our labor costs. Our failure to recruit and retain qualified medical personnel, or to control our labor costs, could have a material adverse effect on our business, financial position, results of operations, and cash flows.

We are a defendant in various lawsuits, and may be subject to liability under qui tam cases, the outcome of which could have a material adverse effect on us.

We operate in a highly regulated and litigious industry. As a result, various lawsuits, claims, and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. We are a defendant in a number of lawsuits. The material lawsuits and investigations, including the subpoenas received from HHS-OIG, are discussed in Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements. Substantial damages, fines, or other remedies assessed against us or agreed to in settlements could have a material adverse effect on our business, financial position, results of operations, and cash flows. Additionally, the costs of defending litigation and investigations, even if frivolous or nonmeritorious, could be significant.

Home care services, by their very nature, are provided in an environment, the patient's place of residence, that is not in the substantial control of the healthcare provider. Accordingly, home care involves an increased level of associated risk of general and professional liability. On any given day, we have thousands of nurses, therapists and other care providers driving to and from the homes of patients where they deliver care. We cannot predict the impact any claims arising out of the travel, the home visits or the care being provided, regardless of their ultimate outcome, could have on our business or reputation or on our ability to attract and retain patients and employees. We also cannot predict the adequacy of any reserves for such losses or recoveries from any insurance or re-insurance policies.

We insure a substantial portion of our professional liability, general liability, and workers' compensation liability risks, which may not include risks related to regulatory fines and penalties, through our captive insurance subsidiary, as discussed further in Note 9, *Self-Insured Risks*, to the accompanying consolidated financial statements. Changes in the number of these liability claims and the cost to resolve them impact the reserves for these risks. A variance between our estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the reserves for these liability risks, which could have an effect on our financial position and results of operations.

The False Claims Act allows private citizens, called "relators," to institute civil proceedings alleging violations of the False Claims Act. These lawsuits, which may be initiated by "whistleblowers," can involve significant monetary damages, fines, attorneys' fees and the award of bounties to the relators who successfully bring these suits and to the government. These *qui tam* cases are sealed by the court at the time of filing. Prior to the lifting of the seal by the court, the only parties typically privy to the information contained in the complaint are the relator, the federal government, and the presiding court. It is possible that *qui tam* lawsuits have been filed against us and that those suits remain under seal or that we are unaware of such filings or prevented by existing law or court order from discussing or disclosing the filing of such suits. We may be subject to liability under one or more undisclosed *qui tam* cases brought pursuant to the False Claims Act.

The proper function, availability, and security of our information systems are critical to our business.

We are and will remain dependent on the proper function, availability and security of our and third-party information systems, including our electronic clinical information system (the "CIS") which plays a substantial role in the operations of the hospitals in which it is installed and the information systems currently in use by Encompass. We undertake substantial measures to protect the safety and security of our information systems and the data maintained within those systems, and we periodically test the adequacy of our security and disaster recovery measures. We have implemented administrative, technical and physical controls on our systems and devices in an attempt to prevent unauthorized access to that data, which includes patient information subject to the protections of the Health Insurance Portability and Accountability Act of 1996 and the Health Information Technology for Economic and Clinical Health Act and other sensitive information. For additional discussion of these laws, see Item 1, *Business*, "Regulation."

As part of our efforts, we may be required to expend significant capital to protect against the threat of security breaches, including cyber attacks, or to alleviate problems caused by breaches, including unauthorized access to or theft of patient data and protected health information stored in our information systems and the introduction of computer malware to our systems. We also attempt to provide our employees training and regular reminders on important measures they can take to prevent breaches. However, given the rapidly evolving nature and proliferation of cyber threats, there can be no assurance our safety and security measures or network security or other controls will detect and prevent security or data breaches, including cyber-attacks, in a timely manner or otherwise prevent unauthorized access to, damage to, or interruption of our systems and operations. For example, it has been widely reported that many well-organized international interests are targeting the theft of patient information through the use of advance persistent threats. Accordingly, we may be vulnerable to losses associated with the improper functioning, security breach or unavailability of our information systems as well as any systems used in acquired operations.

A compromise of our safety and security measures, or network security or other controls, or of those businesses with whom we interact, which results in confidential information being accessed, obtained, damaged or used by unauthorized or improper persons, could harm our reputation and expose us to significant remedial costs as well as regulatory actions and claims from patients, financial institutions, and other persons, any of which could adversely affect our business, financial position, results of operations and cash flows. Moreover, a security breach could require that we expend significant resources to repair or improve our information systems and infrastructure, and could distract management and other key personnel from performing their primary operational duties. In the case of a material breach or cyber-attack, the associated expenses and losses may exceed our current insurance coverage for such events. Failure to maintain proper function, security, or availability of our information systems or protect our data against unauthorized access could have a material adverse effect on our business, financial position, results of operations, and cash flows.

Our CIS is subject to a licensing, implementation, technology hosting, and support agreement with Cerner Corporation. In June 2011, we entered into an agreement with Cerner to begin a company-wide implementation of this system in 2012. As of December 31, 2015, we have installed the CIS in 83 hospitals. We expect to complete installation in our existing hospitals by the end of 2017. Similarly, Encompass has an agreement to license, host, and support its comprehensive management and clinical information system, Homecare Homebase. Our inability, or the inability of software vendors, to continue to maintain and upgrade our information systems, software, and hardware could disrupt or reduce the efficiency of our operations, including affecting patient care. In addition, costs, unexpected problems, and interruptions associated with the implementation or transition to new systems or technology or with adequate support of those systems or technology across multiple hospitals could have a material adverse effect on our business, financial position, results of operations, and cash flows.

Successful execution of our current business plan depends on our key personnel.

The success of our current business plan depends in large part upon the leadership and performance of our executive management team and key employees and our ability to retain and motivate these individuals. We rely upon their ability, expertise, experience, judgment, discretion, integrity and good faith. With respect to our newly acquired home health business, we rely on the experience and expertise of Encompass' management team in that industry. In order to retain this experience and expertise, we have entered into three-year employment agreements that include noncompetition and other restrictive covenants with certain key senior management personnel of Encompass. However, there is no guarantee we will be able to retain these individuals or other members of Encompass' management team. If we are unable to retain these members of Encompass' senior management, we could face increased difficulties in operating Encompass and in expanding our presence in home health and hospice.

There can be no assurance that we will retain our key executives and employees or that we can attract or retain other highly qualified individuals in the future. If we lose key personnel, we may be unable to replace them with personnel of comparable experience in, or knowledge of, the healthcare provider industry or our specific post-acute segments. The loss of

the services of any of these individuals could prevent us from successfully executing our business plan and could have a material adverse effect on our business and results of operations.

Our leverage or level of indebtedness may have negative consequences for our business, and we may incur additional indebtedness in the future.

As of December 31, 2015, we have approximately $2.9 billion of long-term debt outstanding (including that portion of long-term debt classified as current and excluding $288.2 million in capital leases). See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements. Subject to specified limitations, our credit agreement and the indentures governing our debt securities permit us and our subsidiaries to incur material additional debt. If new debt is added to our current debt levels, the risks described here could intensify.

Our indebtedness could have important consequences, including:

- limiting our ability to borrow additional amounts to fund working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy and other general corporate purposes;
- making us more vulnerable to adverse changes in general economic, industry and competitive conditions, in government regulation and in our business by limiting our flexibility in planning for, and making it more difficult for us to react quickly to, changing conditions;
- placing us at a competitive disadvantage compared with competing providers that have less debt; and
- exposing us to risks inherent in interest rate fluctuations for outstanding amounts under our credit facility, which could result in higher interest expense in the event of increases in interest rates, as discussed in Item 7A, *Quantitative and Qualitative Disclosures about Market Risk.*

We are subject to contingent liabilities, prevailing economic conditions, and financial, business, and other factors beyond our control. Although we expect to make scheduled interest payments and principal reductions, we cannot provide assurance that changes in our business or other factors will not occur that may have the effect of preventing us from satisfying obligations under our debt instruments. If we are unable to generate sufficient cash flow from operations in the future to service our debt and meet our other needs or have an unanticipated cash payment obligation, we may have to refinance all or a portion of our debt, obtain additional financing or reduce expenditures or sell assets we deem necessary to our business. We cannot provide assurance these measures would be possible or any additional financing could be obtained.

The restrictive covenants in our credit agreement and the indentures governing our senior notes could affect our ability to execute aspects of our business plan successfully.

The terms of our credit agreement and the indentures governing our senior notes do, and our future debt instruments may, contain various provisions that limit our ability and the ability of certain of our subsidiaries to, among other things:

- incur or guarantee indebtedness;
- pay dividends on, or redeem or repurchase, our capital stock; or repay, redeem or repurchase our subordinated obligations;
- issue or sell certain types of preferred stock;
- make investments;
- incur obligations that restrict the ability of our subsidiaries to make dividends or other payments to us;
- sell assets;
- engage in transactions with affiliates;
- create certain liens;
- enter into sale/leaseback transactions; and
- merge, consolidate, or transfer all or substantially all of our assets.

These covenants could adversely affect our ability to finance our future operations or capital needs and pursue available business opportunities. For additional discussion of our material debt covenants, see the "Liquidity and Capital Resources" section of Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

In addition, our credit agreement requires us to maintain specified financial ratios and satisfy certain financial condition tests. See the "Liquidity and Capital Resources" section of Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Note 8, *Long-term Debt*, to the accompanying consolidated financial statements. Although we remained in compliance with the financial ratios and financial condition tests as of December 31, 2015, we cannot provide assurance we will continue to do so. Events beyond our control, including changes in general economic and business conditions, may affect our ability to meet those financial ratios and financial condition tests. A severe downturn in earnings, failure to realize anticipated earnings from acquisitions, or, if we have outstanding borrowings under our credit facility at the time, a rapid increase in interest rates could impair our ability to comply with those financial ratios and financial condition tests and we may need to obtain waivers from the required proportion of the lenders to avoid being in default. If we try to obtain a waiver or other relief from the required lenders, we may not be able to obtain it or such relief might have a material cost to us or be on terms less favorable than those in our existing debt. If a default occurs, the lenders could exercise their rights, including declaring all the funds borrowed (together with accrued and unpaid interest) to be immediately due and payable, terminating their commitments or instituting foreclosure proceedings against our assets, which, in turn, could cause the default and acceleration of the maturity of our other indebtedness. A breach of any other restrictive covenants contained in our credit agreement or the indentures governing our senior notes would also (after giving effect to applicable grace periods, if any) result in an event of default with the same outcome.

As of December 31, 2015, approximately 75% of our consolidated *Property and equipment, net* was held by HealthSouth Corporation and its guarantor subsidiaries under our credit agreement. See Note 8, *Long-term Debt*, and Note 20, *Condensed Consolidating Financial Information*, to the accompanying consolidated financial statements, and Item 2, *Properties*.

Uncertainty in the capital markets could adversely affect our ability to carry out our development objectives.

In recent years, the global and sovereign credit markets have experienced significant disruptions, and the debt ceiling and federal budget disputes in the United States affected capital markets. Future market shocks could negatively affect the availability or terms of certain types of debt and equity financing, including access to revolving lines of credit. Future business needs combined with market conditions at the time may cause us to seek alternative sources of potentially less attractive financing and may require us to adjust our business plan accordingly. For example, tight credit markets, such as might result from further turmoil in the sovereign debt markets, would likely make additional financing more expensive and difficult to obtain. The inability to obtain additional financing at attractive rates or prices could have a material adverse effect on our financial performance or our growth opportunities.

As a result of credit market uncertainty, we also face potential exposure to counterparties who may be unable to adequately service our needs, including the ability of the lenders under our credit agreement to provide liquidity when needed. We monitor the financial strength of our depositories, creditors, and insurance carriers using publicly available information, as well as qualitative inputs.

If any of our hospitals or home health or hospice agencies fail to comply with the Medicare conditions of participation, that hospital or agency could be terminated from the Medicare program.

Each of our hospitals and home health and hospice agencies must comply with extensive conditions of participation for certification in the Medicare program. If any fail to meet any of the Medicare conditions of participation, we may receive a notice of deficiency from the applicable state survey agency. If that hospital or agency then fails to institute an acceptable plan of correction and correct the deficiency within the applicable correction period, it could lose the ability to bill Medicare. For example, the conditions require that hospice agencies have a certain number of volunteers. A hospital or agency could be terminated from the Medicare benefit if it fails to address the deficiency within the applicable correction period. If CMS terminates one hospital or agency, it may increase its scrutiny of others under common control. Additionally, in October 2014, CMS proposed revisions to the Medicare conditions of participation applicable to home health agencies and intended to provide home health agencies with enhanced flexibility while focusing provider efforts on patient services, quality of care, and quality assessment and performance improvement efforts. Any termination of one or more of our hospitals or agencies from the Medicare program for failure to satisfy the conditions of participation could adversely affect its patient service revenue and profitability and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We maintain our principal executive office at 3660 Grandview Parkway, Birmingham, Alabama. We occupy those office premises under a long-term lease which expires in March 2018. On November 30, 2015, we executed a non-binding term sheet with a developer to build and lease a new corporate office building at another location in Birmingham, Alabama. We expect to move to that location in early 2018. We have notified the landlord for our current office lease that we will not be renewing that lease but we have an option to extend that lease for up to 75 days in the event construction of the new building is not completed as expected.

In addition to our principal executive office, as of December 31, 2015, we leased or owned through various consolidated entities 358 business locations to support our operations. Our hospital leases, which represent the largest portion of our rent expense, generally have 3 to 15 years remaining on their current terms and one or more renewal options for customarily an additional 5-year term. Some renewal options provide for shorter additional terms. Our consolidated entities associated with our leased hospitals are generally responsible for property taxes, property and casualty insurance, and routine maintenance expenses. Our home health and hospice business is based in Dallas, Texas where it leases office space for corporate and administrative functions. The remaining home health and hospice locations are in the localities served by that business and are subject to relatively small space leases, approximately 2,700 square feet on average. Those space leases are typically less than five years in term. We do not believe any one of our individual properties is material to our consolidated operations.

The following table sets forth information regarding our hospital properties (excluding the one hospital that has 41 licensed beds and operates as a joint venture which we account for using the equity method of accounting) and our Encompass locations as of December 31, 2015:

		Number of Hospitals				
State	Licensed Beds	Building and Land Owned	Building Owned and Land Leased	Building and Land Leased	Total	Encompass Locations
Alabama *+	383	1	3	2	6	4
Arizona	335	1	1	3	5	3
Arkansas +	307	2	1	1	4	3
California	134	1	—	1	2	—
Colorado	104	1	—	1	2	5
Connecticut	—	—	—	—	—	1
Delaware *	34	—	1	—	1	—
Florida *	897	9	1	2	12	16
Georgia *+	150	2 [1]	—	1	3	20
Idaho	—	—	—	—	—	11
Illinois *	61	—	1	—	1	—
Indiana	103	—	—	1	1	—
Kansas	242	1	—	2	3	9
Kentucky *+	312	2	1	—	3	1
Louisiana	47	1	—	—	1	—
Maine *	100	—	—	1	1	—
Maryland *+	54	1	—	—	1	1
Massachusetts *	560	2	—	2	4	2
Missouri *	156	—	2	—	2	—
Nevada	219	2	—	1	3	2
New Hampshire *	50	—	1	—	1	—
New Jersey *	199	1	1	1	3	—
New Mexico	87	1	—	—	1	7
North Carolina +	—	—	—	—	—	6
Ohio	110	—	—	2	2	—
Oklahoma	—	—	—	—	—	20
Oregon	—	—	—	—	—	2
Pennsylvania	734	5	—	4	9	3
Puerto Rico *	72	—	—	2	2	—
South Carolina *+	343	1	4	—	5	2
Tennessee *+	435	5	3	—	8	5
Texas	1,538	12	2	9	23	63
Utah	84	1	—	—	1	15
Virginia *	286	2	1	3	6	12
West Virginia *	268	1	3	—	4	—
	8,404	55	26	39	120	213 [2]

* Hospital certificate of need state or U.S. territory

\+ Home health certificate of need state or U.S. territory

(1) The inpatient rehabilitation hospitals in Augusta and Newnan, Georgia are parties to industrial development bond financings that reduce the *ad valorem* taxes payable by each hospital. In connection with each of these bond structures, title to the related property is held by the local development authority. We lease the related hospital property and hold the bonds issued by that authority, the payment on which equals the amount payable under the lease. We may terminate each bond financing and the associated lease at any time at our option without penalty, and fee title to the related hospital property will return to us.

(2) This total includes (1) 179 locations where adult home health services are provided, (2) 7 locations where pediatric home health services are provided, and (3) 27 locations where hospice services are provided. In addition, two of the adult home health locations operate as joint ventures which we account for using the equity method of accounting.

Our principal executive office, hospitals, and other properties are suitable for their respective uses and are, in all material respects, adequate for our present needs. Information regarding the utilization of our licensed beds and other operating statistics can be found in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Item 3. Legal Proceedings

Information relating to certain legal proceedings in which we are involved is included in Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements, which is incorporated herein by reference.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Shares of our common stock trade on the New York Stock Exchange under the ticker symbol "HLS." The following table sets forth the high and low sales prices per share for our common stock as reported on the NYSE from January 1, 2014 through December 31, 2015:

	High	Low
2014		
First Quarter	$ 35.98	$ 29.82
Second Quarter	37.68	33.05
Third Quarter	42.41	35.29
Fourth Quarter	42.00	36.10
2015		
First Quarter	$ 46.92	$ 36.46
Second Quarter	48.13	41.37
Third Quarter	48.37	36.71
Fourth Quarter	39.89	32.55

Holders

As of February 16, 2016, there were 89,777,044 shares of HealthSouth common stock issued and outstanding, net of treasury shares, held by approximately 8,762 holders of record.

Dividends

On October 15, 2013, we paid the first cash dividend, $0.18 per share, on our common stock, and we paid the same per share dividend quarterly through July 15, 2014. On July 17, 2014, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of $0.21 per share on our common stock that was paid on October 15, 2014, and we paid the same per share quarterly dividend through July 15, 2015. On July 16, 2015, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of $0.23 per share that was paid on October 15, 2015, and we paid the same per share quarterly dividend on January 15, 2016. We expect quarterly dividends to continue to be paid in January, April, July, and October. However, the actual declaration of any future cash dividends, and the setting of record and payment dates as well as the per share amounts, will be at the discretion of our board each quarter after consideration of various factors, including our capital position and alternative uses of funds.

The terms of our credit agreement allow us to declare and pay cash dividends on our common stock so long as: (1) we are not in default under our credit agreement and (2) our senior secured leverage ratio remains less than or equal to 1.75x. The terms of our senior note indenture allow us to declare and pay cash dividends on our common stock so long as (1) we are not in default, (2) the consolidated coverage ratio (as defined in the indenture) exceeds 2x or we are otherwise allowed under the indenture to incur debt, and (3) we have capacity under the indenture's restricted payments covenant to declare and pay dividends. We believe we currently have adequate capacity under these covenants to pursue the dividend strategy described in this report for the foreseeable future based on the capacity as of the date of this report and anticipated restricted payments. See Note 8, *Long-term Debt,* to the accompanying consolidated financial statements.

Recent Sales of Unregistered Securities

None.

Securities Authorized for Issuance Under Equity Compensation Plans

The information required by Item 201(d) of Regulation S-K is provided under Item 12, *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*, "Equity Compensation Plans," and incorporated here by reference.

Purchases of Equity Securities

The following table summarizes our repurchases of equity securities during the three months ended December 31, 2015:

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit) ($)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs[1]
October 1 through October 31, 2015	893 [2]	$ 36.38	—	$206,944,707
November 1 through November 30, 2015	808,743 [3]	34.65	808,633	178,922,337
December 1 through December 31, 2015	552,341	34.64	552,341	159,787,934
Total	1,361,977	$ 34.65	1,360,974	

(1) On October 28, 2013, we announced our board of directors authorized the repurchase of up to $200 million of our common stock. On February 14, 2014, our board of directors approved an increase in this common stock repurchase authorization from $200 million to $250 million. The repurchase authorization does not require the repurchase of a specific number of shares, has an indefinite term, and is subject to termination at any time by our board of directors. Subject to certain terms and conditions, including a maximum price per share and compliance with federal and state securities and other laws, the repurchases may be made from time to time in open market transactions, privately negotiated transactions, or other transactions, including trades under a plan established in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended.

(2) Except as noted in the following sentence, an employee tendered these shares as payment of the tax liability incident to the vesting of previously awarded shares of restricted stock. In October, 306 shares were purchased pursuant to our Directors' Deferred Stock Investment Plan. This plan is a nonqualified deferral plan allowing non-employee directors to make advance elections to defer a fixed percentage of their director fees. The plan administrator acquires the shares in the open market which are then held in a rabbi trust. The plan provides that dividends paid on the shares held for the accounts of the directors will be reinvested in shares of our common stock which will also be held in the trust. The directors' rights to all shares in the trust are nonforfeitable, but the shares are only released to the directors after departure from our board.

(3) An employee tendered 110 shares as payment of the exercise price and tax liability incident to the net settlement of an option exercise.

Company Stock Performance

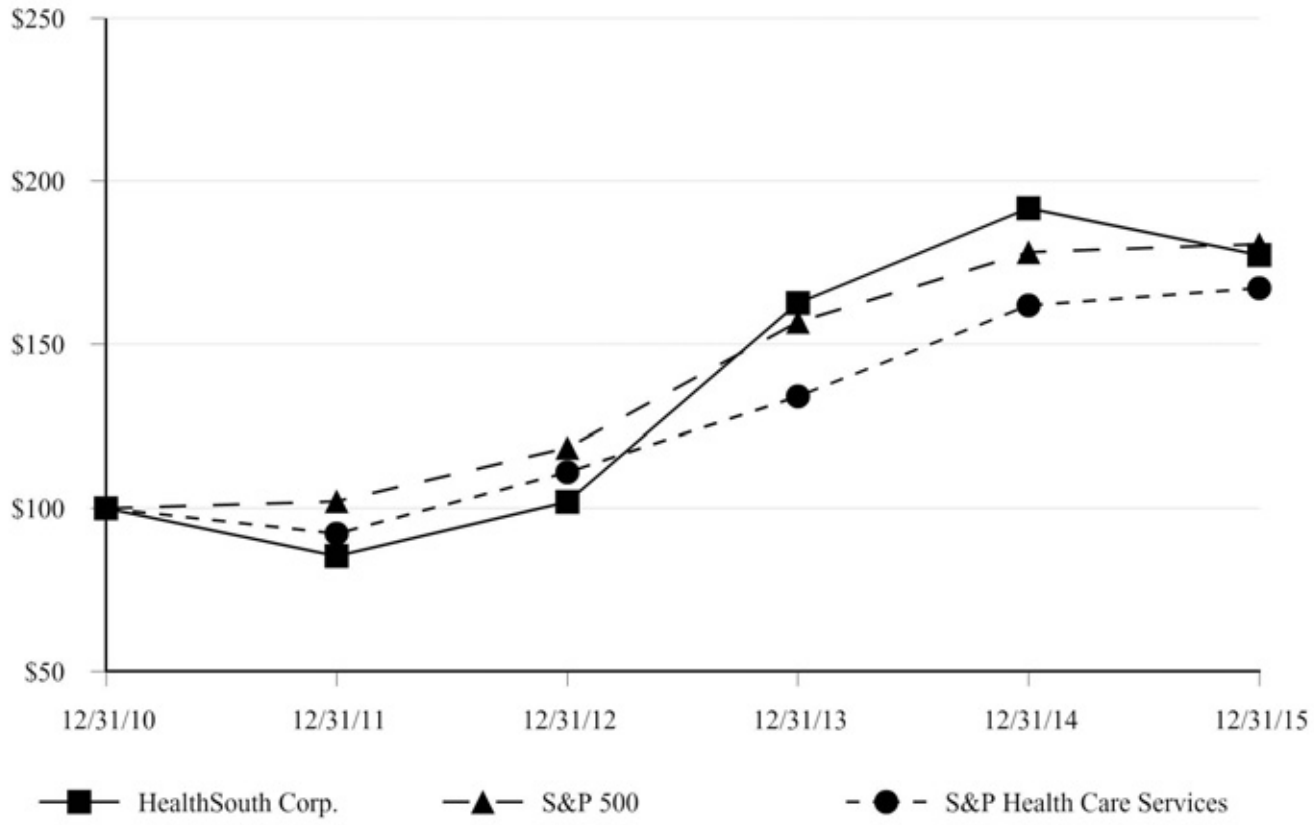
Set forth below is a line graph comparing the total returns of our common stock, the Standard & Poor's 500 Index ("S&P 500"), and the S&P Health Care Services Select Industry Index ("SPSIHP"), an equal-weighted index of at least 35 companies in healthcare services that are also part of the S&P Total Market Index and subject to float-adjusted market capitalization and liquidity requirements. Our compensation committee has in prior years used the SPSIHP as a benchmark for a portion of the awards under our long-term incentive program. The graph assumes $100 invested on December 31, 2010 in our common stock and each of the indices. The returns below assume reinvestment of dividends paid on the related common stock. We have paid a quarterly cash dividend on our common stock since October 2013.

The information contained in the performance graph shall not be deemed "soliciting material" or to be "filed" with the SEC nor shall such information be deemed incorporated by reference into any future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such filing.

The comparisons in the graph below are based upon historical data and are not indicative of, nor intended to forecast, future performance of HealthSouth's common stock. Research Data Group, Inc. provided the data for the indices presented below. We assume no responsibility for the accuracy of the indices' data, but we are not aware of any reason to doubt its accuracy.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN

Among HealthSouth Corporation, the S&P 500 Index, and the S&P Health Care Services Select Industry Index



	For the Year Ended December 31,					
	Base Period	Cumulative Total Return				
Company/Index Name	2010	2011	2012	2013	2014	2015
HealthSouth	100.00	85.32	101.93	162.61	191.71	177.34
Standard & Poor's 500 Index	100.00	102.11	118.45	156.82	178.29	180.75
S&P Health Care Services Select Industry Index	100.00	92.24	111.03	134.03	161.92	167.21

Item 6. Selected Financial Data

We derived the selected historical consolidated financial data presented below for the years ended December 31, 2015, 2014, and 2013 from our audited consolidated financial statements and related notes included elsewhere in this filing. We derived the selected historical consolidated financial data presented below for the years ended December 31, 2012 and 2011 from our consolidated financial statements and related notes included in our Form 10-K for the year ended December 31, 2012. Refer to Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations,* and the notes to the accompanying consolidated financial statements for additional information regarding the financial data presented below, including matters that might cause this data not to be indicative of our future financial position or results of operations.

	For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(In Millions, Except per Share Data)				
Statement of Operations Data: [1]					
Net operating revenues	$ 3,162.9	$ 2,405.9	$ 2,273.2	$ 2,161.9	$ 2,026.9
Operating earnings [2]	485.7	418.4	435.7	378.7	351.4
Provision for income tax expense [3]	141.9	110.7	12.7	108.6	37.1
Income from continuing operations	253.7	276.2	382.5	231.4	205.8
(Loss) income from discontinued operations, net of tax [4]	(0.9)	5.5	(1.1)	4.5	48.8
Net income	252.8	281.7	381.4	235.9	254.6
Less: Net income attributable to noncontrolling interests	(69.7)	(59.7)	(57.8)	(50.9)	(45.9)
Net income attributable to HealthSouth	183.1	222.0	323.6	185.0	208.7
Less: Convertible perpetual preferred stock dividends	(1.6)	(6.3)	(21.0)	(23.9)	(26.0)
Less: Repurchase of convertible perpetual preferred stock [5]	—	—	(71.6)	(0.8)	—
Net income attributable to HealthSouth common shareholders	$ 181.5	$ 215.7	$ 231.0	$ 160.3	$ 182.7
Weighted average common shares outstanding: [6]					
Basic	89.4	86.8	88.1	94.6	93.3
Diluted	101.0	100.7	102.1	108.1	109.2
Earnings per common share:					
Basic earnings per share attributable to HealthSouth common shareholders:					
Continuing operations	$ 2.03	$ 2.40	$ 2.59	$ 1.62	$ 1.39
Discontinued operations	(0.01)	0.06	(0.01)	0.05	0.52
Net income	$ 2.02	$ 2.46	$ 2.58	$ 1.67	$ 1.91
Diluted earnings per share attributable to HealthSouth common shareholders:					
Continuing operations	$ 1.92	$ 2.24	$ 2.59	$ 1.62	$ 1.39
Discontinued operations	(0.01)	0.05	(0.01)	0.05	0.52
Net income	$ 1.91	$ 2.29	$ 2.58	$ 1.67	$ 1.91
Cash dividends per common share [7]	$ 0.88	$ 0.78	$ 0.36	$ —	$ —
Amounts attributable to HealthSouth:					
Income from continuing operations	$ 184.0	$ 216.5	$ 324.7	$ 180.5	$ 158.8
(Loss) income from discontinued operations, net of tax	(0.9)	5.5	(1.1)	4.5	49.9
Net income attributable to HealthSouth	$ 183.1	$ 222.0	$ 323.6	$ 185.0	$ 208.7

	As of December 31,				
	2015	2014	2013	2012	2011
	(In Millions)				
Balance Sheet Data: [1]					
Working capital	$ 172.3	$ 322.3	$ 268.8	$ 335.9	$ 178.4
Total assets [8] [9]	4,606.1	3,388.3	2,514.1	2,402.4	2,252.6
Long-term debt, including current portion [5] [8] [9]	3,171.5	2,111.2	1,497.2	1,231.7	1,235.7
Convertible perpetual preferred stock [5]	—	93.2	93.2	342.2	387.4
HealthSouth shareholders' equity	611.4	473.2	344.6	291.0	116.4

(1) As discussed in Note 2, *Business Combinations*, to the accompanying consolidated financial statements, we acquired the Encompass Home Health and Hospice business ("Encompass") of EHHI Holdings, Inc. on December 31, 2014. Because the acquisition took place on December 31, 2014, our consolidated results of operations prior to 2015 do not include any results of operations from Encompass. Assets acquired, liabilities assumed, and redeemable noncontrolling interests were recorded at their estimated fair values as of the acquisition date.

(2) We define operating earnings as income from continuing operations attributable to HealthSouth before (1) loss on early extinguishment of debt; (2) interest expense and amortization of debt discounts and fees; (3) other income; (4) loss on interest rate swaps; and (5) income tax expense or benefit.

(3) For information related to our *Provision for income tax expense,* see Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and Note 15, *Income Taxes*, to the accompanying consolidated financial statements. During the second quarter of 2013, we entered into closing agreements with the IRS that settled federal income tax matters related to the previous restatement of our 2000 and 2001 financial statements, as well as certain other tax matters, through December 31, 2008 and recorded a net income tax benefit of approximately $115 million.

(4) *Income from discontinued operations, net of tax* in 2011 included post-tax gains from the sale of five long-term acute care hospitals and a settlement related to a previously disclosed audit of unclaimed property.

(5) During the fourth quarter of 2013, we exchanged $320 million in aggregate principal amount of newly issued 2.00% Convertible Senior Subordinated Notes due 2043 for 257,110 shares of our then outstanding 6.50% Series A Convertible Perpetual Preferred Stock. On April 23, 2015, we exercised our rights to force conversion of all remaining outstanding shares of our *Convertible perpetual preferred stock* into common stock. See Note 8, *Long-term Debt* and Note 10, *Convertible Perpetual Preferred Stock*, to the accompanying consolidated financial statements.

(6) During 2015, we repurchased 1.3 million shares of our common stock in the open market for $45.3 million. During 2014, we repurchased 1.3 million shares of our common stock in the open market for $43.1 million. In the first quarter of 2013, we completed a tender offer for our common stock whereby we repurchased approximately 9.1 million shares. See Note 16, *Earnings per Common Share*, to the accompanying consolidated financial statements.

(7) During the third quarter of 2013, our board of directors approved the initiation of a quarterly cash dividend on our common stock of $0.18 per share. In July 2014, our board of directors approved an increase in our quarterly cash dividend to $0.21 per share. In July 2015, our board of directors approved an increase in our quarterly cash dividend of $0.23 per share. See Note 16, *Earnings per Common Share*, to the accompanying consolidated financial statements.

(8) On December 31, 2014, we acquired Encompass. The total cash consideration delivered at closing was $695.5 million. We funded the cash purchase price in the acquisition entirely with draws under the revolving and expanded term loan facilities of our credit agreement. On October 1, 2015, we acquired Reliant Hospital Partners, LLC and affiliated entities. The total cash consideration delivered at closing was approximately $730 million. We funded the cash purchase price in the acquisition with proceeds from our August and September 2015 senior notes issuances and borrowings under our senior secured credit facility. On November 2, 2015, we acquired the home health agency operations of CareSouth Health System, Inc. The total cash consideration delivered at closing was approximately $170 million. We funded the cash purchase price with our term loan facility capacity and cash on hand. See Note 2, *Business Combinations*, and Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

(9) As discussed in Note 1, *Summary of Significant Accounting Policies*, "Recent Accounting Pronouncements" and Note 8, *Long-term Debt*, we adopted ASU 2015-03 and ASU No. 2015-15 on December 31, 2015, which required our debt issuance costs previously included in *Other long-term assets* to be reclassified to *Long-term debt, net of current portion* on our consolidated balance sheets. This change was applied retrospectively to all prior periods presented.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the accompanying consolidated financial statements and related notes. This MD&A is designed to provide the reader with information that will assist in understanding our consolidated financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our consolidated financial statements. See "Cautionary Statement Regarding Forward-Looking Statements" on page ii of this report for a description of important factors that could cause actual results to differ from expected results. See also Item 1A, *Risk Factors*.

Executive Overview

Our Business

We are one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through our network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. As discussed in this Item, "Segment Results of Operations," we manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. For additional information about our business, see Item 1, *Business*.

On December 31, 2014, we completed the acquisition of EHHI Holdings, Inc. ("EHHI") and its Encompass Home Health and Hospice business ("Encompass"), which at the time consisted of 135 home health and hospice locations in 12 states. In the acquisition, we acquired, for cash, all of the issued and outstanding equity interests of EHHI, other than equity interests contributed to HealthSouth Home Health Holdings, Inc. ("Holdings"), a subsidiary of HealthSouth and now indirect parent of EHHI, by certain sellers in exchange for shares of common stock of Holdings. These certain sellers were members of Encompass management, including April Anthony, the Chief Executive Officer of Encompass. These sellers contributed a portion of their shares of common stock of EHHI in exchange for approximately 16.7% of the outstanding shares of common stock of Holdings. We funded the cash purchase price in the acquisition entirely with draws under the revolving and expanded term loan facilities of our credit agreement. The total cash consideration delivered at closing was $695.5 million. We view Encompass as a partnership that brings together the talent and home care experience of the existing Encompass team with all of the resources and post-acute care experience of HealthSouth.

Inpatient Rehabilitation

We are the nation's largest owner and operator of inpatient rehabilitation hospitals in terms of patients treated and discharged, revenues, and number of hospitals. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. While our national network of inpatient hospitals stretches across 29 states and Puerto Rico, we are concentrated in the eastern half of the United States and Texas. As of December 31, 2015, we operate 121 inpatient rehabilitation hospitals, including one hospital that operates as a joint venture which we account for using the equity method of accounting. In addition to HealthSouth hospitals, we manage three inpatient rehabilitation units through management contracts. Our inpatient rehabilitation segment represented approximately 84% of our *Net operating revenues* for the year ended December 31, 2015.

Home Health and Hospice

Encompass is the nation's fourth largest provider of Medicare-certified skilled home health services. As of December 31, 2015, Encompass provides home health and hospice services in 213 locations across 23 states. In addition, two of these home health locations operate as joint ventures which we account for using the equity method of accounting. Encompass home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational, and speech therapy, medical social work, and home health aide services. Encompass also provides specialized home care services in Texas and Kansas for pediatric patients with severe medical conditions. Encompass hospice services primarily include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual support. The Encompass home health and hospice segment represented approximately 16% of our *Net operating revenues* for the year ended December 31, 2015.

During 2015, we transitioned substantially all of HealthSouth's legacy hospital-based home health locations to Encompass. As of December 31, 2015, 23 of HealthSouth's legacy 25 agencies had been integrated into Encompass, with 12 of those locations relocated or merged into existing Encompass locations. In addition, Encompass operates one of HealthSouth's integrated agencies as two locations. We expect to be fully integrated by the end of 2016.

See Item 1, *Business*, and Item 1A, *Risk Factors*, of this report, Note 2, *Business Combinations*, Note 8, *Long-term Debt*, and Note 18, *Segment Reporting*, to the accompanying consolidated financial statements, and the "Results of Operations" and "Liquidity and Capital Resources" sections of this Item.

2015 Overview

Our 2015 strategy focused on the following priorities:

- continuing to provide high-quality, cost-effective care to patients in our existing markets;
- achieving organic growth at our existing hospitals, home health agencies, and hospice agencies;
- expanding our services to more patients who require post-acute healthcare services by constructing and acquiring new hospitals in new markets and acquiring home health and hospice agencies in new markets;
- continuing our shareholder value-enhancing strategies such as common stock dividends and repurchases of our common stock; and
- positioning the Company for continued success in the evolving healthcare delivery system. This preparation includes continuing the installation of our electronic clinical information system in our hospitals which allows for interfaces with all major acute care electronic medical record systems and health information exchanges and participating in bundling projects and Accountable Care Organizations ("ACOs").

During 2015, *Net operating revenues* increased by 31.5% over 2014 due primarily to strong volume growth in both of our operating segments and included the effect of our acquisitions of Encompass, Reliant, and CareSouth (see Note 2, *Business Combinations*, to the accompanying consolidated financial statements).

Within our inpatient rehabilitation segment, discharge growth of 10.9% coupled with a 1.1% increase in net patient revenue per discharge in 2015 generated 11.6% growth in revenue from our hospitals compared to 2014. Discharge growth included a 3.2% increase in same-store discharges. Our inpatient rehabilitation quality and outcome measures, as reported through the Uniform Data System for Medical Rehabilitation (the "UDS"), remained well above the average for hospitals included in the UDS database.

The results of operations for our home health and hospice segment in 2014 included only the results of HealthSouth's legacy hospital-based home health agencies. Thus, year-over-year growth in all operating results and performance metrics resulted from our acquisition of Encompass. The quality of patient care star rating for our home health agencies continued to be well above the national average, as reported by the United States Centers for Medicare and Medicaid Services ("CMS"). In addition, 30-day readmission rates at our home health agencies continued to be well below the national average, as reported by Avalere Health and the Association for Home Health Quality.

We experienced much success with our growth efforts in 2015. Specifically, in October 2015, we completed the previously announced acquisition of the operations of Reliant Hospital Partners, LLC and affiliated entities ("Reliant"). Reliant operated a portfolio of 11 inpatient rehabilitation hospitals in Texas, Massachusetts, and Ohio with a total of 902 beds. All of the Reliant hospitals are leased, and seven of the leases are treated as capital leases for accounting purposes. We assumed all of these lease obligations. The amount of the capital lease obligation initially recognized on our balance sheet was approximately $210 million. At closing, one Reliant hospital entity had a remaining minority limited partner interest of 0.5%. The cash purchase price was reduced by the estimated fair value of this interest. We funded the cash purchase price in the Reliant acquisition with proceeds from our August and September 2015 senior notes issuances (as discussed below) and borrowings under our senior secured credit facility. The total cash consideration delivered at closing was approximately $730 million.

We believe this acquisition complements our existing networks in the highly competitive Houston, Dallas-Fort Worth, and Austin markets while providing entry into new markets in Abilene, Texas; Dayton, Ohio; and the greater Boston metropolitan areas. In 2014, Reliant's operations generated revenues of approximately $249 million. The acquisition of the operations of Reliant were immediately accretive, excluding transaction costs, to our earnings per share.

In addition to completing the Reliant acquisition to expand our portfolio of inpatient rehabilitation hospitals, we:

- began operating the inpatient rehabilitation hospital at Memorial University Medical Center in Savannah, Georgia with our joint venture partner, Memorial Health, on April 1, 2015. The joint venture will build a new, 50-bed replacement inpatient rehabilitation hospital, which is expected to be completed in the first half of 2016;

- acquired Cardinal Hill Rehabilitation Hospital ("Cardinal Hill"), comprised of 158 licensed inpatient rehabilitation beds and 74 licensed skilled nursing beds, in Lexington, Kentucky on May 1, 2015;

- entered into an agreement, in May 2015, with West Tennessee Healthcare to form a joint venture to own and operate a 48-bed inpatient rehabilitation hospital in Jackson, Tennessee. The agreement calls for the relocation of the existing inpatient rehabilitation unit at Jackson-Madison County General Hospital to a free-standing hospital to be built by the joint venture, as well as joint ownership of our existing Cane Creek Rehabilitation Hospital in Martin, Tennessee. Under the agreement, HealthSouth assumed management of the existing rehabilitation unit on January 1, 2016. Construction of the new inpatient rehabilitation hospital will begin in 2016, once the required state regulatory approvals are obtained;

- entered into an agreement, in June 2015, with Mount Carmel Health System to begin construction of a new inpatient rehabilitation hospital in Westerville, Ohio. Construction of the 60-bed joint venture hospital is expected to be completed by the first quarter of 2017;

- formed a joint venture, in June 2015, with St. John Health System to own and operate a 40-bed inpatient rehabilitation hospital in Broken Arrow, Oklahoma. In the first quarter of 2016, the joint venture plans to begin construction of the new 40-bed, free-standing hospital, with construction expected to be completed in the first quarter of 2017;

- entered into an agreement, in June 2015, with CHI St. Vincent Hot Springs, a Catholic Health Initiatives' hospital, to jointly build, own, and operate a 40-bed inpatient rehabilitation hospital in Hot Springs, Arkansas. Initially, the joint venture will own and operate the 20-bed inpatient rehabilitation unit currently located on the campus of CHI St. Vincent Hot Springs. The joint venture's operation of this unit began in February 2016, and the unit was expanded to 27 beds. Additionally, the joint venture began construction of the new hospital in the fourth quarter of 2015, with construction expected to be completed in the third quarter of 2016;

- entered into an agreement, in November 2015, with St. Joseph Health System, a Catholic Health Initiatives' hospital, to jointly own and operate a 49-bed inpatient rehabilitation hospital in Bryan, Texas. The joint venture's operation of this hospital is expected to begin in the second half of 2016 once the required state regulatory approvals are obtained;

- began accepting patients at our newly built, 40-bed inpatient rehabilitation hospital in Franklin, Tennessee in December 2015; and

- continued development of the following de novo hospitals:

Location	# of Beds	Actual / Expected Construction Start Date	Expected Operational Date
Modesto, California	50	Q1 2015	Q2 2016
Murrieta, California*	50	Q2 2017	Q4 2018

*In August 2014, we acquired land and began the design and permitting process to build an inpatient rehabilitation hospital.

We also continued our growth efforts in our home health and hospice segment. In November 2015, Encompass completed its previously announced acquisition of the home health agency operations of CareSouth Health System, Inc. ("CareSouth") for a cash purchase price of approximately $170 million. CareSouth operated a portfolio of 44 home health locations and 3 hospice locations in 7 states (35 of these locations are in CON states) and generated revenues of approximately $104 million in 2014. In addition, two of these home health locations operate as joint ventures which we account for using the equity method of accounting. We funded the cash purchase price in the acquisition with our term loan facility capacity and cash on hand.

The CareSouth acquisition enables HealthSouth to leverage the operating platform of Encompass across home health locations in the new markets of Alabama, Georgia, North Carolina, South Carolina, and Tennessee. CareSouth also improves Encompass' market share position in the key states of Florida and Virginia. Upon completion of this transaction, Encompass became the fourth largest home health provider in Virginia and the eighth largest home health provider in Florida. These new home health locations overlap (within a 30-mile radius) with 14 of HealthSouth's existing inpatient rehabilitation hospitals. The addition of these assets allow HealthSouth to better serve the post-acute needs of patients in those markets by offering both facility-based and home-based post-acute services. Post the Reliant and CareSouth acquisitions, we have Encompass home health locations in 71 of HealthSouth's 121 IRF markets, or 59% overlap.

In addition to completing the CareSouth acquisition, in 2015, we opened four home health locations and two hospice locations and acquired ten home health locations and two hospice locations. The acquired locations included:

- Integrity Home Health Care, Inc. - two locations in the Las Vegas, Nevada area (March 2015);
- Harvey Home Health Services, Inc. - one location in Houston, Texas (April 2015);
- Heritage Home Health, LLC - one location in Texarkana, Arkansas (May 2015);
- Cardinal Hill - one location in Lexington, Kentucky (May 2015);
- Alliance Home Health - two locations in the Fayetteville, Arkansas area (June 2015);
- Southern Utah Home Health, Inc. - two home health locations and two hospice locations in southern Utah (July 2015); and
- Orthopedic Rehab Specialist, LLC - one location in Ocala, Florida (July 2015).

To support our growth efforts, we took the following steps to increase the capacity and flexibility of our balance sheet.

- In January 2015, we issued an additional $400 million of our 5.75% Senior Notes due 2024 at a price of 102% of the principal amount and used $250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility.
- In March 2015, we issued $300 million of 5.125% Senior Notes due 2023 at a price of 100% of the principal amount and, in April 2015, used the net proceeds from the issuance along with cash on hand to redeem all the outstanding principal of our 8.125% Senior Notes due 2020.
- In June 2015, we amended our credit agreement to (1) provide that the leverage ratio financial covenant be calculated on a pro forma basis to include the effects of investments, acquisitions, mergers, and other operational changes and (2) increase the amount of specifically permitted capital lease obligations from $200 million to $350 million.
- In July 2015, we amended our credit agreement to (1) add $500 million of new term loan facilities to our existing $600 million revolving credit facility and $195 million of outstanding term loans, (2) change the maximum leverage ratio in the financial covenants applicable for the period July 2015 through June 2017 from 4.25x to 4.50x and to 4.25x from then until maturity, and (3) extend the maturity date for all borrowings to July 2020. Under the terms of the amendment, our issuance of additional senior notes in August 2015 and September 2015, as discussed below, reduced our availability under the new term loan facilities to $250 million.
- In August 2015, we issued an additional $350 million of our 5.75% Senior Notes due 2024 at a price of 100.50% of the principal amount and used the net proceeds from the issuance to reduce borrowings under our revolving credit facility and, in October 2015, to fund a portion of the Reliant acquisition.
- In September 2015, we issued $350 million of 5.75% Senior Notes due 2025 at a price of 100% of the principal amount and, in October 2015, used the net proceeds from the issuance to fund a portion of the Reliant acquisition.
- In November 2015, we redeemed $50 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022 using borrowings under our senior secured credit facility. Pursuant to the terms of these notes, this optional redemption was made at a price of 103.875%, which resulted in a total cash outlay of approximately $52 million.

For additional information regarding these actions, see Note 8, *Long-term Debt*, to the accompanying consolidated financial statements and the "Liquidity and Capital Resources" section of this Item.

Business Outlook

We believe our business outlook remains positive for two primary reasons. First, demographic trends, such as population aging, should increase long-term demand for facility-based and home-based post-acute services. While we treat patients of all ages, most of our patients are 65 and older, and the number of Medicare enrollees is expected to grow approximately 3% per year for the foreseeable future. We believe the demand for facility-based and home-based post-acute services will continue to increase as the U.S. population ages and life expectancies increase.

Second, we are an industry leader in the growing post-acute sector. As the nation's largest owner and operator of inpatient rehabilitation hospitals, we believe we differentiate ourselves from our competitors based on our broad platform of clinical expertise, the quality of our clinical outcomes, the sustainability of best practices, and the application of rehabilitative technology. As the fourth largest provider of Medicare-certified skilled home health services, we believe we differentiate ourselves from our competitors by virtue of our scale and density in the markets we serve, the application of a highly integrated technology platform, our ability to manage a variety of care pathways, and a proven track record of consummating and integrating acquisitions.

We have invested considerable resources into clinical and management systems and protocols that have allowed us to consistently produce high-quality outcomes for our patients while continuing to contain cost growth. Our proprietary hospital management reporting system aggregates data from each of our key business systems into a comprehensive reporting package used by the management teams in our hospitals, as well as executive management, and allows them to analyze data and trends and create custom reports on a timely basis. Our commitment to technology also includes the on-going implementation of our rehabilitation-specific electronic clinical information system. As of December 31, 2015, we had installed this system in 83 of our 121 hospitals. We believe this system will improve patient care and safety, enhance staff recruitment and retention, and set the stage for connectivity with other providers and health information exchanges. Our home health and hospice segment also uses information technology to enhance patient care and manage the business by utilizing Homecare Homebase℠, a comprehensive information platform that allows home health providers to process clinical, compliance, and marketing information as well as analyze data and trends for management purposes using custom reports on a timely basis. This allows our home health segment to manage the entire patient work flow and provide valuable data for health systems, payors, and ACO partners. We are currently the home health provider to one ACO serving approximately 20,000 patients and are exploring several other participation opportunities.

We believe these factors align with our strengths in, and focus on, post-acute services. In addition, we believe we can address the demand for facility-based and home-based post-acute services in markets where we currently do not have a presence by constructing or acquiring new hospitals and by acquiring home health and hospice agencies in that highly fragmented industry.

Longer-term, the nature and timing of the transformation of the current healthcare system to coordinated care delivery and payment models is uncertain and will likely remain so for some time, as the development of new delivery and payment systems will almost certainly require significant time and resources. Furthermore, many of the alternative approaches being explored may not work as intended. However, as outlined in the "Key Challenges—Changes to Our Operating Environment Resulting from Healthcare Reform" section below, our goal is to position the Company in a prudent manner to be responsive to industry shifts. We have invested in our core business and created an infrastructure that enables us to provide high-quality care on a cost-effective basis. We have been disciplined in creating a capital structure that is flexible with no significant debt maturities prior to 2020. Our balance sheet remains strong and includes a substantial portfolio of owned real estate. We have significant availability under our revolving credit facility, and we continue to generate strong cash flows from operations. Importantly, we have flexibility with how we choose to deploy our cash and create value for shareholders, including repayments of long-term debt, repurchases of our common stock, bed additions, de novos, acquisitions of inpatient rehabilitation hospitals, home health agencies, and hospice agencies, and common stock dividends. While our financial leverage increased as a result of the Encompass, Reliant and CareSouth transactions, we anticipate in the longer term reducing our financial leverage based on growth of Adjusted EBITDA and an allocation of a portion of our free cash flow to debt reduction.

For these and other reasons, we believe we will be able to adapt to changes in reimbursement, sustain our business model, and grow through acquisition and consolidation opportunities as they arise.

Key Challenges

The healthcare industry is facing many well-publicized regulatory and reimbursement challenges. The industry is also facing uncertainty associated with the efforts, primarily arising from initiatives included in the 2010 Healthcare Reform Laws (as defined in Item 1, *Business*, "Regulatory and Reimbursement Challenges") to identify and implement workable coordinated care delivery models. Successful healthcare providers are those who provide high-quality, cost-effective care and have the ability to adjust to changes in the regulatory and operating environments. We believe we have the necessary capabilities — scale, infrastructure, balance sheet, and management — to adapt to changes and continue to succeed in a highly regulated industry, and we have a proven track record of doing so.

As we continue to execute our business plan, the following are some of the challenges we face.

- Operating in a Highly Regulated Industry. We are required to comply with extensive and complex laws and regulations at the federal, state, and local government levels. These rules and regulations have affected, or could in the future affect, our business activities by having an impact on the reimbursement we receive for services provided or the costs of compliance, mandating new documentation standards, requiring additional licensure or certification, regulating our relationships with physicians and other referral sources, regulating the use of our properties, and limiting our ability to enter new markets or add new capacity to existing hospitals and agencies. Ensuring continuous compliance with extensive laws and regulations is an operating requirement for all healthcare providers.

  We have invested, and will continue to invest, substantial time, effort, and expense in implementing and maintaining training programs as well as internal controls and procedures designed to ensure regulatory compliance, and we are committed to continued adherence to these guidelines. More specifically, because Medicare comprises a significant portion of our *Net operating revenues*, it is particularly important for us to remain compliant with the laws and regulations governing the Medicare program and related matters including anti-kickback and anti-fraud requirements. If we were unable to remain compliant with these regulations, our financial position, results of operations, and cash flows could be materially, adversely impacted.

  Concerns held by federal policymakers about the federal deficit and national debt levels could result in enactment of further federal spending reductions, further entitlement reform legislation affecting the Medicare program, or both, in 2016 and beyond. Additionally, many legislators in the United States House of Representatives and the United States Senate continue to express the policy objective of modifying or repealing the Patient Protection and Affordable Care Act (as subsequently amended, the "2010 Healthcare Reform Laws"). At this time, it is unclear what, if any, of the Medicare-related changes may ultimately be enacted and signed into law by the President, but it is possible that any reductions in Medicare spending will have a material impact on reimbursements for healthcare providers generally and post-acute providers specifically. We cannot predict what, if any, changes in Medicare spending or modifications to the 2010 Healthcare Reform Laws will result from future budget and other legislative initiatives.

  On April 16, 2015, the President signed into law the Medicare Access and CHIP (Children's Health Insurance Program) Reauthorization Act, which repealed the statutory mechanism providing for annual automatic adjustments to the Medicare physician fee schedule using a sustainable growth rate formula that has historically resulted in annual deep cuts to physician reimbursement rates, a consequence of which has been the so-called "doc fixes" passed by Congress annually since 2002 to override those automatic adjustments. The primary impact of this act on post-acute care providers is a mandated market basket update of +1.0% in 2018 for rehabilitation hospitals as well as home health and hospice agencies.

  Another challenge relates to reduced Medicare reimbursement, which is also discussed in Item 1A, *Risk Factors*. Unless the United States Congress acts to change or eliminate it, sequestration, which began affecting payments received after April 1, 2013, will continue to result in a 2% decrease to reimbursements otherwise due from Medicare, after taking into consideration other changes to reimbursement rates such as market basket updates.

  Additionally, concerns held by federal policymakers about the federal deficit and national debt levels could result in enactment of further federal spending reductions, further entitlement reform legislation affecting the Medicare program, and/or further reductions to provider payments. Likewise, issues related to the federal budget or the unwillingness to raise the statutory cap on the federal government's ability to issue debt, also referred to as the "debt ceiling," may have a significant impact on the economy and indirectly on our results of operations and financial position. We cannot predict what alternative or additional deficit reduction initiatives, Medicare payment reductions, or post-acute care reforms, if any, will ultimately be enacted into law, or the timing or effect any such

initiatives or reductions will have on us. If enacted, such initiatives or reductions would likely be challenging for all providers, would likely have the effect of limiting Medicare beneficiaries' access to healthcare services, and could have an adverse impact on our financial position, results of operations, and cash flows. However, we believe our efficient cost structure should allow us to absorb, adjust to, or mitigate any potential initiative or reimbursement reductions more easily than most other post-acute providers.

On July 31, 2015, CMS released its notice of final rulemaking for fiscal year 2016 (the "2016 Rule") for inpatient rehabilitation facilities ("IRFs") under the prospective payment system ("IRF-PPS"). The final rule will implement a net 1.7% market basket increase effective for discharges between October 1, 2015 and September 30, 2016, calculated as follows:

Market basket update	2.4%
Healthcare reform reduction	20 basis points
Productivity adjustment	50 basis points

The final rule also includes other changes that impact our hospital-by-hospital base rate for Medicare reimbursement. Such changes include, but are not limited to, revisions to the wage index values, changes to designations between rural and urban facilities, and updates to the outlier fixed-loss threshold. The final rule also continues the freeze of the update to the IRF-PPS facility-level rural adjustment factor, low-income patient factor, and teaching status adjustment factors. Based on our analysis which utilizes, among other things, the acuity of our patients over the 12-month period prior to the final rule's release and incorporates other adjustments included in the final rule, we believe the 2016 Rule will result in a net increase to our Medicare payment rates of approximately 1.6% effective October 1, 2015, prior to the impact of sequestration.

Additionally, the final rule contains changes that could affect us in future years. For example, pursuant to the Improving Medicare Post-Acute Care Transformation Act of 2014 (the "IMPACT Act"), CMS adopted six additional quality reporting measures, the reporting of which beginning on October 1, 2016 will require additional time and expense and could affect reimbursement beginning October 1, 2017. CMS also adopted an IRF-specific market basket that could, in a given year, result in a higher or lower pricing update than the current market basket methodologies.

Reimbursement claims made by healthcare providers, including inpatient rehabilitation hospitals as well as home health and hospice agencies, are subject to audit from time to time by governmental payors and their agents, such as the Medicare Administrative Contractors ("MACs"), fiscal intermediaries and carriers, as well as the OIG, CMS, and state Medicaid programs. Under programs designated as "widespread probes," certain of our MACs have conducted pre-payment claim reviews of our billings and denied payment for certain diagnosis codes. A substantial majority of the denials we have encountered in these probes derive from one MAC. In connection with recent probes, this MAC has made determinations regarding medical necessity which represent its uniquely restrictive interpretations of the CMS coverage rules. We have discussed our objections to those interpretations with both the MAC and CMS. We cannot predict what, if any, changes will result from those discussions. If the MAC continues to deny a significant number of claims for certain diagnosis codes, we may experience increases in the *Provision for doubtful accounts*, decreases in cash flow as a result of increasing accounts receivable, and/or a shift in the patients and conditions we treat, any of which could have an adverse effect on our financial position, results of operations, and liquidity.

On November 16, 2015, CMS issued its final rule establishing the Comprehensive Care for Joint Replacement ("CJR") payment model. This mandatory model holds acute care hospitals accountable for the quality of care they deliver to Medicare fee-for-service beneficiaries for lower extremity joint replacements (i.e., knees and hips) from surgery through recovery. Through the five-year payment model, healthcare providers in 67 geographic areas would continue to be paid under existing Medicare payment systems. However, the hospital where the joint replacement takes place would be held accountable for the quality and costs of care for the entire episode of care — from the time of the surgery through 90 days after discharge. Depending on the quality and cost performance during the entire episode, the hospital may receive an additional payment or be required to repay Medicare for a portion of the episode costs. As a result, the acute care hospitals would be incented to work with physicians and post-acute care providers to ensure beneficiaries receive the coordinated care they need in an efficient manner. We believe its impact would be positive for HealthSouth as it should favor high-quality, low-cost providers like us who have made significant commitments to information systems that enable and enhance connectivity. We also believe the rule further validates our movement into home health via the acquisition of Encompass. Currently,

lower extremity joint replacement patients represent less than 8% of our total annual discharges due to our required compliance with the 60% rule. Given the 67 geographic areas included in the CJR proposal, our patients potentially subject to this model represent less than 2% of our annual Medicare discharges. The lower extremity joint replacement patients we do treat are generally higher acuity and bilateral or possess significant comorbidities. In these cases and in any risk-bearing bundling initiative, quality of outcomes is critical to achieving targeted financial results.

On October 29, 2015, CMS released its notice of final rulemaking for calendar year 2016 for home health agencies under the prospective payment system ("HH-PPS"). Specifically, while the final rule provides for a market basket update of 2.3%, that update is offset by a 2.4% rebasing adjustment reduction (the third year of a four-year phase-in), a productivity adjustment reduction of 40 basis points, and a case-mix coding intensity reduction of 90 basis points. We believe the final rule will result in a net decrease to Encompass' Medicare payment rates of approximately 1.7% effective for episodes ending in calendar year 2016, before sequestration.

Additionally, the HH-PPS provides that quality reporting requirements must be satisfied in order for agencies to avoid a 2% reduction in their annual HH-PPS payment update percentage. All home health agencies must submit both admission and discharge outcome and assessment information sets, or "OASIS assessments," for a minimum of 70% of all patients with episodes of care occurring during the reporting period starting July 1, 2015. In the 2016 final rule, CMS increased the minimum reporting threshold to 80% for episodes occurring between July 1, 2016 and June 30, 2017, and to 90% for episodes occurring from July 1, 2017 and thereafter. We do not expect, based on our agencies' current OASIS submission rates, to experience a material impact.

In addition, the final home health rule establishes a Home Health Value-Based Purchasing model in nine states that will include five performance years beginning January 1, 2016 and test whether incentives for better care can improve outcomes in the delivery of home health services. The model would apply a reduction or increase to current Medicare-certified home health agency payments, depending on quality performance, made to agencies in those nine states. Payment adjustments would be applied on an annual basis, beginning at 3% and increasing to 8% in later years of the initiative.

See also Item 1, *Business*, "Sources of Revenues" and "Regulation," and Item 1A, *Risk Factors*, to this report and Note 17, *Contingencies and Other Commitments*, "Governmental Inquiries and Investigations," to the accompanying consolidated financial statements.

- Changes to Our Operating Environment Resulting from Healthcare Reform. Our challenges related to healthcare reform are discussed in Item 1, *Business*, "Sources of Revenues," and Item 1A, *Risk Factors*. Many provisions within the 2010 Healthcare Reform Laws have impacted, or could in the future impact, our business. Most notably for us are the reductions to our hospitals' annual market basket updates, including productivity adjustments, mandated reductions to home health and hospice Medicare reimbursements, and future payment reforms such as ACOs and bundled payments.

  The healthcare industry in general is facing uncertainty associated with the efforts, primarily arising from initiatives included in the 2010 Healthcare Reform Laws, to identify and implement workable coordinated care delivery models. In a coordinated care delivery model, hospitals, physicians, and other care providers work together to provide coordinated healthcare on a more efficient, patient-centered basis. These providers are then paid based on the overall value of the services they provide to a patient rather than the number of services they provide. While this is consistent with our goal and proven track record of being a high-quality, cost-effective provider, broad-based implementation of a new delivery model would represent a significant transformation for the healthcare industry. As the industry and its regulators explore this transformation, we are positioning the Company in preparation for whatever changes are ultimately made to the delivery system:

  - We have a track record of successful partnerships with acute care providers. Thirty-three of our hospitals already operate as joint ventures with acute care hospitals, and we continue to pursue joint ventures as one of our growth initiatives. These joint ventures create an immediate link to an acute care system and position us to quickly and efficiently integrate our services in a coordinated care model.

  - Our commitment to coordinated care is demonstrated and enhanced by the utilization of technology. Our hospital electronic clinical information system is capable of interfaces with all major acute care electronic medical record systems and health information exchanges making communication easier across the continuum of healthcare providers. Our home health and hospice clinical information system utilizes a

leading home care technology that manages the entire patient work flow. Importantly, we have the ability to use data from both systems to develop clinical protocol best practices.

- Our balance sheet is strong, and we have consistently strong free cash flows. We have no significant debt maturities prior to 2020, and we have significant liquidity under our revolving credit facility. In addition, we own the real estate associated with approximately 68% of our hospitals.

- We have a proven track record of being a high-quality, cost-effective provider. The FIM® Gains (a tool based on an 18-point assessment used to measure functional independence from admission to discharge) at our inpatient rehabilitation hospitals consistently exceed industry results, and the 30-day readmission rates at our home health agencies are lower than the national average. In addition, we have the scale and operating leverage to generate a low cost per discharge/visit.

- We are currently participating in several coordinated care delivery model initiatives and are exploring ACO participation in several others. Eight of our IRFs began participating in Phase 2, the "at-risk" phase, of Model 3 of CMS' Bundled Payments for Care Improvement ("BPCI") initiative in 2015. We also have several IRFs that have signed participation agreements with acute care providers participating in Model 2 of the BPCI initiative. Ten of our home health agencies began participating in Phase 2 of Model 3 of the BPCI initiative in April 2014. In July 2015, 42 additional home health agencies began participating in Phase 2 of Model 3 of this initiative. In addition, we have partnered as the home health provider with Premier PHC™, an ACO serving approximately 20,000 Medicare patients.

Given the complexity and the number of changes in the 2010 Healthcare Reform Laws, we cannot predict their ultimate impact. In addition, the ultimate nature and timing of the transformation of the healthcare delivery system is uncertain, and will likely remain so for some time. We will continue to evaluate these laws and position the Company for this industry shift. Based on our track record, we believe we can adapt to these regulatory and industry changes. Further, we have engaged, and will continue to engage, actively in discussions with key legislators and regulators to attempt to ensure any healthcare laws or regulations adopted or amended promote our goal of high-quality, cost-effective care.

Additionally, in October 2014, the President signed into law the IMPACT Act. The IMPACT Act was developed on a bi-partisan basis by the House Ways and Means and Senate Finance Committees and incorporated feedback from healthcare providers and provider organizations that responded to the Committees' solicitation of post-acute payment reform ideas and proposals. It directs the United States Department of Health and Human Services ("HHS"), in consultation with healthcare stakeholders, to implement standardized data collection processes for post-acute quality and outcome measures. Although the IMPACT Act does not specifically call for the development of a new post-acute payment system, we believe this act will lay the foundation for possible future post-acute payment policies that would be based on patients' medical conditions and other clinical factors rather than the setting where the care is provided. It will create additional data reporting requirements for our hospitals and home health agencies, and we expect to fully comply with these requirements. The precise details of these new reporting requirements, including timing and content, will be developed and implemented by CMS through the regulatory process that we expect will take place over the next several years. While we cannot quantify the potential financial effects of the IMPACT Act on HealthSouth, we believe any post-acute payment system that is data-driven and focuses on the needs and underlying medical conditions of post-acute patients ultimately will be a net positive for providers who offer high-quality, cost-effective care. However, it will likely take years for the related quality measures to be established, quality data to be gathered, standardized patient assessment data to be assembled and disseminated, and potential payment policies to be developed, tested, and promulgated. As the nation's largest owner and operator of inpatient rehabilitation hospitals and fourth largest provider of Medicare-certified skilled home health services, we will work with HHS, the Medicare Payment Advisory Commission, and other healthcare stakeholders on these initiatives.

- Maintaining Strong Volume Growth. Various factors, including competition and increasing regulatory and administrative burdens, may impact our ability to maintain and grow our hospital, home health, and hospice volumes. In any particular market, we may encounter competition from local or national entities with longer operating histories or other competitive advantages, such as acute care hospitals who provide post-acute services similar to ours or other post-acute providers with relationships with referring acute care hospitals or physicians. Aggressive payment review practices by Medicare contractors, aggressive enforcement of regulatory policies by government agencies, and restrictive or burdensome rules, regulations or statutes governing admissions practices may lead us to not accept patients who would be appropriate for and would benefit from the services we provide. In addition, from time to time, we must get regulatory approval to expand our services and locations in states with

certificate of need laws. This approval may be withheld or take longer than expected. In the case of new-store volume growth, the addition of hospitals, home health agencies, and hospice agencies to our portfolio also may be difficult and take longer than expected.

- Recruiting and Retaining High-Quality Personnel. See Item 1A, *Risk Factors*, for a discussion of competition for staffing, shortages of qualified personnel, and other factors that may increase our labor costs. Recruiting and retaining qualified personnel for our inpatient hospitals and home health and hospice agencies remain a high priority for us. We attempt to maintain a comprehensive compensation and benefits package that allows us to remain competitive in this challenging staffing environment while remaining consistent with our goal of being a high-quality, cost-effective provider of inpatient rehabilitative services.

See also Item 1, *Business*, and Item 1A, *Risk Factors*.

These key challenges notwithstanding, we have a strong business model, a strong balance sheet, and a proven track record of achieving strong financial and operational results. We are attempting to position the Company to respond to changes in the healthcare delivery system and believe we will be in a position to take advantage of any opportunities that arise as the industry moves to this new stage. We believe we are positioned to continue to grow, adapt to external events, and create value for our shareholders in 2016 and beyond.

Results of Operations

Payor Mix

During 2015, 2014, and 2013, we derived consolidated *Net operating revenues* from the following payor sources:

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Medicare	74.9%	74.1%	74.5%
Managed care and other discount plans, including Medicare Advantage	17.7%	18.6%	18.5%
Medicaid	3.0%	1.8%	1.2%
Other third-party payors	1.7%	1.8%	1.8%
Workers' compensation	0.9%	1.2%	1.2%
Patients	0.6%	1.0%	1.1%
Other income	1.2%	1.5%	1.7%
Total	100.0%	100.0%	100.0%

Our payor mix is weighted heavily towards Medicare. We receive Medicare reimbursements under the inpatient rehabilitation facility prospective payment system (the “IRF-PPS”), the home health prospective payment system (“HH-PPS”) and the hospice prospective payment system (the “Hospice-PPS”). For additional information regarding Medicare reimbursement, see the “Sources of Revenues” section of Item 1, *Business*.

As part of the Balanced Budget Act of 1997, Congress created a program of private, managed healthcare coverage for Medicare beneficiaries. This program has been referred to as Medicare Part C, or “Medicare Advantage.” The program offers beneficiaries a range of Medicare coverage options by providing a choice between the traditional fee-for-service program (under Medicare Parts A and B) or enrollment in a health maintenance organization, preferred provider organization, point-of-service plan, provider sponsor organization, or an insurance plan operated in conjunction with a medical savings account. Medicare Advantage revenues, included in the “managed care and other discount plans” category in the above table, represented approximately 8% of our total patient revenues during the years ended December 31, 2015, 2014, and 2013.

Our consolidated *Net operating revenues* consist primarily of revenues derived from patient care services and home health and hospice services. *Net operating revenues* also include other revenues generated from management and administrative fees and other nonpatient care services. These other revenues are included in “other income” in the above table.

Our Results

From 2013 through 2015, our consolidated results of operations were as follows:

	For the Year Ended December 31,			Percentage Change	
	2015	2014	2013	2015 v. 2014	2014 v. 2013
	(In Millions)				
Net operating revenues	$ 3,162.9	$ 2,405.9	$ 2,273.2	31.5 %	5.8 %
Less: Provision for doubtful accounts	(47.2)	(31.6)	(26.0)	49.4 %	21.5 %
Net operating revenues less provision for doubtful accounts	3,115.7	2,374.3	2,247.2	31.2 %	5.7 %
Operating expenses:					
Salaries and benefits	1,670.8	1,161.7	1,089.7	43.8 %	6.6 %
Other operating expenses	432.1	351.6	323.0	22.9 %	8.9 %
Occupancy costs	53.9	41.6	47.0	29.6 %	(11.5)%
Supplies	128.7	111.9	105.4	15.0 %	6.2 %
General and administrative expenses	133.3	124.8	119.1	6.8 %	4.8 %
Depreciation and amortization	139.7	107.7	94.7	29.7 %	13.7 %
Government, class action, and related settlements	7.5	(1.7)	(23.5)	(541.2)%	(92.8)%
Professional fees—accounting, tax, and legal	3.0	9.3	9.5	(67.7)%	(2.1)%
Total operating expenses	2,569.0	1,906.9	1,764.9	34.7 %	8.0 %
Loss on early extinguishment of debt	22.4	13.2	2.4	69.7 %	450.0 %
Interest expense and amortization of debt discounts and fees	142.9	109.2	100.4	30.9 %	8.8 %
Other income	(5.5)	(31.2)	(4.5)	(82.4)%	593.3 %
Equity in net income of nonconsolidated affiliates	(8.7)	(10.7)	(11.2)	(18.7)%	(4.5)%
Income from continuing operations before income tax expense	395.6	386.9	395.2	2.2 %	(2.1)%
Provision for income tax expense	141.9	110.7	12.7	28.2 %	771.7 %
Income from continuing operations	253.7	276.2	382.5	(8.1)%	(27.8)%
(Loss) income from discontinued operations, net of tax	(0.9)	5.5	(1.1)	(116.4)%	(600.0)%
Net income	252.8	281.7	381.4	(10.3)%	(26.1)%
Less: Net income attributable to noncontrolling interests	(69.7)	(59.7)	(57.8)	16.8 %	3.3 %
Net income attributable to HealthSouth	$ 183.1	$ 222.0	$ 323.6	(17.5)%	(31.4)%

Provision for Doubtful Accounts and Operating Expenses as a % of Net Operating Revenues

	For the Year Ended December 31,		
	2015	2014	2013
Provision for doubtful accounts	1.5%	1.3 %	1.1 %
Operating expenses:			
Salaries and benefits	52.8%	48.3 %	47.9 %
Other operating expenses	13.7%	14.6 %	14.2 %
Occupancy costs	1.7%	1.7 %	2.1 %
Supplies	4.1%	4.7 %	4.6 %
General and administrative expenses	4.2%	5.2 %	5.2 %
Depreciation and amortization	4.4%	4.5 %	4.2 %
Government, class action, and related settlements	0.2%	(0.1)%	(1.0)%
Professional fees—accounting, tax, and legal	0.1%	0.4 %	0.4 %
Total operating expenses	81.2%	79.3 %	77.6 %

In the discussion that follows, we use "same-store" comparisons to explain the changes in certain performance metrics and line items within our financial statements. We calculate same-store comparisons based on hospitals open throughout both the full current period and prior periods presented. These comparisons include the financial results of market consolidation transactions in existing markets, as it is difficult to determine, with precision, the incremental impact of these transactions on our results of operations.

2015 Compared to 2014

Net Operating Revenues

Our consolidated *Net operating revenues* increased by $757.0 million, or 31.5%, in 2015 compared to 2014. This increase primarily resulted from strong volume growth in both of our operating segments and included the effect of our acquisitions of Encompass, Reliant, and CareSouth. See additional discussion in the "Segment Results of Operations" section of this Item.

Provision for Doubtful Accounts

For several years, under programs designated as "widespread probes," certain of our MACs have conducted pre-payment claim reviews of our billings and denied payment for certain diagnosis codes based on medical necessity. We dispute, or "appeal," most of these denials, but the resolution of these disputes can take in excess of three years, and we cannot provide assurance as to our ongoing and future success of these disputes. As such, we make provisions against these receivables in accordance with our accounting policy that necessarily considers historical collection trends of the receivables in this review process as part of our *Provision for doubtful accounts*. Therefore, as we experience increases or decreases in these denials, or if our actual collections of these denials differ from our estimated collections, we may experience volatility in our *Provision for doubtful accounts*. See also Item 1, *Business*, "Sources of Revenues—Medicare Reimbursement," to this report.

The change in our *Provision for doubtful accounts* as a percent of *Net operating revenues* in 2015 compared to 2014 primarily resulted from an increase in pre-payment claims denials by MACs, and continued substantial delays (exceeding three years) in the adjudication process at the administrative law judge hearing level. As these denials slowly work their way through the appeal process, we examine our success rate and adjust our historical collection percentage to estimate our *Provision for doubtful accounts*. In 2015, we revised our recovery estimates on pending MAC pre-payment claims from 63% to 71% using our historical collection percentage for all amounts denied. For claims we choose to take through all levels of appeal, up to and including administrative law judge hearings, we have historically experienced an approximate 70% success rate.

Salaries and Benefits

Salaries and benefits are the most significant cost to us and represent an investment in our most important asset: our employees. *Salaries and benefits* include all amounts paid to full- and part-time employees who directly participate in or support the operations of our hospitals, including all related costs of benefits provided to employees. It also includes amounts paid for contract labor.

Salaries and benefits increased in 2015 compared to 2014 primarily due to increased patient volumes, a 2.25% merit increase given to all eligible nonmanagement hospital employees effective October 1, 2014, and an increase in group medical costs in our inpatient rehabilitation segment. Increased patient volumes included an increase in the number of full-time equivalents as a result of our hospital development activities and the acquisitions of Encompass, Reliant, and CareSouth. Full-time equivalents also increased due to hospital staffing additions to ensure compliance with new Medicare quality reporting requirements and the creation of a new medical services department.

Salaries and benefits as a percent of *Net operating revenues* increased by 450 basis points during 2015 compared to 2014 primarily as a result of the acquisition of Encompass, the pricing impact of proportionally higher discharge growth from payors where our reimbursement is lower (as discussed in this Item, "Segment Results of Operations—Inpatient Rehabilitation —Net Operating Revenues"), an increase in group medical costs in our inpatient rehabilitation segment, start-up costs associated with our de novo hospitals that opened in the fourth quarter of 2014, and the additional staff associated with Medicare quality reporting and the medical services department. In addition, 2015 also included the pricing impact of updated Supplemental Security Income ("SSI") ratios (as discussed in this Item, "Segment Results of Operations—Inpatient Rehabilitation—Net Operating Revenues").

We provided a 2.5% merit increase to our nonmanagement hospital employees effective October 1, 2015.

Other Operating Expenses

Other operating expenses include costs associated with managing and maintaining our hospitals. These expenses include such items as contract services, utilities, non-income related taxes, insurance, professional fees, and repairs and maintenance.

Other operating expenses increased during 2015 compared to 2014 primarily due to the acquisition of Encompass, increased patient volumes at our hospitals, and the ongoing implementation of our clinical information system. As a percent of *Net operating revenues*, *Other operating expenses* decreased during 2015 compared to 2014 due to increased revenues, primarily as a result of the acquisition of Encompass.

Occupancy costs

Occupancy costs include amounts paid for rent associated with leased hospitals, outpatient rehabilitation satellite clinics, and home health and hospice agencies, including common area maintenance and similar charges. *Occupancy costs* remained flat as a percent of *Net operating revenues* in 2015 compared to 2014 due to our increasing revenue, primarily as a result of the acquisition of Encompass. We expect *Occupancy costs* to increase going forward as a result of our acquisition of Reliant.

Supplies

Supplies expense includes all costs associated with supplies used while providing patient care. Specifically, these costs include pharmaceuticals, food, needles, bandages, and other similar items. *Supplies* expense decreased as a percent of *Net operating revenues* in 2015 compared to 2014 primarily due to our increasing revenue, primarily as a result of the acquisition of Encompass.

General and Administrative Expenses

General and administrative expenses primarily include administrative expenses such as information technology services, human resources, corporate accounting, legal services, and internal audit and controls that are managed from our corporate headquarters in Birmingham, Alabama. These expenses also include stock-based compensation expenses and transaction costs associated with our acquisitions of Reliant and CareSouth in 2015 and Encompass in 2014.

General and administrative expenses increased in 2015 compared to 2014 due primarily to increased expenses associated with stock-based compensation, discussed in Note 14, *Employee Benefit Plans*, to the accompanying consolidated financial statements, and higher transaction costs. *General and administrative expenses* decreased as a percent of *Net operating revenues* in 2015 compared to 2014 primarily due to our increasing revenue, primarily as a result of the acquisition of Encompass.

Depreciation and Amortization

Depreciation and amortization increased during 2015 compared to 2014 due to our acquisitions and capital expenditures throughout 2014 and 2015. We expect *Depreciation and amortization* to increase going forward as a result of our recent and ongoing capital investments.

Government, Class Action, and Related Settlements

The loss included in *Government, Class Action, and Related Settlements* in 2015 resulted from a settlement discussed in Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements.

Professional Fees — Accounting, Tax, and Legal

Professional fees—accounting, tax, and legal for 2015 and 2014 related primarily to legal and consulting fees for continued litigation and support matters.

Loss on Early Extinguishment of Debt

In January 2015, we issued an additional $400 million of our 5.75% Senior Notes due 2024 at a price of 102% of the principal amount and used $250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility. As a result of the term loan prepayment, we recorded a $1.2 million *Loss on early extinguishment of debt* in the first quarter of 2015. In April 2015, we used the net proceeds from the offering of 5.125% Senior Notes due 2023 along with cash on hand to execute the redemption of our 8.125% Senior Notes due 2020. As a result of this redemption, we recorded an $18.8 million *Loss on early extinguishment of debt* in the second quarter of 2015. In November 2015, we used borrowings under our senior secured credit facility to execute the redemption of $50 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022. As a result of this redemption, we recorded an $2.4 million *Loss on early extinguishment of debt* in the fourth quarter of 2015.

The *Loss on early extinguishment of debt* in 2014 resulted from the redemption of our 7.25% Senior Notes due 2018 and the redemption of 10% of the outstanding principal amount of our 7.75% Senior Notes due 2022 in the fourth quarter of 2014.

See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

Interest Expense and Amortization of Debt Discounts and Fees

The increase in *Interest expense and amortization of debt discounts and fees* in 2015 compared to 2014 resulted from an increase in average borrowings offset by a lower average cash interest rate. Average borrowings increased due to our use of debt to fund the acquisitions of Encompass, Reliant, and CareSouth. Our average cash interest rate decreased from 6.3% in 2014 to 5.3% in 2015 due to the redemption of our 7.25% Senior Notes due 2018 in October 2014, the redemption of approximately $25 million of our 7.75% Senior Notes due 2022 in December 2014, and the redemption of our 8.125% Senior Notes due 2020 in April 2015. Cash paid for interest approximated $121 million and $101 million in 2015 and 2014, respectively.

Average borrowings outstanding increased in 2015 primarily as a result of the acquisitions of Encompass, Reliant, and CareSouth. In turn, interest expense is expected to increase in 2016. See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

Other Income

Other income for 2015 included a $1.2 million realized gain from the sale of all the common stock of Surgical Care Affiliates ("SCA"), our former surgery centers division and a $2.0 million gain related to the increase in fair value of our option to purchase up to a 5% equity interest in SCA from April 1, 2015 (the date it became exercisable) to April 13, 2015 (the date we exercised the option). See Note 12, *Fair Value Measurements*, to the accompanying consolidated financial statements.

Other income for 2014 included a $27.2 million gain related to the acquisition of an additional 30% equity interest in Fairlawn. See Note 2, *Business Combinations*, to the accompanying consolidated financial statements.

Income from Continuing Operations Before Income Tax Expense

Our pre-tax income from continuing operations in 2015 increased compared to 2014 due to increased *Net operating revenues* primarily as a result of the acquisitions of Encompass, Reliant, and CareSouth. Our pre-tax income from continuing operations for 2014 included the $27.2 million gain on the consolidation of Fairlawn.

Provision for Income Tax Expense

Due to our federal and state net operating losses ("NOLs"), our cash income taxes approximated $9.4 million, net of refunds, in 2015. These payments resulted primarily from state income tax expense of subsidiaries which have separate state filing requirements, alternative minimum taxes, and federal income taxes for subsidiaries not included in our federal consolidated income tax return. In 2016, we estimate we will pay approximately $20 million to $40 million of cash income taxes, net of refunds. In 2015 and 2014, current income tax expense was $14.8 million and $13.3 million, respectively.

Our effective income tax rate for 2015 was 35.9%. Our *Provision for income tax expense* in 2015 was greater than the federal statutory rate of 35% primarily due to: (1) state and other income tax expense and (2) an increase in our valuation allowance offset by (3) the impact of noncontrolling interests. See Note 1, *Summary of Significant Accounting Policies*, "Income Taxes," for a discussion of the allocation of income or loss related to pass-through entities, which is referred to as the impact of noncontrolling interests in this discussion. The increase in our valuation allowance in 2015 related primarily to changes to our state apportionment percentages resulting from the acquisitions of Encompass, Reliant, and CareSouth and changes to our current forecast of earnings in each jurisdiction.

Our effective income tax rate for 2014 was 28.6%. Our *Provision for income tax expense* in 2014 was less than the federal statutory rate of 35% primarily due to: (1) the impact of noncontrolling interests, (2) the nontaxable gain discussed in Note 2, *Business Combinations*, related to our acquisition of an additional 30% equity interest in Fairlawn, and (3) a decrease in our valuation allowance offset by (4) state and other income tax expense. As a result of the Fairlawn transaction, we released the deferred tax liability associated with the outside tax basis of our investment in Fairlawn because we now possess sufficient ownership to allow for the historical outside tax basis difference to be resolved through a tax-free transaction in the future. The decrease in our valuation allowance in 2014 related primarily to the expiration of state NOLs in certain jurisdictions, our current forecast of future earnings in each jurisdiction, and changes in certain state tax laws.

In certain state jurisdictions, we do not expect to generate sufficient income to use all of the available NOLs prior to their expiration. This determination is based on our evaluation of all available evidence in these jurisdictions including results of operations during the preceding three years, our forecast of future earnings, and prudent tax planning strategies. It is possible we may be required to increase or decrease our valuation allowance at some future time if our forecast of future earnings varies from actual results on a consolidated basis or in the applicable state tax jurisdiction, or if the timing of future tax deductions differs from our expectations.

We recognize the financial statement effects of uncertain tax positions when it is more likely than not, based on the technical merits, a position will be sustained upon examination by and resolution with the taxing authorities. Total remaining gross unrecognized tax benefits were $2.9 million and $0.9 million as of December 31, 2015 and 2014, respectively.

See Note 15, *Income Taxes*, to the accompanying consolidated financial statements and the "Critical Accounting Estimates" section of this Item.

Net Income Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests represents the share of net income or loss allocated to members or partners in our consolidated affiliates. The increase in *Net Income Attributable to Noncontrolling Interests* in 2015 compared to 2014 primarily resulted from our acquisition of Encompass on December 31, 2014.

2014 Compared to 2013

Net Operating Revenues

Net patient revenue from our hospitals was 6.7% higher in 2014 than in 2013. This increase was attributable to a 3.5% increase in patient discharges and a 3.1% increase in net patient revenue per discharge. Discharge growth included a 1.3% increase in same-store discharges. Same-store discharges were negatively impacted by winter storms in the first quarter of 2014 (40 basis points) and the closure of 40 skilled nursing facility beds in June 2014 (20 basis points). Discharge growth from new stores primarily resulted from the consolidation of Fairlawn effective June 1, 2014, as discussed in Note 2, *Business Combinations*, to the accompanying consolidated financial statements. Net patient revenue per discharge in 2014 benefited

from Medicare and managed care price adjustments and higher average acuity for the patients served. Net patient revenue per discharge was negatively impacted in the first quarter of 2014 by approximately $9 million for sequestration, which anniversaried on April 1, 2014. Net patient revenue per discharge in 2013 was negatively impacted by contractual allowances established in the fourth quarter of 2013 related to RAC audits.

Decreased outpatient volumes in 2014 compared to 2013 resulted from the closure of outpatient clinics and continued competition from physicians offering physical therapy services within their own offices.

Provision for Doubtful Accounts

The change in our *Provision for doubtful accounts* as a percent of *Net operating revenues* in 2014 compared to 2013 was primarily the result of continued pre-payment reviews by MACs and substantial delays in the adjudication process at the administrative law judge hearing level.

Salaries and Benefits

Salaries and benefits increased in 2014 compared to 2013 primarily due to increased patient volumes, including an increase in the number of full-time equivalents as a result of our 2013 and 2014 development activities, and a 2.2% merit increase given to all eligible nonmanagement employees effective October 1, 2013.

The net impact of reductions in self-insurance reserves, the negative impact of sequestration, and start-up costs associated with our de novo hospitals that opened in the fourth quarter of 2014 increased *Salaries and benefits* as a percent of *Net operating revenues* in 2014 compared to 2013. Excluding the impact of these three items, *Salaries and benefits* as a percent of *Net operating revenues* would have been approximately 40 basis points lower in 2014 than in 2013. Group medical and workers' compensation reserves were reduced by approximately $8 million in 2014 as compared to approximately $15 million in 2013.

We provided a 2.25% merit increase to our nonmanagement employees effective October 1, 2014.

Other Operating Expenses

Other operating expenses increased during 2014 compared to 2013 primarily as a result of increased patient volumes and approximately $7 million of lower reductions to self-insurance reserves for general and professional liability in 2014 than in 2013. As a percent of *Net operating revenues*, *Other operating expenses* for 2014 increased when compared to 2013 due primarily to these same lower reductions to self-insurance reserves. The increase in *Other operating expenses* as a percent of *Net operating revenues* for 2014 compared to 2013 also included the effects of sequestration experienced in the first quarter of 2014.

Occupancy costs

Occupancy costs decreased in total and as a percent of *Net operating revenues* in 2014 compared to 2013 due to our purchases of the real estate previously subject to operating leases at certain of our hospitals in the latter half of 2013 and first quarter of 2014.

Supplies

Supplies expense as a percent of *Net operating revenues* increased by 10 basis points during the 2014 compared to 2013 due primarily to the impact of sequestration on our *Net operating revenues* in the first quarter of 2014.

General and Administrative Expenses

In March 2008, we sold our corporate campus to Daniel Corporation ("Daniel"), a Birmingham, Alabama-based real estate company. The sale included a deferred purchase price component related to an incomplete 13-story building located on the property, often referred to as the Digital Hospital. Under the agreement, Daniel was obligated upon sale of its interest in the building to pay to us 40% of the net profit realized from the sale. In June 2013, Daniel sold the building to Trinity Medical Center. In the third quarter of 2013, we received $10.8 million in cash from Daniel in connection with the sale of the building. The gain associated with this transaction is being deferred and amortized over five years, which was the remaining life of our lease agreement with Daniel for the portion of the property we continue to occupy with our corporate office at the time of the transaction, as a component of *General and administrative expenses*. Approximately $2 million and $1 million of this gain was included in *General and administrative expenses* in 2014 and 2013, respectively.

General and administrative expenses in 2014 included $9.3 million of transaction expenses related to our acquisition of Encompass. These one-time expenses were offset by decreased expenses associated with stock-based compensation and our Senior Management Bonus Program discussed in Note 14, *Employee Benefit Plans*, to the accompanying consolidated financial statements, as well as the amortization of the deferred gain on the Digital Hospital discussed above. *General and administrative expenses* were flat as a percent of *Net operating revenues* in 2014 compared to 2013 due primarily to our increasing revenue.

Depreciation and Amortization

Depreciation and amortization increased during 2014 compared to 2013 due to our increased capital expenditures and development activities throughout 2013 and 2014.

Government, Class Action, and Related Settlements

The gain included in *Government, class action, and related settlements* in 2013 resulted from a noncash reduction in the estimated liability associated with the apportionment obligation to the plaintiffs in the January 2007 comprehensive settlement of the consolidated securities action, the collection of final judgments against former officers, and the recovery of assets from former officers. See Note 18, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying the 2014 Form 10-K.

Professional Fees — Accounting, Tax, and Legal

Professional fees—accounting, tax, and legal for 2014 and 2013 related primarily to legal and consulting fees for continued litigation and support matters discussed in Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements.

Loss on Early Extinguishment of Debt

The *Loss on early extinguishment of debt* in 2014 resulted from the redemption of our 7.25% Senior Notes due 2018 and the redemption of 10% of the outstanding principal amount of our 7.75% Senior Notes due 2022 in the fourth quarter of 2014. The *Loss on early extinguishment of debt* in 2013 resulted from the redemption of 10% of the outstanding principal amount of our 7.25% Senior Notes due 2018 and our 7.75% Senior Notes due 2022 in November 2013.

See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

Interest Expense and Amortization of Debt Discounts and Fees

The increase in *Interest expense and amortization of debt discounts and fees* during 2014 compared to 2013 primarily resulted from the noncash amortization of debt discounts and financing costs associated with the issuance of our 2.00% Convertible Senior Subordinated Notes due 2043 in November 2013. While our average borrowings increased in 2014 primarily as a result of issuing the convertible notes, our average cash interest rate decreased from 7.1% in 2013 to 6.2% in 2014. Cash paid for interest approximated $101 million and $99 million in 2014 and 2013, respectively.

Other Income

Other income for 2014 included a $27.2 million gain related to the acquisition of an additional 30% equity interest in Fairlawn. See Note 2, *Business Combinations*, to the accompanying consolidated financial statements.

Income from Continuing Operations Before Income Tax Expense

Our pre-tax income from continuing operations for 2014 reflected continued revenue growth and increases in interest expense and depreciation and amortization. Pre-tax income was also impacted by three items having a net, favorable impact of $4.7 million. These items included the $27.2 million gain on the consolidation of Fairlawn offset by the $13.2 million *Loss on early extinguishment of debt* and $9.3 million of Encompass transaction expenses. Pre-tax income from continuing operations for 2013 included $23.5 million of gains related to *Government, class action, and related settlements*.

Provision for Income Tax Expense

As discussed above, our effective income tax rate for 2014 was 28.6%, which was less than the federal statutory rate of 35.0% primarily due to: (1) the impact of noncontrolling interests, (2) the nontaxable gain discussed in Note 2, *Business Combinations*, related to our acquisition of an additional 30% equity interest in Fairlawn, and (3) a decrease in our valuation allowance offset by (4) state and other income tax expense.

Our effective income tax rate for 2013 was 3.2%, which was less than the federal statutory rate of 35.0% primarily due to: (1) the IRS settlement discussed in Note 15, *Income Taxes*, to the accompanying consolidated financial statements, (2) the impact of noncontrolling interests, and (3) a decrease in our valuation allowance offset by (4) state and other income tax expense.

Total remaining gross unrecognized tax benefits were $0.9 million and $1.1 million as of December 31, 2014 and 2013, respectively.

See Note 15, *Income Taxes*, to the accompanying consolidated financial statements and the "Critical Accounting Estimates" section of this Item.

Impact of Inflation

The impact of inflation on the Company will be primarily in the area of labor costs. The healthcare industry is labor intensive. Wages and other expenses increase during periods of inflation and when labor shortages occur in the marketplace. There can be no guarantee we will not experience increases in the cost of labor, as the need for clinical healthcare professionals is expected to grow. In addition, increases in healthcare costs are typically higher than inflation and impact our costs under our employee benefit plans. Managing these costs remains a significant challenge and priority for us.

Suppliers pass along rising costs to us in the form of higher prices. Our supply chain efforts and our continual focus on monitoring and actively managing pharmaceutical costs has enabled us to accommodate increased pricing related to supplies and other operating expenses over the past few years. However, we cannot predict our ability to cover future cost increases.

It should be noted that we have little or no ability to pass on these increased costs associated with providing services to Medicare and Medicaid patients due to federal and state laws that establish fixed reimbursement rates.

Relationships and Transactions with Related Parties

Related party transactions were not material to our operations in 2015, 2014, or 2013, and therefore, are not presented as a separate discussion within this Item.

Segment Results of Operations

Our internal financial reporting and management structure is focused on the major types of services provided by HealthSouth. Beginning in the first quarter of 2015, we manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. Prior period information has been adjusted to conform to the current period presentation. Specifically, HealthSouth's legacy 25 hospital-based home health agencies have been reclassified from our inpatient rehabilitation segment to our home health and hospice segment for all periods presented. For additional information regarding our business segments, including a detailed description of the services we provide, financial data for each segment, and a reconciliation of total segment Adjusted EBITDA to income from continuing operations before income tax expense, see Note 18, *Segment Reporting*, to the accompanying consolidated financial statements.

Inpatient Rehabilitation

During the years ended December 31, 2015, 2014 and 2013, our inpatient rehabilitation segment derived its *Net operating revenues* from the following payor sources:

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Medicare	73.2%	73.9%	74.2%
Managed care and other discount plans, including Medicare Advantage	19.0%	18.8%	18.7%
Medicaid	2.5%	1.8%	1.2%
Other third-party payors	2.0%	1.8%	1.8%
Workers' compensation	1.1%	1.2%	1.3%
Patients	0.7%	1.0%	1.1%
Other income	1.5%	1.5%	1.7%
Total	100.0%	100.0%	100.0%

Additional information regarding our inpatient rehabilitation segment's operating results for the years ended December 31, 2015, 2014 and 2013, is as follows:

	For the Year Ended December 31,			Percentage Change	
	2015	2014	2013	2015 vs. 2014	2014 vs. 2013
	(In Millions, Except Percentage Change)				
Net operating revenues:					
Inpatient	$ 2,547.2	$ 2,272.5	$ 2,130.8	12.1 %	6.7 %
Outpatient and other	105.9	104.8	113.6	1.0 %	(7.7)%
Inpatient rehabilitation segment revenues	2,653.1	2,377.3	2,244.4	11.6 %	5.9 %
Less: Provision for doubtful accounts	(44.7)	(31.2)	(25.6)	43.3 %	21.9 %
Net operating revenues less provision for doubtful accounts	2,608.4	2,346.1	2,218.8	11.2 %	5.7 %
Operating expenses:					
Salaries and benefits	1,310.6	1,141.0	1,069.7	14.9 %	6.7 %
Other operating expenses	387.7	342.5	314.7	13.2 %	8.8 %
Supplies	120.9	111.5	105.2	8.4 %	6.0 %
Occupancy costs	46.2	41.2	46.5	12.1 %	(11.4)%
Other income	(2.3)	(4.0)	(4.5)	(42.5)%	(11.1)%
Equity in net income of nonconsolidated affiliates	(8.6)	(10.7)	(11.2)	(19.6)%	(4.5)%
Noncontrolling interests	62.9	59.3	57.2	6.1 %	3.7 %
Segment Adjusted EBITDA	$ 691.0	$ 665.3	$ 641.2	3.9 %	3.8 %
	(Actual Amounts)				
Discharges	149,161	134,515	129,988	10.9 %	3.5 %
Net patient revenue per discharge	$ 17,077	$ 16,894	$ 16,392	1.1 %	3.1 %
Outpatient visits	577,507	579,555	652,266	(0.4)%	(11.1)%
Average length of stay (days)	12.9	13.2	13.3	(2.3)%	(0.8)%
Occupancy %	62.8%	68.4%	69.3%	(8.2)%	(1.3)%
# of licensed beds	8,404	7,095	6,825	18.4 %	4.0 %
Full-time equivalents*	17,880	16,405	15,956	9.0 %	2.8 %
Employees per occupied bed	3.41	3.40	3.39	0.3 %	0.3 %

* Excludes approximately 400 full-time equivalents in each period who are considered part of corporate overhead with their salaries and benefits included in *General and administrative expenses* in our consolidated statements of operations. Full-time equivalents included in the above table represent HealthSouth employees who participate in or support the operations of our hospitals and exclude an estimate of full-time equivalents related to contract labor.

We actively manage the productive portion of our *Salaries and benefits* utilizing certain metrics, including employees per occupied bed, or "EPOB." This metric is determined by dividing the number of full-time equivalents, including an estimate of full-time equivalents from the utilization of contract labor, by the number of occupied beds during each period. The number of occupied beds is determined by multiplying the number of licensed beds by our occupancy percentage.

Net Operating Revenues

Net patient revenue from our hospitals was 12.1% higher for 2015 compared to 2014. This increase included a 10.9% increase in patient discharges and a 1.1% increase in net patient revenue per discharge. Discharge growth included a 3.2% increase in same-store discharges. Discharge growth from new stores resulted from three de novo hospitals that opened in the

fourth quarter of 2014 (Altamonte Springs, Florida; Newnan, Georgia; and Middletown, Delaware) and one de novo hospital that opened in December 2015 (Franklin, Tennessee), our acquisitions of Reliant (October 2015), Quillen Rehabilitation Hospital ("Quillen") in Johnson City, Tennessee (November 2014) and Cardinal Hill in Lexington, Kentucky (May 2015), and our joint venture with Memorial Health in Savannah, Georgia (April 2015). While we experienced pricing growth from Medicare and managed care payors, the pricing adjustments were negatively impacted by proportionally higher discharge growth in Medicaid and managed care payors where our reimbursement is lower. In addition, our net patient revenue per discharge was negatively impacted in 2015 by approximately $5 million for updated SSI ratios published by CMS for fiscal year 2013.

See Note 2, *Business Combinations*, to the accompanying consolidated financial statements of this report for information regarding Reliant, Cardinal Hill, Quillen, Fairlawn, and our joint venture with Memorial Health.

Adjusted EBITDA

The increase in Adjusted EBITDA in 2015 compared to 2014 primarily resulted from revenue growth from both same stores and new stores, as discussed above. Adjusted EBITDA in 2015 was also impacted by (1) an increase in salaries and benefits as a percent of revenue due to increases in group medical costs, an increase in our licensed skills mix, and an increase in volume-related "premium" pay, (2) increased bad debt expense from continued pre-payment claims denials predominately by one of our MACs, (3) SSI ratio adjustments, as discussed above (4) a settlement of an employee sexual harassment matter that was not covered by insurance, and (5) incremental investments in our operating platform, including a contractual increase in costs associated with the ongoing implementation of our electronic clinical information system, the addition of staff at our hospitals to ensure compliance with new CMS quality reporting requirements, the creation of a new medical services department, and costs associated with our participation in CMS' Model 3 bundling pilot initiative. Increases in group medical costs resulted from an increase in the number and size of large claims (claims greater than $100,000) and an increase in the cost and use of specialty pharmaceuticals.

Home Health and Hospice

During the years ended December 31, 2015, 2014 and 2013, our home health and hospice segment derived its *Net operating revenues* from the following payor sources:

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Medicare	83.7%	96.9%	95.8%
Managed care and other discount plans, including Medicare Advantage	10.7%	1.8%	2.5%
Medicaid	5.5%	—%	—%
Other third-party payors	—%	1.0%	1.4%
Workers' compensation	—%	0.3%	0.3%
Patients	0.1%	—%	—%
Total	100.0%	100.0%	100.0%

Additional information regarding our home health and hospice segment's operating results for the years ended December 31, 2015, 2014 and 2013, is as follows:

	For the Year Ended December 31,			Percentage Change	
	2015	2014	2013	2015 vs. 2014	2014 vs. 2013
	(In Millions, Except Percentage Change)				
Net operating revenues:					
Home health	$ 478.1	$ 28.6	$ 28.8	NMF	NMF
Hospice	31.7	—	—	N/A	N/A
Home health and hospice segment revenues	509.8	28.6	28.8	NMF	NMF
Less: Provision for doubtful accounts	(2.5)	(0.4)	(0.4)	NMF	NMF
Net operating revenues less provision for doubtful accounts	507.3	28.2	28.4	NMF	NMF
Operating expenses:					
Cost of services sold (excluding depreciation and amortization)	244.8	17.0	16.7	NMF	NMF
Support and overhead costs	172.7	6.9	6.6	NMF	NMF
Equity in net income of nonconsolidated affiliates	(0.1)	—	—	NMF	NMF
Noncontrolling interests	6.8	0.4	0.6	NMF	NMF
Segment Adjusted EBITDA	$ 83.1	$ 3.9	$ 4.5	NMF	NMF
	(Actual Amounts)				
Home health:					
Admissions	74,329	7,545	7,403	NMF	NMF
Recertifications	65,039	1,030	914	NMF	NMF
Episodes	137,568	8,236	7,969	NMF	NMF
Average revenue per episode	$ 3,072	$ 3,364	$ 3,462	(8.7)%	(2.8)%
Episodic visits per episode	19.1	18.8	18.6	1.6 %	1.1 %
Total visits	2,889,373	159,672	154,365	NMF	NMF
Cost per visit	$ 72.0	$ 108.0	$ 107.9	(33.3)%	0.1 %
Hospice:					
Admissions	2,452	—	—	N/A	N/A
Patient days	204,898	—	—	N/A	N/A
Revenue per day	$ 155	$ —	$ —	N/A	N/A

The increase in *Net operating revenues* and Adjusted EBITDA during 2015 compared to 2014 was due to our acquisition of Encompass on December 31, 2014 (see Note 2, *Business Combinations*, to the accompanying consolidated financial statements). Because of this acquisition, certain variances in the above table are considered to be not meaningful figures and are labeled as "NMF."

Results of Discontinued Operations

For information regarding discontinued operations, see Note 12, *Fair Value Measurements*, to the accompanying consolidated financial statements.

Liquidity and Capital Resources

Our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility.

The objectives of our capital structure strategy are to ensure we maintain adequate liquidity and flexibility. Pursuing and achieving those objectives allows us to support the execution of our operating and strategic plans and weather temporary disruptions in the capital markets and general business environment. Maintaining adequate liquidity is a function of our unrestricted *Cash and cash equivalents* and our available borrowing capacity. Maintaining flexibility in our capital structure is a function of, among other things, the amount of debt maturities in any given year, the options for debt prepayments without onerous penalties, and limiting restrictive terms and maintenance covenants in our debt agreements.

Consistent with these objectives, in December 2014, we drew $375 million under our expanded term loan facilities and $325 million under our revolving credit facility to fund the acquisition of Encompass. In January 2015, we issued an additional $400 million of our 5.75% Senior Notes due 2024 (the "2024 Notes") at a price of 102% of the principal amount and used $250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility. As a result of this transaction, we recorded a $1.2 million *Loss on early extinguishment of debt* in the first quarter of 2015.

In March 2015, we issued $300 million of 5.125% Senior Notes due 2023 (the "2023 Notes") at a price of 100.0% of the principal amount, which resulted in approximately $295 million in net proceeds from the public offering. On April 10, 2015, we used the net proceeds from the 2023 Notes offering along with cash on hand to redeem all of our 8.125% Senior Notes due 2020 (the "2020 Notes"). Pursuant to the terms of the 2020 Notes, this redemption was made at a price of 104.063%, which resulted in a total cash outlay of approximately $302 million to retire the $290 million in principal. As a result of this redemption, we recorded an $18.8 million *Loss on early extinguishment of debt* in the second quarter of 2015.

In order to facilitate the funding of our development pipeline, including the acquisition of Reliant, in June 2015, we amended our existing credit agreement to (1) provide that the leverage ratio financial covenant be calculated on a pro forma basis to include the effects of investments, acquisitions, mergers, and other operational changes and (2) increase the amount of specifically permitted capital lease obligations from $200 million to $350 million. In July 2015, we further amended our credit agreement to (1) add $500 million of new term loan facilities to our existing $600 million revolving credit facility and $195 million of outstanding term loans, (2) change the maximum leverage ratio in the financial covenants applicable for the period July 2015 through June 2017 from 4.25x to 4.50x and to 4.25x from then until maturity, and (3) extend the maturity date for all borrowings to July 2020. Under the terms of the amendment, the amount available to us under the new term loan facilities would be reduced in the event we incurred additional capital markets indebtedness. Based on our issuance of additional senior notes in August 2015 and September 2015, as discussed below, our availability under the new term loan facilities was reduced to $250 million. In September, we borrowed $125 million of the new term loan facilities, the proceeds of which were used to fund a portion of the Reliant acquisition. We utilized the remaining $125 million of term loan facility capacity, as well as cash on hand, to finance the CareSouth acquisition. See Note 2, *Business Combinations*, to the accompanying consolidated financial statements and the "Executive Overview—2015 Overview" section of this Item.

In August 2015, we issued an additional $350 million of our 2024 Notes at a price of 100.5% of the principal amount, which resulted in approximately $351 million in net proceeds from the private offering. We used the net proceeds to reduce borrowings under our revolving credit facility and fund a portion of the Reliant acquisition. In September 2015, we issued $350 million of 5.75% Senior Notes due 2025 (the "2025 Notes") at a price of 100.0% of the principal amount, which resulted in approximately $344 million in net proceeds from the private offering. We used the net proceeds from this borrowing to fund a portion of the Reliant acquisition. See Note 2, *Business Combinations*, to the accompanying consolidated financial statements and the "Executive Overview—2015 Overview" section of this Item.

In November 2015, we used cash on hand and borrowings under our senior secured credit facility to redeem $50 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022 (the "2022 Notes"). Pursuant to the terms of the 2022 Notes, this optional redemption was made at a price of 103.875%, which resulted in a total cash outlay of approximately $52 million. As a result of this redemption, we recorded a $2.4 million *Loss on early extinguishment of debt* in the fourth quarter of 2015. See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

On February 23, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of $50 million of the outstanding principal amount of our existing 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption will be at a price of 103.875%, which will result in a total cash outlay of approximately $52 million when the transaction closes, which is expected to be on March 24, 2016. We plan to use cash on hand and capacity under our revolving credit facility to fund the redemption. As a result of this redemption, we expect to record an approximate $2 million loss on early extinguishment of debt in the first quarter of 2016. See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

On April 22, 2015, we delivered notice of the exercise of our rights to force conversion of all outstanding shares of our *Convertible perpetual preferred stock* (par value of $0.10 per share and liquidation preference of $1,000 per share) pursuant to

the underlying certificate of designations. The effective date of the conversion was April 23, 2015. On that date, each share of preferred stock automatically converted into 33.9905 shares of our common stock (par value of $0.01 per share). We completed the forced conversion by issuing and delivering in the aggregate 3,271,415 shares of our common stock to the registered holders of the 96,245 shares of the preferred stock outstanding and paying cash in lieu of fractional shares due to those holders. The conversion increased the number of basic shares outstanding by 3,271,415 and did not change the diluted share count. On an annual basis, the conversion of the preferred stock to common stock is expected to result in a net positive cash impact of $3.2 million for the difference between preferred dividends and common dividends on these shares, based on the current common dividend level of $0.23 per share.

We have been disciplined in creating a capital structure that is flexible with no significant debt maturities prior to 2020. Our balance sheet remains strong, and we have significant availability under our credit agreement. We continue to generate strong cash flows from operations, and we have significant flexibility with how we choose to invest our cash and return capital to shareholders. While our financial leverage increased as a result of the Encompass, Reliant and CareSouth transactions, we anticipate in the longer term reducing our financial leverage based on growth of Adjusted EBITDA and an allocation of a portion of our free cash flow to debt reduction.

See Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

Current Liquidity

As of December 31, 2015, we had $61.6 million in *Cash and cash equivalents*. This amount excludes $45.9 million in *Restricted cash* and $56.2 million of restricted marketable securities ($40.1 million of restricted marketable securities are included in *Other long-term assets* in our consolidated balance sheet). Our restricted assets pertain primarily to obligations associated with our captive insurance company, as well as obligations we have under agreements with joint venture partners. See Note 3, *Cash and Marketable Securities*, to the accompanying consolidated financial statements.

In addition to *Cash and cash equivalents*, as of December 31, 2015, we had approximately $436 million available to us under our revolving credit facility. Our credit agreement governs the substantial majority of our senior secured borrowing capacity and contains a leverage ratio and an interest coverage ratio as financial covenants. Our leverage ratio is defined in our credit agreement as the ratio of consolidated total debt (less up to $75 million of cash on hand) to Adjusted EBITDA for the trailing four quarters. In calculating the leverage ratio under our credit agreement, we are permitted to use pro forma Adjusted EBITDA, the calculation of which includes historical income statement items and pro forma adjustments resulting from (1) the dispositions and repayments or incurrence of debt and (2) the investments, acquisitions, mergers, amalgamations, consolidations and operational changes from acquisitions to the extent such items or effects are not yet reflected in our trailing four-quarter financial statements. Our interest coverage ratio is defined in our credit agreement as the ratio of Adjusted EBITDA to consolidated interest expense, excluding the amortization of financing fees, for the trailing four quarters. As of December 31, 2015, the maximum leverage ratio requirement per our credit agreement was 4.50x and the minimum interest coverage ratio requirement was 3.0x, and we were in compliance with these covenants. Based on Adjusted EBITDA for 2015 and the interest rate in effect under our credit agreement during the three-month period ended December 31, 2015, if we had drawn on the first day and maintained the maximum amount of outstanding draws under our revolving credit facility for the entire year, we would still be in compliance with the maximum leverage ratio and minimum interest coverage ratio requirements.

We do not face near-term refinancing risk, as the amounts outstanding under our credit agreement do not mature until 2020, and our bonds all mature in 2022 and beyond. See the “Contractual Obligations” section below for information related to our contractual obligations as of December 31, 2015.

We anticipate we will continue to generate strong cash flows from operations that, together with availability under our revolving credit facility, will allow us to invest in growth opportunities and continue to improve our existing business. We also will continue to consider additional shareholder value-enhancing strategies such as repurchases of our common stock and distribution of common stock dividends, including the potential growth of the quarterly cash dividend on our common stock, recognizing that these actions may increase our leverage ratio. See also the “Authorizations for Returning Capital to Stakeholders” section of this Item.

See Item 1A, *Risk Factors*, for a discussion of risks and uncertainties facing us.

Sources and Uses of Cash

The following table shows the cash flows provided by or used in operating, investing, and financing activities for the years ended December 31, 2015, 2014, and 2013 (in millions):

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Net cash provided by operating activities	$ 484.8	$ 444.9	$ 470.3
Net cash used in investing activities	(1,129.8)	(876.9)	(226.2)
Net cash provided by (used in) financing activities	639.9	434.2	(312.4)
(Decrease) increase in cash and cash equivalents	$ (5.1)	$ 2.2	$ (68.3)

2015 Compared to 2014

Operating activities. The increase in *Net cash provided by operating activities* during 2015 compared to 2014 primarily resulted from revenue growth. Cash flows provided by operating activities in 2015 were also impacted by increased cash interest expense and higher working capital. Higher working capital resulted from growth in accounts receivable due to additional claims denials and continued delays at the administrative law judge hearing level.

Investing activities. The increase in *Net cash used in investing activities* during 2015 compared to 2014 resulted primarily from the acquisitions of Reliant and CareSouth described in Note 2, *Business Combinations*, to the accompanying consolidated financial statements.

Financing activities. The increase in *Net cash provided by financing activities* during 2015 compared to 2014 primarily resulted from the public offering of the 2023 Notes, the additional offering of the 2024 Notes, and the private offering of the 2025 Notes to fund the acquisitions of Reliant and CareSouth as discussed above and in Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

2014 Compared to 2013

Operating activities. The decrease in *Net cash provided by operating activities* from 2013 to 2014 primarily resulted from growth in accounts receivable due to additional claims denials predominantly by one Medicare Administrative Contractor and continued delays at the administrative law judge hearing level. See Item 1, *Business*, "Sources of Revenues—Medicare Reimbursement—Inpatient Rehabilitation."

Investing activities. The increase in *Net cash used in investing activities* during 2014 compared to 2013 primarily resulted from the acquisition of Encompass. The total cash consideration delivered at closing was $695.5 million.

Financing activities. *Net cash provided by financing activities* in 2014 primarily resulted from draws under the revolving and expanded term loan facilities of our credit agreement to fund the acquisition of Encompass. Excluding the Encompass-related borrowings, *Net cash used in financing activities* would have decreased in 2014 primarily due to repurchases of our common stock as part of a tender offer in the first quarter of 2013 offset by an increase in common stock cash dividends in 2014.

See Note 2, *Business Combinations*, Note 8, *Long-term Debt*, and Note 16, *Earnings per Common Share*, to the accompanying consolidated financial statements.

Contractual Obligations

Our consolidated contractual obligations as of December 31, 2015 are as follows (in millions):

	Total	2016	2017-2018	2019-2020	2021 and thereafter
Long-term debt obligations:					
Long-term debt, excluding revolving credit facility and capital lease obligations [a]	$ 2,753.3	$ 24.9	$ 46.9	$ 648.5	$ 2,033.0
Revolving credit facility	130.0	—	—	130.0	—
Interest on long-term debt [b]	1,264.6	140.8	279.6	272.7	571.5
Capital lease obligations [c]	543.1	32.8	67.5	58.1	384.7
Operating lease obligations [d][e]	387.6	59.2	98.1	74.1	156.2
Purchase obligations [e][f]	114.2	33.3	49.3	24.4	7.2
Other long-term liabilities [g][h]	3.7	0.3	0.4	0.4	2.6
Total	$ 5,196.5	$ 291.3	$ 541.8	$ 1,208.2	$ 3,155.2

[a] Included in long-term debt are amounts owed on our bonds payable and other notes payable. These borrowings are further explained in Note 8, *Long-term Debt,* to the accompanying consolidated financial statements.

[b] Interest on our fixed rate debt is presented using the stated interest rate. Interest expense on our variable rate debt is estimated using the rate in effect as of December 31, 2015. Interest related to capital lease obligations is excluded from this line. Future minimum payments, which are accounted for as interest, related to sale/leaseback transactions involving real estate accounted for as financings are included in this line (see Note 5, *Property and Equipment*, and Note 8, *Long-term Debt*, to the accompanying consolidated financial statements). Amounts exclude amortization of debt discounts, amortization of loan fees, or fees for lines of credit that would be included in interest expense in our consolidated statements of operations.

[c] Amounts include interest portion of future minimum capital lease payments.

[d] Our inpatient rehabilitation segment leases approximately 32% of its hospitals as well as other property and equipment under operating leases in the normal course of business. Our home health and hospice segment leases relatively small office spaces in the localities it serves, space for its corporate office, and other equipment under operating leases in the normal course of business. Some of our hospital leases contain escalation clauses based on changes in the Consumer Price Index while others have fixed escalation terms. The minimum lease payments do not include contingent rental expense. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. For more information, see Note 5, *Property and Equipment,* to the accompanying consolidated financial statements.

[e] Future operating lease obligations and purchase obligations are not recognized in our consolidated balance sheet.

[f] Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on HealthSouth and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. Our purchase obligations primarily relate to software licensing and support.

[g] Because their future cash outflows are uncertain, the following noncurrent liabilities are excluded from the table above: general liability, professional liability, and workers' compensation risks, noncurrent amounts related to third-party billing audits, and deferred income taxes. Also, as of December 31, 2015, we had $2.9 million of total gross unrecognized tax benefits. For more information, see Note 9, *Self-Insured Risks,* Note 15, *Income Taxes,* and Note 17, *Contingencies and Other Commitments,* to the accompanying consolidated financial statements.

[h] The table above does not include *Redeemable noncontrolling interests* of $121.1 million because of the uncertainty surrounding the timing and amounts of any related cash outflows. See Note 11, *Redeemable Noncontrolling Interests*, to the accompanying consolidated financial statements.

Our capital expenditures include costs associated with our hospital refresh program, de novo projects, capacity expansions, technology initiatives, and building and equipment upgrades and purchases. During the year ended December 31, 2015, we made capital expenditures of approximately $157 million for property and equipment and capitalized software. These expenditures in 2015 are exclusive of approximately $985 million in net cash related to our acquisition activity. During 2016, we expect to spend approximately $185 million to $230 million for capital expenditures. Approximately $95 million to $110 million of this budgeted amount is considered nondiscretionary expenditures, which we may refer to in other filings as "maintenance" expenditures. Actual amounts spent will be dependent upon the timing of construction projects and acquisition opportunities for our home health and hospice business.

Authorizations for Returning Capital to Stakeholders

In October 2014, February 2015, and May 2015, our board of directors declared a cash dividend of $0.21 per share that was paid in January 2015, April 2015, and July 2015, respectively. On July 16, 2015, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of $0.23 per share, payable on October 15, 2015 to stockholders of record on October 1, 2015. On October 23, 2015, our board of directors declared a cash dividend of $0.23 per share, payable on January 15, 2016 to stockholders of record on January 2, 2016. We expect quarterly dividends to be paid in January, April, July, and October. However, the actual declaration of any future cash dividends, and the setting of record and payment dates as well as the per share amounts, will be at the discretion of our board of directors after consideration of various factors, including our capital position and alternative uses of funds. Cash dividends are expected to be funded using cash flows from operations, cash on hand, and availability under our credit agreement.

The payment of cash dividends on our common stock triggers antidilution adjustments, except in instances when such adjustments are deemed *de minimis,* under our convertible notes and our previous convertible perpetual preferred stock. See Note 8, *Long-term Debt*, Note 10, *Convertible Perpetual Preferred Stock*, and Note 16, *Earnings per Common Share*, to the accompanying consolidated financial statements.

On February 14, 2014, our board of directors approved an increase in our existing common stock repurchase authorization from $200 million to $250 million. As of December 31, 2015, approximately $160 million remained under this authorization. The repurchase authorization does not require the repurchase of a specific number of shares, has an indefinite term, and is subject to termination at any time by our board of directors. Subject to certain terms and conditions, including a maximum price per share and compliance with federal and state securities and other laws, the repurchases may be made from time to time in open market transactions, privately negotiated transactions, or other transactions, including trades under a plan established in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During 2015, we repurchased 1.3 million shares of our common stock in the open market for $45.3 million under this repurchase authorization using cash on hand. Future repurchases under this authorization generally are expected to be funded using a combination of cash on hand and availability under our $600 million revolving credit facility.

Adjusted EBITDA

Management believes Adjusted EBITDA as defined in our credit agreement is a measure of our ability to service our debt and our ability to make capital expenditures. We reconcile Adjusted EBITDA to *Net income* and to *Net cash provided by operating activities*.

We use Adjusted EBITDA on a consolidated basis as a liquidity measure. We believe this financial measure on a consolidated basis is important in analyzing our liquidity because it is the key component of certain material covenants contained within our credit agreement, which is discussed in more detail in Note 8, *Long-term Debt*, to the accompanying consolidated financial statements. These covenants are material terms of the credit agreement. Noncompliance with these financial covenants under our credit agreement — our interest coverage ratio and our leverage ratio — could result in our lenders requiring us to immediately repay all amounts borrowed. If we anticipated a potential covenant violation, we would seek relief from our lenders, which would have some cost to us, and such relief might be on terms less favorable to us than those in our existing credit agreement. In addition, if we cannot satisfy these financial covenants, we would be prohibited under our credit agreement from engaging in certain activities, such as incurring additional indebtedness, paying common stock dividends, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted EBITDA is critical to our assessment of our liquidity.

In general terms, the credit agreement definition of Adjusted EBITDA, therein referred to as "Adjusted Consolidated EBITDA," allows us to add back to consolidated *Net income* interest expense, income taxes, and depreciation and amortization and then add back to consolidated *Net income* (1) all unusual or nonrecurring items reducing consolidated *Net income* (of which only up to $10 million in a year may be cash expenditures), (2) any losses from discontinued operations and closed locations, (3) costs and expenses, including legal fees and expert witness fees, incurred with respect to litigation

associated with stockholder derivative litigation, and (4) share-based compensation expense. We also subtract from consolidated *Net income* all unusual or nonrecurring items to the extent increasing consolidated *Net income*.

Under the credit agreement, the Adjusted EBITDA calculation does not include net income attributable to noncontrolling interests and includes (1) gain or loss on disposal of assets, (2) professional fees unrelated to the stockholder derivative litigation, (3) unusual or nonrecurring cash expenditures in excess of $10 million, and (4) pro forma adjustments resulting from debt transactions and development activities. These items may not be indicative of our ongoing performance, so the Adjusted EBITDA calculation presented here includes adjustments for them.

Adjusted EBITDA is not a measure of financial performance under generally accepted accounting principles in the United States of America, and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted EBITDA should not be considered a substitute for *Net income* or cash flows from operating, investing, or financing activities. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. Revenues and expenses are measured in accordance with the policies and procedures described in Note 1, *Summary of Significant Accounting Policies*, to the accompanying consolidated financial statements.

Our Adjusted EBITDA for the years ended December 31, 2015, 2014, and 2013 was as follows (in millions):

Reconciliation of Net Income to Adjusted EBITDA

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Net income	$ 252.8	$ 281.7	$ 381.4
Loss (income) from discontinued operations, net of tax, attributable to HealthSouth	0.9	(5.5)	1.1
Provision for income tax expense	141.9	110.7	12.7
Interest expense and amortization of debt discounts and fees	142.9	109.2	100.4
Loss on early extinguishment of debt	22.4	13.2	2.4
Professional fees—accounting, tax, and legal	3.0	9.3	9.5
Government, class action, and related settlements	7.5	(1.7)	(23.5)
Net noncash loss on disposal or impairment of assets	2.6	6.7	5.9
Depreciation and amortization	139.7	107.7	94.7
Stock-based compensation expense	26.2	23.9	24.8
Net income attributable to noncontrolling interests	(69.7)	(59.7)	(57.8)
Gain on consolidation of former equity method hospital	—	(27.2)	—
Transaction costs	12.3	9.3	—
Adjusted EBITDA	$ 682.5	$ 577.6	$ 551.6

Reconciliation of Net Cash Provided by Operating Activities to Adjusted EBITDA

	For the Year Ended December 31,		
	2015	2014	2013
Net cash provided by operating activities	$ 484.8	$ 444.9	$ 470.3
Provision for doubtful accounts	(47.2)	(31.6)	(26.0)
Professional fees—accounting, tax, and legal	3.0	9.3	9.5
Interest expense and amortization of debt discounts and fees	142.9	109.2	100.4
Equity in net income of nonconsolidated affiliates	8.7	10.7	11.2
Net income attributable to noncontrolling interests in continuing operations	(69.7)	(59.7)	(57.8)
Amortization of debt-related items	(14.3)	(12.7)	(5.0)
Distributions from nonconsolidated affiliates	(7.7)	(12.6)	(11.4)
Current portion of income tax expense	14.8	13.3	6.3
Change in assets and liabilities	147.1	90.1	48.9
Net premium paid on bond transactions	3.9	4.3	1.7
Operating cash used in discontinued operations	0.7	1.2	1.9
Transaction costs	12.3	9.3	—
Other	3.2	1.9	1.6
Adjusted EBITDA	$ 682.5	$ 577.6	$ 551.6

Growth in Adjusted EBITDA from 2015 to 2014 resulted primarily from the acquisition of Encompass on December 31, 2014. As discussed above in the "Segment Results of Operations" section of this Item, increased *Net operating revenues* in our inpatient rehabilitation segment were impacted by (1) an increase in salaries and benefits as a percent of revenue due to increases in group medical costs, an increase in our licensed skills mix, and an increase in volume-related "premium" pay, (2) increased bad debt expense from continued pre-payment claims denials predominately by one of our MACs, (3) SSI ratio adjustments, and (4) incremental investments in our operating platform.

Growth in Adjusted EBITDA from 2013 to 2014 was due primarily to continued revenue growth, as well as an approximate $6 million contribution to Adjusted EBITDA from the increase in ownership and consolidation of Fairlawn. The comparison to last year was negatively impacted by approximately $14 million attributable to lower reductions in our self-insurance reserves in 2014 than in 2013, as discussed in the "Results of Operations" section of this Item. Adjusted EBITDA in 2014 also included approximately $8 million for the negative impact of sequestration in the first quarter of 2014 and approximately $4 million in higher net start-up costs, year over year, for new hospitals.

Off-Balance Sheet Arrangements

In accordance with the definition under SEC rules, the following qualify as off-balance sheet arrangements:

- any obligation under certain guarantees or contracts;
- a retained or contingent interest in assets transferred to an unconsolidated entity or similar entity or similar arrangement that serves as credit, liquidity, or market risk support to that entity for such assets;
- any obligation under certain derivative instruments; and
- any obligation under a material variable interest held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the registrant, or engages in leasing, hedging, or research and development services with the registrant.

As of December 31, 2015, we do not have any material off-balance sheet arrangements.

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2015, we are not involved in any unconsolidated SPE transactions.

Critical Accounting Estimates

Our consolidated financial statements are prepared in accordance with GAAP. In connection with the preparation of our financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. We base our assumptions, estimates, and judgments on historical experience, current trends, and other factors we believe to be relevant at the time we prepared our consolidated financial statements. On a regular basis, we review the accounting policies, assumptions, estimates, and judgments to ensure our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Our significant accounting policies are discussed in Note 1, *Summary of Significant Accounting Policies*, to the accompanying consolidated financial statements. We believe the following accounting estimates are the most critical to aid in fully understanding and evaluating our reported financial results, as they require our most difficult, subjective, or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain. We have reviewed these critical accounting estimates and related disclosures with the audit committee of our board of directors.

See also Note 2, *Business Combinations*, to the accompanying consolidated financial statements.

Revenue Recognition

We recognize net patient service revenue in the reporting period in which we perform the service based on our current billing rates (i.e., gross charges) less actual adjustments and estimated discounts for contractual allowances (principally for patients covered by Medicare, Medicaid, and managed care and other health plans). See Note 1, *Summary of Significant Accounting Policies*, "Net Operating Revenues," to the accompanying consolidated financial statements for a complete discussion of our revenue recognition policies.

Our accounting systems calculate contractual allowances on a patient-by-patient basis based on the rates in effect for each primary third-party payor. Other factors that are considered and could further influence the level of our reserves include the patient's total length of stay for in-house patients, each patient's discharge destination, the proportion of patients with secondary insurance coverage and the level of reimbursement under that secondary coverage, and the amount of charges that will be disallowed by payors. Such additional factors are assumed to remain consistent with the experience for patients discharged in similar time periods for the same payor classes, and additional reserves are provided to account for these factors.

Management continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms that result from contract renegotiations and renewals. In addition, laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.

In addition, CMS has developed and instituted various Medicare audit programs under which CMS contracts with private companies to conduct claims and medical record audits. In connection with CMS approved and announced RAC audits related to IRFs, we received requests in 2013 and 2014 to review certain patient files for discharges occurring from 2010 to 2014. To date, the Medicare payments that are subject to these audit requests represent less than 1% of our Medicare patient discharges during those years, and not all of these patient file requests have resulted in payment denial determinations by the RACs. While we make provisions for these claims based on our historical experience and success rates in the claims adjudication process, which is the same process we follow for appealing denials of certain diagnosis codes by MACs, we cannot provide assurance as to our future success in the resolution of these and future disputes, nor can we predict or estimate the scope or number of denials that ultimately may be received. During 2015 and 2014, we adjusted our *Net operating revenues* by approximately ($0.6) million and $0.4 million, respectively, for post-payment claims that are part of this review process.

Due to complexities involved in determining amounts ultimately due under reimbursement arrangements with third-party payors, which are often subject to interpretation and review, we may receive reimbursement for healthcare services authorized and provided that is different from our estimates, and such differences could be material. However, we continually review the amounts actually collected in subsequent periods in order to determine the amounts by which our estimates differed. Historically, such differences have not been material from either a quantitative or qualitative perspective.

Allowance for Doubtful Accounts

The collection of outstanding receivables from third-party payors and patients is our primary source of cash and is critical to our operating performance. We provide for accounts receivable that could become uncollectible by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. See Note 1, *Summary of Significant Accounting Policies*, "Accounts Receivable and the Allowance for Doubtful Accounts," and Note 4, *Accounts Receivable*, to the accompanying consolidated financial statements for a complete discussion of our policies related to the allowance for doubtful accounts.

We estimate our allowance for doubtful accounts based on the aging of our accounts receivable, our historical collection experience for each type of payor, and other relevant factors so that the remaining receivables, net of allowances, are reflected at their estimated net realizable values. Changes in general economic conditions (such as increased unemployment rates or periods of recession), business office operations, payor mix, or trends in federal or state governmental and private employer healthcare coverage could affect our collection of accounts receivable. Our collection risks include patient accounts for which the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient responsibility amounts (deductibles and co-payments) remain outstanding. In addition, reimbursement claims made by health care providers are subject to audit from time to time by governmental payors and their agents.

For several years, under programs designated as "widespread probes," certain of our MACs have conducted pre-payment claim reviews of our billing and denied payment for certain diagnosis codes based on medical necessity. We dispute, or "appeal," most of these denials, and we collect approximately 71% of all amounts denied. For claims we choose to take through all levels of appeal, up to and including administrative law judge hearings, we have historically experienced an approximate 70% success rate. Because we do not write off receivables until all collection efforts have been exhausted, we do not write-off receivables related to denied claims while they are in this review process. The resolution of these disputes can take in excess of three years.

If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material. As of December 31, 2015 and 2014, $126.1 million and $62.2 million, or 22.1% and 15.4%, respectively, of our patient accounts receivable represented denials by MACs that were in the pre-payment medical necessity review process. During the years ended December 31, 2015, 2014, and 2013, we wrote off $2.6 million, $1.4 million, and $2.2 million, respectively, of previously denied claims while we collected $7.4 million, $7.1 million, and $1.7 million, respectively, of previously denied claims.

The table below shows a summary of our net accounts receivable balances as of December 31, 2015 and 2014. Information on the concentration of total patient accounts receivable by payor class can be found in Note 1, *Summary of Significant Accounting Policies*, "Accounts Receivable and the Allowance for Doubtful Accounts," to the accompanying consolidated financial statements.

	As of December 31,	
	2015	2014*
	(In Millions)	
0 - 30 Days	$ 300.3	$ 230.4
31 - 60 Days	39.0	30.1
61 - 90 Days	24.5	12.3
91 - 120 Days	9.9	5.2
120 + Days	29.6	31.3
Current patients accounts receivable, net	403.3	309.3
Noncurrent patient accounts receivable, net	96.6	51.4
Other accounts receivable	7.2	13.9
Accounts receivable, net	**$ 507.1**	**$ 374.6**

*Due to a methodology change, we have adjusted the 2014 amounts, which only impacts the aging categories and not total *Accounts receivable, net*.

Self-Insured Risks

We are self-insured for certain losses related to professional liability, general liability, and workers' compensation risks. Although we obtain third-party insurance coverage to limit our exposure to these claims, a substantial portion of our professional liability, general liability, and workers' compensation risks are insured through a wholly owned insurance subsidiary. See Note 9, *Self-Insured Risks*, to the accompanying consolidated financial statements for a more complete discussion of our self-insured risks.

Our self-insured liabilities contain uncertainties because management must make assumptions and apply judgment to estimate the ultimate cost of reported claims and claims incurred but not reported as of the balance sheet date. Our reserves and provisions for professional liability, general liability, and workers' compensation risks are based largely upon semi-annual actuarial calculations prepared by third-party actuaries.

Periodically, we review our assumptions and the valuations provided by third-party actuaries to determine the adequacy of our self-insurance reserves. The following are the key assumptions and other factors that significantly influence our estimate of self-insurance reserves:

- historical claims experience;
- trending of loss development factors;
- trends in the frequency and severity of claims;
- coverage limits of third-party insurance;
- demographic information;
- statistical confidence levels;
- medical cost inflation;
- payroll dollars; and
- hospital patient census.

The time period to resolve claims can vary depending upon the jurisdiction, the nature, and the form of resolution of the claims. The estimation of the timing of payments beyond a year can vary significantly. In addition, if current and future claims differ from historical trends, our estimated reserves for self-insured claims may be significantly affected. Our self-insurance reserves are not discounted.

Given the number of factors used to establish our self-insurance reserves, we believe there is limited benefit to isolating any individual assumption or parameter from the detailed computational process and calculating the impact of changing that single item. Instead, we believe the sensitivity in our reserve estimates is best illustrated by changes in the statistical confidence level used in the computations. Using a higher statistical confidence level increases the estimated self-insurance reserves. The following table shows the sensitivity of our recorded self-insurance reserves to the statistical confidence level (in millions):

Net self-insurance reserves as of December 31, 2015:	
As reported, with 50% statistical confidence level	115.5
With 70% statistical confidence level	123.4

In the years leading up to 2013, we experienced volatility in our estimates of prior year claim reserves due primarily to favorable trends in claims and industry-wide loss development trends. We believe our efforts to improve patient safety and overall quality of care, as well as our efforts to reduce workplace injuries, have helped contain our ultimate claim costs. See Note 9, *Self-Insured Risks*, to the accompanying consolidated financial statements for additional information.

We believe our self-insurance reserves are adequate to cover projected costs. Due to the considerable variability that is inherent in such estimates, there can be no assurance the ultimate liability will not exceed management's estimates. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.

Goodwill

Absent any impairment indicators, we evaluate goodwill for impairment as of October 1st of each year. We test goodwill for impairment at the reporting unit level and are required to make certain subjective and complex judgments on a number of matters, including assumptions and estimates used to determine the fair value of our inpatient rehabilitation and home health and hospice reporting units. We assess qualitative factors in each reporting unit to determine whether it is necessary to perform the first step of the two-step quantitative goodwill impairment test. The quantitative impairment test is required only if we conclude it is more likely than not a reporting unit's fair value is less than its carrying amount.

If, based on our qualitative assessment, we were to believe we must proceed to Step 1, we would determine the fair value of the applicable reporting unit using generally accepted valuation techniques including the income approach and the market approach. We would validate our estimates under the income approach by reconciling the estimated fair value of the reporting units determined under the income approach to our market capitalization and estimated fair value determined under the market approach. Values from the income approach and market approach would then be evaluated and weighted to arrive at the estimated aggregate fair value of the reporting units.

The income approach includes the use of each reporting unit's projected operating results and cash flows that are discounted using a weighted-average cost of capital that reflects market participant assumptions. The projected operating results use management's best estimates of economic and market conditions over the forecasted period including assumptions for pricing and volume, operating expenses, and capital expenditures. Other significant estimates and assumptions include cost-saving synergies and tax benefits that would accrue to a market participant under a fair value methodology. The market approach estimates fair value through the use of observable inputs, including the Company's stock price.

See Note 1, *Summary of Significant Accounting Policies*, "Goodwill and Other Intangibles," and Note 6, *Goodwill and Other Intangible Assets*, to the accompanying consolidated financial statements for additional information.

The following events and circumstances are certain of the qualitative factors we consider in evaluating whether it is more likely than not the fair value of a reporting unit is less than its carrying amount:

- Macroeconomic conditions, such as deterioration in general economic conditions, limitations on accessing capital, or other developments in equity and credit markets;
- Industry and market considerations and changes in healthcare regulations, including reimbursement and compliance requirements under the Medicare and Medicaid programs;
- Cost factors, such as an increase in labor, supply, or other costs;
- Overall financial performance, such as negative or declining cash flows or a decline in actual or forecasted revenue or earnings;
- Other relevant company-specific events, such as material changes in management or key personnel or outstanding litigation;
- Material events, such as a change in the composition or carrying amount of each reporting unit's net assets, including acquisitions and dispositions; and
- Consideration of the relationship of our market capitalization to our book value, as well as a sustained decrease in our share price.

In the fourth quarter of 2015, we performed our annual evaluation of goodwill and determined no adjustment to impair goodwill was necessary. If actual results are not consistent with our assumptions and estimates, we may be exposed to goodwill impairment charges. However, at this time, we continue to believe our inpatient rehabilitation and home health and hospice reporting units are not at risk for any impairment charges.

Income Taxes

We provide for income taxes using the asset and liability method. We also evaluate our tax positions and establish assets and liabilities in accordance with the applicable accounting guidance on uncertainty in income taxes. See Note 1, *Summary of Significant Accounting Policies*, "Income Taxes," and Note 15, *Income Taxes*, to the accompanying consolidated financial statements for a more complete discussion of income taxes and our policies related to income taxes.

The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. We are required to make many subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in our consolidated financial statements.

The ultimate recovery of certain of our deferred tax assets is dependent on the amount and timing of taxable income we will ultimately generate in the future, as well as other factors. A high degree of judgment is required to determine the extent a valuation allowance should be provided against deferred tax assets. On a quarterly basis, we assess the likelihood of realization of our deferred tax assets considering all available evidence, both positive and negative. Our operating performance in recent years, the scheduled reversal of temporary differences, our forecast of taxable income in future periods in each applicable tax jurisdiction, our ability to sustain a core level of earnings, and the availability of prudent tax planning strategies are important considerations in our assessment. Our forecast of future earnings includes assumptions about patient volumes, payor reimbursement, labor costs, hospital operating expenses, and interest expense. Based on the weight of available evidence, we determine if it is more likely than not our deferred tax assets will be realized in the future.

Our liability for unrecognized tax benefits contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposures associated with our various filing positions which are periodically audited by tax authorities. In addition, our effective income tax rate is affected by changes in tax law, the tax jurisdictions in which we operate, and the results of income tax audits.

During the year ended December 31, 2015, we increased our valuation allowance by $4.6 million. As of December 31, 2015, we had a remaining valuation allowance of $27.6 million which primarily related to state NOLs. At the state jurisdiction level, we determined it was necessary to maintain a valuation allowance due to uncertainties related to our ability to utilize a portion of the NOLs before they expire. The amount of the valuation allowance has been determined for each tax jurisdiction based on the weight of all available evidence, as described above, including management's estimates of taxable income for each jurisdiction in which we operate over the periods in which the related deferred tax assets will be recoverable.

While management believes the assumptions included in its forecast of future earnings are reasonable and it is more likely than not the net deferred tax asset balance as of December 31, 2015 will be realized, no such assurances can be provided. If management's expectations for future operating results on a consolidated basis or at the state jurisdiction level vary from actual results due to changes in healthcare regulations, general economic conditions, or other factors, we may need to increase our valuation allowance, or reverse amounts recorded currently in the valuation allowance, for all or a portion of our deferred tax assets. Similarly, future adjustments to our valuation allowance may be necessary if the timing of future tax deductions is different than currently expected. Our income tax expense in future periods will be reduced or increased to the extent of offsetting decreases or increases, respectively, in our valuation allowance in the period when the change in circumstances occurs. These changes could have a significant impact on our future earnings.

Assessment of Loss Contingencies

We have legal and other contingencies that could result in significant losses upon the ultimate resolution of such contingencies. See Note 1, *Summary of Significant Accounting Policies*, "Litigation Reserves," and Note 17, *Contingencies and Other Commitments*, to the accompanying consolidated financial statements for additional information.

We have provided for losses in situations where we have concluded it is probable a loss has been or will be incurred and the amount of loss is reasonably estimable. A significant amount of judgment is involved in determining whether a loss is probable and reasonably estimable due to the uncertainty involved in determining the likelihood of future events and estimating the financial statement impact of such events. If further developments or resolution of a contingent matter are not consistent with our assumptions and judgments, we may need to recognize a significant charge in a future period related to an existing contingent matter.

Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, see Note 1, *Summary of Significant Accounting Policies*, to the accompanying consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Our primary exposure to market risk is to changes in interest rates on our variable rate long-term debt. We use sensitivity analysis models to evaluate the impact of interest rate changes on our variable rate debt. As of December 31, 2015, our primary variable rate debt outstanding related to $130.0 million in advances under our revolving credit facility and $443.3 million outstanding under our term loan facilities. Assuming outstanding balances were to remain the same, a 1% increase in interest rates would result in an incremental negative cash flow of approximately $5.1 million over the next 12 months, while a 1% decrease in interest rates would result in an incremental positive cash flow of approximately $3.3 million over the next 12 months, assuming floating rate indices are floored at 0%.

The fair value of our fixed rate debt is determined using inputs, including quoted prices in nonactive markets, that are observable either directly or indirectly, or *Level 2* inputs within the fair value hierarchy, and is summarized as follows (in millions):

	December 31, 2015		December 31, 2014	
Financial Instrument:	**Book Value**	**Market Value**	**Book Value**	**Market Value**
8.125% Senior Notes due 2020				
Carrying Value	$ —	$ —	$ 282.7	$ —
Unamortized debt discount and fees	—	—	7.3	—
Principal amount	—	—	290.0	302.5
7.75% Senior Notes due 2022				
Carrying Value	174.3	—	223.7	—
Unamortized debt premium and fees	1.6	—	2.3	—
Principal amount	175.9	183.7	226.0	240.7
5.125% Senior Notes due 2023				
Carrying Value	294.6	—	—	—
Unamortized debt discount and fees	5.4	—	—	—
Principal amount	300.0	288.0	—	—
5.75% Senior Notes due 2024				
Carrying Value	1,192.6	—	447.4	—
Unamortized debt discount and fees	7.4	—	2.6	—
Principal amount	1,200.0	1,146.0	450.0	471.4
5.75% Senior Notes due 2025				
Carrying Value	343.4	—	—	—
Unamortized debt discount and fees	6.6	—	—	—
Principal amount	350.0	332.5	—	—
2.00% Convertible Senior Subordinated Notes due 2043				
Carrying Value	265.9	—	256.7	—
Unamortized debt discount and fees	54.1	—	63.3	—
Principal amount	320.0	345.0	320.0	358.4

Foreign operations, and the related market risks associated with foreign currencies, are currently, and have been, insignificant to our financial position, results of operations, and cash flows.

See also Note 8, *Long-term Debt*, to the accompanying consolidated financial statements.

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements and related notes are filed together with this report. See the index to financial statements on page F-1 for a list of financial statements filed with this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out by our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Our disclosure controls and procedures are designed to ensure that information required to be disclosed in reports we file or submit under the

Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosures. Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2015, our disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on its financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, management used the criteria set forth in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, the COSO framework. Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2015, our internal control over financial reporting was effective.

Management has excluded the acquired operations of Reliant Hospital Partners, LLC ("Reliant") and CareSouth Health System, Inc. ("CareSouth") from its assessment of internal control over financial reporting as of December 31, 2015 because they were acquired by the Company in purchase business combinations during 2015. Combined total assets and total revenues of Reliant and CareSouth represent approximately 7% and 3%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2015.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2015 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Changes in Internal Control Over Financial Reporting

On December 31, 2014, we completed the acquisition of EHHI Holdings, Inc. and its Encompass Home Health and Hospice business ("Encompass"). Except for any changes in internal controls related to the integration of Encompass, there were no changes in the Company's internal controls over financial reporting that occurred during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

We expect to file a definitive proxy statement relating to our 2016 Annual Meeting of Stockholders (the "2016 Proxy Statement") with the United States Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of our most recent fiscal year. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only the information from the 2016 Proxy Statement that specifically addresses disclosure requirements of Items 10-14 below is incorporated by reference.

Item 10. Directors and Executive Officers of the Registrant

The information required by Item 10 is hereby incorporated by reference from our 2016 Proxy Statement under the captions "Items of Business Requiring Your Vote—Proposal 1—Election of Directors," "Corporate Governance and Board Structure—Code of Ethics," "Corporate Governance and Board Structure—Proposals for Director Nominees by Stockholders," "Corporate Governance and Board Structure—Audit Committee," "Section 16(a) Beneficial Ownership Reporting Compliance," and "Executive Officers."

Item 11. Executive Compensation

The information required by Item 11 is hereby incorporated by reference from our 2016 Proxy Statement under the captions "Corporate Governance and Board Structure—Compensation of Directors," "Compensation Committee Matters," and "Executive Compensation."

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Equity Compensation Plans

The following table sets forth, as of December 31, 2015, information concerning compensation plans under which our securities are authorized for issuance. The table does not reflect grants, awards, exercises, terminations, or expirations since that date. All share amounts and exercise prices have been adjusted to reflect stock splits that occurred after the date on which any particular underlying plan was adopted, to the extent applicable.

	Securities to be Issued Upon Exercise	Weighted Average Price[1]	Securities Available for Future Issuance
Plans approved by stockholders	3,435,785 [2]	$ 21.30	4,022,491 [3]
Plans not approved by stockholders	773,603 [4]	21.49	—
Total	4,209,388		4,022,491

[1] This calculation does not take into account awards of restricted stock, restricted stock units, or performance share units.

[2] This amount assumes maximum performance by performance-based awards for which the performance has not yet been determined.

[3] This amount represents the number of shares available for future equity grants under the Amended and Restated 2008 Equity Incentive Plan approved by our stockholders in May 2011.

[4] This amount includes (a) 686,773 shares issuable upon exercise of stock options outstanding under the 2005 Equity Incentive Plan and (b) 86,830 restricted stock units issued under the 2004 Amended and Restated Director Incentive Plan.

2004 Amended and Restated Director Incentive Plan

The 2004 Amended and Restated Director Incentive Plan (the "2004 Plan") provided for the grant of common stock, awards of restricted common stock, and the right to receive awards of common stock, which we refer to as "restricted stock units," to our nonemployee directors. The 2004 Plan expired in March 2008 and was replaced by the 2008 Equity Incentive Plan. Some awards remain outstanding. Awards granted under the 2004 Plan at the time of its termination will continue in effect in accordance with their terms. Awards of restricted stock units were fully vested when awarded and will be settled in shares of common stock on the earlier of the six-month anniversary of the date on which the director ceases to serve on the board of directors or certain change in control events. The restricted stock units generally cannot be transferred. Awards are

generally protected against dilution upon the issuance of stock dividends and in the event of a stock split, recapitalization, or other major corporate restructuring.

2005 Equity Incentive Plan

The 2005 Equity Incentive Plan (the "2005 Plan") provided for the grant of stock options, restricted stock, stock appreciation rights, deferred stock, and other stock-based awards to our directors, executives, and other key employees as determined by the board of directors or the compensation committee in accordance with the terms of the 2005 Plan and evidenced by an award agreement with each participant. The 2005 Plan expired in November 2008 and was replaced by the 2008 Equity Incentive Plan. Some option awards remain outstanding and are fully vested. Awards granted under the 2005 Plan at the time of its termination will continue in effect in accordance with their terms. The outstanding options have an exercise price not less than the fair market value of such shares of common stock on the date of grant and an expiration date that is ten years after the grant date. Awards are generally protected against dilution upon the issuance of stock dividends and in the event of a stock split, recapitalization, or other major corporate restructuring.

Security Ownership of Certain Beneficial Owners and Management

The other information required by Item 12 is hereby incorporated by reference from our 2016 Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management."

Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by Item 13 is hereby incorporated by reference from our 2016 Proxy Statement under the captions "Corporate Governance and Board Structure—Director Independence" and "Certain Relationships and Related Transactions."

Item 14. Principal Accountant Fees and Services

The information required by Item 14 is hereby incorporated by reference from our 2016 Proxy Statement under the caption "Items of Business Requiring Your Vote—Proposal 2—Ratification of Appointment of Independent Registered Public Accounting Firm."

PART IV

Item 15. Exhibits and Financial Statement Schedules

Financial Statements

See the accompanying index on page F-1 for a list of financial statements filed as part of this report.

Financial Statement Schedules

None.

Exhibits

See Exhibit Index immediately following page F-82 of this report.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

HEALTHSOUTH CORPORATION

By: /s/ JAY GRINNEY

Jay Grinney
President and Chief Executive Officer

Date: February 24, 2016

[Signatures continue on the following page]

POWER OF ATTORNEY

Each person whose signature appears below hereby constitutes and appoints Patrick Darby his true and lawful attorney-in-fact and agent with full power of substitution and re-substitution, for him in his name, place and stead, in any and all capacities, to sign any and all amendments to this Report and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, and hereby grants to such attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent or his substitute or substitutes may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ Jay Grinney **Jay Grinney**	President and Chief Executive Officer and Director	February 24, 2016
/s/ Douglas E. Coltharp **Douglas E. Coltharp**	Executive Vice President and Chief Financial Officer	February 24, 2016
/s/ Andrew L. Price **Andrew L. Price**	Chief Accounting Officer	February 24, 2016
/s/ Leo I. Higdon, Jr. **Leo I. Higdon, Jr.**	Chairman of the Board of Directors	February 24, 2016
/s/ John W. Chidsey **John W. Chidsey**	Director	February 24, 2016
/s/ Donald L. Correll **Donald L. Correll**	Director	February 24, 2016
/s/ Yvonne M. Curl **Yvonne M. Curl**	Director	February 24, 2016
/s/ Charles M. Elson **Charles M. Elson**	Director	February 24, 2016
/s/ Joan E. Herman **Joan E. Herman**	Director	February 24, 2016
/s/ Leslye G. Katz **Leslye G. Katz**	Director	February 24, 2016
/s/ John E. Maupin, Jr. **John E. Maupin, Jr.**	Director	February 24, 2016
/s/ L. Edward Shaw, Jr. **L. Edward Shaw, Jr.**	Director	February 24, 2016

Item 15. Financial Statements

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of HealthSouth Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of HealthSouth Corporation and its subsidiaries (the "Company") at December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for debt issuance costs and the manner in which it accounts for deferred taxes in 2015.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management's Report on Internal Control over Financial Reporting, management has excluded the acquired operations of Reliant Hospital Partners, LLC ("Reliant") and CareSouth Health System, Inc. ("CareSouth") from its assessment of internal control over financial reporting as of December 31, 2015 because they were acquired by the Company in purchase business combinations during 2015. We have also excluded Reliant and CareSouth from our audit of internal control over financial reporting. Reliant and CareSouth are subsidiaries of HealthSouth Corporation whose combined total assets and total revenues represent approximately 7% and 3%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2015.

/s/ PricewaterhouseCoopers LLP
Birmingham, Alabama
February 24, 2016

HealthSouth Corporation and Subsidiaries

Consolidated Statements of Operations

	For the Year Ended December 31,		
	2015	2014	2013
	(In Millions, Except Per Share Data)		
Net operating revenues	**$ 3,162.9**	$ 2,405.9	$ 2,273.2
Less: Provision for doubtful accounts	**(47.2)**	(31.6)	(26.0)
Net operating revenues less provision for doubtful accounts	**3,115.7**	2,374.3	2,247.2
Operating expenses:			
Salaries and benefits	**1,670.8**	1,161.7	1,089.7
Other operating expenses	**432.1**	351.6	323.0
Occupancy costs	**53.9**	41.6	47.0
Supplies	**128.7**	111.9	105.4
General and administrative expenses	**133.3**	124.8	119.1
Depreciation and amortization	**139.7**	107.7	94.7
Government, class action, and related settlements	**7.5**	(1.7)	(23.5)
Professional fees—accounting, tax, and legal	**3.0**	9.3	9.5
Total operating expenses	**2,569.0**	1,906.9	1,764.9
Loss on early extinguishment of debt	**22.4**	13.2	2.4
Interest expense and amortization of debt discounts and fees	**142.9**	109.2	100.4
Other income	**(5.5)**	(31.2)	(4.5)
Equity in net income of nonconsolidated affiliates	**(8.7)**	(10.7)	(11.2)
Income from continuing operations before income tax expense	**395.6**	386.9	395.2
Provision for income tax expense	**141.9**	110.7	12.7
Income from continuing operations	**253.7**	276.2	382.5
(Loss) income from discontinued operations, net of tax	**(0.9)**	5.5	(1.1)
Net income	**252.8**	281.7	381.4
Less: Net income attributable to noncontrolling interests	**(69.7)**	(59.7)	(57.8)
Net income attributable to HealthSouth	**183.1**	222.0	323.6
Less: Convertible perpetual preferred stock dividends	**(1.6)**	(6.3)	(21.0)
Less: Repurchase of convertible perpetual preferred stock	**—**	—	(71.6)
Net income attributable to HealthSouth common shareholders	**$ 181.5**	$ 215.7	$ 231.0
Weighted average common shares outstanding:			
Basic	**89.4**	86.8	88.1
Diluted	**101.0**	100.7	102.1
Earnings per common share:			
Basic earnings per share attributable to HealthSouth common shareholders:			
Continuing operations	**$ 2.03**	$ 2.40	$ 2.59
Discontinued operations	**(0.01)**	0.06	(0.01)
Net income	**$ 2.02**	$ 2.46	$ 2.58
Diluted earnings per share attributable to HealthSouth common shareholders:			
Continuing operations	**$ 1.92**	$ 2.24	$ 2.59
Discontinued operations	**(0.01)**	0.05	(0.01)
Net income	**$ 1.91**	$ 2.29	$ 2.58
Cash dividends per common share	**$ 0.88**	$ 0.78	$ 0.36
Amounts attributable to HealthSouth common shareholders:			
Income from continuing operations	**$ 184.0**	$ 216.5	$ 324.7
(Loss) income from discontinued operations, net of tax	**(0.9)**	5.5	(1.1)
Net income attributable to HealthSouth	**$ 183.1**	$ 222.0	$ 323.6

The accompanying notes to consolidated financial statements are an integral part of these statements.

HealthSouth Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income

	For the Year Ended December 31,		
	2015	**2014**	**2013**
		(In Millions)	
COMPREHENSIVE INCOME			
Net income	**$ 252.8**	$ 281.7	$ 381.4
Other comprehensive loss, net of tax:			
Net change in unrealized loss on available-for-sale securities:			
Unrealized net holding loss arising during the period	**(0.1)**	(0.2)	(0.7)
Reclassifications to net income	**(1.2)**	(0.5)	(0.9)
Other comprehensive loss before income taxes	**(1.3)**	(0.7)	(1.6)
Provision for income tax benefit related to other comprehensive loss items	**0.6**	0.3	0.1
Other comprehensive loss, net of tax:	**(0.7)**	(0.4)	(1.5)
Comprehensive income	**252.1**	281.3	379.9
Comprehensive income attributable to noncontrolling interests	**(69.7)**	(59.7)	(57.8)
Comprehensive income attributable to HealthSouth	**$ 182.4**	$ 221.6	$ 322.1

The accompanying notes to consolidated financial statements are an integral part of these statements.

HealthSouth Corporation and Subsidiaries

Consolidated Balance Sheets

	As of December 31,	
	2015	**2014**
	(In Millions, Except Share Data)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 61.6**	$ 66.7
Restricted cash	**45.9**	45.6
Accounts receivable, net of allowance for doubtful accounts of $39.3 in 2015; $22.2 in 2014	**410.5**	323.2
Deferred income tax assets	**—**	188.4
Prepaid expenses and other current assets	**80.7**	62.7
Total current assets	**598.7**	686.6
Property and equipment, net	**1,310.1**	1,019.7
Goodwill	**1,890.1**	1,084.0
Intangible assets, net	**419.4**	306.1
Deferred income tax assets	**190.8**	129.4
Other long-term assets	**197.0**	162.5
Total assets	**$ 4,606.1**	$ 3,388.3
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	**$ 36.8**	$ 20.8
Accounts payable	**61.6**	53.4
Accrued payroll	**126.2**	123.3
Accrued interest payable	**29.7**	21.2
Other current liabilities	**172.1**	145.6
Total current liabilities	**426.4**	364.3
Long-term debt, net of current portion	**3,134.7**	2,090.4
Self-insured risks	**101.6**	98.7
Other long-term liabilities	**43.0**	37.5
	3,705.7	2,590.9
Commitments and contingencies		
Convertible perpetual preferred stock, $.10 par value; 1,500,000 shares authorized; zero shares issued in 2015 and 96,245 shares issued in 2014; liquidation preference of $1,000 per share	**—**	93.2
Redeemable noncontrolling interests	**121.1**	84.7
Shareholders' equity:		
HealthSouth shareholders' equity:		
Common stock, $.01 par value; 200,000,000 shares authorized; issued: 108,275,900 in 2015; 104,058,832 in 2014	**1.1**	1.0
Capital in excess of par value	**2,834.9**	2,810.5
Accumulated deficit	**(1,696.0)**	(1,879.1)
Accumulated other comprehensive loss	**(1.2)**	(0.5)
Treasury stock, at cost (18,145,822 shares in 2015 and 16,270,159 shares in 2014)	**(527.4)**	(458.7)
Total HealthSouth shareholders' equity	**611.4**	473.2
Noncontrolling interests	**167.9**	146.3
Total shareholders' equity	**779.3**	619.5
Total liabilities and shareholders' equity	**$ 4,606.1**	$ 3,388.3

The accompanying notes to consolidated financial statements are an integral part of these statements.

HealthSouth Corporation and Subsidiaries

Consolidated Statements of Shareholders' Equity

	HealthSouth Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Noncontrolling Interests	Total
	(In Millions)							
December 31, 2012	95.7	$ 1.0	$ 2,876.6	$ (2,424.7)	$ 1.4	$ (163.3)	$ 112.5	$ 403.5
Net income	—	—	—	323.6	—	—	52.0	375.6
Receipt of treasury stock	(0.3)	—	—	—	—	(5.8)	—	(5.8)
Dividends declared on common stock	—	—	(32.0)	—	—	—	—	(32.0)
Dividends declared on convertible perpetual preferred stock	—	—	(21.0)	—	—	—	—	(21.0)
Stock-based compensation	—	—	24.8	—	—	—	—	24.8
Stock options exercised	0.3	—	8.2	—	—	—	—	8.2
Stock warrants exercised	0.5	—	15.3	—	—	—	—	15.3
Distributions declared	—	—	—	—	—	—	(40.4)	(40.4)
Repurchases of common stock through tender offer	(9.1)	—	—	—	—	(234.1)	—	(234.1)
Repurchase of preferred stock through convertible exchange	—	—	(71.6)	—	—	—	—	(71.6)
Equity portion of convertible debt	—	—	71.0	—	—	—	—	71.0
Tax impact of equity portion of convertible debt	—	—	(28.0)	—	—	—	—	(28.0)
Other	0.9	—	6.1	—	(1.5)	(1.4)	—	3.2
December 31, 2013	88.0	1.0	2,849.4	(2,101.1)	(0.1)	(404.6)	124.1	468.7
Net income	—	—	—	222.0	—	—	53.1	275.1
Receipt of treasury stock	(0.3)	—	—	—	—	(9.7)	—	(9.7)
Dividends declared on common stock	—	—	(69.0)	—	—	—	—	(69.0)
Dividends declared on convertible perpetual preferred stock	—	—	(6.3)	—	—	—	—	(6.3)
Stock-based compensation	—	—	23.9	—	—	—	—	23.9
Stock options exercised	0.3	—	7.5	—	—	(0.1)	—	7.4
Stock warrants exercised	0.2	—	6.3	—	—	—	—	6.3
Distributions declared	—	—	—	—	—	—	(44.9)	(44.9)
Repurchases of common stock in open market	(1.3)	—	—	—	—	(43.1)	—	(43.1)
Consolidation of Fairlawn Rehabilitation Hospital	—	—	—	—	—	—	14.0	14.0
Other	0.9	—	(1.3)	—	(0.4)	(1.2)	—	(2.9)
December 31, 2014	87.8	1.0	2,810.5	(1,879.1)	(0.5)	(458.7)	146.3	619.5
Net income	**—**	**—**	**—**	**183.1**	**—**	**—**	**55.9**	**239.0**
Conversion of preferred stock	**3.3**	**—**	**93.2**	**—**	**—**	**—**	**—**	**93.2**
Receipt of treasury stock	**(0.5)**	**—**	**—**	**—**	**—**	**(17.2)**	**—**	**(17.2)**
Dividends declared on common stock	**—**	**—**	**(79.9)**	**—**	**—**	**—**	**—**	**(79.9)**
Dividends declared on convertible perpetual preferred stock	**—**	**—**	**(1.6)**	**—**	**—**	**—**	**—**	**(1.6)**
Stock-based compensation	**—**	**—**	**22.4**	**—**	**—**	**—**	**—**	**22.4**
Stock options exercised	**0.2**	**—**	**6.7**	**—**	**—**	**(4.4)**	**—**	**2.3**
Distributions declared	**—**	**—**	**—**	**—**	**—**	**—**	**(49.0)**	**(49.0)**
Repurchases of common stock in open market	**(1.3)**	**—**	**—**	**—**	**—**	**(45.3)**	**—**	**(45.3)**
Capital contributions from consolidated affiliates	**—**	**—**	**—**	**—**	**—**	**—**	**14.8**	**14.8**
Fair value adjustments to redeemable noncontrolling interests, net of tax	**—**	**—**	**(18.2)**	**—**	**—**	**—**	**—**	**(18.2)**
Other	**0.6**	**0.1**	**1.8**	**—**	**(0.7)**	**(1.8)**	**(0.1)**	**(0.7)**
December 31, 2015	**90.1**	**$ 1.1**	**$ 2,834.9**	**$ (1,696.0)**	**$ (1.2)**	**$ (527.4)**	**$ 167.9**	**$ 779.3**

The accompanying notes to consolidated financial statements are an integral part of these statements.

HealthSouth Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	For the Year Ended December 31,		
	2015	**2014**	**2013**
		(In Millions)	
Cash flows from operating activities:			
Net income	**$ 252.8**	$ 281.7	$ 381.4
Loss (income) from discontinued operations, net of tax	**0.9**	(5.5)	1.1
Adjustments to reconcile net income to net cash provided by operating activities—			
Provision for doubtful accounts	**47.2**	31.6	26.0
Provision for government, class action, and related settlements	**7.5**	(1.7)	(23.5)
Depreciation and amortization	**139.7**	107.7	94.7
Amortization of debt-related items	**14.3**	12.7	5.0
Loss on early extinguishment of debt	**22.4**	13.2	2.4
Equity in net income of nonconsolidated affiliates	**(8.7)**	(10.7)	(11.2)
Distributions from nonconsolidated affiliates	**7.7**	12.6	11.4
Stock-based compensation	**26.2**	23.9	24.8
Deferred tax expense	**127.1**	97.4	6.4
Gain on consolidation of Fairlawn	**—**	(27.2)	—
Other	**(0.6)**	4.8	4.3
(Increase) decrease in assets, net of acquisitions—			
Accounts receivable	**(134.1)**	(91.6)	(55.1)
Prepaid expenses and other assets	**(9.6)**	6.5	(4.8)
Increase (decrease) in liabilities, net of acquisitions—			
Accounts payable	**0.9**	5.4	6.4
Other liabilities	**(4.3)**	(10.4)	4.6
Premium received on bond issuance	**9.8**	6.3	—
Premium paid on redemption of bonds	**(13.7)**	(10.6)	(1.7)
Net cash used in operating activities of discontinued operations	**(0.7)**	(1.2)	(1.9)
Total adjustments	**231.1**	168.7	87.8
Net cash provided by operating activities	**484.8**	444.9	470.3
Cash flows from investing activities:			
Acquisition of businesses, net of cash acquired	**(985.1)**	(694.8)	(28.9)
Purchases of property and equipment	**(128.4)**	(170.9)	(195.2)
Capitalized software costs	**(28.1)**	(17.0)	(21.3)
Proceeds from sale of restricted investments	**0.2**	0.3	16.9
Proceeds from sale of Digital Hospital	**—**	—	10.8
Proceeds from sale of marketable securities	**12.8**	—	—
Purchases of restricted investments	**(7.1)**	(3.5)	(9.2)
Net change in restricted cash	**2.7**	6.8	(3.1)
Other	**2.7**	2.2	0.5
Net cash provided by investing activities of discontinued operations	**0.5**	—	3.3
Net cash used in investing activities	**(1,129.8)**	**(876.9)**	**(226.2)**

(Continued)

HealthSouth Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)

	For the Year Ended December 31,		
	2015	**2014**	**2013**
		(In Millions)	
Cash flows from financing activities:			
Principal borrowings on term loan facilities	**250.0**	450.0	—
Proceeds from bond issuance	**1,400.0**	175.0	—
Principal payments on debt, including pre-payments	**(597.4)**	(302.6)	(62.5)
Principal borrowings on notes	**—**	—	15.2
Borrowings on revolving credit facility	**540.0**	440.0	197.0
Payments on revolving credit facility	**(735.0)**	(160.0)	(152.0)
Principal payments under capital lease obligations	**(11.0)**	(6.1)	(10.1)
Debt amendment and issuance costs	**(31.9)**	(6.5)	(2.6)
Repurchases of common stock, including fees and expenses	**(45.3)**	(43.1)	(234.1)
Dividends paid on common stock	**(77.2)**	(65.8)	(15.7)
Dividends paid on convertible perpetual preferred stock	**(3.1)**	(6.3)	(23.0)
Distributions paid to noncontrolling interests of consolidated affiliates	**(54.4)**	(54.1)	(46.3)
Proceeds from exercising stock warrants	**—**	6.3	15.3
Other	**5.2**	7.4	6.4
Net cash provided by (used in) financing activities	**639.9**	434.2	(312.4)
(Decrease) increase in cash and cash equivalents	**(5.1)**	2.2	(68.3)
Cash and cash equivalents at beginning of year	**66.7**	64.5	132.8
Cash and cash equivalents at end of year	**$ 61.6**	$ 66.7	$ 64.5
Supplemental cash flow information:			
Cash (paid) received during the year for —			
Interest	**$ (121.4)**	$ (100.6)	$ (99.4)
Income tax refunds	**7.4**	1.3	4.8
Income tax payments	**(16.8)**	(17.7)	(12.5)
Supplemental schedule of noncash investing and financing activities:			
Convertible debt issued	**$ —**	$ —	$ 320.0
Repurchase of preferred stock	**—**	—	(320.0)
Equity rollover from Encompass management	**—**	64.5	—
Preferred stock conversion	**93.2**	—	—

The accompanying notes to consolidated financial statements are an integral part of these statements.

1. Summary of Significant Accounting Policies:

Organization and Description of Business—

HealthSouth Corporation, incorporated in Delaware in 1984, including its subsidiaries, is one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through our network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. As a result of the December 31, 2014 acquisition of Encompass Home Health and Hospice ("Encompass"), management changed the way it manages and operates the consolidated reporting entity and modified the reports used by its chief operating decision maker to assess performance and allocate resources. These changes required us to revise our segment reporting from our historic presentation of only one reportable segment. We now manage our operations and disclose financial information using two reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. See Note 18, *Segment Reporting*.

Basis of Presentation and Consolidation—

The accompanying consolidated financial statements of HealthSouth and its subsidiaries were prepared in accordance with generally accepted accounting principles in the United States of America and include the assets, liabilities, revenues, and expenses of all wholly-owned subsidiaries, majority-owned subsidiaries over which we exercise control, and, when applicable, entities in which we have a controlling financial interest.

We use the equity method to account for our investments in entities we do not control, but where we have the ability to exercise significant influence over operating and financial policies. Consolidated *Net income attributable to HealthSouth* includes our share of the net earnings of these entities. The difference between consolidation and the equity method impacts certain of our financial ratios because of the presentation of the detailed line items reported in the consolidated financial statements for consolidated entities compared to a one line presentation of equity method investments.

We use the cost method to account for our investments in entities we do not control and for which we do not have the ability to exercise significant influence over operating and financial policies. In accordance with the cost method, these investments are recorded at the lower of cost or fair value, as appropriate.

We also consider the guidance for consolidating variable interest entities.

We eliminate all significant intercompany accounts and transactions from our financial results.

Use of Estimates and Assumptions—

The preparation of our consolidated financial statements in conformity with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but not limited to: (1) allowance for contractual revenue adjustments; (2) allowance for doubtful accounts; (3) fair value of acquired assets and assumed liabilities in business combinations; (4) asset impairments, including goodwill; (5) depreciable lives of assets; (6) useful lives of intangible assets; (7) economic lives and fair value of leased assets; (8) income tax valuation allowances; (9) uncertain tax positions; (10) fair value of stock options and restricted stock containing a market condition; (11) fair value of redeemable noncontrolling interests; (12) reserves for self-insured healthcare plans; (13) reserves for professional, workers' compensation, and comprehensive general insurance liability risks; and (14) contingency and litigation reserves. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluation, as considered necessary. Actual results could differ from those estimates.

Risks and Uncertainties—

As a healthcare provider, we are required to comply with extensive and complex laws and regulations at the federal, state, and local government levels. These laws and regulations relate to, among other things:

- licensure, certification, and accreditation;
- policies, either at the national or local level, delineating what conditions must be met to qualify for reimbursement under Medicare (also referred to as coverage requirements);
- coding and billing for services;
- requirements of the 60% compliance threshold under The Medicare, Medicaid and State Children's Health Insurance Program (SCHIP) Extension Act of 2007;
- relationships with physicians and other referral sources, including physician self-referral and anti-kickback laws;
- quality of medical care;
- use and maintenance of medical supplies and equipment;
- maintenance and security of patient information and medical records;
- acquisition and dispensing of pharmaceuticals and controlled substances; and
- disposal of medical and hazardous waste.

In the future, changes in these laws or regulations or the manner in which they are enforced could subject our current or past practices to allegations of impropriety or illegality or could require us to make changes in our hospitals, equipment, personnel, services, capital expenditure programs, operating procedures, contractual arrangements, and patient admittance practices, as well as the way in which we deliver home health and hospice services.

If we fail to comply with applicable laws and regulations, we could be required to return portions of reimbursements deemed after the fact to have not been appropriate. We could also be subjected to liabilities, including (1) criminal penalties, (2) civil penalties, including monetary penalties and the loss of our licenses to operate one or more of our hospitals or agencies, and (3) exclusion or suspension of one or more of our hospitals from participation in the Medicare, Medicaid, and other federal and state healthcare programs which, if lengthy in duration and material to us, could potentially trigger a default under our credit agreement. Because Medicare comprises a significant portion of our *Net operating revenues*, it is important for us to remain compliant with the laws and regulations governing the Medicare program and related matters including anti-kickback and anti-fraud requirements. Reductions in reimbursements, substantial damages, and other remedies assessed against us could have a material adverse effect on our business, financial position, results of operation, and cash flows. Even the assertion of a violation, depending on its nature, could have a material adverse effect upon our stock price or reputation.

Historically, the United States Congress and some state legislatures have periodically proposed significant changes in regulations governing the healthcare system. Many of these changes have resulted in limitations on the increases in and, in some cases, significant roll-backs or reductions in the levels of payments to healthcare providers for services under many government reimbursement programs. There can be no assurance that future governmental initiatives will not result in pricing roll-backs or freezes or reimbursement reductions. Because we receive a significant percentage of our revenues from Medicare, such changes in legislation might have a material adverse effect on our financial position, results of operations, and cash flows.

Pursuant to legislative directives and authorizations from Congress, the United States Centers for Medicare and Medicaid Services ("CMS") developed and instituted various Medicare audit programs. We undertake significant efforts through training and education to ensure compliance with coding and medical necessity coverage rules. Despite our belief that our coding and assessment of patients is accurate, audits may lead to assertions that we have been underpaid or overpaid by Medicare or submitted improper claims in some instances, require us to incur additional costs to respond to requests for records

and defend the validity of payments and claims, and ultimately require us to refund any amounts determined to have been overpaid. We cannot predict when or how these programs will affect us.

In addition, there are increasing pressures from many third-party payors to control healthcare costs and to reduce or limit increases in reimbursement rates for medical services. Our relationships with managed care and nongovernmental third-party payors are generally governed by negotiated agreements. These agreements set forth the amounts we are entitled to receive for our services. We could be adversely affected in some of the markets where we operate if we are unable to negotiate and maintain favorable agreements with third-party payors.

Our third-party payors may also, from time to time, request audits of the amounts paid, or to be paid, to us. We could be adversely affected in some of the markets where we operate if the auditing payor alleges substantial overpayments were made to us due to coding errors or lack of documentation to support medical necessity determinations.

As discussed in Note 17, *Contingencies and Other Commitments*, we are a party to a number of lawsuits. We cannot predict the outcome of litigation filed against us. Substantial damages or other monetary remedies assessed against us could have a material adverse effect on our business, financial position, results of operations, and cash flows.

Net Operating Revenues—

We derived consolidated *Net operating revenues* from the following payor sources:

	For the Year Ended December 31,		
	2015	2014	2013
Medicare	74.9%	74.1%	74.5%
Managed care and other discount plans, including Medicare Advantage	17.7%	18.6%	18.5%
Medicaid	3.0%	1.8%	1.2%
Other third-party payors	1.7%	1.8%	1.8%
Workers' compensation	0.9%	1.2%	1.2%
Patients	0.6%	1.0%	1.1%
Other income	1.2%	1.5%	1.7%
Total	100.0%	100.0%	100.0%

We record gross service charges in our accounting records on an accrual basis using our established rates for the type of service provided to the patient. We recognize an estimated contractual allowance and an estimate of potential subsequent adjustments that may arise from post-payment and other reviews to reduce gross patient charges to the amount we estimate we will actually realize for the service rendered based upon previously agreed to rates with a payor. Our accounting systems calculate contractual allowances on a patient-by-patient basis based on the rates in effect for each primary third-party payor.

Management continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms that result from contract renegotiations and renewals. Due to complexities involved in determining amounts ultimately due under reimbursement arrangements with third-party payors, which are often subject to interpretation, we may receive reimbursement for healthcare services authorized and provided that is different from our estimates, and such differences could be material. In addition, laws and regulations governing the Medicare and Medicaid programs are complex, subject to interpretation, and are routinely modified for provider reimbursement. All healthcare providers participating in the Medicare and Medicaid programs are required to meet certain financial reporting requirements. Federal regulations require submission of annual cost reports covering medical costs and expenses associated with the services provided under each hospital, home health, and hospice provider number to program beneficiaries. Annual cost reports required under the Medicare and Medicaid programs are subject to routine audits, which may result in adjustments to the amounts ultimately determined to be due to HealthSouth under these reimbursement programs. These audits often require several years to reach the final determination of amounts earned under the programs. If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.

CMS has been granted authority to suspend payments, in whole or in part, to Medicare providers if CMS possesses reliable information an overpayment, fraud, or willful misrepresentation exists. If CMS suspects payments are being made as the result of fraud or misrepresentation, CMS may suspend payment at any time without providing prior notice to us. The initial suspension period is limited to 180 days. However, the payment suspension period can be extended almost indefinitely if the matter is under investigation by the United States Department of Health and Human Services Office of Inspector General (the "HHS-OIG") or the United States Department of Justice. Therefore, we are unable to predict if or when we may be subject to a suspension of payments by the Medicare and/or Medicaid programs, the possible length of the suspension period, or the potential cash flow impact of a payment suspension. Any such suspension would adversely impact our financial position, results of operations, and cash flows.

Pursuant to legislative directives and authorizations from Congress, CMS has developed and instituted various Medicare audit programs under which CMS contracts with private companies to conduct claims and medical record audits. As a matter of course, we undertake significant efforts through training and education to ensure compliance with Medicare requirements. However, audits may lead to assertions we have been underpaid or overpaid by Medicare or submitted improper claims in some instances, require us to incur additional costs to respond to requests for records and defend the validity of payments and claims, and ultimately require us to refund any amounts determined to have been overpaid. We cannot predict when or how these audit programs will affect us.

Inpatient Rehabilitation Revenues

Our inpatient rehabilitation segment derived its *Net operating revenues* from the following payor sources:

	As of December 31,		
	2015	**2014**	**2013**
Medicare	73.2%	73.9%	74.2%
Managed care and other discount plans, including Medicare Advantage	19.0%	18.8%	18.7%
Medicaid	2.5%	1.8%	1.2%
Other third-party payors	2.0%	1.8%	1.8%
Workers' compensation	1.1%	1.2%	1.3%
Patients	0.7%	1.0%	1.1%
Other income	1.5%	1.5%	1.7%
Total	100.0%	100.0%	100.0%

Revenues recognized by our inpatient rehabilitation segment are subject to a number of elements which impact both the overall amount of revenue realized as well as the timing of the collection of the related accounts receivable. Factors that are considered and could influence the level of our reserves include the patient's total length of stay for in-house patients, each patient's discharge destination, the proportion of patients with secondary insurance coverage and the level of reimbursement under that secondary coverage, and the amount of charges that will be disallowed by payors. Such additional factors are assumed to remain consistent with the experience for patients discharged in similar time periods for the same payor classes, and additional reserves are provided to account for these factors.

In connection with CMS approved and announced Recovery Audit Contractors ("RACs") audits related to inpatient rehabilitation facilities ("IRFs"), we received requests in 2014 and 2013 to review certain patient files for discharges occurring from 2010 to 2014. These post-payment RAC audits are focused on medical necessity requirements for admission to IRFs rather than targeting a specific diagnosis code as in previous pre-payment audits. Medical necessity is an assessment by an independent physician of a patient's ability to tolerate and benefit from intensive multi-disciplinary therapy provided in an IRF setting.

To date, the Medicare payments that are subject to these audit requests represent less than 1% of our Medicare patient discharges from 2010 to 2014, and not all of these patient file requests have resulted in payment denial determinations by the RACs. Because we have confidence in the medical judgment of both the referring and the admitting physicians who assess the treatment needs of their patients, we have appealed substantially all RAC denials arising from these audits using the same

process we follow for appealing denials of certain diagnosis codes by Medicare Administrative Contractors ("MACs") (see "Accounts Receivable and Allowance for Doubtful Accounts" below). Due to the delays announced by CMS in the related adjudication process, we believe the resolution of any claims that are subsequently denied as a result of these RAC audits could take in excess of three years. In addition, because we have limited experience with RACs in the context of post-payment reviews of this nature, we cannot provide assurance as to the future success of these disputes. As such, we make provisions for these claims based on our historical experience and success rates in the claims adjudication process, which is the same process we follow for appealing denials of certain diagnosis codes by MACs. As the ultimate results of these audits impact our estimates of amounts determined to be due to HealthSouth under these reimbursement programs, our provision for claims that are part of this post-payment review process are recorded to *Net operating revenues*. During 2015 and 2014, we adjusted our *Net operating revenues* by approximately ($0.6) million and $0.4 million, respectively, for post-payment claims that are part of this review process.

Home Health and Hospice Revenues

The results of operations for our home health and hospice segment in 2014 and 2013 included only the results of HealthSouth's legacy hospital-based home health agencies. Our home health and hospice segment derived its *Net operating revenues* from the following payor sources:

	As of December 31,		
	2015	**2014**	**2013**
Medicare	83.7%	96.9%	95.8%
Managed care and other discount plans, including Medicare Advantage	10.7%	1.8%	2.5%
Medicaid	5.5%	—%	—%
Other third-party payors	—%	1.0%	1.4%
Workers' compensation	—%	0.3%	0.3%
Patients	0.1%	—%	—%
Total	100.0%	100.0%	100.0%

Home health and hospice revenues are earned as services are performed either on an episode of care basis, on a per visit basis, or on a daily basis, depending upon the payment terms and conditions established with each payor for services provided.

Home Health

Under the Medicare home health prospective payment system, we are paid by Medicare based on episodes of care. An episode of care is defined as a length of stay up to 60 days, with multiple continuous episodes allowed. A base episode payment is established by the Medicare program through federal legislation. The base episode payment can be adjusted based on each patient's health including clinical condition, functional abilities, and service needs, as well as for the applicable geographic wage index, low utilization, patient transfers, and other factors. The services covered by the episode payment include all disciplines of care in addition to medical supplies.

A portion of reimbursement from each Medicare episode is billed near the start of each episode, and cash is typically received before all services are rendered. Revenue for the episode of care is recorded over an average length of treatment period using a calendar day prorating method. The amount of revenue recognized for episodes of care which are incomplete at period end is based on the pro rata number of days in the episode which have been completed as of the period end date. As of December 31, 2015, the difference between the cash received from Medicare for a request for anticipated payment on episodes in progress and the associated estimated revenue was not material and was recorded in *Other current liabilities* in our condensed consolidated balance sheets.

We are subject to certain Medicare regulations affecting outlier revenue if our patient's care was unusually costly. Regulations require a cap on all outlier revenue at 10% of total Medicare revenue received by each provider during a cost

reporting year. Management has reviewed the potential cap. Reserves recorded for the outlier cap were not material as of December 31, 2015.

For episodic-based rates that are paid by other insurance carriers, including Medicare Advantage, we recognize revenue in a similar manner as discussed above for Medicare revenues. However, these rates can vary based upon the negotiated terms. For non-episodic-based revenue, gross revenue is recorded on an accrual basis based upon the date of service at amounts equal to our established or estimated per-visit rates. Contractual allowances are recorded for the differences between our standard rates and the applicable contracted rates.

Hospice

Medicare revenues for hospice are recorded on an accrual basis based on the number of days a patient has been on service at amounts equal to an estimated daily or hourly payment rate. The payment rate is dependent on whether a patient is receiving routine home care, general inpatient care, continuous home care or respite care. Adjustments to Medicare revenues are recorded based on an inability to obtain appropriate billing documentation or authorizations acceptable to the payor or other reasons unrelated to credit risk. Hospice companies are subject to two specific payment limit caps under the Medicare program. One limit relates to inpatient care days that exceed 20% of the total days of hospice care provided for the year. The second limit relates to an aggregate Medicare reimbursement cap calculated by the Medicare fiscal intermediary. Currently, we do not believe we are at risk for exceeding these caps and have not recorded a reserve for these caps as of December 31, 2015.

For non-Medicare hospice revenues, we record gross revenue on an accrual basis based upon the date of service at amounts equal to our established rates or estimated per day rates, as applicable. Contractual adjustments are recorded for the difference between our established rates and the amounts estimated to be realizable from patients and third parties for services provided and are deducted from gross revenue to determine our net service revenue.

We are subject to changes in government legislation that could impact Medicare payment levels and changes in payor patterns that may impact the level and timing of payments for services rendered.

Cash and Cash Equivalents—

Cash and cash equivalents include highly liquid investments with maturities of three months or less when purchased. Carrying values of *Cash and cash equivalents* approximate fair value due to the short-term nature of these instruments.

We maintain amounts on deposit with various financial institutions, which may, at times, exceed federally insured limits. However, management periodically evaluates the credit-worthiness of those institutions, and we have not experienced any losses on such deposits.

Marketable Securities—

We record all equity securities with readily determinable fair values and for which we do not exercise significant influence as available-for-sale securities. We carry the available-for-sale securities at fair value and report unrealized holding gains or losses, net of income taxes, in *Accumulated other comprehensive loss*, which is a separate component of shareholders' equity. We recognize realized gains and losses in our consolidated statements of operations using the specific identification method.

Unrealized losses are charged against earnings when a decline in fair value is determined to be other than temporary. Management reviews several factors to determine whether a loss is other than temporary, such as the length of time a security is in an unrealized loss position, the extent to which fair value is less than cost, the financial condition and near term prospects of the issuer, industry, or geographic area and our ability and intent to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

Accounts Receivable and Allowance for Doubtful Accounts—

We report accounts receivable at estimated net realizable amounts from services rendered from federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies, workers' compensation programs, employers, and patients. Our accounts receivable are geographically dispersed, but a significant portion of our revenues are concentrated by type of payors. The concentration of net patient service accounts receivable by payor class, as a percentage of total net patient service accounts receivable, is as follows:

	As of December 31,	
	2015	2014
Medicare	70.5%	72.2%
Managed care and other discount plans, including Medicare Advantage	19.7%	18.5%
Medicaid	2.9%	1.8%
Other third-party payors	4.1%	3.8%
Workers' compensation	1.9%	1.9%
Patients	0.9%	1.8%
Total	100.0%	100.0%

While revenues and accounts receivable from the Medicare program are significant to our operations, we do not believe there are significant credit risks associated with this government agency. We do not believe there are any other significant concentrations of revenues from any particular payor that would subject us to any significant credit risks in the collection of our accounts receivable.

We provide for accounts receivable that could become uncollectible by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. Additions to the allowance for doubtful accounts are made by means of the *Provision for doubtful accounts*. We write off uncollectible accounts (after exhausting collection efforts) against the allowance for doubtful accounts. Subsequent recoveries are recorded via the *Provision for doubtful accounts*.

We estimate our allowance for doubtful accounts based on the aging of our accounts receivable, our historical collection experience for each type of payor, and other relevant factors so that the remaining receivables, net of allowances, are reflected at their estimated net realizable values. Accounts requiring collection efforts are reviewed via system-generated work queues that automatically stage (based on age and size of outstanding balance) accounts requiring collection efforts for patient account representatives. Collection efforts include contacting the applicable party (both in writing and by telephone), providing information (both financial and clinical) to allow for payment or to overturn payor decisions to deny payment, and arranging payment plans with self-pay patients, among other techniques. When we determine all in-house efforts have been exhausted or it is a more prudent use of resources, accounts may be turned over to a collection agency. Accounts are written off after all collection efforts (internal and external) have been exhausted.

The collection of outstanding receivables from Medicare, managed care payors, other third-party payors, and patients is our primary source of cash and is critical to our operating performance. While it is our policy to verify insurance prior to a patient being admitted, there are various exceptions that can occur. Such exceptions include instances where we are (1) unable to obtain verification because the patient's insurance company was unable to be reached or contacted, (2) a determination is made that a patient may be eligible for benefits under various government programs, such as Medicaid, and it takes several days, weeks, or months before qualification for such benefits is confirmed or denied, and (3) the patient is transferred to our hospital from an acute care hospital without having access to a credit card, cash, or check to pay the applicable patient responsibility amounts (i.e., deductibles and co-payments).

Our primary collection risks relate to patient responsibility amounts and pre-payment claim reviews conducted by MACs. Patient responsibility amounts include accounts for which the patient was the primary payor or the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient co-payment amounts remain outstanding. Changes in the economy, such as increased unemployment rates or periods of recession, can further exacerbate our ability to collect patient responsibility amounts.

For several years, under programs designated as "widespread probes," certain of our MACs have conducted pre-payment claim reviews of our billings and denied payment for certain diagnosis codes. We dispute, or "appeal," most of these denials, and we have historically collected approximately 71% of all amounts denied. For claims we choose to take to administrative law judge hearings, we have historically experienced an approximate 70% success rate. The resolution of these disputes can take in excess of three years, and we cannot provide assurance as to our ongoing and future success of these disputes. As such, we make provisions against these receivables in accordance with our accounting policy that necessarily considers historical collection trends of the receivables in this review process as part of our *Provision for doubtful accounts*. Because we do not write-off receivables until all collection efforts have been exhausted, we do not write off receivables related to denied claims while they are in this review process. When the amount collected related to denied claims differs from the net amount previously recorded, these collection differences are recorded in the *Provision for doubtful accounts*. As a result, the timing of these denials by MACs and their subsequent collection can create volatility in our *Provision for doubtful accounts*.

If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material. Changes in general economic conditions, business office operations, payor mix, or trends in federal or state governmental and private employer healthcare coverage could affect our collection of accounts receivable, financial position, results of operations, and cash flows.

Property and Equipment—

We report land, buildings, improvements, vehicles, and equipment at cost, net of accumulated depreciation and amortization and any asset impairments. We report assets under capital lease obligations at the lower of fair value or the present value of the aggregate future minimum lease payments at the beginning of the lease term. We depreciate our assets using the straight-line method over the shorter of the estimated useful life of the assets or life of the lease term, excluding any lease renewals, unless the lease renewals are reasonably assured. Useful lives are generally as follows:

	Years
Buildings	10 to 30
Leasehold improvements	2 to 15
Vehicles	5
Furniture, fixtures, and equipment	3 to 10
Assets under capital lease obligations:	
Real estate	15 to 20
Vehicles	3 to 4
Equipment	3 to 5

Maintenance and repairs of property and equipment are expensed as incurred. We capitalize replacements and betterments that increase the estimated useful life of an asset. We capitalize pre-acquisition costs when they are directly identifiable with a specific property, the costs would be capitalizable if the property were already acquired, and acquisition of the property is probable. We capitalize interest expense on major construction and development projects while in progress.

We retain fully depreciated assets in property and accumulated depreciation accounts until we remove them from service. In the case of sale, retirement, or disposal, the asset cost and related accumulated depreciation balances are removed from the respective accounts, and the resulting net amount, less any proceeds, is included as a component of income from continuing operations in the consolidated statements of operations. However, if the sale, retirement, or disposal involves a discontinued operation, the resulting net amount, less any proceeds, is included in the results of discontinued operations.

We account for operating leases by recognizing rents, including any rent holidays, on a straight-line basis over the term of the lease.

Goodwill and Other Intangible Assets—

We are required to test our goodwill and indefinite-lived intangible asset for impairment at least annually, absent some triggering event that would accelerate an impairment assessment. Absent any impairment indicators, we perform this impairment testing as of October 1st of each year. We recognize an impairment charge for any amount by which the carrying amount of the asset exceeds its implied fair value. We present an impairment charge as a separate line item within income from continuing operations in the consolidated statements of operations, unless the impairment is associated with a discontinued operation. In that case, we include the impairment charge, on a net-of-tax basis, within the results of discontinued operations.

We assess qualitative factors in our inpatient rehabilitation and home health and hospice reporting units to determine whether it is necessary to perform the first step of the two-step quantitative impairment test. If, based on this qualitative assessment, we were to believe we must proceed to Step 1, we would determine the fair value of our reporting units using generally accepted valuation techniques including the income approach and the market approach. The income approach includes the use of each reporting unit's discounted projected operating results and cash flows. This approach includes many assumptions related to pricing and volume, operating expenses, capital expenditures, discount factors, tax rates, etc. Changes in economic and operating conditions impacting these assumptions could result in goodwill impairment in future periods. We reconcile the estimated fair value of our reporting units to our market capitalization. When we dispose of a hospital or home health or hospice agency, goodwill is allocated to the gain or loss on disposition using the relative fair value methodology.

We assess qualitative factors related to our indefinite-lived intangible asset to determine whether it is necessary to perform the first step of the two-step quantitative impairment test. If, based on this qualitative assessment, we were to believe we must proceed to Step 1, we would determine the fair value of our indefinite-lived intangible asset using generally accepted valuation techniques including the relief-from-royalty method. This method is a form of the income approach in which value is equated to a series of cash flows and discounted at a risk-adjusted rate. It is based on a hypothetical royalty, calculated as a percentage of forecasted revenue, that we would otherwise be willing to pay to use the asset, assuming it were not already owned. This approach includes assumptions related to pricing and volume, as well as a royalty rate a hypothetical third party would be willing to pay for use of the asset. When making our royalty rate assumption, we look to rates paid in arms-length licensing transactions for assets comparable to our asset.

We amortize the cost of intangible assets with finite useful lives over their respective estimated useful lives to their estimated residual value. As of December 31, 2015, none of our finite useful lived intangible assets has an estimated residual value. We also review these assets for impairment whenever events or changes in circumstances indicate we may not be able to recover the asset's carrying amount.

The range of estimated useful lives and the amortization basis for our intangible assets, excluding goodwill, are generally as follows:

	Estimated Useful Life and Amortization Basis
Certificates of need	10 to 30 years using straight-line basis
Licenses	10 to 20 years using straight-line basis
Noncompete agreements	1 to 18 years using straight-line basis
Trade names:	
Encompass	indefinite-lived asset
All other	1 to 20 years using straight-line basis
Internal-use software	3 to 7 years using straight-line basis
Market access assets	20 years using accelerated basis

We capitalize the costs of obtaining or developing internal-use software, including external direct costs of material and services and directly related payroll costs. Amortization begins when the internal-use software is ready for its intended use. Costs incurred during the preliminary project and post-implementation stages, as well as maintenance and training costs, are expensed as incurred.

Our market access assets are valued using discounted cash flows under the income approach. The value of the market access assets is attributable to our ability to gain access to and penetrate an acquired facility's historical market patient base. To determine this value, we first develop a debt-free net cash flow forecast under various patient volume scenarios. The debt-free net cash flow is then discounted back to present value using a discount factor, which includes an adjustment for company-specific risk. As noted in the above table, we amortize these assets over 20 years using an accelerated basis that reflects the pattern in which we believe the economic benefits of the market access will be consumed.

Impairment of Long-Lived Assets and Other Intangible Assets—

We assess the recoverability of long-lived assets (excluding goodwill and our indefinite-lived asset) and identifiable acquired intangible assets with finite useful lives, whenever events or changes in circumstances indicate we may not be able to recover the asset's carrying amount. We measure the recoverability of assets to be held and used by a comparison of the carrying amount of the asset to the expected net future cash flows to be generated by that asset, or, for identifiable intangibles with finite useful lives, by determining whether the amortization of the intangible asset balance over its remaining life can be recovered through undiscounted future cash flows. The amount of impairment of identifiable intangible assets with finite useful lives, if any, to be recognized is measured based on projected discounted future cash flows. We measure the amount of impairment of other long-lived assets (excluding goodwill) as the amount by which the carrying value of the asset exceeds the fair market value of the asset, which is generally determined based on projected discounted future cash flows or appraised values. We classify long-lived assets to be disposed of other than by sale as held and used until they are disposed. We report long-lived assets to be disposed of by sale as held for sale and recognize those assets in the balance sheet at the lower of carrying amount or fair value less cost to sell, and we cease depreciation.

Investments in and Advances to Nonconsolidated Affiliates—

Investments in entities we do not control but in which we have the ability to exercise significant influence over the operating and financial policies of the investee are accounted for under the equity method. Equity method investments are recorded at original cost and adjusted periodically to recognize our proportionate share of the investees' net income or losses after the date of investment, additional contributions made, dividends or distributions received, and impairment losses resulting from adjustments to net realizable value. We record equity method losses in excess of the carrying amount of an investment when we guarantee obligations or we are otherwise committed to provide further financial support to the affiliate.

We use the cost method to account for equity investments for which the equity securities do not have readily determinable fair values and for which we do not have the ability to exercise significant influence. Under the cost method of accounting, private equity investments are carried at cost and are adjusted only for other-than-temporary declines in fair value, additional investments, or distributions deemed to be a return of capital.

Management periodically assesses the recoverability of our equity method and cost method investments and equity method goodwill for impairment. We consider all available information, including the recoverability of the investment, the earnings and near-term prospects of the affiliate, factors related to the industry, conditions of the affiliate, and our ability, if any, to influence the management of the affiliate. We assess fair value based on valuation methodologies, as appropriate, including discounted cash flows, estimates of sales proceeds, and external appraisals, as appropriate. If an investment or equity method goodwill is considered to be impaired and the decline in value is other than temporary, we record an appropriate write-down.

Financing Costs—

We amortize financing costs using the effective interest method over the expected life of the related debt. Excluding financing costs related to our revolving line of credit (which is included in *Other long-term assets*), financing costs are presented as a direct deduction from the face amount of the financings. The related expense is included in *Interest expense and amortization of debt discounts and fees* in our consolidated statements of operations. See the *Recent Accounting Pronouncements* section of this note.

We accrete discounts and amortize premiums using the effective interest method over the expected life of the related debt, and we report discounts or premiums as a direct deduction from, or addition to, the face amount of the financing. The related income or expense is included in *Interest expense and amortization of debt discounts and fees* in our consolidated statements of operations.

Fair Value Measurements—

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions market participants would use in pricing an asset or liability.

The basis for these assumptions establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- *Level 1* – Observable inputs such as quoted prices in active markets;
- *Level 2* – Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and
- *Level 3* – Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques. The three valuation techniques are as follows:

- *Market approach* – Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- *Cost approach* – Amount that would be required to replace the service capacity of an asset (i.e., replacement cost); and
- *Income approach* – Techniques to convert future cash flows to a single present amount based on market expectations (including present value techniques, option-pricing models, and lattice models).

Our financial instruments consist mainly of cash and cash equivalents, restricted cash, restricted marketable securities, accounts receivable, accounts payable, letters of credit, and long-term debt. The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, and accounts payable approximate fair value because of the short-term maturity of these instruments. The fair value of our letters of credit is deemed to be the amount of payment guaranteed on our behalf by third-party financial institutions. We determine the fair value of our long-term debt using quoted market prices, when available, or discounted cash flows based on various factors, including maturity schedules, call features, and current market rates.

On a recurring basis, we are required to measure our available-for-sale restricted marketable securities at fair value. The fair values of our available-for-sale restricted marketable securities are determined based on quoted market prices in active markets or quoted prices, dealer quotations, or alternative pricing sources supported by observable inputs in markets that are not considered to be active.

On a nonrecurring basis, we are required to measure property and equipment, goodwill, other intangible assets, investments in nonconsolidated affiliates, and assets and liabilities of discontinued operations at fair value. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges or similar adjustments made to the carrying value of the applicable assets. The fair value of our property and equipment is determined using discounted cash flows and significant unobservable inputs, unless there is an offer to purchase such assets, which could be the basis for determining fair value. The fair value of our intangible assets, excluding goodwill, is determined using discounted cash flows and significant unobservable inputs. The fair value of our investments in nonconsolidated affiliates is determined using quoted prices in private markets, discounted cash flows or earnings, or market multiples derived from a set of comparables. The fair value of our assets and liabilities of discontinued operations is determined using discounted cash flows and significant unobservable inputs unless there is an offer to purchase such assets and liabilities, which would be the basis for determining fair value. The fair value of our goodwill is determined using discounted projected operating results and cash flows, which involve significant unobservable inputs.

See also the “Redeemable Noncontrolling Interests” section of this note.

Noncontrolling Interests in Consolidated Affiliates—

The consolidated financial statements include all assets, liabilities, revenues, and expenses of less-than-100%-owned affiliates we control. Accordingly, we have recorded noncontrolling interests in the earnings and equity of such entities. We record adjustments to noncontrolling interests for the allocable portion of income or loss to which the noncontrolling interests holders are entitled based upon their portion of the subsidiaries they own. Distributions to holders of noncontrolling interests are adjusted to the respective noncontrolling interests holders' balance.

Convertible Perpetual Preferred Stock—

Our *Convertible perpetual preferred stock* contained fundamental change provisions that allowed the holder to require us to redeem the preferred stock for cash if certain events occurred. As redemption under these provisions was not solely within our control, we classified our *Convertible perpetual preferred stock* as temporary equity.

Redeemable Noncontrolling Interests—

Certain of our joint venture agreements contain provisions that allow our partners to require us to purchase their interests in the joint venture at fair value at certain points in the future. Likewise, and as discussed in Note 2, *Business Combinations*, certain members of Encompass management hold similar put rights regarding their interests in our home health and hospice business. Because these noncontrolling interests provide for redemption features that are not solely within our control, we classify them as *Redeemable noncontrolling interests* outside of permanent equity in our consolidated balance sheets. At the end of each reporting period, we compare the carrying value of the *Redeemable noncontrolling interests* to their estimated redemption value. If the estimated redemption value is greater than the current carrying value, the carrying value is adjusted to the estimated redemption value, with the adjustments recorded through equity in the line item *Capital in excess of par value*.

The fair value of the *Redeemable noncontrolling interests* related to our home health segment is determined using the product of a twelve-month specified performance measure and a specified median market price multiple based on a basket of public health companies. The fair value of our *Redeemable noncontrolling interests* in our joint venture hospitals is determined primarily using the income approach. The income approach includes the use of the hospital's projected operating results and cash flows discounted using a rate that reflects market participant assumptions for the applicable hospitals, or *Level 3* inputs. The projected operating results use management's best estimates of economic and market conditions over the forecasted periods including assumptions for pricing and volume, operating expenses, and capital expenditures.

Share-Based Payments—

HealthSouth has shareholder-approved stock-based compensation plans that provide for the granting of stock-based compensation to certain employees and directors. All share-based payments to employees, excluding stock appreciation rights ("SARs"), are recognized in the financial statements based on their estimated grant-date fair value and amortized on a straight-line basis over the applicable requisite service period. Share-based payments to employees in the form of SARs are recognized in the financial statements based on their current fair value and expensed ratably over the applicable service period.

Litigation Reserves—

We accrue for loss contingencies associated with outstanding litigation for which management has determined it is probable a loss contingency exists and the amount of loss can be reasonably estimated. If the accrued amount associated with a loss contingency is greater than $5.0 million, we also accrue estimated future legal fees associated with the loss contingency. This requires management to estimate the amount of legal fees that will be incurred in the defense of the litigation. These estimates are based on our expectations of the scope, length to complete, and complexity of the claims. In the future, additional adjustments may be recorded as the scope, length, or complexity of outstanding litigation changes.

Advertising Costs—

We expense costs of print, radio, television, and other advertisements as incurred. Advertising expenses, primarily included in *Other operating expenses* within the accompanying consolidated statements of operations, were $7.3 million, $5.3 million, and $5.2 million in each of the years ended December 31, 2015, 2014, and 2013, respectively.

Professional Fees—Accounting, Tax, and Legal—

In 2015, 2014, and 2013*, Professional fees—accounting, tax, and legal* related primarily to legal and consulting fees for continued litigation and support matters discussed in Note 17, *Contingencies and Other Commitments*.

Income Taxes—

We provide for income taxes using the asset and liability method. This approach recognizes the amount of income taxes payable or refundable for the current year, as well as deferred tax assets and liabilities for the future tax consequence of events recognized in the consolidated financial statements and income tax returns. Deferred income tax assets and liabilities are adjusted to recognize the effects of changes in tax laws or enacted tax rates.

A valuation allowance is required when it is more likely than not some portion of the deferred tax assets will not be realized. Realization is dependent on generating sufficient future taxable income in the applicable tax jurisdiction. On a quarterly basis, we assess the likelihood of realization of our deferred tax assets considering all available evidence, both positive and negative. Our most recent operating performance, the scheduled reversal of temporary differences, our forecast of taxable income in future periods by jurisdiction, our ability to sustain a core level of earnings, and the availability of prudent tax planning strategies are important considerations in our assessment.

We evaluate our tax positions and establish assets and liabilities in accordance with the applicable accounting guidance on uncertainty in income taxes. We review these tax uncertainties in light of changing facts and circumstances, such as the progress of tax audits, and adjust them accordingly.

We use the with-and-without method to determine when we will recognize excess tax benefits from stock-based compensation. Under this method, we recognize these excess tax benefits only after we fully realize the tax benefits of net operating losses.

HealthSouth and its corporate subsidiaries file a consolidated federal income tax return. Some subsidiaries consolidated for financial reporting purposes are not part of the consolidated group for federal income tax purposes and file separate federal income tax returns. State income tax returns are filed on a separate, combined, or consolidated basis in accordance with relevant state laws and regulations. Partnerships, limited liability companies, and other pass-through entities we consolidate or account for using the equity method of accounting file separate federal and state income tax returns. We include the allocable portion of each pass-through entity's income or loss in our federal income tax return. We allocate the remaining income or loss of each pass-through entity to the other partners or members who are responsible for their portion of the taxes.

Assets and Liabilities in and Results of Discontinued Operations—

Effective January 1, 2015, in connection with a new standard issued by the FASB, we changed our criteria for determining which disposals are presented as discontinued operations. Historically, any component that had been disposed of or was classified as held for sale qualified for discontinued operations reporting unless there was significant continuing involvement with the disposed component or continuing cash flows. In contrast, we now report the disposal of the component, or group of components, as discontinued operations only when it represents a strategic shift that has, or will have, a major effect on our operations and financial results. As a result, the sale or disposal of a single HealthSouth facility no longer qualifies as a discontinued operation. This accounting change was made prospectively. No new components were recognized as discontinued operations during 2015.

In the period a component of an entity has been disposed of or classified as held for sale, we reclassify the results of operations for current and prior periods into a single caption titled *(Loss) income from discontinued operations, net of tax*. In addition, we classify the assets and liabilities of those components as current and noncurrent assets and liabilities within *Prepaid expenses and other current assets*, *Other long-term assets*, *Other current liabilities*, and *Other long-term liabilities* in our consolidated balance sheets. We also classify cash flows related to discontinued operations as one line item within each category of cash flows in our consolidated statements of cash flows.

Earnings per Common Share—

The calculation of earnings per common share is based on the weighted-average number of our common shares outstanding during the applicable period. The calculation for diluted earnings per common share recognizes the effect of all potential dilutive common shares, including warrants, that were outstanding during the respective periods, unless their impact would be antidilutive. The calculation of earnings per common share also considers the effect of participating securities. Stock-based compensation awards that contain nonforfeitable rights to dividends and dividend equivalents, such as our nonvested restricted stock awards granted before 2014 and restricted stock units, are considered participating securities and are included in the computation of earnings per common share pursuant to the two-class method. In applying the two-class method, earnings are allocated to both common stock shares and participating securities based on their respective weighted-average shares outstanding for the period.

We use the if-converted method to include our *Convertible perpetual preferred stock* and convertible senior subordinated notes in our computation of diluted earnings per share. All other potential dilutive shares, including warrants, are included in our weighted-average diluted share count using the treasury stock method.

Treasury Stock—

Shares of common stock repurchased by us are recorded at cost as treasury stock. When shares are reissued, we use an average cost method to determine cost. The difference between the cost of the shares and the re-issuance price is added to or deducted from *Capital in excess of par value*. We account for the retirement of treasury stock as a reduction of retained earnings. However, due to our *Accumulated deficit*, the retirement of treasury stock is currently recorded as a reduction of *Capital in excess of par value*.

Comprehensive Income—

Comprehensive income is comprised of *Net income* and changes in unrealized gains or losses on available-for-sale securities and is included in the consolidated statements of comprehensive income.

Recent Accounting Pronouncements—

In May 2014, the FASB updated its revenue recognition standard to clarify the principles for recognizing revenue and eliminate industry-specific guidance. In addition, the updated standard revises current disclosure requirements in an effort to help financial statement users better understand the nature, amount, timing, and uncertainty of revenue that is recognized. This revised standard will be effective for HealthSouth for the annual reporting period beginning on January 1, 2017, including interim periods within that year. Early adoption is not permitted. We continue to review the requirements of this revised standard and any potential impact it may have on our financial position, results of operations, or cash flows. It will require us to reclassify our *Provision for doubtful accounts* from a component of *Net operating revenues* to operating expenses.

In February 2015, the FASB issued ASU 2015-02, “Consolidations (Topic 810) - Amendments to the Consolidation Analysis,” which provides guidance on evaluating whether a reporting entity should consolidate certain legal entities. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (“VIE”). Under this analysis, limited partnerships and other similar entities will be considered a VIE unless the limited partners hold substantive kick-out rights or participating rights. Further, the amendments eliminate the presumption that a general partner should consolidate a limited partnership under the voting interest model, as well as affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships. This standard is effective for annual periods beginning after December 15, 2015 and interim periods within those annual periods. Early adoption is permitted, and the reporting entity may apply the amendments using a modified retrospective approach or a full retrospective application. We do not expect the adoption of this authoritative guidance in 2016 to have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.” The new guidance requires that debt issuance costs related to a recognized debt liability be presented on the consolidated balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. For public companies, the new guidance is effective for fiscal years beginning after December 15, 2015 and

interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued and the new guidance should be applied on a retrospective basis. We elected to early adopt this new guidance effective as of December 31, 2015 and have applied these changes retrospectively to all periods presented. The adoption of this guidance did not have material effect on our consolidated financial position, results of operations, or cash flows. See Note 8, *Long-Term Debt*, and Note 12, *Fair Value Measurements.*

In July 2015, the FASB updated its revenue recognition standard to defer its effective date by one year. The FASB decided, based on its outreach to various stakeholders and the forthcoming amendments to the new revenue standard, that a deferral is necessary to provide adequate time to effectively implement the new revenue standard. This revised standard will be effective for our annual reporting period beginning on January 1, 2018, including interim periods within that year. Early adoption is permitted but not earlier than the original effective date.

In August 2015, the FASB issued ASU No. 2015-15, "Interest-Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements," to provide authoritative guidance related to line-of-credit arrangements, which were not addressed in ASU No. 2015-03. An entity may defer and present debt issuance costs related to line-of-credit arrangements as an asset. We elected to early adopt this new guidance effective as of December 31, 2015 and have applied these changes retrospectively to all periods presented. The adoption of this guidance did not have a material effect on our consolidated financial position, results of operations, or cash flows. See Note 8, *Long-Term Debt*, and Note 12, *Fair Value Measurements.*

In September 2015, the FASB issued ASU 2015-16 "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments." This standard eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. The new standard requires an acquirer to recognize measurement-period adjustments during the period in which it determines the amount of the adjustment. In addition, it requires the acquirer to record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts as if the accounting had been completed at the acquisition date. This standard is effective prospectively for annual periods beginning after December 15, 2015 and interim periods within those annual periods. Early application is permitted. We do not expect the adoption of this authoritative guidance in 2016 to have a material impact on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes," to simplify the presentation of deferred taxes in the consolidated balance sheet. Under this amendment, entities will no longer be required to separate deferred income tax liabilities and assets into current and noncurrent amounts. Rather, the amendment requires deferred tax liabilities and assets be classified as noncurrent in a consolidated balance sheet. For public companies, the revised standard is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted with retrospective application optional. We elected to early adopt this new guidance effective as of December 31, 2015. Prior periods were not retrospectively adjusted for this change in accounting principle. The adoption of this guidance did not have material effect on our consolidated financial position, results of operations, or cash flows. See Note 15, *Income Taxes.*

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities." This standard revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. This revised standard requires the change in fair value of many equity investments to be recognized in net income. This revised standard is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. We continue to review the requirements of this revised standard and any potential impact it may have on our financial position, results of operations, or cash flows.

We do not believe any other recently issued, but not yet effective, accounting standards will have a material effect on our consolidated financial position, results of operations, or cash flows.

2. Business Combinations:

2015 Acquisitions

Inpatient Rehabilitation

Reliant Acquisition

In October 2015, we completed the previously announced acquisition of the operations of Reliant Hospital Partners, LLC and affiliated entities ("Reliant"). Reliant operates a portfolio of 11 inpatient rehabilitation hospitals in Texas, Massachusetts, and Ohio with a total of 902 beds. All of the Reliant hospitals are leased, and seven of the leases are treated as capital leases for accounting purposes. We assumed all of these lease obligations. The amount of the capital lease obligation initially recognized on our balance sheet was approximately $210 million. At closing, one Reliant hospital entity had a remaining minority limited partner interest of 0.5%. The cash purchase price was reduced by the estimated fair value of this interest. We funded the cash purchase price in the acquisition with proceeds from our August and September 2015 senior notes issuances and borrowings under our senior secured credit facility. See Note 8, *Long-term Debt.*

With this acquisition, we are able to offer comprehensive, high-quality and cost-effective facility-based care across new and existing service areas. We expect approximately 86% of the goodwill resulting from this transaction to be deductible for federal income tax purposes. The goodwill reflects our expectations of our ability to gain access to and penetrate each acquired hospital's historical patient base and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets.

We accounted for this transaction under the acquisition method of accounting and reported the results of operations of Reliant from its date of acquisition. Assets acquired, liabilities assumed, and noncontrolling interests were recorded at their estimated fair values as of the acquisition date. Estimated fair values were based on various valuation methodologies including: replacement cost and continued use methods for property and equipment; an income approach using primarily discounted cash flow techniques for the noncompete and license intangible assets and capital lease liabilities; an income approach utilizing the relief-from-royalty method for the trade name intangible assets; an income approach utilizing the excess earnings method for the certificate of need intangible assets; and an estimated realizable value approach using historical trends and other relevant information for accounts receivable and certain accrued liabilities. The aforementioned income methods utilize management's estimates of future operating results and cash flows discounted using a weighted average cost of capital that reflects market participant assumptions. For all other assets and liabilities, the fair value was assumed to represent carrying value due to their short maturities. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill.

The fair values recorded were based upon a preliminary valuation. Estimates and assumptions used in such valuation are subject to change, which could be significant, within the measurement period (up to one year from the acquisition date). The primary areas of the preliminary valuation that are not yet finalized relate to the fair values of amounts for income taxes, adjustments to working capital, and the final amount of residual goodwill. We expect to continue to obtain information to assist us in determining the fair values of the net assets acquired at the acquisition date during the measurement period.

The preliminary fair value of the assets acquired and liabilities assumed at the acquisition date were as follows (in millions):

Cash and cash equivalents	$	42.6
Accounts receivable		25.7
Prepaid expenses and other current assets		2.8
Property and equipment		220.6
Identifiable intangible assets:		
Noncompete agreements (useful lives of 1 to 2 years)		9.7
Trade names (useful lives of 20 years)		8.9
Certificates of need (useful lives of 20 years)		36.6
Licenses (useful lives of 20 years)		11.4
Goodwill		642.6
Other long-term assets		0.9
Total assets acquired		1,001.8
Liabilities assumed:		
Current portion of long-term debt		4.1
Accounts payable		1.7
Accrued payroll		3.7
Other current liabilities		10.8
Long-term debt, net of current portion		205.8
Deferred tax liabilities		3.9
Total liabilities assumed		230.0
Noncontrolling interests		0.4
Net assets acquired	$	771.4

Information regarding the net cash paid for the acquisition of Reliant is as follows (in millions):

Fair value of assets acquired, net of $42.6 million of cash acquired	$	316.6
Goodwill		642.6
Fair value of liabilities assumed		(230.0)
Noncontrolling interests		(0.4)
Net cash paid for acquisition	$	728.8

Other Inpatient Rehabilitation Acquisitions

In April 2015, we acquired 83% of the inpatient rehabilitation hospital at Memorial University Medical Center ("Memorial"), a 50-bed inpatient rehabilitation hospital in Savannah, Georgia, through a joint venture with Memorial Health. The joint venture, which was funded using cash on hand, was not material to our financial position, results of operations, or cash flows. The Memorial transaction was made to enhance our position and ability to provide inpatient rehabilitative services to patients in Savannah and its surrounding areas. As a result of this transaction, Goodwill increased by $0.7 million, none of which is deductible for federal income tax purposes.

In May 2015, we acquired Cardinal Hill Rehabilitation Hospital ("Cardinal Hill"), comprised of 158 licensed inpatient rehabilitation beds, 74 licensed skilled nursing beds, and one home health location, in Lexington, Kentucky. This acquisition was made to enhance our position and ability to provide inpatient rehabilitative and home health services to patients in

Lexington, Kentucky and its surrounding areas. The acquisition, which was funded using availability under our revolving credit facility, was not material to our financial position, results of operations, or cash flows. Goodwill did not increase as a result of this transaction.

We accounted for these transactions under the acquisition method of accounting and reported the results of operations of the acquired hospitals from their respective dates of acquisition. Assets acquired, liabilities assumed, and noncontrolling interests, if any, were recorded at their estimated fair values as of the respective acquisition dates. The fair values of identifiable intangible assets were based on valuations using the cost and income approaches. The cost approach is based on amounts that would be required to replace the asset (i.e., replacement cost). The income approach, which was also used to estimate the fair value of any noncontrolling interest, is based on management's estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired, if any, was recorded as goodwill. The goodwill reflects our expectations of our ability to gain access to and penetrate the acquired or consolidated hospitals' historical patient base and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets.

The fair value of the assets acquired and liabilities assumed at the acquisition dates for the other inpatient rehabilitation transactions completed in 2015 were as follows (in millions):

Total current assets	$ 10.1
Property and equipment	42.7
Identifiable intangible assets:	
Noncompete agreements (useful lives of 2 to 3 years)	0.1
Trade names (useful lives of 20 years)	0.8
Certificates of need (useful lives of 20 years)	8.8
Licenses (useful lives of 20 years)	0.2
Goodwill	0.7
Total assets acquired	63.4
Total liabilities assumed	(2.7)
Net assets acquired	$ 60.7

Information regarding the net cash paid for other inpatient rehabilitation acquisitions during each period presented is as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Fair value of assets acquired	$ 62.8	$ 60.1	$ 15.6
Goodwill	0.7	34.6	13.7
Fair value of liabilities assumed	(2.7)	(21.2)	(0.4)
Fair value of noncontrolling interest owned by joint venture partner	(4.2)	(18.3)	—
Fair value of equity interest prior to acquisition	—	(35.0)	—
Net cash paid for acquisitions	$ 56.6	$ 20.2	$ 28.9

See also Note 7, *Investments in and Advances to Nonconsolidated Affiliates.*

Home Health and Hospice

CareSouth Acquisition

In November 2015, Encompass, a subsidiary of HealthSouth, completed its previously announced acquisition of the home health agency operations of CareSouth Health System, Inc. ("CareSouth"). CareSouth operates a portfolio of 44 home health agencies and 3 hospice agencies in Alabama, Florida, Georgia, North Carolina, South Carolina, Tennessee, and Virginia. In addition, two of these home health agencies operate as joint ventures which we account for using the equity method of accounting. We funded the cash purchase price in the acquisition with our term loan facility capacity and cash on hand. See Note 8, *Long-term Debt.*

With this acquisition, we are able to offer comprehensive, high-quality and cost-effective home-based care across new and existing service areas. We expect approximately 6.5% of the goodwill resulting from this transaction to be deductible for federal income tax purposes. The goodwill reflects our expectations of favorable growth opportunities in the home health and hospice markets based on positive demographic trends.

We accounted for this transaction under the acquisition method of accounting and reported the results of operations of CareSouth from its date of acquisition. Assets acquired, liabilities assumed, and noncontrolling interests were recorded at their estimated fair values as of the acquisition date. Estimated fair values were based on various valuation methodologies including: replacement cost and continued use methods for property and equipment; an income approach using primarily discounted cash flow techniques for the noncompete and license intangible assets and capital lease liabilities; an income approach utilizing the relief-from-royalty method for the trade name intangible asset; an income approach utilizing the excess earnings method for the certificate of need intangible assets; and an estimated realizable value approach using historical trends and other relevant information for accounts receivable and certain accrued liabilities. The aforementioned income methods utilize management's estimates of future operating results and cash flows discounted using a weighted average cost of capital that reflects market participant assumptions. For all other assets and liabilities, the fair value was assumed to represent carrying value due to their short maturities. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill.

The fair values recorded were based upon a preliminary valuation. Estimates and assumptions used in such valuation are subject to change, which could be significant, within the measurement period (up to one year from the acquisition date). The primary areas of the preliminary valuation that are not yet finalized relate to the fair values of amounts for income taxes, adjustments to working capital, and the final amount of residual goodwill. We expect to continue to obtain information to assist us in determining the fair values of the net assets acquired at the acquisition date during the measurement period.

The preliminary fair value of the assets acquired and liabilities assumed at the acquisition date were as follows (in millions):

Cash and cash equivalents	$ 0.4
Accounts receivable	10.5
Prepaid expenses and other current assets	2.4
Property and equipment	0.7
Identifiable intangible assets:	
Noncompete agreements (useful lives of 3 years)	0.8
Trade name (useful life of 5 years)	2.8
Certificates of need (useful lives of 10 years)	15.6
Licenses (useful lives of 10 years)	13.0
Internal use software	0.4
Goodwill	142.5
Investment in nonconsolidated subsidiaries	2.2
Total assets acquired	191.3
Liabilities assumed:	
Current portion of long-term debt	0.1
Accounts payable	2.4
Accrued payroll	2.4
Other current liabilities	2.8
Long-term debt, net of current portion	0.2
Deferred tax liabilties	9.4
Total liabilities assumed	17.3
Noncontrolling interests	4.3
Net assets acquired	$ 169.7

Information regarding the net cash paid for the acquisition of CareSouth is as follows (in millions):

Fair value of assets acquired, net of $0.4 million of cash acquired	$ 48.4
Goodwill	142.5
Fair value of liabilities assumed	(17.3)
Fair value of noncontrolling interest owned by joint venture partner	(4.3)
Net cash paid for acquisitions	$ 169.3

Other Home Health and Hospice Acquisitions

Other than the CareSouth acquisition discussed above, we completed the following home health and hospice acquisitions, none of which were individually material to our financial position, results of operations, or cash flows. Each acquisition was made to enhance our position and ability to provide post-acute healthcare services to patients in the applicable geographic areas. Each acquisition was funded with cash on hand.

- In March 2015, we acquired Integrity Home Health Care, Inc. (“Integrity”), a home health company with two locations in the Las Vegas, Nevada area.

- In April 2015, we acquired Harvey Home Health Services, Inc. ("Harvey"), a home health company in Houston, Texas.
- In May 2015, we acquired Heritage Home Health Care, LLC ("Heritage"), a home health company in Texarkana, Arkansas.
- In June 2015, we acquired Washington County Home Health Care, Inc. and Benton County Home Health, Inc., doing business as Alliance Home Health ("Alliance"), a home health company with two locations in the Fayetteville, Arkansas area.
- In July 2015, we acquired Southern Utah Home Health, Inc. ("Southern Utah"), a home health and hospice company with two home health locations and two hospice locations in southern Utah.
- In July 2015, we acquired Orthopedic Rehab Specialist, LLC ("ORS"), a home health company in Ocala, Florida.

We accounted for all of these transactions under the acquisition method of accounting and reported the results of operations of the acquired locations from their respective dates of acquisition. Assets acquired and liabilities assumed were recorded at their estimated fair values as of the respective acquisition dates. The fair values of identifiable intangible assets were based on valuations using the cost and income approaches. The cost approach is based on amounts that would be required to replace the asset (i.e., replacement cost). The income approach is based on management's estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill. The goodwill reflects our expectations of our ability to utilize the acquired locations' mobile workforce and established relationships within each community and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets. All goodwill recorded as a result of these transactions is deductible for federal income tax purposes.

The fair value of the assets acquired and liabilities assumed at the acquisition dates for the other home health and hospice transactions completed in 2015 were as follows (in millions):

Property and equipment	$ 0.1
Identifiable intangible assets:	
Noncompete agreements (useful lives of 2 to 5 years)	1.3
Trade names (useful lives of 1 year)	0.5
Certificates of need (useful lives of 10 years)	4.9
Licenses (useful lives of 10 years)	3.6
Goodwill	20.3
Total assets acquired	30.7
Total liabilities assumed	(0.2)
Net assets acquired	$ 30.5

Information regarding the net cash paid for the other home health and hospice acquisitions during each period presented is as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Fair value of assets acquired	$ 10.4	$ —	$ —
Goodwill	20.3	—	—
Fair value of liabilities assumed	(0.2)	—	—
Net cash paid for acquisitions	$ 30.5	$ —	$ —

2015 Pro Forma Results of Operations

The following table summarizes the results of operations of the above mentioned transactions from their respective dates of acquisition included in our consolidated results of operations and the unaudited pro forma results of operations of the combined entity had the date of the acquisitions been January 1, 2014 (in millions):

	Net Operating Revenues	Net Income Attributable to HealthSouth
Acquired entities only: Actual from acquisition date to December 31, 2015:*		
Reliant	$ 63.7	$ 11.2
All Other Inpatient	54.7	1.7
CareSouth	19.2	2.5
All Other Home Health and Hospice	17.8	1.2
Combined entity: Supplemental pro forma from 1/01/2015-12/31/2015 (unaudited)	3,479.9	234.0
Combined entity: Supplemental pro forma from 1/01/2014-12/31/2014 (unaudited)	2,851.0	276.9

* Savannah - includes operating results from April 1, 2015 through December 31, 2015
Cardinal Hill - includes operating results from May 1, 2015 through December 31, 2015
Integrity - includes operating results from March 3, 2015 through December 31, 2015
Harvey - includes operating results from April 15, 2015 through December 31, 2015
Heritage - includes operating results from May 1, 2015 through December 31, 2015
Alliance - includes operating results from June 4, 2015 through December 31, 2015
Southern Utah - includes operating results from July 1, 2015 through December 31, 2015
ORS - includes operating results from July 13, 2015 through December 31, 2015
Reliant - includes operating results from October 1, 2015 through December 31, 2015
CareSouth - includes operating results from November 2, 2015 through December 31, 2015

The information presented above is for illustrative purposes only and is not necessarily indicative of results that would have been achieved if the acquisitions had occurred as of the beginning of our 2014 reporting period. For the Reliant and CareSouth acquisitions, the unaudited pro forma information above includes adjustments for: (1) acquisition costs; (2) amortization of incremental identifiable intangible assets; (3) management fees paid to their former equity holders; (4) interest on debt incurred to fund the acquisitions (see Note 8, *Long-term Debt*); (5) income taxes using a rate of 40%; and (6) noncontrolling interests.

2014 and 2013 Acquisitions

Encompass Acquisition

On December 31, 2014, we completed the acquisition of EHHI and its Encompass Home Health and Hospice business. On the acquisition date, Encompass provided home health and hospice services out of 135 locations across 12 states. In the acquisition, we acquired all of the issued and outstanding equity interests of EHHI, other than equity interests contributed to HealthSouth Home Health Holdings, Inc. (“Holdings”), a subsidiary of HealthSouth and now indirect parent of EHHI, by certain sellers in exchange for shares of common stock of Holdings. These certain sellers, who are members of Encompass management, including April Anthony, the Chief Executive Officer of Encompass, contributed a portion of their shares of common stock of EHHI, valued at approximately $64.5 million, in exchange for shares of common stock of Holdings. As a result of that contribution, they hold approximately 16.7% of the outstanding common stock of Holdings, while HealthSouth owns the remainder. In addition, Ms. Anthony and certain other employees of Encompass entered into amended and restated employment agreements, each agreement having an initial term of three years. We funded the cash purchase price in the acquisition entirely with draws under the revolving and expanded term loan facilities of our credit agreement. See Note 8, *Long-term Debt*.

This acquisition was made to enhance our position and expand our ability to provide post-acute healthcare services to patients. Approximately 23% of the goodwill resulting from this transaction is deductible for federal income tax purposes. The goodwill reflects our expectations of favorable growth opportunities in the home health and hospice markets based on positive demographic trends.

We accounted for this transaction under the acquisition method of accounting. Because the acquisition took place on December 31, 2014, our consolidated results of operations for the year ended December 31, 2014 do not include any results of operations from Encompass. Assets acquired, liabilities assumed, and redeemable noncontrolling interests were recorded at their estimated fair values as of the acquisition date. Fair values were based on various valuation methodologies including: replacement cost and continued use methods for property and equipment; an income approach using primarily discounted cash flow techniques for amortizable intangible assets; an income approach utilizing the relief-from-royalty method for the indefinite-lived intangible asset; and an estimated realizable value approach using historical trends and other relevant information for accounts receivable and certain accrued liabilities. For all other assets and liabilities, the fair value was assumed to represent carrying value due to their short maturities. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill.

The fair value of the assets acquired and liabilities assumed at the acquisition date for Encompass were as follows (in millions):

Cash and cash equivalents	$ 20.9
Accounts receivable	37.6
Prepaid expenses and other current assets	8.6
Property and equipment	9.6
Identifiable intangible assets:	
Noncompete agreements (useful life of 2 to 5 years)	5.6
Trade name (indefinite life)	135.2
Licenses (useful life of 10 years)	58.2
Internal-use software (useful life of 3 years)	3.2
Goodwill	592.5
Other long-term assets	2.1
Total assets acquired	873.5
Current portion of long-term debt	2.0
Accounts payable	0.9
Accrued payroll	25.8
Other current liabilities	18.5
Long-term debt, net of current portion	2.0
Deferred tax liabilities	64.3
Total liabilities assumed	113.5
Redeemable noncontrolling interests	64.5
Net assets acquired	$ 695.5

Information regarding the net cash paid for the acquisition of Encompass is as follows (in millions):

Fair value of assets acquired, net of $20.9 million of cash acquired	$	260.1
Goodwill		592.5
Fair value of liabilities assumed		(113.5)
Redeemable noncontrolling interests		(64.5)
Net cash paid for acquisition	$	674.6

See also Note 11, *Redeemable Noncontrolling Interests*.

Other Acquisitions

In June 2014, using cash on hand, we acquired an additional 30% equity interest from UMass Memorial Health Care, our joint venture partner in Fairlawn Rehabilitation Hospital ("Fairlawn") in Worcester, Massachusetts. This transaction increased our ownership interest from 50% to 80% and resulted in a change in accounting for this hospital from the equity method of accounting to a consolidated entity. As a result of our consolidation of this hospital and the remeasurement of our previously held equity interest at fair value, *Goodwill* increased by $34.0 million, and we recorded a $27.2 million gain as part of *Other income* during 2014. The Fairlawn transaction was made to increase our ownership in a profitable hospital and continue to grow our core business by consolidating its operations. None of the goodwill resulting from this transaction is deductible for federal income tax purposes. See also Note 15, *Income Taxes*.

In November 2014, we acquired 50.1% of the James H. & Cecile C. Quillen Rehabilitation Hospital ("Quillen"), a 26-bed inpatient rehabilitation hospital in Johnson City, Tennessee, through a joint venture with Mountain States Health Alliance. The joint venture, which was funded using cash on hand, was not material to our financial position, results of operations, or cash flows. The Quillen transaction was made to enhance our position and ability to provide inpatient rehabilitative services to patients in Johnson City and its surrounding areas. As a result of this transaction, *Goodwill* increased by $0.6 million, none of which is deductible for federal income tax purposes. The noncontrolling interest associated with this agreement includes redemption features that are not solely within our control and, therefore, is considered *Redeemable noncontrolling interests.* See Note 11, *Redeemable Noncontrolling Interests*.

In April 2013, we closed the transaction to acquire Walton Rehabilitation Hospital, a 58-bed inpatient rehabilitation hospital in Augusta, Georgia. This acquisition was made to enhance our position and ability to provide inpatient rehabilitative services to patients in Augusta, Georgia and its surrounding areas. The acquisition, which was funded using availability under our revolving credit facility, was not material to our financial position, results of operations, or cash flows. As a result of this transaction, *Goodwill* increased by $13.7 million, all of which is deductible for federal income tax purposes.

We accounted for all of these transactions under the acquisition method of accounting and reported the results of operations of the acquired or newly consolidated hospitals from their respective dates of acquisition. Assets acquired and liabilities assumed were recorded at their estimated fair values as of the respective acquisition dates. The fair values of identifiable intangible assets were based on valuations using the cost and income approaches. The cost approach is based on amounts that would be required to replace the asset (i.e., replacement cost). The income approach is based on management's estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill. The goodwill reflects our expectations of our ability to gain access to and penetrate the acquired or consolidated hospitals' historical patient base and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets.

The fair value of the assets acquired and liabilities assumed at the acquisition dates for the other acquisitions completed in 2014 were as follows (in millions):

Total current assets	$ 12.1
Property and equipment, net	36.9
Identifiable intangible assets:	
Noncompete agreements (useful lives of 2 to 3 years)	0.4
Trade names (useful lives of 20 years)	2.9
Certificates of need (useful lives of 20 years)	10.8
Licenses (useful lives of 20 years)	2.1
Goodwill	34.6
Total assets acquired	99.8
Total current liabilities assumed	(7.8)
Total long-term liabilities assumed	(13.4)
Net assets acquired	$ 78.6

Information regarding the net cash paid for all other acquisitions during each period presented is as follows (in millions):

	For the Year Ended December 31,	
	2014	2013
Fair value of assets acquired, net of $5.1 million of cash acquired in 2014	$ 60.1	$ 15.6
Goodwill	34.6	13.7
Fair value of liabilities assumed	(21.2)	(0.4)
Fair value of noncontrolling interest owned by joint venture partner	(18.3)	—
Fair value of equity interest prior to acquisition	(35.0)	—
Net cash paid for acquisitions	$ 20.2	$ 28.9

See also Note 7, *Investments in and Advances to Nonconsolidated Affiliates.*

2014 Pro Forma Results of Operations

The following table summarizes the results of operations of the above 2014 transactions from their respective dates of acquisition included in our consolidated results of operations and the unaudited pro forma results of operations of the combined entity had the date of the acquisitions been January 1, 2013 (in millions):

	Net Operating Revenues	Net Income Attributable to HealthSouth
Acquired entities only: Actual from acquisition date to December 31, 2014*	$ 27.2	$ 4.0
Combined entity: Supplemental pro forma from 1/01/2014-12/31/2014 (unaudited)	2,799.8	237.5
Combined entity: Supplemental pro forma from 1/01/2013-12/31/2013 (unaudited)	2,627.6	311.3

* Encompass - Actual amounts are zero due to the acquisition of Encompass on December 31, 2014.
Fairlawn - includes operating results from June 1, 2014 through December 31, 2014
Quillen - includes operating results from November 1, 2014 through December 31, 2014

The information presented above is for illustrative purposes only and is not necessarily indicative of results that would have been achieved if the acquisitions had occurred as of the beginning of our 2013 reporting period. For the Encompass acquisition, the unaudited pro forma information above includes adjustments for: (1) acquisition costs; (2) amortization of incremental identifiable intangible assets; (3) management fees paid to Encompass' former equity holders; (4) interest on debt incurred to fund the acquisition (see Note 8, *Long-term Debt*); (5) income taxes using a rate of 40%; and (6) noncontrolling interests.

3. Cash and Marketable Securities:

The components of our investments as of December 31, 2015 are as follows (in millions):

	Cash & Cash Equivalents	Restricted Cash	Restricted Marketable Securities	Total
Cash	$ 61.6	$ 45.9	$ —	$ 107.5
Equity securities	—	—	56.2	56.2
Total	$ 61.6	$ 45.9	$ 56.2	$ 163.7

The components of our investments as of December 31, 2014 are as follows (in millions):

	Cash & Cash Equivalents	Restricted Cash	Restricted Marketable Securities	Total
Cash	$ 66.7	$ 45.6	$ —	$ 112.3
Equity securities	—	—	50.5	50.5
Total	$ 66.7	$ 45.6	$ 50.5	$ 162.8

Restricted Cash—

As of December 31, 2015 and 2014, *Restricted cash* consisted of the following (in millions):

	As of December 31,	
	2015	2014
Affiliate cash	$ 20.3	$ 13.1
Self-insured captive funds	25.6	32.4
Paid-loss deposit funds	—	0.1
Total restricted cash	$ 45.9	$ 45.6

Affiliate cash represents cash accounts maintained by joint ventures in which we participate where one or more of our external partners requested, and we agreed, that the joint venture's cash not be commingled with other corporate cash accounts and be used only to fund the operations of those joint ventures. Self-insured captive funds represent cash held at our wholly owned insurance captive, HCS, Ltd., as discussed in Note 9, *Self-Insured Risks*. These funds are committed to pay third-party administrators for claims incurred and are restricted by insurance regulations and requirements. These funds cannot be used for purposes outside HCS without the permission of the Cayman Islands Monetary Authority. Paid-loss deposit funds represent cash held by third-party administrators to fund expenses and other payments related to claims.

The classification of restricted cash held by HCS as current or noncurrent depends on the classification of the corresponding claims liability. As of December 31, 2015 and 2014, all restricted cash was current.

Marketable Securities—

Restricted marketable securities at both balance sheet dates represent restricted assets held at HCS. HCS insures HealthSouth's professional liability, workers' compensation, and other insurance claims. These funds are committed for payment of claims incurred, and the classification of these marketable securities as current or noncurrent depends on the classification of the corresponding claims liability. As of December 31, 2015 and 2014, $40.1 million and $45.9 million, respectively, of restricted marketable securities are included in *Other long-term assets* in our consolidated balance sheets.

A summary of our restricted marketable securities as of December 31, 2015 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	$ 58.3	$ 0.3	$ (2.4)	$ 56.2

A summary of our restricted marketable securities as of December 31, 2014 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	$ 51.3	$ 0.5	$ (1.3)	$ 50.5

Cost in the above tables includes adjustments made to the cost basis of our equity securities for other-than-temporary impairments. During the years ended December 31, 2015, 2014, and 2013, we did not record any impairment charges related to our restricted marketable securities.

Investing information related to our restricted marketable securities is as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Proceeds from sales of restricted available-for-sale securities	$ —	$ —	$ 16.6
Proceeds from sales of nonrestricted available-for-sale securities	$ 12.8	$ 2.7	$ —
Gross realized gains	$ 1.2	$ 0.5	$ 1.0
Gross realized losses	$ —	$ (0.1)	$ (0.1)

Our portfolio of marketable securities is comprised of investments in mutual funds that hold investments in a variety of industries and geographies. As discussed in Note 1, *Summary of Significant Accounting Policies*, "Marketable Securities," when our portfolio includes marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, we examine the severity and duration of the impairments in relation to the cost of the individual investments. We also consider the industry and geography in which each investment is held and the near-term prospects for a recovery in each.

4. Accounts Receivable:

Accounts receivable consists of the following (in millions):

	As of December 31,	
	2015	2014
Current:		
Patient accounts receivable, net of allowance for doubtful accounts of $39.3 million in 2015; $22.2 million in 2014	$ 403.3	$ 309.3
Other accounts receivable	7.2	13.9
	410.5	**323.2**
Noncurrent patient accounts receivable, net of allowance for doubtful accounts of $32.3 million in 2015; $20.8 million in 2014	96.6	51.4
Accounts receivable, net	**$ 507.1**	**$ 374.6**

Because the resolution of claims that are part of Medicare audit programs can take in excess of three years, we review the patient receivables that are part of this adjudication process to determine their appropriate classification as either current or noncurrent. Amounts considered noncurrent are included in *Other long-term assets* in our consolidated balance sheet.

At December 31, 2015 and 2014, our allowance for doubtful accounts represented approximately 12.5% and 10.7%, respectively, of the total patient due accounts receivable balance.

The following is the activity related to our allowance for doubtful accounts (in millions):

For the Year Ended December 31,	Balance at Beginning of Period	Additions and Charges to Expense	Deductions and Accounts Written Off	Balance at End of Period
2015	$ 43.0	$ 47.2	$ (18.6)	$ 71.6
2014	$ 33.1	$ 31.6	$ (21.7)	$ 43.0
2013	$ 28.7	$ 26.0	$ (21.6)	$ 33.1

5. Property and Equipment:

Property and equipment consists of the following (in millions):

	As of December 31,	
	2015	2014
Land	$ 113.3	$ 108.1
Buildings	1,521.1	1,214.4
Leasehold improvements	96.2	79.1
Vehicles	10.0	9.3
Furniture, fixtures, and equipment	392.7	364.2
	2,133.3	1,775.1
Less: Accumulated depreciation and amortization	(874.3)	(784.0)
	1,259.0	991.1
Construction in progress	51.1	28.6
Property and equipment, net	$ 1,310.1	$ 1,019.7

As of December 31, 2015, approximately 75% of our consolidated *Property and equipment, net* held by HealthSouth Corporation and its guarantor subsidiaries was pledged to the lenders under our credit agreement. See Note 8, *Long-term Debt*, and Note 20, *Condensed Consolidating Financial Information*.

Information related to fully depreciated assets and assets under capital lease obligations is as follows (in millions):

	As of December 31,	
	2015	2014
Fully depreciated assets	$ 252.4	$ 240.9
Assets under capital lease obligations:		
Buildings	$ 333.9	$ 124.4
Vehicles	6.5	5.2
Equipment	0.3	0.2
	340.7	129.8
Less: Accumulated amortization	(66.6)	(55.2)
Assets under capital lease obligations, net	$ 274.1	$ 74.6

See also Note 2, *Business Combinations.*

The amount of depreciation expense, amortization expense relating to assets under capital lease obligations, interest capitalized, and rent expense under operating leases is as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Depreciation expense	$ 91.0	$ 79.9	$ 67.9
Amortization expense	$ 12.7	$ 7.5	$ 9.5
Interest capitalized	$ 1.3	$ 1.5	$ 1.9
Rent expense:			
Minimum rent payments	$ 48.8	$ 37.3	$ 40.3
Contingent and other rents	21.6	18.2	20.3
Other	3.8	3.9	4.2
Total rent expense	$ 74.2	$ 59.4	$ 64.8

Leases—

We lease certain land, buildings, and equipment under noncancelable operating leases generally expiring at various dates through 2028. We also lease certain buildings and equipment under capital leases generally expiring at various dates through 2037. Operating leases generally have 3- to 15-year terms, with one or more renewal options, with terms to be negotiated at the time of renewal. Various facility leases include provisions for rent escalation to recognize increased operating costs or require us to pay certain maintenance and utility costs. Contingent rents are included in rent expense in the year incurred.

Some facilities are subleased to other parties. Rental income from subleases approximated $5.0 million, $5.1 million, and $4.9 million for the years ended December 31, 2015, 2014, and 2013, respectively. Total expected future minimum rentals under these noncancelable subleases approximated $13.5 million as of December 31, 2015.

Certain leases contain annual escalation clauses based on changes in the Consumer Price Index while others have fixed escalation terms. The excess of cumulative rent expense (recognized on a straight-line basis) over cumulative rent payments made on leases with fixed escalation terms is recognized as straight-line rental accrual and is included in *Other long-term liabilities* in the accompanying consolidated balance sheets, as follows (in millions):

	As of December 31,	
	2015	**2014**
Straight-line rental accrual	$ 11.8	$ 14.6

In March 2008, we sold our corporate campus to Daniel Corporation ("Daniel"), a Birmingham, Alabama-based real estate company. The sale included a deferred purchase price component related to an incomplete 13-story building located on the property, often referred to as the Digital Hospital. Under the agreement, Daniel was obligated upon sale of its interest in the building to pay to us 40% of the net profit realized from the sale. In June 2013, Daniel sold the building to Trinity Medical Center. In the third quarter of 2013, we received $10.8 million in cash from Daniel in connection with the sale of the building. The gain associated with this transaction is being deferred and amortized over five years, which is the remaining life of our lease agreement with Daniel for the portion of the property we continue to occupy with our corporate office, as a component of *General and administrative expenses*.

Future minimum lease payments at December 31, 2015, for those leases having an initial or remaining noncancelable lease term in excess of one year, are as follows (in millions):

Year Ending December 31,	**Operating Leases**	**Capital Lease Obligations**	**Total**
2016	$ 59.2	$ 32.8	$ 92.0
2017	52.1	34.1	86.2
2018	46.0	33.4	79.4
2019	41.2	30.3	71.5
2020	32.9	27.8	60.7
2021 and thereafter	156.2	384.7	540.9
	$ 387.6	543.1	$ 930.7
Less: Interest portion		(254.9)	
Obligations under capital leases		$ 288.2	

In addition to the above, and as discussed in Note 8, *Long-term Debt*, "Other Notes Payable," we have two sale/leaseback transactions involving real estate accounted for as financings. Future minimum payments, which are accounted for as interest, under these obligations are $2.7 million in each of the next five years and $8.3 million thereafter.

6. Goodwill and Other Intangible Assets:

The following table shows changes in the carrying amount of *Goodwill* for the years ended December 31, 2015, 2014, and 2013 (in millions):

	Amount
Goodwill as of December 31, 2012	$ 437.3
Acquisition	13.7
Conversion of 100% owned hospital into a joint venture	6.2
Divestiture of skilled nursing facility beds	(0.3)
Goodwill as of December 31, 2013	456.9
Acquisitions	593.1
Consolidation of joint venture formerly accounted for under the equity method of accounting	34.0
Goodwill as of December 31, 2014	1,084.0
Acquisitions	806.1
Goodwill as of December 31, 2015	$ 1,890.1

Goodwill increased in 2013 as a result of our acquisition of Walton Rehabilitation Hospital and conversion of our 100% owned hospital in Jonesboro, Arkansas into a joint venture with St. Bernards Healthcare offset by the divestiture of 41 skilled nursing facility beds. *Goodwill* increased in 2014 as a result of our consolidation of Fairlawn and the remeasurement of our previously held equity interest at fair value and our acquisitions of Encompass and Quillen. *Goodwill* increased in 2015 as a result of our acquisitions of Reliant, CareSouth, and other inpatient and home health and hospice operations. See Note 2, *Business Combinations* and Note 11, *Redeemable Noncontrolling Interests*.

We performed impairment reviews as of October 1, 2015, 2014, and 2013 and concluded no *Goodwill* impairment existed. As of December 31, 2015, we had no accumulated impairment losses related to *Goodwill*.

The following table provides information regarding our other intangible assets (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net
Certificates of need:			
2015	$ 93.9	$ (6.9)	$ 87.0
2014	27.9	(4.0)	23.9
Licenses:			
2015	$ 138.9	$ (53.7)	$ 85.2
2014	110.8	(46.3)	64.5
Noncompete agreements:			
2015	$ 58.0	$ (37.0)	$ 21.0
2014	46.2	(29.4)	16.8
Trade name - Encompass:			
2015	$ 135.2	$ —	$ 135.2
2014	135.2	—	135.2
Trade names - all other:			
2015	$ 32.9	$ (11.5)	$ 21.4
2014	19.9	(10.1)	9.8
Internal-use software:			
2015	$ 155.7	$ (90.5)	$ 65.2
2014	125.3	(74.5)	50.8
Market access assets:			
2015	$ 13.2	$ (8.8)	$ 4.4
2014	13.2	(8.1)	5.1
Total intangible assets:			
2015	$ 627.8	$ (208.4)	$ 419.4
2014	478.5	(172.4)	306.1

Amortization expense for other intangible assets is as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Amortization expense	$ 36.0	$ 20.3	$ 17.3

Total estimated amortization expense for our other intangible assets for the next five years is as follows (in millions):

Year Ending December 31,	Estimated Amortization Expense
2016	$ 45.4
2017	38.7
2018	30.3
2019	26.8
2020	23.3

7. Investments in and Advances to Nonconsolidated Affiliates:

Investments in and advances to nonconsolidated affiliates as of December 31, 2015 represents our investment in seven partially owned subsidiaries, of which six are general or limited partnerships, limited liability companies, or joint ventures in which HealthSouth or one of its subsidiaries is a general or limited partner, managing member, member, or venturer, as applicable. We do not control these affiliates but have the ability to exercise significant influence over the operating and financial policies of certain of these affiliates. Our ownership percentages in these affiliates range from approximately 1% to 60%. We account for these investments using the cost and equity methods of accounting. Our investments, which are included in *Other long-term assets* in our consolidated balance sheets, consist of the following (in millions):

	As of December 31,	
	2015	2014
Equity method investments:		
Capital contributions	$ 0.9	$ 0.8
Cumulative share of income	88.0	77.3
Cumulative share of distributions	(77.5)	(69.9)
	11.4	8.2
Cost method investments:		
Capital contributions, net of distributions and impairments	0.3	1.2
Total investments in and advances to nonconsolidated affiliates	$ 11.7	$ 9.4

The following summarizes the combined assets, liabilities, and equity and the combined results of operations of our equity method affiliates (on a 100% basis, in millions):

	As of December 31,	
	2015	2014
Assets—		
Current	$ 7.8	$ 9.6
Noncurrent	20.5	13.1
Total assets	$ 28.3	$ 22.7
Liabilities and equity—		
Current liabilities	$ 1.4	$ 0.7
Noncurrent liabilities	0.1	0.1
Partners' capital and shareholders' equity—		
HealthSouth	11.4	8.2
Outside partners	15.4	13.7
Total liabilities and equity	$ 28.3	$ 22.7

Condensed statements of operations (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Net operating revenues	$ 36.5	$ 50.2	$ 74.3
Operating expenses	(15.0)	(25.9)	(43.6)
Income from continuing operations, net of tax	18.9	30.9	24.6
Net income	18.9	30.9	24.6

See Note 2, *Business Combinations*.

8. Long-term Debt:

Our long-term debt outstanding consists of the following (in millions):

	As of December 31,	
	2015	2014
Credit Agreement—		
Advances under revolving credit facility	$ 130.0	$ 325.0
Term loan facilities	443.3	447.5
Bonds payable—		
8.125% Senior Notes due 2020	—	282.7
7.75% Senior Notes due 2022	174.3	223.7
5.125% Senior Notes due 2023	294.6	—
5.75% Senior Notes due 2024	1,192.6	447.4
5.75% Senior Notes due 2025	343.4	—
2.00% Convertible Senior Subordinated Notes due 2043	265.9	256.7
Other notes payable	39.2	41.5
Capital lease obligations	288.2	86.7
	3,171.5	2,111.2
Less: Current portion	(36.8)	(20.8)
Long-term debt, net of current portion	$ 3,134.7	$ 2,090.4

On December 31, 2015, we adopted ASU 2015-03 and ASU No. 2015-15, which require debt issuance costs related to a recognized debt liability be presented on the consolidated balance sheet as a direct deduction from the debt liability, As of December 31, 2014, $20.4 million of debt issuance costs previously included in *Other long-term assets* have been reclassified to *Long-term debt, net of current portion* on our consolidated balance sheet. See Note 1, *Summary of Significant Accounting Policies*, “Recent Accounting Pronouncements.”

The following chart shows scheduled principal payments due on long-term debt for the next five years and thereafter (in millions):

Year Ending December 31,	Face Amount	Net Amount
2016	$ 37.0	$ 37.0
2017	36.1	36.1
2018	36.3	36.3
2019	39.5	39.4
2020	814.2	758.4
Thereafter	2,285.4	2,264.3
Total	$ 3,248.5	$ 3,171.5

During 2015, we:

- issued, in January 2015, an additional $400 million of our 5.75% Senior Notes due 2024 (the "2024 Notes") at a price of 102% of the principal amount and used $250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility. As a result of the repayment of borrowings under our term loan facility, we recorded a $1.2 million *Loss on early extinguishment of debt* in the first quarter of 2015;

- issued, in March 2015, $300 million of 5.125% Senior Notes due 2023 (the "2023 Notes") at a price of 100.0% of the principal amount, which resulted in approximately $295 million in net proceeds used for the redemption of our 8.125% Senior Notes due 2020 (the "2020 Notes") as discussed below;

- redeemed, in April 2015, all of our 2020 Notes using the net proceeds from the 2023 Notes offering along with cash on hand. Pursuant to the terms of these notes, this redemption was made at a price of 104.063%, which resulted in a total cash outlay of approximately $302 million to retire the $290 million in principal. As a result of this redemption, we recorded an $18.8 million *Loss on early extinguishment of debt* in the second quarter of 2015;

- amended, in June and July 2015, our existing credit agreement to, among other things, add $500 million of new term loan facilities, increase the amount of specifically permitted capital lease obligations from $200 million to $350 million, change the maximum leverage ratio in the financial covenants applicable for the period July 2015 through June 2017 from 4.25x to 4.5x and to 4.25x from then until maturity, and extend the maturity date for all borrowings to July 2020. Based on our issuance of additional senior notes in August 2015 and September 2015, as discussed below, our availability under the new term loan facilities was reduced to $250 million. In September, we borrowed $125 million of the new term loan facilities, the proceeds of which were used to fund a portion of the Reliant acquisition. In October, we utilized the remaining $125 million of term loan facility capacity to finance a portion of the CareSouth acquisition. See Note 2, *Business Combinations*;

- issued, in August 2015, an additional $350 million of our 2024 Notes at a price of 100.5% of the principal amount, which resulted in approximately $351 million in net proceeds from the private offering. We used the net proceeds to reduce borrowings under our revolving credit facility and fund a portion of the Reliant acquisition, as discussed in Note 2, *Business Combinations*;

- issued, in September 2015, $350 million of 5.75% Senior Notes due 2025 (the "2025 Notes") at a price of 100.0% of the principal amount, which resulted in approximately $344 million in net proceeds from the private offering. We used the net proceeds to fund a portion of the Reliant acquisition, as discussed in Note 2, *Business Combinations*; and

- redeemed, in November 2015, $50 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022 (the "2022 Notes") using borrowings under our senior secured credit facility. Pursuant to the terms of the 2022 Notes, this optional redemption was made at a price of 103.875%, which resulted in a total cash

outlay of approximately $52 million. As a result of this redemption, we recorded a $2.4 million *Loss on early extinguishment of debt* in the fourth quarter of 2015.

On February 23, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of $50 million of the outstanding principal amount of the 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption will be at a price of 103.875%, which will result in a total cash outlay of approximately $52 million when the transaction closes, which is expected to be on March 24, 2016. We plan to use cash on hand and capacity under our revolving credit facility to fund the redemption. As a result of this redemption, we expect to record an approximate $2 million loss on early extinguishment of debt in the first quarter of 2016.

During 2014, we:

- issued, in September 2014, an additional $175 million of our 2024 Notes at a price of 103.625% of the principal amount, which resulted in approximately $182 million in net proceeds from the public offering. We used the net proceeds to redeem our 7.25% Senior Notes due 2018 (the "2018 Notes") as discussed below;

- amended, in September and December 2014, our existing credit agreement to, among other things, add $450 million of term loan facility capacity, permit unlimited restricted payments (as defined in the credit agreement) so long as the senior secured leverage ratio remains less than or equal to 1.75x, and extend the revolver maturity from June 2018 to September 2019;

- redeemed, in October 2014, the outstanding principal amount of our 2018 Notes using the net proceeds from the September offering of our 2024 Notes, a $75 million draw under our term loan facilities, and cash on hand. Pursuant to the terms of the 2018 Notes, this redemption was made at a price of 103.625%, which resulted in a total cash outlay of approximately $281 million to retire the approximate $271 million in principal; and

- redeemed, in December 2014, approximately $25 million of the outstanding principal amount of our existing 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption represented 10% of the outstanding principal amount of the notes at a price of 103%, which resulted in a total cash outlay of approximately $26 million. We used cash on hand for this redemption.

As a result of the above 2014 redemptions, we recorded a $13.2 million *Loss on early extinguishment of debt* in 2014. Additionally, in December 2014, we drew $375 million under our term loan facilities and $325 million under our revolving credit facility to fund the acquisition of Encompass. See Note 2, *Business Combinations*.

In November 2013, we redeemed approximately $30 million and approximately $28 million of the outstanding principal amount of our existing 2018 Notes and our existing 2022 Notes, respectively. Pursuant to the terms of these senior notes, this optional redemption represented 10% of the outstanding principal amount of the notes at a price of 103%, which resulted in a total cash outlay of approximately $60 million to retire the approximate $58 million in principal. We used a combination of cash on hand and availability under our revolving credit facility for these redemptions. As a result of these redemptions, we recorded a $2.4 million *Loss on early extinguishment of debt* in 2013. Additionally, in November 2013, we exchanged $320 million in aggregate principal amount of newly issued 2.00% Convertible Senior Subordinated Notes due 2043 for 257,110 shares of our outstanding 6.50% Series A Convertible Perpetual Preferred Stock. See Note 10, *Convertible Perpetual Preferred Stock.*

Senior Secured Credit Agreement—

2015 Credit Agreement

In June and July 2015, we amended our existing credit agreement, previously amended on December 23, 2014 (the "Credit Agreement"). The Credit Agreement provides for a $600 million revolving credit facility, with a $260 million letter of credit subfacility and a swingline loan subfacility, all of which mature in July 2020. Outstanding term loan borrowings are payable in equal consecutive quarterly installments, commencing on March 31, 2016, of 1.25% of the aggregate principal amount of the term loans outstanding as of December 31, 2015, with the remainder due at maturity. We have the right at any time to prepay, in whole or in part, any borrowing under the term loan facilities.

Amounts drawn on the term loan facilities and the revolving credit facility bear interest at a rate per annum of, at our option, (1) LIBOR or (2) the higher of (a) Barclays' Bank PLC's ("Barclays") prime rate and (b) the federal funds rate plus 0.5%, in each case, plus, in each case, an applicable margin that varies depending upon our leverage ratio. We are also subject to a commitment fee of 0.375% per annum on the daily amount of the unutilized commitments under the term loan facilities and revolving credit facility. The current interest rate on borrowings under the Credit Agreement is LIBOR plus 2.00%.

The Credit Agreement contains affirmative and negative covenants and default and acceleration provisions, including a minimum interest coverage ratio and a maximum leverage ratio that change over time. Under one such negative covenant, we are restricted from paying common stock dividends, prepaying certain senior notes, and repurchasing preferred and common equity unless (1) we are not in default under the terms of the Credit Agreement and (2) our senior secured leverage ratio, as defined in the Credit Agreement, does not exceed 1.75x. In the event the senior secured leverage ratio exceeds 1.75x, these payments are subject to a limit of $200 million plus an amount equal to a portion of available excess cash flows each fiscal year. Our obligations under the Credit Agreement are secured by the current and future personal property of the Company and its subsidiary guarantors. The current maximum leverage ratio in the financial covenants is 4.50x.

As of December 31, 2015, $130 million were drawn under the revolving credit facility with an interest rate of 2.3%. Amounts drawn as of December 31, 2015 exclude $34.2 million utilized under the letter of credit subfacility, which were being used in the ordinary course of business to secure workers' compensation and other insurance coverages and for general corporate purposes.

2014 Credit Agreement

In September and December 2014, we amended our existing credit agreement, previously amended on June 11, 2013 (the "2014 Credit Agreement"). The 2014 Credit Agreement provided for $450 million of term loan capacity and a $600 million revolving credit facility, with a $260 million letter of credit subfacility and a swingline loan subfacility, all of which would have matured in September 2019. Outstanding term loan borrowings were payable in equal consecutive quarterly installments, commencing on March 31, 2015, of 1.25% of the aggregate principal amount of the term loans outstanding as of March 31, 2015 with the remainder due at maturity. The 2014 Credit Agreement contained the same affirmative and negative covenants and default and acceleration provisions as the Credit Agreement, except for the maximum leverage ratio was 4.25x.

As of December 31, 2014, $325 million were drawn under the revolving credit facility with an interest rate of 2.0%. Amounts drawn as of December 31, 2014 excluded $31.8 million utilized under the letter of credit subfacility, which were being used in the ordinary course of business to secure workers' compensation and other insurance coverages and for general corporate purposes.

2013 Credit Agreement

On June 11, 2013, we amended our existing credit agreement, dated August 10, 2012 (the " 2013 Credit Agreement"). The 2013 Credit Agreement provided for a $600 million revolving credit facility with a $260 million letter of credit subfacility and a swingline loan subfacility, all of which would have matured in June 2018.

The 2013 Credit Agreement contained comparable affirmative and negative covenants and default and acceleration provisions as the 2014 Credit Agreement. Our obligations under the 2013 Credit Agreement were secured by substantially all of the real and personal property of us and our subsidiary guarantors, including mortgages with respect to certain of our material real property that we owned as of the date of the 2013 Credit Agreement.

Bonds Payable—

Nonconvertible Notes

The Company's 2020 Notes, 2022 Notes, 2023 Notes, 2024 Notes, and 2025 Notes (collectively, the "Senior Notes") were issued pursuant to an indenture (the "Base Indenture") dated as of December 1, 2009 between us and The Bank of Nova Scotia Trust Company of New York, as trustee (the "Original Trustee"), as supplemented by each Senior Notes respective supplemental indenture (together with the Base Indenture, the "Indenture"), among us, the Subsidiary Guarantors (as defined in the Indenture), and the Original Trustee. The Original Trustee notified us of its intention to discontinue its corporate trust operations and, accordingly, to resign upon the appointment of a successor trustee. Effective July 29, 2013, Wells Fargo Bank,

National Association, was appointed as successor trustee under the Indenture.

Pursuant to the terms of the Indenture, the Senior Notes are jointly and severally guaranteed on a senior, unsecured basis by all of our existing and future subsidiaries that guarantee borrowings under our Credit Agreement and other capital markets debt (see Note 20, *Condensed Consolidating Financial Information*). The Senior Notes are senior, unsecured obligations of HealthSouth and rank equally with our other senior indebtedness, senior to any of our subordinated indebtedness, and effectively junior to our secured indebtedness to the extent of the value of the collateral securing such indebtedness.

Upon the occurrence of a change in control (as defined in the Indenture), each holder of the Senior Notes may require us to repurchase all or a portion of the notes in cash at a price equal to 101% of the principal amount of the Senior Notes to be repurchased, plus accrued and unpaid interest.

The Senior Notes contain covenants and default and acceleration provisions, that, among other things, limit our and certain of our subsidiaries' ability to (1) incur additional debt, (2) make certain restricted payments, (3) consummate specified asset sales, (4) incur liens, and (5) merge or consolidate with another person.

2018 and 2022 Notes

On October 7, 2010, we completed a public offering of $525.0 million aggregate principal amount of senior notes, which included $275.0 million of 2018 Notes at par and $250.0 million of 2022 Notes at par (collectively, the "2018 and 2022 Senior Notes"). We used the net proceeds from the initial offering of the 2018 and 2022 Senior Notes to repay amounts outstanding under the term loan facility of our former credit agreement dated March 2006.

On March 7, 2011, we completed a public offering of $120 million aggregate principal amount of senior notes, which included an additional $60 million of the 2018 Notes at 103.25% of the principal amount and an additional $60 million of the 2022 Notes at 103.50% of the principal amount. Net proceeds from this offering were approximately $122 million. We used approximately $45 million of the net proceeds to repay a portion of the amounts outstanding under our revolving credit facility. In June 2011, the remainder of the net proceeds were used to redeem a portion of our former senior notes due 2016 outstanding at that time.

On October 9, 2012, $64.5 million of the net proceeds from our public offering of the 2024 Notes were used to redeem $33.5 million of the outstanding principal amount of our existing 2018 Notes and $31.0 million of the outstanding principal amount of our existing 2022 Notes. The notes were redeemed at a price of 103%, which resulted in an additional cash outlay of $1.9 million from the net proceeds.

On November 29, 2013, we redeemed $30.2 million and $27.9 million of the outstanding principal amount of our existing 2018 Notes and our existing 2022 Notes, respectively. Pursuant to the terms of these senior notes, this optional redemption represented 10% of the outstanding principal amount of the notes at a price of 103%, which resulted in a total cash outlay of approximately $60 million to retire the $58.1 million in principal. We used a combination of cash on hand and availability under our revolving credit facility for this redemption.

On October 1, 2014, we redeemed the remaining $271.4 million outstanding principal amount of our 2018 Notes. Pursuant to the terms of the 2018 Notes, this redemption was made at a price of 103.625%, which resulted in a total cash outlay of approximately $281 million to retire the $271.4 million in principal. We used the net proceeds from the $175 million September offering of our existing 2024 Notes discussed below, a $75 million draw under our term loan facilities, and cash on hand for this redemption. The 2018 Notes would have matured on October 1, 2018. Inclusive of financing costs, the effective interest rate on the 2018 Notes was 7.5%. Interest was payable semiannually in arrears on April 1 and October 1 of each year.

On December 1, 2014, we redeemed $25.1 million of the outstanding principal amount of our existing 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption represented 10% of the outstanding principal amount of the notes at a price of 103%, which resulted in a total cash outlay of approximately $26 million to retire the $25.1 million in principal. We used cash on hand for this redemption.

On November 30, 2015, we redeemed $50.0 million of the outstanding principal amount of our existing 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption was made at a price of 103.875%, which resulted in a total

cash outlay of approximately $52 million. We used cash borrowings under our senior secured credit facility to fund the redemption.

2022 Notes

The 2022 Notes mature on September 15, 2022 and bear interest at a per annum rate of 7.75%. Inclusive of financing costs, the effective interest rate on the 2022 Notes is 7.9%. Interest is payable semiannually in arrears on March 15 and September 15 of each year.

We may redeem the 2022 Notes, in whole or in part, at any time on or after September 15, 2015, at the redemption prices set forth below:

Period	Redemption Price*
2015	103.875%
2016	102.583%
2017	101.292%
2018 and thereafter	100.000%

* Expressed in percentage of principal amount

2020 Notes

In December 2009, we issued $290.0 million of the 2020 Notes at 98.327% of par. We used the net proceeds from this transaction along with cash on hand to tender for and redeem all of our former floating rate senior notes due 2014 outstanding at that time.

If not for the April 2015 redemption as discussed above, the 2020 Notes would have matured on February 15, 2020. Inclusive of discounts and financing costs, the effective interest rate on the 2020 Notes was 8.7%. Interest was payable semiannually in arrears on February 15 and August 15 of each year.

2023 Notes

On March 12, 2015, we issued $300 million of the 2023 Notes at a price of 100.0% of the principal amount, which resulted in approximately $295 million in net proceeds from the public offering. The 2023 Notes mature on March 15, 2023 and bear interest at a per annum rate of 5.125%. Interest on the 2023 Notes is payable semiannually in arrears on March 15 and September 15, beginning on September 15, 2015.

We may redeem the 2023 Notes, in whole or in part, at any time on or after March 15, 2018 at the redemption prices set forth below:

Period	Redemption Price*
2018	103.844%
2019	102.563%
2020	101.281%
2021 and thereafter	100.000%

* Expressed in percentage of principal amount

2024 Notes

On September 11, 2012, we completed a public offering of $275 million aggregate principal amount of the 2024 Notes at a public offering price of 100% of the principal amount. Net proceeds from this offering were approximately $270 million. We used $195 million of the net proceeds to repay the amounts outstanding under our revolving credit facility. Additionally, in October 2012, $64.5 million of the net proceeds were used to redeem a portion of our 2018 and 2022 Senior Notes.

On September 18, 2014, we issued an additional $175 million of the 2024 Notes at a price of 103.625% of the principal amount, which resulted in approximately $182 million in net proceeds from the public offering. We used the net proceeds to redeem the 2018 Notes, as discussed above.

On January 29, 2015, we issued an additional $400 million of the 2024 Notes at a price of 102% of the principal amount, which resulted in approximately $406 million in net proceeds from the public offering. We used $250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility.

On August 7, 2015, we issued an additional $350 million of our 2024 Notes at a price of 100.5% of the principal amount, which resulted in approximately $351 million in net proceeds from the private offering. We used the net proceeds to reduce borrowings under our revolving credit facility and fund a portion of the Reliant acquisition, as discussed in Note 2, *Business Combinations.*

The 2024 Notes mature on November 1, 2024 and bear interest at a per annum rate of 5.75%. Inclusive of financing costs, the effective interest rate on the 2024 Notes is 5.8%. Interest is payable semiannually in arrears on May 1 and November 1 of each year.

We may redeem the 2024 Notes, in whole or in part, at any time on or after November 1, 2017, at the redemption prices set forth below:

Period	Redemption Price*
2017	102.875%
2018	101.917%
2019	100.958%
2020 and thereafter	100.000%

* Expressed in percentage of principal amount

2025 Notes

On September 16, 2015, we issued $350 million of the 2025 Notes at a price of 100.0% of the principal amount, which resulted in approximately $344 million in net proceeds from the private offering. We used the net proceeds from this borrowing to fund a portion of the Reliant acquisition. The 2025 Notes mature on September 15, 2025 and bear interest at a per annum rate of 5.75%. Interest on the 2025 Notes is payable semiannually in arrears on March 15 and September 15, beginning on March 15, 2016.

We may redeem the 2025 Notes, in whole or in part, at any time on or after September 15, 2020, at the redemption prices set forth below:

Period	Redemption Price*
2020	102.875%
2021	101.917%
2022	100.958%
2023 and thereafter	100.000%

* Expressed in percentage of principal amount

Convertible Notes

Convertible Senior Subordinated Notes Due 2043

On November 18, 2013, we exchanged $320 million in aggregate principal amount of newly issued 2.00% Convertible Senior Subordinated Notes due 2043 (the "Convertible Notes") for 257,110 shares of our outstanding 6.50% Series A Convertible Perpetual Preferred Stock. The Company's Convertible Notes were issued pursuant to an indenture dated November 18, 2013 (the "Convertible Notes Indenture") between us and Wells Fargo Bank, National Association, as trustee and conversion agent. The Convertible Notes are senior subordinated unsecured obligations of the Company. As such, the Convertible Notes are subordinated to all our existing and future senior unsecured debt and are effectively subordinated to our existing and future secured debt to the extent of the value of the collateral securing such debt. Additionally, the Convertible Notes are structurally subordinated to all existing and future debt and other obligations of our subsidiaries.

The Convertible Notes bear regular interest at a rate of 2.0% per year payable semiannually in arrears in cash on June 1 and December 1 of each year. Beginning with the six-month period starting December 1, 2018, contingent interest is payable, in addition to regular interest, if the trading price of the Convertible Notes for each of the five trading days ending two trading days prior to any six-month contingent interest period is equal to or greater than $1,200. The amount of contingent interest payable per $1,000 principal amount of the Convertible Notes in respect of any contingent interest period is equal to 0.25% of the average trading price of the Convertible Notes during the specified measurement period. Due to discounts and financing costs, the effective interest rate on the Convertible Notes is 6.0%.

The Convertible Notes mature on December 1, 2043, unless earlier redeemed, repurchased, or converted. The Convertible Notes are convertible, at the option of the holder, at any time on or prior to the close of business on the business day immediately preceding December 1, 2043 into shares of our common stock at an initial conversion rate of 25.2194 shares per $1,000 principal amount of the Convertible Notes, subject to customary antidilution adjustments. This conversion rate equates to an initial conversion price of $39.652 per share. We may elect to settle any conversion, in whole or in part, by delivering cash in lieu of shares. Upon the occurrence of certain change of control events and a redemption prior to December 2018, in either case, in connection with elections by holders to convert their Convertible Notes, we will pay a make-whole premium on any Convertible Notes converted by increasing the conversion rate on such Convertible Notes.

The payment of dividends on our common stock has triggered and will continue to trigger, from time to time, the antidilutive adjustment provisions of the Convertible Notes, except in instances when such adjustments are deemed *de minimis*. The current conversion price of the Convertible Notes is $38.08, and the current conversion rate is 26.2583 for each $1,000 principal amount of the Convertible Notes.

Prior to December 1, 2018, we may redeem all or any part of the Convertible Notes if the volume weighted-average price per share of our common stock is at least 120% of the conversion price of the Convertible Notes for at least 20 trading days during any 30 consecutive trading day period, at a redemption price equal to 100% of the principal amount of Convertible Notes to be redeemed, plus accrued and unpaid interest, provided that, as described above, the holders may elect to convert their Convertible Notes in lieu of the redemption and receive any make-whole premium due. On or after December 1, 2018, we

may, at our option, redeem all or any part of the Convertible Notes at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed, plus accrued and unpaid interest.

Upon the occurrence of a fundamental change (as defined in the Convertible Notes Indenture), each holder of the Convertible Notes may require us to repurchase for cash all or any portion of such holders' Convertible Notes at a price equal to 100% of the principal amount of the repurchased Convertible Notes, plus accrued and unpaid interest thereon to, but excluding, the repurchase date and, if the fundamental change also constitutes a nonstock change of control (as defined in the Convertible Notes Indenture), the amount of any make-whole premium due. Holders may, at their option, also require us to repurchase all or any portion of such holders' Convertible Notes on December 1 of 2020, 2027, 2034, and 2041 at a price equal to 100% of the principal amount of the repurchased Convertible Notes, plus accrued and unpaid interest thereon to, but excluding, the repurchase date.

The Convertible Notes Indenture contains customary events of default, which includes, among other things, a default in the obligation of the Company to convert the Convertible Notes that continues for five business days.

See also Note 10, *Convertible Perpetual Preferred Stock*.

Other Notes Payable—

Our notes payable consist of the following (in millions):

	As of December 31,		
	2015	2014	Interest Rates
Sale/leaseback transactions involving real estate accounted for as financings	$ 28.0	$ 28.0	8.1% to 11.2%
Acquisition of an inpatient rehabilitation unit	1.3	2.9	7.8%
Construction of a new hospital	9.6	10.3	LIBOR + 2.5%; 2.7% as of December 31, 2015 and 2014
Other	0.3	0.3	6.8%
Other notes payable	$ 39.2	$ 41.5	

Capital Lease Obligations—

We engage in a significant number of leasing transactions including real estate and other equipment utilized in operations. Leases meeting certain accounting criteria have been recorded as an asset and liability at the lower of fair value or the net present value of the aggregate future minimum lease payments at the inception of the lease. Interest rates used in computing the net present value of the lease payments generally ranged from 2% to 11% based on our incremental borrowing rate at the inception of the lease. Our leasing transactions include arrangements for vehicles with major finance companies and manufacturers who retain ownership in the equipment during the term of the lease and with a variety of both small and large real estate owners.

9. Self-Insured Risks:

We insure a substantial portion of our professional liability, general liability, and workers' compensation risks through a self-insured retention program ("SIR") underwritten by our consolidated wholly owned offshore captive insurance subsidiary, HCS, Ltd., which we fund via regularly scheduled premium payments. HCS is an insurance company licensed by the Cayman Island Monetary Authority. We use HCS to fund our first layer of insurance coverage up to approximately $25 million for annual aggregate losses associated with general and professional liability risks. Workers' compensation exposures are capped on a per claim basis. Risks in excess of specified limits per claim and in excess of our aggregate SIR amount are covered by unrelated commercial carriers.

The following table presents the changes in our self-insurance reserves for the years ended December 31, 2015, 2014, and 2013 (in millions):

	2015	2014	2013
Balance at beginning of period, gross	$ 134.3	$ 140.3	$ 148.3
Less: Reinsurance receivables	(26.0)	(32.6)	(29.4)
Balance at beginning of period, net	108.3	107.7	118.9
Increase for the provision of current year claims	37.1	34.7	34.4
Decrease for the provision of prior year claims	(4.6)	(3.5)	(5.9)
Decrease related to change in statistical confidence level	—	—	(6.7)
Expenses related to discontinued operations	(0.5)	(0.3)	(1.8)
Payments related to current year claims	(4.7)	(4.4)	(3.9)
Payments related to prior year claims	(22.5)	(25.9)	(27.3)
Acquisitions	2.4	—	—
Balance at end of period, net	115.5	108.3	107.7
Add: Reinsurance receivables	26.6	26.0	32.6
Balance at end of period, gross	$ 142.1	$ 134.3	$ 140.3

As of December 31, 2015 and 2014, $40.5 million and $35.6 million, respectively, of these reserves are included in *Other current liabilities* in our consolidated balance sheets.

Provisions for these risks are based primarily upon actuarially determined estimates. These reserves represent the unpaid portion of the estimated ultimate cost of all reported and unreported losses incurred through the respective consolidated balance sheet dates. The reserves are estimated using individual case-basis valuations and actuarial analyses. Those estimates are subject to the effects of trends in loss severity and frequency. The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The changes to the estimated ultimate loss amounts are included in current operating results.

In the years leading up to 2013, we experienced volatility in our estimates of prior year claim reserves due primarily to favorable trends in claims and industry-wide loss development trends. Our efforts to improve patient safety and overall quality of care, as well as our efforts to reduce workplace injuries, helped contain our ultimate claim costs. With the accumulation of this additional historical data and favorable trends, when we analyzed our assumptions during our semi-annual review of our self-insurance reserves in the fourth quarter of 2013, we lowered the statistical confidence level used to determine our self-insurance reserves from 70% to 50%. This change reduced our reserves included in continuing operations by $6.7 million in the fourth quarter of 2013.

The reserves for these self-insured risks cover approximately 1,100 individual claims at December 31, 2015 and 2014, and estimates for potential unreported claims. The time period required to resolve these claims can vary depending upon the jurisdiction, the nature, and the form of resolution of the claims. The estimation of the timing of payments beyond a year can vary significantly. Although considerable variability is inherent in reserve estimates, management believes the reserves for losses and loss expenses are adequate; however, there can be no assurance the ultimate liability will not exceed management's estimates.

10. Convertible Perpetual Preferred Stock:

On March 7, 2006, we completed the sale of 400,000 shares of our 6.50% Series A Convertible Perpetual Preferred Stock. The preferred stock has a liquidation preference of $1,000 per share of preferred stock, which is contingently subject to accretion. Holders of the preferred stock are entitled to receive, when and if declared by our board of directors, cash dividends at the rate of 6.50% per annum on the accreted liquidation preference per share, payable quarterly in arrears. Dividends on the preferred stock are cumulative. Each holder of preferred stock has one vote for each share held by the holder on all matters voted upon by the holders of our common stock.

The preferred stock is convertible, at the option of the holder, at any time into shares of our common stock. We may at any time cause the shares of preferred stock to be automatically converted into shares of our common stock at the conversion rate then in effect if the closing sale price of our common stock for 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date we give the notice of forced conversion exceeds 150% of the conversion price of the preferred stock. If we are subject to a fundamental change, as defined in the certificate of designation of the preferred stock, each holder of shares of preferred stock has the right, subject to certain limitations, to require us to purchase with cash any or all of its shares of preferred stock at a purchase price equal to 100% of the accreted liquidation preference, plus any accrued and unpaid dividends to the date of purchase. In addition, if holders of the preferred stock elect to convert shares of preferred stock in connection with certain fundamental changes, we will in certain circumstances increase the conversion rate for such shares of preferred stock. As redemption of the preferred stock is contingent upon the occurrence of a fundamental change, and since we do not deem a fundamental change probable of occurring, accretion of our *Convertible perpetual preferred stock* is not necessary.

The agreement underlying the preferred stock includes antidilutive protection that requires adjustments to the number of shares of common stock issuable upon conversion and the exercise price for common stock upon the occurrence of certain events, including payment of cash dividends on our common stock after a *de minimis* threshold. At issuance, the preferred stock had a conversion price of $30.50 per share, which was equal to an initial conversion rate of 32.7869 shares of common stock per share of preferred stock.

In the fourth quarter of 2013, we exchanged $320.0 million in aggregate principal amount of newly issued 2.00% Convertible Senior Subordinated Notes due 2043 for 257,110 shares of our outstanding preferred stock. No common stock was issued as part of these exchange transactions. See Note 8, *Long-term Debt*.

On April 22, 2015, we delivered notice of the exercise of our rights to force conversion of all outstanding shares of our *Convertible perpetual preferred stock* (par value of $0.10 per share and liquidation preference of $1,000 per share) pursuant to the underlying certificate of designations. The effective date of the conversion was April 23, 2015. On that date, each share of preferred stock automatically converted into 33.9905 shares of our common stock (par value of $0.01 per share). We completed the forced conversion by issuing and delivering in the aggregate 3,271,415 shares of our common stock to the registered holders of the 96,245 shares of the preferred stock outstanding and paying cash in lieu of fractional shares due to those holders.

The following is a summary of the activity related to our *Convertible perpetual preferred stock* from December 31, 2012 to December 31, 2015 (in millions, except share data):

	Number of Shares Outstanding	Amount
Balance as of December 31, 2012	353,355	$ 342.2
Repurchase of preferred stock	(257,110)	(249.0)
Balance as of December 31, 2013 and 2014	96,245	93.2
Conversion of preferred stock	(96,245)	(93.2)
Balance as of December 31, 2015	—	$ —

The allocation of the consideration exchanged for repurchases of preferred stock is as follows (in millions):

	For the Year Ended December 31, 2013
Carrying value of shares repurchased	$ 249.0
Cumulative dividends included as part of repurchase price	2.2
Excess exchanged in transaction	71.6
	$ 322.8

For 2013, the difference between the fair value of the consideration paid to the holders of the preferred stock, or $322.8 million (including fees), and the carrying value of the preferred stock in our balance sheet, or $249.0 million, resulted in a charge of $73.8 million to *Capital in excess of par value* that was treated like a dividend and subtracted from *Net income* to arrive at *Net income attributable to HealthSouth common shareholders* in our consolidated statement of operations. Of this amount, $2.2 million represents cumulative dividends through the date of the repurchase transactions.

We declared $1.6 million, $6.3 million, and $21.0 million in dividends on our preferred stock in the years ended December 31, 2015, 2014, and 2013, respectively. As of December 31, 2014, accrued dividends of $1.6 million were included in *Other current liabilities* on our consolidated balance sheet and was paid in January 2015.

11. Redeemable Noncontrolling Interests

The following is a summary of the activity related to our *Redeemable noncontrolling interests* (in millions):

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Balance at beginning of period	$ 84.7	$ 13.5	$ 7.2
Acquisition of Encompass	—	64.5	—
Net income attributable to noncontrolling interests	13.8	6.6	5.8
Distributions	(7.3)	(8.5)	(4.9)
Contribution to joint venture	—	4.3	7.1
Change in fair value	29.9	4.3	(1.7)
Balance at end of period	$ 121.1	$ 84.7	$ 13.5

The following table reconciles the net income attributable to nonredeemable *Noncontrolling interests*, as recorded in the shareholders' equity section of the consolidated balance sheets, and the net income attributable to *Redeemable noncontrolling interests*, as recorded in the mezzanine section of the consolidated balance sheets, to the *Net income attributable to noncontrolling interests* presented on the consolidated statements of operations (in millions):

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Net income attributable to nonredeemable noncontrolling interests	$ 55.9	$ 53.1	$ 52.0
Net income attributable to redeemable noncontrolling interests	13.8	6.6	5.8
Net income attributable to noncontrolling interests	$ 69.7	$ 59.7	$ 57.8

See also Note 2, *Business Combinations*.

12. Fair Value Measurements:

Our financial assets and liabilities that are measured at fair value on a recurring basis are as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
As of December 31, 2015	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Valuation Technique [1]**
Prepaid expenses and other current assets:					
Current portion of restricted marketable securities	$ 16.1	$ —	$ 16.1	$ —	M
Other long-term assets:					
Restricted marketable securities	40.1	—	40.1	—	M
Redeemable noncontrolling interests	121.1	—	—	121.1	I
As of December 31, 2014					
Prepaid expenses and other current assets:					
Current portion of restricted marketable securities	$ 4.6	$ —	$ 4.6	$ —	M
Other long-term assets:					
Option to purchase SCA stock	9.9	—	—	9.9	M
Restricted marketable securities	45.9	—	45.9	—	M
Redeemable noncontrolling interests	84.7	—	—	84.7	I

[1] The three valuation techniques are: market approach (M), cost approach (C), and income approach (I).

In connection with the 2007 sale of our surgery centers division, now known as Surgical Care Affiliates ("SCA"), to ASC Acquisition LLC, an affiliate of TPG Partners V, L.P. ("TPG"), a private investment partnership, we received an option, subject to terms and conditions set forth below, to purchase up to a 5% equity interest in SCA. The price of the option was equal to the original issuance price of the units subscribed for by TPG and certain other co-investors in connection with the acquisition plus a 15% premium, compounded annually. The option had a term of ten years and was exercisable upon certain liquidity events, including a public offering of SCA's shares of common stock that resulted in 30% or more of SCA's common stock being listed or traded on a national securities exchange. On November 4, 2013, SCA announced the closing of its initial public offering, which did not reach the 30% threshold to trigger a qualifying liquidity event.

During the second quarter of 2014, we entered into an amendment to the option agreement that required us to settle the option net of our exercise price. The addition of this new feature resulted in the option becoming a derivative that must be recorded as an asset or liability on our consolidated balance sheet and marked to market each period. As of December 31, 2014, the fair value of this option was $9.9 million and is included in *Other long-term assets* in our consolidated balance sheet. *Income from discontinued operations, net of tax* for the year ended December 31, 2014 included a $9.9 million gain resulting from the initial recording of this option as a derivative and its fair value adjustments during 2014. *Income from discontinued operations, net of tax* for the year ended December 31, 2015 included a $0.4 million net loss resulting from the change in fair value of this option from December 31, 2014 to March 31, 2015.

On April 1, 2015, TPG closed a secondary offering of SCA common stock, which resulted in greater than 30% of SCA's common stock being listed or traded on a national securities exchange, and our option became exercisable. On April 9, 2015, we delivered notice of exercise of the option to SCA. On April 13, 2015, SCA settled the net exercise of the option by delivering to us 326,242 shares of SCA common stock. The closing price of the stock on that date was $35.43 per share. *Other income* for the year ended December 31, 2015 included a $2.0 million gain resulting from the change in fair value of this option

from April 1, 2015, the date the option became exercisable, to April 13, 2015, the date we settled the net exercise of the option and received shares of SCA common stock.

During the second and third quarter of 2015, we sold all of our shares of SCA common stock resulting in a realized gain of $1.2 million that is included in *Other income* in our consolidated statements of operations for the year ended December 31, 2015. The fair value of the option and related adjustments were determined using a lattice model. Inputs into the model included the historical price volatility of SCA's common stock, the risk free interest rate, and probability factors for the timing of when the option will be exercisable.

In addition to assets and liabilities recorded at fair value on a recurring basis, we are also required to record assets and liabilities at fair value on a nonrecurring basis. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges or similar adjustments made to the carrying value of the applicable assets. During the year ended December 31, 2015, we did not record any gains or losses related to our nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis as part of our continuing operations.

As a result of our consolidation of Fairlawn in 2014 and the remeasurement of our previously held equity interest at fair value, we recorded a $27.2 million gain as part of *Other income* during the year ended December 31, 2014. We determined the fair value of our previously held equity interest using the income approach. The income approach included the use of Fairlawn's projected operating results and cash flows discounted using a rate that reflects market participant assumptions. The projected operating results used management's best estimates of economic and market conditions over the forecasted period including assumptions for pricing and volume, operating expenses, and capital expenditures. See Note 2, *Business Combinations*.

As discussed in Note 1, *Summary of Significant Accounting Policies*, "Fair Value Measurements," the carrying value equals fair value for our financial instruments that are not included in the table below and are classified as current in our consolidated balance sheets. The carrying amounts and estimated fair values for our other financial instruments are presented in the following table (in millions):

	As of December 31, 2015		As of December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term debt:				
Advances under revolving credit facility	$ 130.0	$ 130.0	$ 325.0	$ 325.0
Term loan facilities	443.3	445.0	447.5	450.0
8.125% Senior Notes due 2020	—	—	282.7	302.5
7.75% Senior Notes due 2022	174.3	183.7	223.7	240.7
5.125% Senior Notes due 2023	294.6	288.0	—	—
5.75% Senior Notes due 2024	1,192.6	1,146.0	447.4	471.4
5.75% Senior Notes due 2025	343.4	332.5	—	—
2.00% Convertible Senior Subordinated Notes due 2043	265.9	345.0	256.7	358.4
Other notes payable	39.2	39.2	41.5	41.5
Financial commitments:				
Letters of credit	—	34.2	—	31.8

Fair values for our long-term debt and financial commitments are determined using inputs, including quoted prices in nonactive markets, that are observable either directly or indirectly, or *Level 2* inputs within the fair value hierarchy. See Note 1, *Summary of Significant Accounting Policies*, "Fair Value Measurements."

See also Note 11, *Redeemable Noncontrolling Interests.*

13. Share-Based Payments:

The Company has awarded employee stock-based compensation in the form of stock options, SARs, and restricted stock awards under the terms of share-based incentive plans designed to align employee and executive interests to those of its stockholders. Excluding SARs issued in 2014, all employee stock-based compensation awarded in 2015, 2014, and 2013 was issued under the Amended and Restated 2008 Equity Incentive Plan, a stockholder-approved plan that reserves and provides for the grant of up to nine million shares of common stock. This plan allows the grants of nonqualified stock options, incentive stock options, restricted stock, stock appreciation rights, performance shares, performance share units, dividend equivalents, restricted stock units ("RSUs"), and/or other stock-based awards.

Stock Options—

Under our share-based incentive plans, officers and employees are given the right to purchase shares of HealthSouth common stock at a fixed grant price determined on the day the options are granted. The terms and conditions of the options, including exercise prices and the periods in which options are exercisable, are generally at the discretion of the compensation committee of our board of directors. However, no options are exercisable beyond ten years from the date of grant. Granted options vest over the awards' requisite service periods, which are generally three years.

The fair values of the options granted during the years ended December 31, 2015, 2014, and 2013 have been estimated at the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	For the Year Ended December 31,		
	2015	**2014**	**2013**
Expected volatility	39.5%	40.3%	41.8%
Risk-free interest rate	1.9%	2.2%	1.4%
Expected life (years)	7.7	7.2	7.2
Dividend yield	2.1%	2.1%	0.0%

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected stock price volatility. We estimate our expected term through an analysis of actual, historical post-vesting exercise, cancellation, and expiration behavior by our employees and projected post-vesting activity of outstanding options. We calculate volatility based on the historical volatility of our common stock over the period commensurate with the expected life of the options. The risk-free interest rate is the implied daily yield currently available on U.S. Treasury issues with a remaining term closely approximating the expected term used as the input to the Black-Scholes option-pricing model. While our board of directors initiated quarterly cash dividends on our common stock in 2013 (see Note 16, *Earnings per Common Share*), we did not include a dividend payment as part of our pricing model in 2013 because we had not historically paid dividends at the time of our option grants. In 2015 and 2014, we estimated our dividend yield based on our annual dividend rate and our stock price on the dividend payment dates. We estimate forfeitures through an analysis of actual, historical pre-vesting option forfeiture activity. Under the Black-Scholes option-pricing model, the weighted-average fair value per share of employee stock options granted during the years ended December 31, 2015, 2014, and 2013 was $15.11, $11.41, and $10.96, respectively.

A summary of our stock option activity and related information is as follows:

	Shares (In Thousands)	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Life (Years)	Aggregate Intrinsic Value (In Millions)
Outstanding, December 31, 2014	2,207	$ 20.85		
Granted	108	43.14		
Exercised	(257)	26.06		
Forfeitures	(2)	24.85		
Expirations	—	—		
Outstanding, December 31, 2015	2,056	21.37	4.1	$ 28.5
Exercisable, December 31, 2015	1,811	19.47	3.5	27.8

We recognized approximately $1.6 million, $1.9 million, and $2.1 million of compensation expense related to our stock options for the years ended December 31, 2015, 2014, and 2013, respectively. As of December 31, 2015, there was $1.8 million of unrecognized compensation cost related to unvested stock options. This cost is expected to be recognized over a weighted-average period of 21 months. The total intrinsic value of options exercised during the years ended December 31, 2015, 2014, and 2013 was $4.2 million, $2.4 million, and $1.9 million, respectively.

Stock Appreciation Rights—

In conjunction with the Encompass acquisition, we granted SARs based on Holdings' common stock to certain members of Encompass management at closing on December 31, 2014. Under a separate plan, we granted 122,976 SARs that vest based on continued employment and an additional 129,124 SARs that vest based on continued employment and the extent of Encompass' attainment of a target 2017 specified performance measure. In general terms, half of the SARs of each type will vest on December 31, 2018 with the remainder vesting on December 31, 2019. The SARs that ultimately vest will expire on the tenth anniversary of the grant date or within a specified period following any earlier termination of employment. Upon exercise, each SAR must be settled for cash in the amount by which the per share fair value of Holdings' common stock on the exercise date exceeds the agreed upon per share fair value on the acquisition date. The fair value of Holdings' common stock is determined using the product of the trailing 12-month specified performance measure for Holdings and a specified median market price multiple based on a basket of public home health companies.

The fair values of the SARs granted in conjunction with the Encompass acquisition have been estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions: an expected volatility of 30.7%, risk-free interest rate of 2.1%, and an expected life of 6.3 years. We did not include a dividend payment as part of our pricing model because Holdings currently does not pay dividends on their common stock.

Under the Black-Scholes option-pricing model, the weighted-average fair value per share of SARs granted in conjunction with the Encompass acquisition was $64.09.

We recognized approximately $3.5 million of compensation expense related to our SARs for the year ended December 31, 2015. As of December 31, 2015, there was $12.2 million of unrecognized compensation cost related to unvested SARs. This cost is expected to be recognized over a weighted-average period of 6.25 years. As of December 31, 2015, 252,100 SARs were outstanding.

Restricted Stock—

The restricted stock awards granted in 2015, 2014, and 2013 included service-based awards, performance-based awards (that also included a service requirement), and market condition awards (that also included a service requirement). These awards generally vest over a three-year requisite service period. For awards with a service and/or performance requirement, the fair value of the award is determined by the closing price of our common stock on the grant date. For awards with a market condition, the fair value of the awards is determined using a lattice model. Inputs into the model include the

historical price volatility of our common stock, the historical volatility of the common stock of the companies in the defined peer group, and the risk-free interest rate. Utilizing these inputs and potential future changes in stock prices, multiple trials are run to determine the fair value.

A summary of our issued restricted stock awards is as follows (share information in thousands):

	Shares	Weighted-Average Grant Date Fair Value
Nonvested shares at December 31, 2014	1,197	$ 23.31
Granted	689	27.86
Vested	(1,005)	22.18
Forfeited	(39)	30.03
Nonvested shares at December 31, 2015	842	28.05

The weighted-average grant date fair value of restricted stock granted during the years ended December 31, 2014 and 2013 was $23.94 and $23.55 per share, respectively. We recognized approximately $19.5 million, $20.8 million, and $21.6 million of compensation expense related to our restricted stock awards for the years ended December 31, 2015, 2014, and 2013, respectively. As of December 31, 2015, there was $16.2 million of unrecognized compensation expense related to unvested restricted stock. This cost is expected to be recognized over a weighted-average period of 21 months. The remaining unrecognized compensation expense for the performance-based awards may vary each reporting period based on changes in the expected achievement of performance measures. The total fair value of shares vested during the years ended December 31, 2015, 2014, and 2013 was $41.0 million, $25.9 million, and $15.7 million, respectively.

Nonemployee Stock-Based Compensation Plans—

During the years ended December 31, 2015, 2014, and 2013, we provided incentives to our nonemployee members of our board of directors through the issuance of RSUs out of our share-based incentive plans. RSUs are fully vested when awarded and receive dividend equivalents in the form of additional RSUs upon the payment of a cash dividend on our common stock. During the years ended December 31, 2015, 2014, and 2013, we issued 30,744, 36,350, and 51,180 RSUs, respectively, with a fair value of $42.46, $33.02, and $22.47, respectively, per unit. We recognized approximately $1.3 million, $1.2 million, and $1.2 million, respectively, of compensation expense upon their issuance in 2015, 2014, and 2013. There was no unrecognized compensation related to unvested shares as of December 31, 2015. During the years ended December 31, 2015, 2014, and 2013, we issued an additional 7,645, 8,149, and 1,831, respectively, of RSUs as dividend equivalents. As of December 31, 2015, 391,855 RSUs were outstanding.

14. Employee Benefit Plans:

Substantially all HealthSouth hospital employees are eligible to enroll in HealthSouth-sponsored healthcare plans, including coverage for medical and dental benefits. Our primary healthcare plans are national plans administered by third-party administrators. We are self-insured for these plans. During 2015, 2014, and 2013, costs associated with these plans, net of amounts paid by employees, approximated $109.3 million, $85.2 million, and $73.4 million, respectively.

The HealthSouth Retirement Investment Plan is a qualified 401(k) savings plan. The plan allows eligible employees to contribute up to 100% of their pay on a pre-tax basis into their individual retirement account in the plan subject to the normal maximum limits set annually by the Internal Revenue Service. HealthSouth's employer matching contribution is 50% of the first 6% of each participant's elective deferrals. All contributions to the plan are in the form of cash. Employees who are at least 21 years of age are eligible to participate in the plan. Employer contributions vest 100% after three years of service. Participants are always fully vested in their own contributions.

Employer contributions to the HealthSouth Retirement Investment Plan approximated $15.0 million, $13.9 million, and $13.2 million in 2015, 2014, and 2013, respectively. In 2015, 2014, and 2013, approximately $0.9 million, $0.5 million,

and $0.5 million, respectively, from the plan's forfeiture account were used to fund the matching contributions in accordance with the terms of the plan.

Senior Management Bonus Program—

We maintain a Senior Management Bonus Program to reward senior management for performance based on a combination of corporate or regional goals and individual goals. The corporate and regional goals are approved on an annual basis by our board of directors as part of our routine budgeting and financial planning process. The individual goals, which are weighted according to importance, are determined between each participant and his or her immediate supervisor. The program applies to persons who join the Company in, or are promoted to, senior management positions. In 2016, we expect to pay approximately $9.1 million under the program for the year ended December 31, 2015. In February 2015 and 2014, we paid $9.0 million and $11.5 million, respectively, under the program for the years ended December 31, 2014 and 2013.

15. Income Taxes:

The significant components of the *Provision for income tax expense* related to continuing operations are as follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Current:			
Federal	$ 2.6	$ 2.5	$ 0.9
State and other	12.2	10.8	5.4
Total current expense	14.8	13.3	6.3
Deferred:			
Federal	113.9	95.3	11.3
State and other	13.2	2.1	(4.9)
Total deferred expense	127.1	97.4	6.4
Total income tax expense related to continuing operations	$ 141.9	$ 110.7	$ 12.7

A reconciliation of differences between the federal income tax at statutory rates and our actual income tax expense on our income from continuing operations, which include federal, state, and other income taxes, is presented below:

	For the Year Ended December 31,		
	2015	2014	2013
Tax expense at statutory rate	35.0 %	35.0 %	35.0 %
Increase (decrease) in tax rate resulting from:			
State and other income taxes, net of federal tax benefit	3.6 %	4.3 %	4.0 %
Increase (decrease) in valuation allowance	1.2 %	(1.9)%	(2.3)%
Settlement of tax claims	0.1 %	— %	(28.7)%
Noncontrolling interests	(5.3)%	(5.1)%	(5.1)%
Acquisition of additional equity interest in Fairlawn	— %	(3.6)%	— %
Other, net	1.3 %	(0.1)%	0.3 %
Income tax expense	35.9 %	28.6 %	3.2 %

The *Provision for income tax expense* in 2015 was greater than the federal statutory rate primarily due to: 1) state and other income tax expense and (2) an increase in our valuation allowance offset by (3) the impact of noncontrolling interests. See Note 1, *Summary of Significant Accounting Policies*, "Income Taxes," for a discussion of the allocation of income or loss

related to pass-through entities, which is referred to as the impact of noncontrolling interests in this discussion. The increase in our valuation allowance in 2015 related primarily to changes to our state apportionment percentages resulting from the acquisitions of Encompass, Reliant, and CareSouth and changes to our current forecast of earnings in each jurisdiction.

The *Provision for income tax expense* in 2014 was less than the federal statutory rate primarily due to: (1) the impact of noncontrolling interests, (2) the nontaxable gain discussed in Note 2, *Business Combinations*, related to our acquisition of an additional 30% equity interest in Fairlawn, and (3) a decrease in our valuation allowance offset by (4) state and other income tax expense. As a result of the Fairlawn transaction, we released the deferred tax liability associated with the outside tax basis of our investment in Fairlawn because we now possess sufficient ownership to allow for the historical outside tax basis difference to be resolved through a tax-free transaction in the future.

The *Provision for income tax expense* in 2013 was less than the federal statutory rate primarily due to: (1) the IRS settlement discussed below, (2) the impact of noncontrolling interests, and (3) a decrease in our valuation allowance, as discussed below, offset by (4) state and other income tax expense.

In April 2013, we entered into closing agreements with the IRS that settled federal income tax matters related to the previous restatement of our 2000 and 2001 financial statements, as well as certain other tax matters, through December 31, 2008. As a result of these closing agreements, we increased our deferred tax assets, primarily our federal net operating loss carryforward ("NOL"), and recorded a net federal income tax benefit of approximately $115 million in the second quarter of 2013. This federal income tax benefit primarily resulted from an approximate $283 million increase to our federal NOL on a gross basis.

Deferred income taxes recognize the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes and the impact of available NOLs. The significant components of HealthSouth's deferred tax assets and liabilities are presented in the following table (in millions):

	As of December 31,	
	2015	2014
Deferred income tax assets:		
Net operating loss	$ 161.1	$ 301.3
Property, net	48.2	40.7
Insurance reserve	26.0	25.6
Stock-based compensation	23.4	23.7
Allowance for doubtful accounts	24.5	18.0
Alternative minimum tax	10.6	10.5
Carrying value of partnerships	22.1	23.8
Other accruals	25.7	20.6
Tax credits	14.0	9.9
Noncontrolling interest	10.6	—
Other	0.8	1.6
Total deferred income tax assets	367.0	475.7
Less: Valuation allowance	(27.6)	(23.0)
Net deferred income tax assets	339.4	452.7
Deferred income tax liabilities:		
Intangibles	(112.8)	(97.5)
Convertible debt interest	(35.3)	(31.7)
Other	(0.5)	(5.7)
Total deferred income tax liabilities	(148.6)	(134.9)
Net deferred income tax assets	190.8	317.8
Less: Current deferred tax assets	—	188.4
Noncurrent deferred tax assets	$ 190.8	$ 129.4

In the consolidated statements of shareholders' equity, the fair value adjustments to redeemable noncontrolling interests have been reported net of tax for each period presented. The amount of tax (benefit) expense allocated to *Capital in excess of par value* was ($11.7) million, ($1.8) million, and $2.9 million for the years ended December 31, 2015, 2014, and 2013, respectively.

At December 31, 2015, we had an unused federal NOL of $91.6 million (approximately $261.6 million on a gross basis) and state NOLs of $69.5 million. Such losses expire in various amounts at varying times through 2031. Our reported federal NOL as of December 31, 2015 excludes $14.6 million related to operating loss carryforwards resulting from excess tax benefits related to share-based awards, the tax benefits of which, when recognized, will be accounted for as a credit to additional paid-in-capital when they reduce taxes payable. At December 31, 2015, we had unused federal tax credit carryforwards of $14.0 million. These credit carryforwards expire in various amounts at various times through 2035.

For the years ended December 31, 2015, 2014, and 2013, the net changes in our valuation allowance were $4.6 million, ($7.7) million, and ($9.1) million, respectively. The increase in our valuation allowance in 2015 related primarily to changes to our state apportionment percentages resulting from the acquisitions of Encompass, Reliant, and CareSouth and changes to our current forecast of earnings in each jurisdiction. The decrease in our valuation allowance in 2014 related primarily to the expiration of state NOLs in certain jurisdictions, our current forecast of future earnings in each jurisdiction, and

changes in certain state tax laws. The decrease in our valuation allowance in 2013 related primarily to our capital loss carryforwards, our then current forecast of future earnings in each jurisdiction, and changes in certain state tax laws. During the second quarter of 2013, we determined a valuation allowance related to our capital loss carryforwards was no longer required as sufficient positive evidence existed to substantiate their utilization. This evidence included our partial utilization of these assets as a result of realizing capital gains in 2013 and the identification of sufficient taxable capital gain income within the available capital loss carryforward period.

As of December 31, 2015, we have a remaining valuation allowance of $27.6 million. This valuation allowance remains recorded due to uncertainties regarding our ability to utilize a portion of our state NOLs and other credits before they expire. The amount of the valuation allowance has been determined for each tax jurisdiction based on the weight of all available evidence including management's estimates of taxable income for each jurisdiction in which we operate over the periods in which the related deferred tax assets will be recoverable. It is possible we may be required to increase or decrease our valuation allowance at some future time if our forecast of future earnings varies from actual results on a consolidated basis or in the applicable state tax jurisdictions, or if the timing of future tax deductions our credit utilizations differs from our expectations.

As of January 1, 2013, total remaining gross unrecognized tax benefits were $78.0 million, $76.0 million of which would have affected our effective tax rate if recognized. The amount of unrecognized tax benefits changed during 2013 primarily due to the April 2013 IRS settlement discussed above. Total remaining gross unrecognized tax benefits were $1.1 million as of December 31, 2013, $0.4 million of which would have affected our effective tax rate if recognized. The amount of unrecognized tax benefits did not change significantly during 2014. Total remaining gross unrecognized tax benefits were $0.9 million as of December 31, 2014, all of which would have affected our effective tax rate if recognized. The amount of unrecognized tax benefits did not change significantly during 2015. Total remaining gross unrecognized tax benefits were $2.9 million as of December 31, 2015, all of which would affect our effective tax rate if recognized.

A reconciliation of the beginning and ending liability for unrecognized tax benefits is as follows (in millions):

	Gross Unrecognized Income Tax Benefits	Accrued Interest and Penalties
January 1, 2013	$ 78.0	$ —
Gross amount of increases in unrecognized tax benefits related to prior periods	46.7	0.3
Gross amount of decreases in unrecognized tax benefits related to prior periods	(1.9)	—
Decreases in unrecognized tax benefits relating to settlements with taxing authorities	(121.7)	—
December 31, 2013	1.1	0.3
Gross amount of increases in unrecognized tax benefits related to prior periods	0.7	0.1
Gross amount of decreases in unrecognized tax benefits related to prior periods	(0.9)	(0.4)
December 31, 2014	0.9	—
Gross amount of increases in unrecognized tax benefits related to prior periods	1.7	—
Gross amount of increases in unrecognized tax benefits related to current period	0.3	—
December 31, 2015	$ 2.9	$ —

Our continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. Interest recorded as part of our income tax provision during 2015, 2014, and 2013 was not material. Accrued interest income related to income taxes as of December 31, 2015 and 2014 was not material.

In December 2014, we signed an agreement with the IRS to begin participating in their Compliance Assurance Process, a program in which we and the IRS endeavor to agree on the treatment of significant tax positions prior to the filing of our federal income tax return. We renewed this agreement in December 2015 for the 2016 tax year. As a result of this agreement, the IRS surveyed our 2013, 2012, and 2011 federal income tax returns and will examine our 2015 and 2016 returns when filed. Our 2014 federal income tax return has been filed, and the IRS has not indicated its intent to examine or survey this

return. The IRS is also separately examining the 2013 return of one of our partnership affiliates acquired in the CareSouth transaction. We have settled federal income tax examinations with the IRS for all tax years through 2010. Our state income tax returns are also periodically examined by various regulatory taxing authorities. We are currently under audit by seven states for tax years ranging from 2007 through 2014.

For the tax years that remain open under the applicable statutes of limitations, amounts related to these unrecognized tax benefits have been considered by management in its estimate of our potential net recovery of prior years' income taxes. Based on discussions with taxing authorities, we anticipate $0.5 million to $2.9 million of our unrecognized tax benefits may be released within the next 12 months.

See also Note 1, *Summary of Significant Accounting Policies*, "Recent Accounting Pronouncements."

16. Earnings per Common Share:

The following table sets forth the computation of basic and diluted earnings per common share (in millions, except per share amounts):

	For the Year Ended December 31,		
	2015	2014	2013
Basic:			
Numerator:			
Income from continuing operations	$ 253.7	$ 276.2	$ 382.5
Less: Net income attributable to noncontrolling interests included in continuing operations	(69.7)	(59.7)	(57.8)
Less: Income allocated to participating securities	(1.0)	(2.3)	(3.4)
Less: Convertible perpetual preferred stock dividends	(1.6)	(6.3)	(21.0)
Less: Repurchase of convertible perpetual preferred stock	—	—	(71.6)
Income from continuing operations attributable to HealthSouth common shareholders	181.4	207.9	228.7
(Loss) income from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.9)	5.5	(1.1)
Less: Income from discontinued operations allocated to participating securities	—	(0.1)	—
Net income attributable to HealthSouth common shareholders	$ 180.5	$ 213.3	$ 227.6
Denominator:			
Basic weighted average common shares outstanding	89.4	86.8	88.1
Basic earnings per share attributable to HealthSouth common shareholders:			
Continuing operations	$ 2.03	$ 2.40	$ 2.59
Discontinued operations	(0.01)	0.06	(0.01)
Net income	$ 2.02	$ 2.46	$ 2.58
Diluted:			
Numerator:			
Income from continuing operations	$ 253.7	$ 276.2	$ 382.5
Less: Net income attributable to noncontrolling interests included in continuing operations	(69.7)	(59.7)	(57.8)
Add: Interest on convertible debt, net of tax	9.4	9.0	1.0
Income from continuing operations attributable to HealthSouth common shareholders	193.4	225.5	325.7
(Loss) income from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.9)	5.5	(1.1)
Net income attributable to HealthSouth common shareholders	$ 192.5	$ 231.0	$ 324.6
Denominator:			
Diluted weighted average common shares outstanding	101.0	100.7	102.1
Diluted earnings per share attributable to HealthSouth common shareholders:			
Continuing operations	$ 1.92	$ 2.24	$ 2.59
Discontinued operations	(0.01)	0.05	(0.01)
Net income	$ 1.91	$ 2.29	$ 2.58

The following table sets forth the reconciliation between basic weighted average common shares outstanding and diluted weighted average common shares outstanding (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Basic weighted average common shares outstanding	89.4	86.8	88.1
Convertible perpetual preferred stock	1.0	3.2	10.5
Convertible senior subordinated notes	8.3	8.2	1.0
Restricted stock awards, dilutive stock options, and restricted stock units	2.3	2.5	2.5
Diluted weighted average common shares outstanding	101.0	100.7	102.1

For the year ended December 31, 2013, adding back amounts related to the repurchase of our preferred stock to our *Income from continuing operations attributable to HealthSouth common shareholders* causes a per share increase when calculating diluted earnings per common share resulting in an antidilutive per share amount. See Note 10, *Convertible Perpetual Preferred Stock*. Therefore, basic and diluted earnings per common share is the same for the year ended December 31, 2013.

Options to purchase approximately 0.1 million shares of common stock were outstanding as of December 31, 2015 and 2014 but were not included in the computation of diluted weighted-average shares because to do so would have been antidilutive.

In February 2013, our board of directors approved an increase in our existing common stock repurchase authorization from $125 million (authorized in October 2011) to $350 million. During the first quarter of 2013, we completed a tender offer for our common stock. As a result of the tender offer, we purchased 9.1 million shares at a price of $25.50 per share for a total cost of $234.1 million, including fees and expenses relating to the tender offer. The remaining repurchase authorization expired at the end of the tender offer.

In October 2013, our board of directors authorized the repurchase of up to $200 million of our common stock. In February 2014, our board of directors approved an increase in this common stock repurchase authorization from $200 million to $250 million. The repurchase authorization does not require the repurchase of a specific number of shares, has an indefinite term, and is subject to termination at any time by our board of directors. During 2015 and 2014, we repurchased 1.3 million and 1.3 million shares of our common stock in the open market for $45.3 million and $43.1 million, respectively.

In July 2013, our board of directors approved the initiation of a quarterly cash dividend of $0.18 per share on our common stock. The first quarterly dividend was declared in July 2013 and paid in October 2013. This $0.18 per share cash dividend on our common stock was declared and paid each quarter through July 2014. In July 2014, our board of directors approved an increase in the quarterly cash dividend on our common stock and declared a dividend of $0.21 per share. The cash dividend of $0.21 per common share was declared and paid each quarter through July 2015. In July 2015, our board of directors approved an increase in the quarterly cash dividend and declared a dividend of $0.23 per share. The cash dividend of $0.23 per common share was declared in July 2015 and October 2015 and paid in October 2015 and January 2016. As of December 31, 2015 and 2014, accrued common stock dividends of $21.3 million and $18.6 million were included in *Other current liabilities* in our consolidated balance sheet. Future dividend payments are subject to declaration by our board of directors.

In January 2004, we repaid our then-outstanding 3.25% Convertible Debentures using the net proceeds of a loan arranged by Credit Suisse First Boston. In connection with this transaction, we issued ten million warrants with an expiration date of January 16, 2014 to the lender to purchase shares of our common stock. The agreement underlying these warrants included antidilutive protection that required adjustments to the number of shares of common stock purchasable upon exercise and the exercise price for common stock upon the occurrence of certain events. Following our one-for-five reverse stock split in October 2006, the warrants were exercisable for two million shares of our common stock at an exercise price of $32.50. This antidilution protection also provided for adjustment upon payment of cash dividends on our common stock after a *de minimis* threshold. The payment in January 2014 of an $0.18 per share dividend on our common stock triggered the antidilutive adjustment for these warrants. When these warrants expired in January 2014, the resulting exercise price of each warrant was

$32.16, and the resulting exercise rate was 0.2021 for each warrant. The warrants were not assumed exercised for dilutive shares outstanding for the year ended December 31, 2012 because they were antidilutive in that period.

The following table summarizes information relating to these warrants and their activity during 2013 and through their expiration date (number of warrants in millions):

	Number of Warrants	Weighted Average Exercise Price
Common stock warrants outstanding as of December 31, 2012	10.0	$ 32.50
Cashless exercise	(4.8)	32.50
Cash exercise	(2.3)	32.50
Common stock warrants outstanding as of December 31, 2013	2.9	32.50
Cashless exercise	(1.8)	32.16
Cash exercise	(1.0)	32.16
Expired	(0.1)	32.16
Common stock warrants outstanding as of January 16, 2014	—	

The above exercises resulted in the issuance of 0.5 million and 0.2 million shares of common stock in 2013 and 2014, respectively. Cash exercises resulted in gross proceeds of $15.3 million and $6.3 million during 2013 and 2014, respectively.

On September 30, 2009, we issued 5.0 million shares of common stock and 8.2 million common stock warrants in full satisfaction of our obligation to do so under the January 2007 comprehensive settlement of the consolidated securities action brought against us by our stockholders and bondholders. Each warrant has a term of approximately seven years from the date of issuance and an exercise price of $41.40 per share. The warrants were not assumed exercised for dilutive shares outstanding because they were antidilutive in the periods presented.

See also Note 8, *Long-term Debt*, and Note 10, *Convertible Perpetual Preferred Stock.*

17. Contingencies and Other Commitments:

We operate in a highly regulated and litigious industry. As a result, various lawsuits, claims, and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. The resolution of any such lawsuits, claims, or legal and regulatory proceedings could materially and adversely affect our financial position, results of operations, and cash flows in a given period.

General Medicine Action—

On August 16, 2004, General Medicine, P.C. filed a lawsuit in the Circuit Court of Jefferson County, Alabama (the "Alabama Action") against us captioned *General Medicine, P.C. v. HealthSouth Corp.* seeking the recovery of allegedly fraudulent transfers involving assets of Horizon/CMS Healthcare Corporation, a former subsidiary of HealthSouth.

General Medicine's underlying claim against Horizon/CMS originates from a services contract entered into in 1995 between General Medicine and Horizon/CMS whereby General Medicine agreed to provide medical director services to skilled nursing facilities owned by Horizon/CMS for a term of three years. Horizon/CMS terminated the agreement for cause six months after it was executed, and General Medicine then initiated a lawsuit against Horizon/CMS in the United States District Court for the Eastern District of Michigan in 1996 (the "Michigan Action"). General Medicine's complaint in the Michigan Action alleged that Horizon/CMS breached the services contract by wrongfully terminating General Medicine. We acquired Horizon/CMS in 1997 and sold it to Meadowbrook Healthcare, Inc. in 2001 pursuant to a stock purchase agreement. In 2004, Meadowbrook, without the knowledge of HealthSouth, consented to the entry of a final judgment in the Michigan Action in favor of General Medicine against Horizon/CMS for the alleged wrongful termination of the contract with General Medicine in the amount of $376 million (the "Consent Judgment"). The $376 million damages figure was unilaterally selected by General Medicine and was not tested or opposed by Meadowbrook. Additionally, the settlement agreement (the "Settlement") used as the basis for the Consent Judgment provided that Meadowbrook would pay only $300,000 to General Medicine to settle the

Michigan Action and that General Medicine would seek to recover the remaining balance of the Consent Judgment solely from us. We were not a party to the Michigan Action, the Settlement negotiated by Meadowbrook, or the Consent Judgment.

The complaint filed by General Medicine against us in the Alabama Action alleged that while Horizon/CMS was our wholly owned subsidiary, General Medicine was an existing creditor of Horizon/CMS by virtue of the breach of contract claim underlying the Settlement. The complaint also alleged we caused Horizon/CMS to transfer its assets to us for less than a reasonably equivalent value or, in the alternative, with the actual intent to defraud creditors of Horizon/CMS, including General Medicine, in violation of the Alabama Uniform Fraudulent Transfer Act. General Medicine further alleged in its amended complaint that we were liable for the Consent Judgment despite not being a party to it because as Horizon/CMS's parent we failed to observe corporate formalities in our operation and ownership of Horizon/CMS, misused our control of Horizon/CMS, stripped assets from Horizon/CMS, and engaged in other conduct which amounted to a fraud on Horizon/CMS's creditors. General Medicine requested relief including recovery of the unpaid amount of the Consent Judgment, the avoidance of the subject transfers of assets, attachment of the assets transferred to us, appointment of a receiver over the transferred properties, and a monetary judgment for the value of properties transferred.

We denied liability to General Medicine and asserted defenses and a counterclaim against General Medicine that the Consent Judgment was the product of collusion by General Medicine and Meadowbrook. Consequently, we asserted that the Consent Judgment was not evidence of a legitimate debt owed by Horizon/CMS to General Medicine that was collectible from HealthSouth under any theory of liability.

The trial in the Alabama Action began on March 9, 2015. On March 22, 2015, we entered into an agreement with General Medicine to settle the Alabama Action. Although the specific terms of this settlement agreement are confidential, both parties agreed to dismiss with prejudice the lawsuit pending in the Circuit Court of Jefferson County, Alabama and to release all claims between the parties. In exchange for General Medicine's release, we agreed to pay an amount of cash that is not material.

Other Litigation—

We have been named as a defendant in a lawsuit filed March 28, 2003 by several individual stockholders in the Circuit Court of Jefferson County, Alabama, captioned *Nichols v. HealthSouth Corp*. The plaintiffs allege that we, some of our former officers, and our former investment bank engaged in a scheme to overstate and misrepresent our earnings and financial position. The plaintiffs are seeking compensatory and punitive damages. This case was consolidated with a now resolved case for discovery and other pretrial purposes and was stayed in the Circuit Court on August 8, 2005. The plaintiffs filed an amended complaint on November 9, 2010 to which we responded with a motion to dismiss filed on December 22, 2010. During a hearing on February 24, 2012, plaintiffs' counsel indicated his intent to dismiss certain claims against us. Instead, on March 9, 2012, the plaintiffs amended their complaint to include additional securities fraud claims against HealthSouth and add several former officers to the lawsuit. On September 12, 2012, the plaintiffs further amended their complaint to request certification as a class action. One of those named officers has repeatedly attempted to remove the case to federal district court, most recently on December 11, 2012. We filed our latest motion to remand the case back to state court on January 10, 2013. On September 27, 2013, the federal court remanded the case back to state court. On November 25, 2014, the plaintiffs filed another amended complaint to assert new allegations relating to the time period of 1997 to 2002. On December 10, 2014, we filed a motion to dismiss on the grounds the plaintiffs lack standing because their claims are derivative in nature, and the claims are time-barred by the statute of limitations. A hearing on our motion has not yet been set.

We intend to vigorously defend ourselves in this case. Based on the stage of litigation, review of the current facts and circumstances as we understand them, the nature of the underlying claim, the results of the proceedings to date, and the nature and scope of the defense we continue to mount, we do not believe an adverse judgment or settlement is probable in this matter, and it is also not possible to estimate the amount of loss, if any, or range of possible loss that might result from an adverse judgment or settlement of this case.

Governmental Inquiries and Investigations—

On June 24, 2011, we received a document subpoena addressed to HealthSouth Hospital of Houston, a long-term acute care hospital ("LTCH") we closed in August 2011, and issued from the Dallas, Texas office of the HHS-OIG. The subpoena stated it was in connection with an investigation of possible false or otherwise improper claims submitted to Medicare and

Medicaid and requested documents and materials relating to patient admissions, length of stay, and discharge matters at this closed LTCH. We furnished the documents requested and have heard nothing from the HHS-OIG since December 2012.

On March 4, 2013, we received document subpoenas from an office of the HHS-OIG addressed to four of our hospitals. Those subpoenas also requested complete copies of medical records for 100 patients treated at each of those hospitals between September 2008 and June 2012. The investigation is being conducted by the United States Department of Justice (the "DOJ"). On April 24, 2014, we received document subpoenas relating to an additional seven of our hospitals. The new subpoenas reference substantially similar investigation subject matter as the original subpoenas and request materials from the period January 2008 through December 2013. Two of the four hospitals addressed in the original set of subpoenas have received supplemental subpoenas to cover this new time period. The most recent subpoenas do not include requests for specific patient files. However, in February 2015, the DOJ requested the voluntary production of the medical records of an additional 70 patients, some of whom were treated in hospitals not subject to the subpoenas, and we provided these records.

All of the subpoenas are in connection with an investigation of alleged improper or fraudulent claims submitted to Medicare and Medicaid and request documents and materials relating to practices, procedures, protocols and policies, of certain pre- and post-admissions activities at these hospitals including, among other things, marketing functions, pre-admission screening, post-admission physician evaluations, patient assessment instruments, individualized patient plans of care, and compliance with the Medicare 60% rule. Under the Medicare rule commonly referred to as the "60% rule," an inpatient rehabilitation hospital must treat 60% or more of its patients from at least one of a specified list of medical conditions in order to be reimbursed at the inpatient rehabilitation hospital payment rates, rather than at the lower acute care hospital payment rates.

We are cooperating fully with the DOJ in connection with these subpoenas and are currently unable to predict the timing or outcome of the related investigations.

Other Matters—

The False Claims Act, 18 U.S.C. § 287, allows private citizens, called "relators," to institute civil proceedings alleging violations of the False Claims Act. These *qui tam* cases are sealed by the court at the time of filing. Prior to the release of the seal by the presiding court, the only parties typically privy to the information contained in the complaint are the relator, the federal government, and the court. It is possible that *qui tam* lawsuits have been filed against us and that those suits remain under seal or that we are unaware of such filings or prevented by existing law or court order from discussing or disclosing the filing of such suits. We may be subject to liability under one or more undisclosed *qui tam* cases brought pursuant to the False Claims Act.

It is our obligation as a participant in Medicare and other federal healthcare programs to routinely conduct audits and reviews of the accuracy of our billing systems and other regulatory compliance matters. As a result of these reviews, we have made, and will continue to make, disclosures to the HHS-OIG and CMS relating to amounts we suspect represent over-payments from these programs, whether due to inaccurate billing or otherwise. Some of these disclosures have resulted in, or may result in, HealthSouth refunding amounts to Medicare or other federal healthcare programs.

Other Commitments—

We are a party to service and other contracts in connection with conducting our business. Minimum amounts due under these agreements are $33.3 million in 2016, $28.2 million in 2017, $21.1 million in 2018, $12.6 million in 2019, $11.9 million in 2020, and $7.2 million thereafter. These contracts primarily relate to software licensing and support.

18. Segment Reporting:

As described in Note 2, *Business Combinations*, we completed the acquisition of Encompass on December 31, 2014. As a result of this transaction, in the first quarter of 2015, management changed the way it manages and operates the consolidated reporting entity and modified the reports used by our chief operating decision maker to assess performance and allocate resources. These changes required us to revise our segment reporting from our historic presentation of only one reportable segment.

Our internal financial reporting and management structure is focused on the major types of services provided by HealthSouth. Beginning in the first quarter of 2015, we manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. Prior period information has been adjusted to conform to the current period presentation. Specifically, HealthSouth's legacy 25 hospital-based home health agencies have been reclassified from our inpatient rehabilitation segment to our home health and hospice segment for all periods presented.

These reportable operating segments are consistent with information used by our chief executive officer, who is our chief operating decision maker, to assess performance and allocate resources. The following is a brief description of our reportable segments:

- *Inpatient Rehabilitation* - Our national network of inpatient rehabilitation hospitals stretches across 29 states and Puerto Rico, with a concentration of hospitals in the eastern half of the United States and Texas. As of December 31, 2015, we operate 121 inpatient rehabilitation hospitals, including one hospital that operates as a joint venture which we account for using the equity method of accounting. In addition, we manage three inpatient rehabilitation units through management contracts. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. Our inpatient rehabilitation hospitals provide a higher level of rehabilitative care to patients who are recovering from conditions such as stroke and other neurological disorders, cardiac and pulmonary conditions, brain and spinal cord injuries, complex orthopedic conditions, and amputations.

- *Home Health and Hospice* - As of December 31, 2015, we provide home health and hospice services in 213 locations across 23 states. In addition, two of these agencies operate as joint ventures which we account for using the equity method of accounting. Our home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational, and speech therapy, medical social work, and home health aide services. We also provide specialized home care services in Texas and Kansas for pediatric patients with severe medical conditions. Our hospice services primarily include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual support.

The accounting policies of our reportable segments are the same as those described in Note 1, *Summary of Significant Accounting Policies*, "Net Operating Revenues" and "Accounts Receivable and Allowance for Doubtful Accounts." All revenues for our services are generated through external customers. See Note 1, *Summary of Significant Accounting Policies*, "Net Operating Revenues," for the payor composition of our revenues. No corporate overhead is allocated to either of our reportable segments. Our chief operating decision maker evaluates the performance of our segments and allocates resources to them based on adjusted earnings before interest, taxes, depreciation, and amortization ("Segment Adjusted EBITDA").

Selected financial information for our reportable segments is as follows (in millions):

	Inpatient Rehabilitation			Home Health and Hospice		
	For the Year Ended December 31,			For the Year Ended December 31,		
	2015	2014	2013	2015	2014	2013
Net operating revenues	$ 2,653.1	$ 2,377.3	$ 2,244.4	$ 509.8	$ 28.6	$ 28.8
Less: Provision for doubtful accounts	(44.7)	(31.2)	(25.6)	(2.5)	(0.4)	(0.4)
Net operating revenues less provision for doubtful accounts	2,608.4	2,346.1	2,218.8	507.3	28.2	28.4
Operating expenses:						
Inpatient rehabilitation:						
Salaries and benefits	1,310.6	1,141.0	1,069.7	—	—	—
Other operating expenses	387.7	342.5	314.7	—	—	—
Supplies	120.9	111.5	105.2	—	—	—
Occupancy costs	46.2	41.2	46.5	—	—	—
Home health and hospice:						
Cost of services sold (excluding depreciation and amortization)	—	—	—	244.8	17.0	16.7
Support and overhead costs	—	—	—	172.7	6.9	6.6
	1,865.4	1,636.2	1,536.1	417.5	23.9	23.3
Other income	(2.3)	(4.0)	(4.5)	—	—	—
Equity in net income of nonconsolidated affiliates	(8.6)	(10.7)	(11.2)	(0.1)	—	—
Noncontrolling interests	62.9	59.3	57.2	6.8	0.4	0.6
Segment Adjusted EBITDA	$ 691.0	$ 665.3	$ 641.2	$ 83.1	$ 3.9	$ 4.5
Capital expenditures	$ 151.7	$ 187.9	$ 216.5	$ 5.8	$ —	$ —

	Inpatient Rehabilitation	Home Health and Hospice	HealthSouth Consolidated
As of December 31, 2015			
Total assets	$ 3,589.0	$ 1,088.4	$ 4,606.1
Investments in and advances to nonconsolidated affiliates	9.3	2.4	11.7
As of December 31, 2014			
Total assets	$ 2,576.3	$ 876.3	$ 3,388.3
Investments in and advances to nonconsolidated affiliates	9.4	—	9.4

Segment reconciliations (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Total segment Adjusted EBITDA	$ 774.1	$ 669.2	$ 645.7
General and administrative expenses	(133.3)	(124.8)	(119.1)
Depreciation and amortization	(139.7)	(107.7)	(94.7)
Loss on disposal or impairment of assets	(2.6)	(6.7)	(5.9)
Government, class action, and related settlements	(7.5)	1.7	23.5
Professional fees - accounting, tax, and legal	(3.0)	(9.3)	(9.5)
Loss on early extinguishment of debt	(22.4)	(13.2)	(2.4)
Interest expense and amortization of debt discounts and fees	(142.9)	(109.2)	(100.4)
Gain on consolidation of former equity method hospital	—	27.2	—
Net income attributable to noncontrolling interests	69.7	59.7	57.8
Gain related to SCA equity interest	3.2	—	—
Other	—	—	0.2
Income from continuing operations before income tax expense	$ 395.6	$ 386.9	$ 395.2

	As of December 31, 2015	As of December 31, 2014
Total assets for reportable segments	$ 4,677.4	$ 3,452.6
Reclassification of noncurrent deferred income tax liabilities to net noncurrent deferred income tax assets	(71.3)	(64.3)
Total consolidated assets	$ 4,606.1	$ 3,388.3

Additional detail regarding the revenues of our operating segments by service line follows (in millions):

	For the Year Ended December 31,		
	2015	2014	2013
Inpatient rehabilitation:			
Inpatient	$ 2,547.2	$ 2,272.5	$ 2,130.8
Outpatient and other	105.9	104.8	113.6
Total inpatient rehabilitation	2,653.1	2,377.3	2,244.4
Home health and hospice:			
Home health	478.1	28.6	28.8
Hospice	31.7	—	—
Total home health and hospice	509.8	28.6	28.8
Total net operating revenues	$ 3,162.9	$ 2,405.9	$ 2,273.2

19. Quarterly Data (Unaudited):

	2015				
	First	Second	Third	Fourth	Total
	(In Millions, Except Per Share Data)				
Net operating revenues	$ 740.6	$ 764.4	$ 778.6	$ 879.3	$ 3,162.9
Operating earnings [(a)]	105.6	123.4	121.2	135.5	485.7
Provision for income tax expense	30.3	32.2	35.9	43.5	141.9
Income from continuing operations	59.3	61.8	67.5	65.1	253.7
(Loss) income from discontinued operations, net of tax	(0.3)	(1.6)	0.3	0.7	(0.9)
Net income	59.0	60.2	67.8	65.8	252.8
Less: Net income attributable to noncontrolling interests	(16.5)	(17.3)	(17.1)	(18.8)	(69.7)
Net income attributable to HealthSouth	$ 42.5	$ 42.9	$ 50.7	$ 47.0	$ 183.1
Earnings per common share:					
Basic earnings per share attributable to HealthSouth common shareholders: [(b)]					
Continuing operations	$ 0.47	$ 0.49	$ 0.56	$ 0.51	$ 2.03
Discontinued operations	—	(0.02)	—	0.01	(0.01)
Net income	$ 0.47	$ 0.47	$ 0.56	$ 0.52	$ 2.02
Diluted earnings per share attributable to HealthSouth common shareholders: [(b)]					
Continuing operations	$ 0.44	$ 0.47	$ 0.52	$ 0.48	$ 1.92
Discontinued operations	—	(0.02)	—	0.01	(0.01)
Net income	$ 0.44	$ 0.45	$ 0.52	$ 0.49	$ 1.91

(a) We define operating earnings as income from continuing operations attributable to HealthSouth before (1) loss on early extinguishment of debt; (2) interest expense and amortization of debt discounts and fees; (3) other income; and (4) income tax expense.

(b) Per share amounts may not sum due to the weighted average common shares outstanding during each quarter compared to the weighted average common shares outstanding during the entire year.

	2014				
	First	Second	Third	Fourth	Total
	(In Millions, Except Per Share Data)				
Net operating revenues	$ 591.2	$ 604.4	$ 596.9	$ 613.4	$ 2,405.9
Operating earnings [(a)]	105.8	115.4	100.7	96.5	418.4
Provision for income tax expense	32.8	36.5	22.1	19.3	110.7
Income from continuing operations	61.6	94.1	65.7	54.8	276.2
(Loss) income from discontinued operations, net of tax	(0.1)	3.8	(0.9)	2.7	5.5
Net income	61.5	97.9	64.8	57.5	281.7
Less: Net income attributable to noncontrolling interests	(14.8)	(14.8)	(14.7)	(15.4)	(59.7)
Net income attributable to HealthSouth	$ 46.7	$ 83.1	$ 50.1	$ 42.1	$ 222.0
Earnings per common share:					
Basic earnings per share attributable to HealthSouth common shareholders: [(b)]					
Continuing operations	$ 0.51	$ 0.89	$ 0.56	$ 0.43	$ 2.40
Discontinued operations	—	0.04	(0.01)	0.03	0.06
Net income	$ 0.51	$ 0.93	$ 0.55	$ 0.46	$ 2.46
Diluted earnings per share attributable to HealthSouth common shareholders:					
Continuing operations	$ 0.48	$ 0.81	$ 0.53	$ 0.41	$ 2.24
Discontinued operations	—	0.04	(0.01)	0.03	0.05
Net income	$ 0.48	$ 0.85	$ 0.52	$ 0.44	$ 2.29

(a) We define operating earnings as income from continuing operations attributable to HealthSouth before (1) loss on early extinguishment of debt; (2) interest expense and amortization of debt discounts and fees; (3) other income; and (4) income tax expense or benefit.

(b) Per share amounts may not sum due to the weighted average common shares outstanding during each quarter compared to the weighted average common shares outstanding during the entire year.

20. Condensed Consolidating Financial Information:

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered." Each of the subsidiary guarantors is 100% owned by HealthSouth, and all guarantees are full and unconditional and joint and several, subject to certain customary conditions for release. HealthSouth's investments in its consolidated subsidiaries, as well as guarantor subsidiaries' investments in nonguarantor subsidiaries and nonguarantor subsidiaries' investments in guarantor subsidiaries, are presented under the equity method of accounting with the related investment presented within the line items *Intercompany receivable* and *Intercompany payable* in the accompanying condensed consolidating balance sheets.

The terms of our credit agreement allow us to declare and pay cash dividends on our common stock so long as: (1) we are not in default under our credit agreement and (2) our senior secured leverage ratio (as defined in our credit agreement) remains less than or equal to 1.75x. The terms of our senior note indenture allow us to declare and pay cash dividends on our common stock so long as (1) we are not in default, (2) the consolidated coverage ratio (as defined in the indenture) exceeds 2x or we are otherwise allowed under the indenture to incur debt, and (3) we have capacity under the indenture's restricted payments covenant to declare and pay dividends. See Note 8, *Long-term Debt*.

In the first quarter of 2015, we revised our condensed consolidating balance sheet as of December 31, 2014 to correct the classification of $51.4 million of net noncurrent deferred tax liabilities of our Nonguarantor Subsidiaries from noncurrent

Deferred income tax assets to *Other long-term liabilities*. The impact of this revision was to increase total assets and increase liabilities for Nonguarantor Subsidiaries, with an offset to Eliminating Entries. This revision was not material to the related financial statements as of and for the year ended December 31, 2014 and had no impact on our condensed consolidated balance sheet as of December 31, 2014.

Periodically, certain wholly owned subsidiaries of HealthSouth make dividends or distributions of available cash and/or intercompany receivable balances to their parents. In addition, HealthSouth makes contributions to certain wholly owned subsidiaries. When made, these dividends, distributions, and contributions impact the *Intercompany receivable*, *Intercompany payable*, and *HealthSouth shareholders' equity* line items in the accompanying condensed consolidating balance sheet but have no impact on the consolidated financial statements of HealthSouth Corporation.

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Statement of Operations

	For the Year Ended December 31, 2015				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net operating revenues	$ 19.4	$ 1,927.0	$ 1,320.0	$ (103.5)	$ 3,162.9
Less: Provision for doubtful accounts	—	(34.6)	(12.6)	—	(47.2)
Net operating revenues less provision for doubtful accounts	19.4	1,892.4	1,307.4	(103.5)	3,115.7
Operating expenses:					
Salaries and benefits	49.4	893.2	745.3	(17.1)	1,670.8
Other operating expenses	31.3	274.7	167.4	(41.3)	432.1
Occupancy costs	4.0	69.4	25.6	(45.1)	53.9
Supplies	—	85.2	43.5	—	128.7
General and administrative expenses	128.3	—	5.0	—	133.3
Depreciation and amortization	9.9	84.3	45.5	—	139.7
Government, class action, and related settlements	7.5	—	—	—	7.5
Professional fees—accounting, tax, and legal	3.0	—	—	—	3.0
Total operating expenses	233.4	1,406.8	1,032.3	(103.5)	2,569.0
Loss on early extinguishment of debt	22.4	—	—	—	22.4
Interest expense and amortization of debt discounts and fees	130.0	11.9	12.4	(11.4)	142.9
Other income	(13.6)	(0.2)	(3.1)	11.4	(5.5)
Equity in net income of nonconsolidated affiliates	—	(8.5)	(0.2)	—	(8.7)
Equity in net income of consolidated affiliates	(322.7)	(34.5)	—	357.2	—
Management fees	(119.7)	91.6	28.1	—	—
Income from continuing operations before income tax (benefit) expense	89.6	425.3	237.9	(357.2)	395.6
Provision for income tax (benefit) expense	(94.6)	169.7	66.8	—	141.9
Income from continuing operations	184.2	255.6	171.1	(357.2)	253.7
(Loss) income from discontinued operations, net of tax	(1.1)	—	0.2	—	(0.9)
Net income	183.1	255.6	171.3	(357.2)	252.8
Less: Net income attributable to noncontrolling interests	—	—	(69.7)	—	(69.7)
Net income attributable to HealthSouth	$ 183.1	$ 255.6	$ 101.6	$ (357.2)	$ 183.1
Comprehensive income	$ 182.4	$ 255.6	$ 171.3	$ (357.2)	$ 252.1
Comprehensive income attributable to HealthSouth	$ 182.4	$ 255.6	$ 101.6	$ (357.2)	$ 182.4

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Statement of Operations

	For the Year Ended December 31, 2014				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net operating revenues	$ 16.1	$ 1,719.1	$ 761.1	$ (90.4)	$ 2,405.9
Less: Provision for doubtful accounts	—	(22.3)	(9.3)	—	(31.6)
Net operating revenues less provision for doubtful accounts	16.1	1,696.8	751.8	(90.4)	2,374.3
Operating expenses:					
Salaries and benefits	22.3	795.7	358.8	(15.1)	1,161.7
Other operating expenses	21.6	246.7	120.1	(36.8)	351.6
Occupancy costs	4.2	58.2	17.7	(38.5)	41.6
Supplies	—	78.6	33.3	—	111.9
General and administrative expenses	124.8	—	—	—	124.8
Depreciation and amortization	9.7	71.9	26.1	—	107.7
Government, class action, and related settlements	(1.7)	—	—	—	(1.7)
Professional fees—accounting, tax, and legal	9.3	—	—	—	9.3
Total operating expenses	190.2	1,251.1	556.0	(90.4)	1,906.9
Loss on early extinguishment of debt	13.2	—	—	—	13.2
Interest expense and amortization of debt discounts and fees	99.8	7.8	2.8	(1.2)	109.2
Other income	(0.7)	(28.5)	(3.2)	1.2	(31.2)
Equity in net income of nonconsolidated affiliates	—	(10.7)	—	—	(10.7)
Equity in net income of consolidated affiliates	(314.0)	(30.6)	—	344.6	—
Management fees	(107.9)	82.2	25.7	—	—
Income from continuing operations before income tax (benefit) expense	135.5	425.5	170.5	(344.6)	386.9
Provision for income tax (benefit) expense	(80.8)	148.0	43.5	—	110.7
Income from continuing operations	216.3	277.5	127.0	(344.6)	276.2
Income (loss) from discontinued operations, net of tax	5.7	—	(0.2)	—	5.5
Net income	222.0	277.5	126.8	(344.6)	281.7
Less: Net income attributable to noncontrolling interests	—	—	(59.7)	—	(59.7)
Net income attributable to HealthSouth	$ 222.0	$ 277.5	$ 67.1	$ (344.6)	$ 222.0
Comprehensive income	$ 221.6	$ 277.5	$ 126.8	$ (344.6)	$ 281.3
Comprehensive income attributable to HealthSouth	$ 221.6	$ 277.5	$ 67.1	$ (344.6)	$ 221.6

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Statement of Operations

	For the Year Ended December 31, 2013				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net operating revenues	$ 12.2	$ 1,622.4	$ 709.8	$ (71.2)	$ 2,273.2
Less: Provision for doubtful accounts	—	(18.3)	(7.7)	—	(26.0)
Net operating revenues less provision for doubtful accounts	12.2	1,604.1	702.1	(71.2)	2,247.2
Operating expenses:					
Salaries and benefits	12.1	757.7	334.4	(14.5)	1,089.7
Other operating expenses	10.8	238.5	107.5	(33.8)	323.0
Occupancy costs	4.1	48.3	17.5	(22.9)	47.0
Supplies	—	73.8	31.6	—	105.4
General and administrative expenses	119.1	—	—	—	119.1
Depreciation and amortization	8.8	65.1	20.8	—	94.7
Government, class action, and related settlements	(23.5)	—	—	—	(23.5)
Professional fees—accounting, tax, and legal	9.5	—	—	—	9.5
Total operating expenses	140.9	1,183.4	511.8	(71.2)	1,764.9
Loss on early extinguishment of debt	2.4	—	—	—	2.4
Interest expense and amortization of debt discounts and fees	90.4	8.1	3.1	(1.2)	100.4
Other income	(1.0)	(1.2)	(3.5)	1.2	(4.5)
Equity in net income of nonconsolidated affiliates	(3.6)	(7.5)	(0.1)	—	(11.2)
Equity in net income of consolidated affiliates	(268.0)	(20.6)	—	288.6	—
Management fees	(102.3)	78.6	23.7	—	—
Income from continuing operations before income tax (benefit) expense	153.4	363.3	167.1	(288.6)	395.2
Provision for income tax (benefit) expense	(169.0)	134.4	47.3	—	12.7
Income from continuing operations	322.4	228.9	119.8	(288.6)	382.5
Income (loss) from discontinued operations, net of tax	1.2	(0.8)	(1.5)	—	(1.1)
Net income	323.6	228.1	118.3	(288.6)	381.4
Less: Net income attributable to noncontrolling interests	—	—	(57.8)	—	(57.8)
Net income attributable to HealthSouth	$ 323.6	$ 228.1	$ 60.5	$ (288.6)	$ 323.6
Comprehensive income	$ 322.1	$ 228.1	$ 118.3	$ (288.6)	$ 379.9
Comprehensive income attributable to HealthSouth	$ 322.1	$ 228.1	$ 60.5	$ (288.6)	$ 322.1

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Balance Sheet

	As of December 31, 2015				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Assets					
Current assets:					
Cash and cash equivalents	$ 41.2	$ 1.3	$ 19.1	$ —	$ 61.6
Restricted cash	—	—	45.9	—	45.9
Accounts receivable, net	—	267.2	143.3	—	410.5
Prepaid expenses and other current assets	29.3	22.7	47.5	(18.8)	80.7
Total current assets	70.5	291.2	255.8	(18.8)	598.7
Property and equipment, net	14.5	965.7	329.9	—	1,310.1
Goodwill	—	863.2	1,026.9	—	1,890.1
Intangible assets, net	8.8	123.2	287.4	—	419.4
Deferred income tax assets	176.2	64.1	—	(49.5)	190.8
Other long-term assets	48.6	75.3	73.1	—	197.0
Intercompany notes receivable	546.6	—	—	(546.6)	—
Intercompany receivable and investments in consolidated affiliates	2,779.7	—	—	(2,779.7)	—
Total assets	$ 3,644.9	$ 2,382.7	$ 1,973.1	$ (3,394.6)	$ 4,606.1
Liabilities and Shareholders' Equity					
Current liabilities:					
Current portion of long-term debt	$ 40.0	$ 6.8	$ 7.5	$ (17.5)	$ 36.8
Accounts payable	5.8	35.2	20.6	—	61.6
Accrued payroll	27.7	50.7	47.8	—	126.2
Accrued interest payable	26.5	2.9	0.3	—	29.7
Other current liabilities	68.0	19.0	86.4	(1.3)	172.1
Total current liabilities	168.0	114.6	162.6	(18.8)	426.4
Long-term debt, net of current portion	2,821.9	255.6	57.2	—	3,134.7
Intercompany notes payable	—	—	546.6	(546.6)	—
Self-insured risks	19.8	—	81.8	—	101.6
Other long-term liabilities	23.8	12.4	55.9	(49.1)	43.0
Intercompany payable	—	141.7	179.1	(320.8)	—
	3,033.5	524.3	1,083.2	(935.3)	3,705.7
Commitments and contingencies					
Redeemable noncontrolling interests	—	—	121.1	—	121.1
Shareholders' equity:					
HealthSouth shareholders' equity	611.4	1,858.4	600.9	(2,459.3)	611.4
Noncontrolling interests	—	—	167.9	—	167.9
Total shareholders' equity	611.4	1,858.4	768.8	(2,459.3)	779.3
Total liabilities and shareholders' equity	$ 3,644.9	$ 2,382.7	$ 1,973.1	$ (3,394.6)	$ 4,606.1

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Balance Sheet

	As of December 31, 2014				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Assets					
Current assets:					
Cash and cash equivalents	$ 41.9	$ 1.5	$ 23.3	$ —	$ 66.7
Restricted cash	—	—	45.6	—	45.6
Accounts receivable, net	—	202.6	120.6	—	323.2
Deferred income tax assets	125.0	39.8	23.6	—	188.4
Prepaid expenses and other current assets	30.9	15.4	35.2	(18.8)	62.7
Total current assets	197.8	259.3	248.3	(18.8)	686.6
Property and equipment, net	16.1	752.0	251.6	—	1,019.7
Goodwill	—	279.6	804.4	—	1,084.0
Intangible assets, net	11.3	50.6	244.2	—	306.1
Deferred income tax assets	163.3	17.5	—	(51.4)	129.4
Other long-term assets	55.8	42.5	64.2	—	162.5
Intercompany notes receivable	385.2	—	—	(385.2)	—
Intercompany receivable and investments in consolidated affiliates	1,898.7	—	—	(1,898.7)	—
Total assets	$ 2,728.2	$ 1,401.5	$ 1,612.7	$ (2,354.1)	$ 3,388.3
Liabilities and Shareholders' Equity					
Current liabilities:					
Current portion of long-term debt	$ 27.9	$ 4.2	$ 6.2	$ (17.5)	$ 20.8
Accounts payable	9.3	29.5	14.6	—	53.4
Accrued payroll	17.5	55.6	50.2	—	123.3
Accrued interest payable	19.2	1.8	0.2	—	21.2
Other current liabilities	70.4	15.2	61.3	(1.3)	145.6
Total current liabilities	144.3	106.3	132.5	(18.8)	364.3
Long-term debt, net of current portion	1,973.4	83.9	33.1	—	2,090.4
Intercompany notes payable	—	—	385.2	(385.2)	—
Self-insured risks	22.9	—	75.8	—	98.7
Other long-term liabilities	21.2	12.7	55.0	(51.4)	37.5
Intercompany payable	—	381.0	173.2	(554.2)	—
	2,161.8	583.9	854.8	(1,009.6)	2,590.9
Commitments and contingencies					
Convertible perpetual preferred stock	93.2	—	—	—	93.2
Redeemable noncontrolling interests	—	—	84.7	—	84.7
Shareholders' equity:					
HealthSouth shareholders' equity	473.2	817.6	526.9	(1,344.5)	473.2
Noncontrolling interests	—	—	146.3	—	146.3
Total shareholders' equity	473.2	817.6	673.2	(1,344.5)	619.5
Total liabilities and shareholders' equity	$ 2,728.2	$ 1,401.5	$ 1,612.7	$ (2,354.1)	$ 3,388.3

Condensed Consolidating Statement of Cash Flows

	For the Year Ended December 31, 2015				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net cash provided by operating activities	$ 29.6	$ 222.6	$ 232.2	$ 0.4	$ 484.8
Cash flows from investing activities:					
Acquisition of businesses, net of cash acquired	(954.6)	—	(30.5)	—	(985.1)
Purchases of property and equipment	(15.9)	(46.1)	(66.4)	—	(128.4)
Capitalized software costs	(24.5)	(0.4)	(3.2)	—	(28.1)
Proceeds from sale of restricted investments	—	—	0.2	—	0.2
Proceeds from sale of marketable securities	12.8	—	—	—	12.8
Purchases of restricted investments	—	—	(7.1)	—	(7.1)
Net change in restricted cash	—	—	2.7	—	2.7
Funding of intercompany note receivable	(2.0)	—	—	2.0	—
Proceeds from repayment of intercompany note receivable	24.0	—	—	(24.0)	—
Other	(0.5)	2.3	0.9	—	2.7
Net cash provided by investing activities of discontinued operations	0.5	—	—	—	0.5
Net cash used in investing activities	(960.2)	(44.2)	(103.4)	(22.0)	(1,129.8)
Cash flows from financing activities:					
Principal borrowings on term loan facilities	250.0	—	2.0	(2.0)	250.0
Proceeds from bond issuance	1,400.0	—	—	—	1,400.0
Principal payments on debt, including pre-payments	(595.0)	(1.6)	(0.8)	—	(597.4)
Principal payments on intercompany note payable	—	—	(24.0)	24.0	—
Borrowings on revolving credit facility	540.0	—	—	—	540.0
Payments on revolving credit facility	(735.0)	—	—	—	(735.0)
Debt amendment and issuance costs	(31.9)	—	—	—	(31.9)
Principal payments under capital lease obligations	(0.3)	(4.5)	(6.2)	—	(11.0)
Repurchases of common stock, including fees and expenses	(45.3)	—	—	—	(45.3)
Dividends paid on common stock	(77.2)	—	—	—	(77.2)
Dividends paid on convertible perpetual preferred stock	(3.1)	—	—	—	(3.1)
Distributions paid to noncontrolling interests of consolidated affiliates	—	—	(54.4)	—	(54.4)
Other	2.2	1.5	1.5	—	5.2
Change in intercompany advances	225.5	(174.0)	(51.1)	(0.4)	—
Net cash provided by (used in) financing activities	929.9	(178.6)	(133.0)	21.6	639.9
Decrease in cash and cash equivalents	(0.7)	(0.2)	(4.2)	—	(5.1)
Cash and cash equivalents at beginning of year	41.9	1.5	23.3	—	66.7
Cash and cash equivalents at end of year	$ 41.2	$ 1.3	$ 19.1	$ —	$ 61.6
Supplemental schedule of noncash investing activity:					
Conversion of preferred stock to common stock	$ 93.2	$ —	$ —	$ —	$ 93.2
Intercompany note activity	(183.5)	—	183.5	—	—

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Statement of Cash Flows

	For the Year Ended December 31, 2014				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net cash provided by operating activities	$ 21.9	$ 260.1	$ 162.9	$ —	$ 444.9
Cash flows from investing activities:					
Acquisition of businesses, net of cash acquired	(674.6)	—	(20.2)	—	(694.8)
Purchases of property and equipment	(15.6)	(124.0)	(31.3)	—	(170.9)
Capitalized software costs	(8.6)	(1.4)	(7.0)	—	(17.0)
Proceeds from sale of restricted investments	—	—	0.3	—	0.3
Purchases of restricted investments	—	—	(3.5)	—	(3.5)
Net change in restricted cash	1.0	—	5.8	—	6.8
Other	—	(0.7)	2.9	—	2.2
Net cash used in investing activities	(697.8)	(126.1)	(53.0)	—	(876.9)
Cash flows from financing activities:					
Principal borrowings on term loan facilities	450.0	—	—	—	450.0
Proceeds from bond issuance	175.0	—	—	—	175.0
Principal payments on debt, including pre-payments	(298.0)	(1.5)	(3.1)	—	(302.6)
Borrowings on revolving credit facility	440.0	—	—	—	440.0
Payments on revolving credit facility	(160.0)	—	—	—	(160.0)
Principal payments under capital lease obligations	(0.3)	(2.5)	(3.3)	—	(6.1)
Debt amendment and issuance costs	(6.5)	—	—	—	(6.5)
Repurchases of common stock, including fees and expenses	(43.1)	—	—	—	(43.1)
Dividends paid on common stock	(65.8)	—	—	—	(65.8)
Dividends paid on convertible perpetual preferred stock	(6.3)	—	—	—	(6.3)
Distributions paid to noncontrolling interests of consolidated affiliates	—	—	(54.1)	—	(54.1)
Proceeds from exercising stock warrants	6.3	—	—	—	6.3
Other	7.4	—	—	—	7.4
Change in intercompany advances	158.6	(130.8)	(27.8)	—	—
Net cash provided by (used in) financing activities	657.3	(134.8)	(88.3)	—	434.2
(Decrease) increase in cash and cash equivalents	(18.6)	(0.8)	21.6	—	2.2
Cash and cash equivalents at beginning of year	60.5	2.3	1.7	—	64.5
Cash and cash equivalents at end of year	$ 41.9	$ 1.5	$ 23.3	$ —	$ 66.7
Supplemental schedule of noncash financing activities:					
Equity rollover from Encompass management	$ —	$ —	$ 64.5	$ —	$ 64.5

HealthSouth Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Condensed Consolidating Statement of Cash Flows

	For the Year Ended December 31, 2013				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
			(In Millions)		
Net cash provided by operating activities	$ 113.2	$ 235.7	$ 121.4	$ —	$ 470.3
Cash flows from investing activities:					
Acquisition of businesses, net of cash acquired	—	(28.9)	—	—	(28.9)
Purchases of property and equipment	(2.8)	(167.9)	(24.5)	—	(195.2)
Capitalized software costs	(6.0)	(11.1)	(4.2)	—	(21.3)
Proceeds from sale of restricted investments	—	—	16.9	—	16.9
Proceeds from sale of Digital Hospital	10.8	—	—	—	10.8
Purchases of restricted investments	—	—	(9.2)	—	(9.2)
Net change in restricted cash	(0.2)	—	(2.9)	—	(3.1)
Other	—	0.9	(0.4)	—	0.5
Net cash provided by investing activities of discontinued operations	—	3.1	0.2	—	3.3
Net cash provided by (used in) investing activities	1.8	(203.9)	(24.1)	—	(226.2)
Cash flows from financing activities:					
Principal payments on debt, including pre-payments	(59.5)	(1.3)	(1.7)	—	(62.5)
Principal borrowings on notes	—	—	15.2	—	15.2
Borrowings on revolving credit facility	197.0	—	—	—	197.0
Payments on revolving credit facility	(152.0)	—	—	—	(152.0)
Principal payments under capital lease obligations	(0.3)	(6.3)	(3.5)	—	(10.1)
Debt amendment and issuance costs	(2.6)	—	—	—	(2.6)
Repurchases of common stock, including fees and expenses	(234.1)	—	—	—	(234.1)
Dividends paid on common stock	(15.7)	—	—	—	(15.7)
Dividends paid on convertible perpetual preferred stock	(23.0)	—	—	—	(23.0)
Distributions paid to noncontrolling interests of consolidated affiliates	—	—	(46.3)	—	(46.3)
Proceeds from exercising stock warrants	15.3	—	—	—	15.3
Other	4.8	—	1.6	—	6.4
Change in intercompany advances	84.3	(22.2)	(62.1)	—	—
Net cash used in financing activities	(185.8)	(29.8)	(96.8)	—	(312.4)
(Decrease) increase in cash and cash equivalents	(70.8)	2.0	0.5	—	(68.3)
Cash and cash equivalents at beginning of year	131.3	0.3	1.2	—	132.8
Cash and cash equivalents at end of year	$ 60.5	$ 2.3	$ 1.7	$ —	$ 64.5
Supplemental schedule of noncash financing activities:					
Convertible debt issued	$ 320.0	$ —	$ —	$ —	$ 320.0
Repurchase of preferred stock	(320.0)	—	—	—	(320.0)

EXHIBIT LIST

No.	Description
2.1	Stock Purchase Agreement, dated as of November 23, 2014, by and among EHHI Holdings, Inc., the sellers party thereto, HealthSouth Corporation, HealthSouth Home Health Corporation, and the sellers' representative named therein (incorporated by reference to Exhibit 2.1 to HealthSouth's Annual Report on Form 10-K filed on March 2, 2015).#
2.2	Rollover Stock Agreement, dated as of November 23, 2014, by and among HealthSouth Corporation, HealthSouth Home Health Holdings, Inc., and the selling stockholders of EHHI Holdings, Inc. named therein (incorporated by reference to Exhibit 2.2 to HealthSouth's Annual Report on Form 10-K filed on March 2, 2015).#
2.3	Acquisition Agreement, dated as of June 10, 2015, by and among HealthSouth Corporation, HealthSouth Acquisition Holdings, LLC, Reliant Holding Company, LLC, Reliant Hospital Partners, LLC, Nautic Partners VI, L.P., Nautic Partners VI-A, L.P., Reliant Blocker Corp., the additional indemnitors listed therein, and the sellers' representative named therein (incorporated by reference to Exhibit 2.1 to HealthSouth's Current Report on Form 8-K filed on June 12, 2015).#
3.1.1	Restated Certificate of Incorporation of HealthSouth Corporation, as filed in the Office of the Secretary of State of the State of Delaware on May 21, 1998.*
3.1.2	Certificate of Amendment to the Restated Certificate of Incorporation of HealthSouth Corporation, as filed in the Office of the Secretary of State of the State of Delaware on October 25, 2006 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on October 31, 2006).
3.1.3	Certificate of Designations of 6.50% Series A Convertible Perpetual Preferred Stock, as filed with the Secretary of State of the State of Delaware on March 7, 2006 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on March 9, 2006).
3.2	Amended and Restated Bylaws of HealthSouth Corporation, effective as of May 7, 2015 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on May 11, 2015).
4.1	Warrant Agreement, dated as of September 30, 2009, among HealthSouth Corporation and Computershare Inc. and Computershare Trust Company, N.A., jointly and severally as warrant agent (incorporated by reference to Exhibit 4.1 to HealthSouth's Registration Statement on Form 8-A filed on October 1, 2009).
4.2.1	Indenture, dated as of December 1, 2009, between HealthSouth Corporation and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York, relating to HealthSouth's 7.250% Senior Notes due 2018, 7.750% Senior Notes due 2022, 5.75% Senior Notes due 2024, and 5.75% Senior Notes due 2025 (incorporated by reference to Exhibit 4.7.1 to HealthSouth's Annual Report on Form 10-K filed on February 23, 2010).
4.2.2	First Supplemental Indenture, dated December 1, 2009, among HealthSouth Corporation, the Subsidiary Guarantors (as defined therein) and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York (incorporated by reference to Exhibit 4.7.2 to HealthSouth's Annual Report on Form 10-K filed on February 23, 2010).
4.2.3	Second Supplemental Indenture, dated as of October 7, 2010, among HealthSouth Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York (incorporated by reference to Exhibit 4.2 to HealthSouth's Current Report on Form 8-K filed on October 12, 2010).
4.2.4	Third Supplemental Indenture, dated October 7, 2010, among HealthSouth Corporation, the Subsidiary Guarantors (as defined therein) and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York, relating to HealthSouth's 7.750% Senior Notes due 2022 (incorporated by reference to Exhibit 4.3 to HealthSouth's Current Report on Form 8-K filed on October 12, 2010).
4.2.5	Fourth Supplemental Indenture, dated September 11, 2012, among HealthSouth Corporation, the Subsidiary Guarantors (as defined therein) and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York, relating to HealthSouth's 5.75% Senior Notes due 2024 (incorporated by reference to Exhibit 4.2 to HealthSouth's Current Report on Form 8-K filed on September 11, 2012).

4.2.6 Fifth Supplemental Indenture, dated as of March 12, 2015, among HealthSouth Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as trustee, relating to HealthSouth's 5.125% Senior Notes due 2023 (incorporated by reference to Exhibit 4.2 to HealthSouth's Current Report on Form 8-K filed on March 12, 2015).

4.2.7 Sixth Supplemental Indenture, dated as of August 7, 2015, among HealthSouth Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as trustee, relating to HealthSouth's 5.75% Senior Notes due 2024 (incorporated by reference to Exhibit 4.4 to HealthSouth's Current Report on Form 8-K filed on August 12, 2015).

4.2.8 Registration Rights Agreement, dated August 7, 2015, among HealthSouth Corporation, the subsidiary guarantors named therein and the several initial purchasers named therein (incorporated by reference to Exhibit 4.5 to HealthSouth's Current Report on Form 8-K filed on August 12, 2015).

4.2.9 Seventh Supplemental Indenture, dated as of September 16, 2015, among HealthSouth Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as trustee and successor in interest to The Bank of Nova Scotia Trust Company of New York, relating to HealthSouth's 5.75% Senior Notes due 2025 (incorporated by reference to Exhibit 4.2 to HealthSouth's Current Report on Form 8-K filed on September 21, 2015).

4.2.10 Registration Rights Agreement, dated September 16, 2015, among HealthSouth Corporation, the subsidiary guarantors named therein and the representative of the several initial purchasers named therein (incorporated by reference to Exhibit 4.4 to HealthSouth's Current Report on Form 8-K filed on September 21, 2015).

4.3 Indenture, dated November 18, 2013, by and between HealthSouth Corporation and Wells Fargo Bank, National Association, as trustee, relating to HealthSouth's 2.00% Convertible Senior Subordinated Notes due 2043 (incorporated by reference to Exhibit 4.1 to HealthSouth's Current Report on Form 8-K filed on November 19, 2013).

10.1.1 HealthSouth Corporation Amended and Restated 2004 Director Incentive Plan.** +

10.1.2 Form of Restricted Stock Unit Agreement (Amended and Restated 2004 Director Incentive Plan).** +

10.2 Form of Indemnity Agreement entered into between HealthSouth Corporation and the directors of HealthSouth.* +

10.3 HealthSouth Corporation Third Amended and Restated Change in Control Benefits Plan (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on December 8, 2014). +

10.4 Description of the HealthSouth Corporation Senior Management Compensation Recoupment Policy (incorporated by reference to Item 5, "Other Matters," in HealthSouth's Quarterly Report on Form 10-Q filed on November 4, 2009).+

10.5 Description of the HealthSouth Corporation Senior Management Bonus and Long-Term Incentive Plans (incorporated by reference to the section captioned "Executive Compensation – Compensation Discussion and Analysis – Elements of Executive Compensation" in HealthSouth's Definitive Proxy Statement on Schedule 14A filed on April 6, 2015).+

10.6 Description of the annual compensation arrangement for non-employee directors of HealthSouth Corporation (incorporated by reference to the section captioned "Corporate Governance and Board Structure – Compensation of Directors" in HealthSouth's Definitive Proxy Statement on Schedule 14A, filed on April 6, 2015).+

10.7 HealthSouth Corporation Fourth Amended and Restated Executive Severance Plan (incorporated by reference to Exhibit 10.1 to HealthSouth's Quarterly Report on Form 10-Q filed on October 29, 2013).+

10.8 HealthSouth Corporation Nonqualified 401(k) Plan (incorporated by reference to Exhibit 10.1 to HealthSouth's Quarterly Report on Form 10-Q filed on July 29, 2014).+

10.9.1 HealthSouth Corporation 2005 Equity Incentive Plan (incorporated by reference to Exhibit 10 to HealthSouth's Current Report on Form 8-K, filed on November 21, 2005).+

10.9.2 Form of Non-Qualified Stock Option Agreement (2005 Equity Incentive Plan).**+

10.10.1 HealthSouth Corporation Amended and Restated 2008 Equity Incentive Plan (incorporated by reference to Exhibit 4(d) to HealthSouth's Registration Statement on Form S-8 filed on August 2, 2011).+

10.10.2 Form of Non-Qualified Stock Option Agreement (2008 Equity Incentive Plan)(incorporated by reference to Exhibit 10.28.2 to HealthSouth's Annual Report on Form 10-K filed on February 24, 2009). +

10.10.3 Form of Non-Qualified Stock Option Agreement (Amended and Restated 2008 Equity Incentive Plan (incorporated by reference to Exhibit 10.1.2 to HealthSouth's Quarterly Report on Form 10-Q filed on August 4, 2011).+

10.10.4 Form of Restricted Stock Agreement (Amended and Restated 2008 Equity Incentive Plan (incorporated by reference to Exhibit 10.1.3 to HealthSouth's Quarterly Report on Form 10-Q filed on August 4, 2011).+

10.10.5 Form of Performance Share Unit Award (Amended and Restated 2008 Equity Incentive Plan (incorporated by reference to Exhibit 10.1.4 to HealthSouth's Quarterly Report on Form 10-Q filed on August 4, 2011 and the description in Item 5, "Other Items," in HealthSouth's Quarterly Report on Form 10-Q filed on July 30, 2013).+

10.10.6 Form of Restricted Stock Unit Award (Amended and Restated 2008 Equity Incentive Plan (incorporated by reference to Exhibit 10.1.5 to HealthSouth's Quarterly Report on Form 10-Q filed on August 4, 2011).+

10.11 HealthSouth Corporation Directors' Deferred Stock Investment Plan (incorporated by reference to HealthSouth's Annual Report on Form 10-K filed on February 19, 2013).+

10.12.1 Third Amended and Restated Credit Agreement, dated August 10, 2012, among HealthSouth Corporation, Barclays Bank PLC, as administrative agent and collateral agent, Citigroup Global Markets Inc., as syndication agent, Bank of America, N.A., Goldman Sachs Lending Partners LLC, and Morgan Stanley Senior Funding, Inc., as co-documentation agents, and various other lenders from time to time (incorporated by reference to Exhibit 10.1 to HealthSouth's Quarterly Report on Form 10-Q filed on October 26, 2012).

10.12.2 First Amendment to the Third Amended and Restated Credit Agreement, dated June 11, 2013, among HealthSouth Corporation, Barclays Bank PLC, as administrative agent and collateral agent, Citigroup Global Markets Inc., as syndication agent, Bank of America, N.A., Goldman Sachs Lending Partners LLC, and Morgan Stanley Senior Funding, Inc., as co-documentation agents, and various other lenders from time to time (incorporated by reference to Exhibit 10.1 to HealthSouth's Quarterly Report on Form 10-Q filed on July 30, 2013).

10.12.3 Second Amendment and Additional Tranche Term Loan Amendment to Third Amended and Restated Credit Agreement, dated as of September 22, 2014, among HealthSouth Corporation, Barclays Bank PLC, as administrative agent and collateral agent, Citigroup Global Markets Inc., as syndication agent, Bank of America, N.A., Goldman Sachs Lending Partners LLC, and Morgan Stanley Senior Funding, Inc., as co-documentation agents, and various other lenders from time to time (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on September 24, 2014).

10.12.4 Additional Tranche Term Loan Amendment to Third Amended and Restated Credit Agreement, dated as of December 23, 2014, among HealthSouth Corporation, its subsidiary guarantors, the lenders party thereto, and Barclays Bank PLC, as administrative agent (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on December 23, 2014).

10.12.5 Third Amendment and Additional Tranche Term Loan Amendment to Third Amended and Restated Credit Agreement, dated as of June 24, 2015, among HealthSouth Corporation, Barclays Bank PLC, as administrative agent and collateral agent, Citigroup Global Markets Inc., as syndication agent, Bank of America, N.A., Goldman Sachs Lending Partners LLC, and Morgan Stanley Senior Funding, Inc., as co-documentation agents, and various other lenders from time to time (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on June 25, 2015).

10.12.6 Fourth Amendment and Additional Tranches of Term Loans Amendment to Third Amended and Restated Credit Agreement, dated as of July 29, 2015, among HealthSouth Corporation, Barclays Bank PLC, as administrative agent and collateral agent, Citigroup Global Markets Inc., as syndication agent, Bank of America, N.A., Goldman Sachs Lending Partners LLC, and Morgan Stanley Senior Funding, Inc., as co-documentation agents, and various other lenders from time to time (incorporated by reference to Exhibit 10.2 to HealthSouth's Quarterly Report on Form 10-Q filed on October 29, 2015).

10.12.7 Amended and Restated Collateral and Guarantee Agreement, dated as of October 26, 2010, among HealthSouth Corporation, its subsidiaries identified herein, and Barclays Bank PLC, as collateral agent (incorporated by reference to Exhibit 10.3 to HealthSouth's Current Report on Form 8-K/A filed on November 23, 2010).

10.13 Homecare Homebase, L.L.C. Restated Client Service and License Agreement, dated December 31, 2014, by and between Homecare Homebase, L.L.C. and EHHI Holdings, Inc. (incorporated by reference to Exhibit 10.19 to HealthSouth's Annual Report on Form 10-K filed on March 2, 2015).ˆ

10.14 Amended and Restated Senior Management Agreement, dated as of November 23, 2014, by and among EHHI Holdings, Inc., April Anthony, HealthSouth Corporation, and solely for purposes of Sections 6(b) and 6(j) thereof, Thoma Cressey Fund VIII, L.P. (incorporated by reference to Exhibit 10.20 to HealthSouth's Annual Report on Form 10-K filed on March 2, 2015).+

12.1 Computation of Ratios.

21.1 Subsidiaries of HealthSouth Corporation.

23.1 Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm.

24.1 Power of Attorney (included as part of signature page).

31.1 Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Sections of the HealthSouth Corporation Annual Report on Form 10-K for the year ended December 31, 2015, formatted in XBRL (eXtensible Business Reporting Language), submitted in the following files:

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule will be furnished supplementally to the Securities and Exchange Commission upon request.

* Incorporated by reference to HealthSouth's Annual Report on Form 10-K filed with the SEC on June 27, 2005.

** Incorporated by reference to HealthSouth's Annual Report on Form 10-K filed with the SEC on March 29, 2006.

+ Management contract or compensatory plan or arrangement.

ˆ Certain portions of this exhibit have been omitted pursuant to a request for confidential treatment. The nonpublic information has been filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended.

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jay Grinney, certify that:

1. I have reviewed this Annual Report on Form 10-K of HealthSouth Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2016

By: /s/ Jay Grinney

Name: Jay Grinney

Title: President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Douglas E. Coltharp, certify that:

1. I have reviewed this Annual Report on Form 10-K of HealthSouth Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2016

By: /s/ Douglas E. Coltharp

Name: Douglas E. Coltharp

Title: Executive Vice President and Chief Financial Officer

Exhibit 32.1

CERTIFICATE OF CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of HealthSouth Corporation on Form 10-K for the period ended December 31, 2015, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jay Grinney, President and Chief Executive Officer of HealthSouth Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (the "2002 Act"), that to the best of my knowledge and belief:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HealthSouth Corporation.

Date: February 24, 2016

By: /s/ Jay Grinney

Name: Jay Grinney

Title: President and Chief Executive Officer

A signed original of this written statement has been provided to HealthSouth Corporation and will be retained by HealthSouth Corporation and furnished to the Securities and Exchange Commission or its staff upon request. This written statement shall not, except to the extent required by the 2002 Act, be deemed filed by HealthSouth Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that HealthSouth Corporation specifically incorporates it by reference.

Exhibit 32.2

CERTIFICATE OF CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of HealthSouth Corporation on Form 10-K for the period ended December 31, 2015, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Douglas E. Coltharp, Executive Vice President and Chief Financial Officer of HealthSouth Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (the "2002 Act"), that to the best of my knowledge and belief:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HealthSouth Corporation.

Date: February 24, 2016

By: /s/ Douglas E. Coltharp

Name: Douglas E. Coltharp

Title: Executive Vice President and Chief Financial Officer

A signed original of this written statement has been provided to HealthSouth Corporation and will be retained by HealthSouth Corporation and furnished to the Securities and Exchange Commission or its staff upon request. This written statement shall not, except to the extent required by the 2002 Act, be deemed filed by HealthSouth Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that HealthSouth Corporation specifically incorporates it by reference.

Board of Directors

LEO I. HIGDON, JR.
Chairman of the Board
HealthSouth Corporation
Director
Eaton Vance Corp.
Citizens Financial Group, Inc.

JOHN W. CHIDSEY
Executive Board Member
HotSchedules, LLC

DONALD L. CORRELL
Chief Executive Officer and Co-founder
KWP Capital, LLC

YVONNE M. CURL
Director
Nationwide Mutual Insurance Company

CHARLES M. ELSON
Director
John L. Weinberg Center for Corporate Governance
University of Delaware

JAY GRINNEY
President and Chief Executive Officer
HealthSouth Corporation

JOAN E. HERMAN
President and Chief Executive Officer
Herman & Associates, LLC

LESLYE G. KATZ
Director
ICF International, Inc.

JOHN E. MAUPIN, JR.
Director
LifePoint Hospitals, Inc.
Regions Financial Corp.

L. EDWARD SHAW, JR.
Director
MSA Safety Inc.

Executive Officers

JAY GRINNEY
President and Chief Executive Officer

DOUGLAS E. COLTHARP
Executive Vice President and Chief Financial Officer

MARK J. TARR
Executive Vice President and Chief Operating Officer

PATRICK DARBY
Executive Vice President, General Counsel and Secretary

CHERYL B. LEVY
Chief Human Resources Officer

ELISSA J. CHARBONNEAU, D.O.
Chief Medical Officer

ANDREW L. PRICE
Chief Accounting Officer

EDMUND M. FAY
Senior Vice President and Treasurer

APRIL ANTHONY
Chief Executive Officer and President, Encompass

Stockholder Information

CORPORATE OFFICES
HealthSouth Corporation
3660 Grandview Parkway, Suite 200
Birmingham, Alabama 35243
(205) 967-7116

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
PricewaterhouseCoopers LLP
Colonial Brookwood Center
569 Brookwood Village, Ste 851
Birmingham, AL 35209

TRANSFER AGENT AND REGISTRAR
Written Requests:
Computershare Investor Services
P O Box 30170
College Station TX 77842-3170

By overnight delivery:
Computershare Investor Services
211 Quality Circle, Suite 210
College Station TX 77845
1-877-456-7913 (U.S.)
1-781-575-4686 (non-U.S.)
web.queries@computershare.com

STOCK LISTING
HealthSouth common stock trades on the New York Stock Exchange ("NYSE") under the symbol "HLS."

STOCKHOLDER INFORMATION AND INQUIRIES
Stockholders and investors seeking information concerning stock ownership or HealthSouth generally are invited to contact HealthSouth's Investor Relations by calling (205) 968-6400 or sending an email to feedback@healthsouth.com.

Information concerning HealthSouth can also be obtained through our website at www.healthsouth.com.

ANNUAL MEETING OF STOCKHOLDERS
The annual meeting will be held on May 5, 2016 at 11 a.m., central time, at our corporate headquarters, 3660 Grandview Parkway, Suite 200, Birmingham, Alabama 35243.

CERTIFICATIONS
Our chief executive officer and chief financial officer have filed with the Securities and Exchange Commission the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1 and 31.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

HealthSouth ANNUAL REPORT 2015

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3660 Grandview Parkway, Suite 200
Birmingham, AL 35243

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