Operator: Good morning, everyone, and welcome to HealthSouth's First Quarter 2009 Earnings Conference Call. At this time, I would like to inform all participants that your lines will be in a listen-only mode. After the speakers' remarks there will be a question-and-answer period. Today's conference call is being recorded. Your participation implies consent to our recording this call. If you have any objections, you may disconnect at this time.

I would now like to turn the call over to Ms. Mary Ann Arico, HealthSouth's Senior Vice President of Investor Relations and Corporate Communications. Please go ahead.

Mary Ann Arico, Senior Vice President, Investor Relations and Corporate Communications

Thank you, and good morning everyone. Thank you for joining us today for the HealthSouth's first quarter 2009 earnings call. With me on the call in Birmingham today are Jay Grinney, President and Chief Executive Officer; John Workman, Chief Financial Officer; Mark Tarr, Executive Vice President of Operations; John Whittington, our General Counsel; Andy Price, Senior Vice President of Accounting; and Ed Fay, Senior Vice President and Treasurer.

Before we begin, if you do not already have a copy, the press release, financial statements and the related 8-K filings with the SEC are available on our website at healthsouth.com in the Investors' section. In addition to the required information, we have also provided a set of slides, which are available on the website. The first 12 slides will be referred to during the call. The remaining 13 slides include supplemental information, including GAAP reconciliation for the first quarter.

Moving to slide one, the safe harbor. During the call, we will make forward-looking statements, which are subject to risks and uncertainties, many of which are beyond our control. Certain risks, uncertainties and other factors that could cause actual results to differ materially from management's projections, forecasts, estimates, and expectations are discussed in the company's Form 10-K for 2008 and other SEC filings, including the Form 10-Q for first quarter 2009 scheduled to be filed this week. We encourage you to read them.

You are cautioned not to place undue reliance on the estimates, projections, guidance, and other forward-looking information presented. Statements made throughout the presentation are based on current estimates of future events, and speak only of today. The company does not undertake a duty to update or correct these forward-looking statements.

Our slide presentation and discussion on the call will include certain non-GAAP financial measures. For such measures, reconciliation to the most directly comparable GAAP measure is available at the end of the slide presentation or at the end of the related press release, both of which are available on our website and as part of the Form 8-K filed with the SEC last night. And with that, I will turn it over to Jay.

Jay Grinney, President and Chief Executive Officer

Great, thank you Mary Ann. This morning we are pleased to report the results of another very solid quarter, which we believe continues to validate the strength and sustainability of our business model that focuses on deleveraging, growth and expense management.

Strong cash flow from operating activities in the quarter allowed us to reduce our long-term debt by $85 million and bring our leverage ratio to 4.9 times based on a trailing four quarter adjusted consolidated EBITDA. Getting below the five times leverage ratio was an important milestone for the company and we are very pleased to have achieved this so early in the year.

Volumes in the quarter were up in all regions. Discharges increased 5.7% on an aggregate basis, despite the leap year effect in 2008, with same-store discharges up 4.8% compared to the first quarter of 2008.

Disciplined expense management yielded impressive results across all key operating expense line items. As a percent of net operating revenues, salaries and benefits declined 20 basis points, hospital-related expenses declined 80 basis points, and G&A expenses declined 70 basis points compared to the first quarter of 2008. We are extremely pleased with the commitment of our employees and management teams to providing high-quality, cost-effective care as demonstrated by these results.

Good volumes, coupled with solid expense management, yielded a 10.7% or $9.5 million increase in adjusted consolidated EBITDA compared to the first quarter of last year, despite the fact that Q1 of '08 included a Medicare price increase that was rolled back on April 1 of last year.

Finally, adjusted income from continuing operations in the quarter was $0.39 per share, up $0.21 or approximately 117% over last year. All in all, the first quarter was an excellent start to the year.

With that, I'm going to turn it over to John Workman for a more through walkthrough of our results.

John L. Workman, Executive Vice President and Chief Financial Officer

Thank you, Jay. I will be referencing the slides we filed on Form 8-K in my comments today that Mary Ann mentioned. As Jay discussed, we are very pleased with the results for the quarter.

Regarding the income statement and first looking at our inpatient hospital revenues, our inpatient revenues increased by 3.3% over last year's quarter to $433.1 million. The current quarter includes revenues from our Vineland acquisition and our Arlington and Midland consolidations. Discharges increased 4.8% on a same-store basis.

Pricing, as expressed on a per-discharge basis, decreased 2.2% from a year ago, which is consistent with the price increase we had in the fourth quarter of 2007 that was subsequently rolled back effective April 1, 2008.

Our length of stay was six-tenths a day shorter than the same quarter a year ago. Despite the shorter length of stay, our occupancy improved to 69.4% from 67% a year ago, which can be found on slide 16.

In looking forward, we want to remind you that TeamWorks was installed progressively through 2008 in our hospitals. This will make our comparables more challenging as we progress through 2009.

Regarding our outpatient facilities, outpatient and other revenue declined 6.9% to the same quarter a year ago. There were 12 fewer outpatient satellites this quarter than there were a year ago for the same quarter. This element of our business is more discretionary in nature than our inpatient hospitals. With this in mind, and with some additional potential closures, you should expect outpatient revenues to continue to decline in 2009, though I will remind you that outpatient is not a large proportion of our revenue base and even a smaller portion of earnings. You also should see that decline perhaps lessening as we cycle through those 12 outpatient satellites that were closed throughout 2008.

Next, turning to operating expenses, which can be found on slide six, salaries and benefits improved in the quarter as a percent of revenue by 20 basis points as Jay mentioned, allowing us to continue to provide high-quality patient care, but on a cost-effective basis. There was a slight dollar increase of 1.9% in the dollar amount, generally attributable to the higher number of patients

treated and a result of a 3% average merit increase to all employees except senior management effective October 1, 2008. As a reminder, these increases will be effective for the first nine months of 2009 before we have any Medicare pricing opportunity.

We continue to see improvement in labor productivity, expressed as employee per occupied bed, to 3.47 from 3.53 a year ago, can be found on slide six. As we mentioned to you in 2008, we have made some changes regarding benefits, including paid time off, which we believe contributed to the improvement both the last year and on a sequential basis regarding salaries and benefits.

Next, looking at hospital-related expenses, which we group as other operating, supplies, occupancy and bad debt as a group, and those can be found on slide six; those expenses expressed as a percent of revenues improved 80 basis points compared to a year ago and improved 20 basis points sequentially from the fourth quarter of 2008. Within hospital-related expenses, bad debts were flat to last year at 1.7% of revenues. As we look further into 2009, we may experience some increase as a percent of revenue due to the worsening economy, but still expect to be within the 1.5 to 1.8% run rate that we have previously mentioned.

Looking at general and administrative expenses, we showed significant improvement to last year, representing 4.6% of revenues. We have previously stated that our goal was to be at 4.75% of net operating revenues, and thus, we've hit that goal in this quarter.

Next, looking at depreciation and amortization, it's below last year for the quarter as the first quarter of 2008 included accelerating depreciation on the corporate complex of approximately $10 million that was taken to reduce the value to the amount for which it was sold.

Government, class action, and related settlements caption includes our mark-to-market non-cash impact for the five million shares and 8.2 million warrants, which have a 41.40 strike price, that we agreed to contribute as part of the securities litigation settlement. These shares and warrants may be distributed in 2009. Lastly, professional fees relate to amounts being spent in pursuit of the derivative claims against Ernst & Young and Richard Scrushy, and John Whittington is going to provide an update on those later.

Next, looking at items below operating expenses, interest expense was $13 million below last year due to our lower debt level and lower LIBOR rates. I am going to speak more about debt later. The mark-to-market charge on the interest rate swap was because LIBOR was lower at the end of the first quarter than it was at the end of the year. As a reminder, our swap has stepped down slightly, but still covers 1.056 billion of notional amount and is at a 5.22% fixed rate. The swap notional amount declines by 72 million next year and goes to zero in March 2011. We have added $200 million of forward swaps that are effective in March 2011 through September or December 2012, and our rate at 2.6 to 2.9% fixed.

We have $1.2 million expensed on the income tax line this quarter. The majority of this expense relates to state income taxes and alternative minimum tax since our NOLs cannot be used to entirely offset taxable income. This tax will generate ATM credit carry-forwards that do not have an expiration date. We continue to believe that normalized taxes for the year will be between $5 to $7 million, and we believe that will be the case for the foreseeable future.

Next, I'd just like to comment on a new accounting pronouncement. We adopted FASB Statement No. 160, non-controlling interest in consolidated financial statements, effective January 1, 2009. This change effectively reports our minority interest below the net income line. In arriving at adjusted consolidated EBITDA and adjusted net income numbers, including EPS, we have subtracted these amounts as we've done in the past. It does include non-controlling interest for both continuing and discontinued operations in this amount.

Next, looking at adjusted consolidated EBITDA, slide seven. As Jay mentioned, adjusted consolidated EBITDA was 98.7 million for the first quarter compared to 89.2 million in the first quarter of 2008. Some comments about that; the first quarter of 2008 last year included benefit of

approximately $7 to $8 million from the Medicare price increase instituted on October 1, 2007, that was rolled back April 1, 2008. We attribute the improvement in 2009 over 2008 to strong volume growth, lower G&A costs, and effective management of hospital-related expenses and improved labor productivity, allowing us to deliver high-quality patient care on a cost-effective basis.

Looking at net income and earnings per share, which can be found on slide 23. When we discuss net income and EPS in the quarter, we believe there are some adjustments that should be considered. These items are either non-cash or non-recurring. And we look at those when we consider income from continuing operations. The adjustments to EPS are similar in nature to adjusted consolidated EBITDA, but not identical. The adjustments to EPS generally relate to payment on litigation, mark-to-market or fair value adjustments to liabilities, and the gain of early extinguishment of debt. We have also adjusted to a normalized income tax expense to reflect a run rate for this element.

Considering these items, adjusted income from continuing operations is $39.8 million, representing a $17.8 million improvement in income. And adjusted EPS is $0.39 per share, representing a $0.21 per share improvement in EPS over the first quarter of 2008. The EPS improvement represents a 116.7% increase over the first quarter of 2008.

Next, I'd like to turn to the balance sheet. Available cash was $90.7 million at March 31, 2009. Some of that cash will be used to pay additional legal fees to securities lawyers, likely later in 2009. The decrease in restricted cash since year-end is due to the escrow of the UBS proceeds being released. Long-term debt, on slide 20, was 1.728 billion at the end of the first quarter of 2009. Debt was reduced $85 million since year-end 2008.

Our leverage ratio, which is the debt divided by the adjusted consolidated EBITDA on a trailing four quarters basis, declined an additional 0.4 turns from year-end, and we're happy to report we're now below a 5.0 times ratio and we're at 4.9. Having achieved a 4.9 ratio by the end of the first quarter, we believe our longer-term goal of 3.5 to 4.0 times by the end of 2012 is progressively more achievable. Just as importantly, our funded senior secured debt ratio was down to 2.2 at the end of the first quarter. This gives us more confidence that we should be able to refinance our bank lines when they come due in 2012 and 2013.

With the uncertainty in the economy, we have also included a liquidity schedule on slide 11. Based on our available cash and undrawn revolver, we had 490.5 million of liquidity at the end of the first quarter. This represents an improvement of $151 million over our position at year-end.

Turning to cash flow on slide nine, we have extended our cash flow schedule for the quarter, so it has more detail in line with our annual presentation in our Form 10-K. Free cash flow, adjusted for interest rate swap payments and dividends on preferred stock and excluding the benefit of non-recurring items, was 38.7 million for the first quarter of 2009. Total capital expenditures were 17.2 million. The following is a breakdown of the components: Capital expenditures not of a maintenance nature were 9.7 million. These primarily represent payments towards already announced de novos, bed expansions, and some corporate expenditures. Maintenance capital expenditures of $7.5 million included monies spent on our refresh programs in our hospitals.

As Jay mentioned in his comments, we will continue to be focused on improving our capital structure. We will continue to be very disciplined in our use of cash, with a strong direction to reduce our leverage. As evidence of this, we continue to evaluate opportunities outside of debt reduction from a cash-on-cash perspective, generally expecting a "payback" in three to four years.

With this, I will turn it back over to Jay.

Jay Grinney, President and Chief Executive Officer

Great, thank you, John. Before we conclude and take questions, I'd like to ask John Whittington, our General Counsel, to update you on the remaining major litigation items. I'll then come back and address our outlook for the remainder of the year, including our thoughts on the proposal to bundle acute care and post-acute payments.

John P. Whittington, Executive Vice President and General Counsel

Thank you, Jay. The first case I would like to report on is the Ernst & Young case. We have asserted numerous claims against E&Y, including claims for breach of contract and malpractice, fraud and breach of fiduciary duties. These claims will be decided by a three-person arbitration panel. We are now in the process of selecting the panel and are hopeful that the panel will be seated within the next 60 days. We are optimistic that we will receive a final ruling by the panel in 2009.

As you may recall, discovery proceedings for the UBS, Scrushy and E&Y claims were conducted contemporaneously by consent of all the parties, and those discovery proceedings are now complete, except for expert witness discovery in the E&Y case, which should be addressed as soon as the arbitration panel is seated. We expect the arbitration hearing, once it begins, will last six to eight weeks. As a general rule, the determinations of an arbitration panel are not subject to appeal and are final orders. Payment of an arbitration award is due within 30 days of the date of the award. We continue to aggressively assert our claims and have confidence in the merits of our claims.

The second case I'd like to report on is the Richard Scrushy case. Our claims against Richard Scrushy have been set for a trial in Birmingham on May the 11th, 2009. It will be a bench trial, meaning non-jury. Our claims against Mr. Scrushy are based on breach of contract and breach of fiduciary duties, and we have also asserted a claim for rescission of his employment agreements. We expect the trial to last approximately one week. But unlike the E&Y arbitration, it will be subject to appeal.

In addition to the damage claims that we have asserted against E&Y and others, we have also asserted claims against Mr. Scrushy for profits realized from insider trading, for benefits received by him in connection with a series of self-dealing transactions, and disgorgement of bonuses he received in 1996. As with our claims against E&Y, we have confidence in the merits of our claims against Mr. Scrushy.

As a reminder, and simply for clarification, the two litigation matters I've just discussed are not part of the Federal Securities Action by our former stockholders and bondholders against Mr. Scrushy, Ernst & Young and UBS. We are no longer a party to that litigation or any future settlements between those plaintiffs and those remaining defendants.

Finally, I'd like to talk briefly about the General Medicine litigation. On November 10, 2008, we reported that we had filed a motion in the U.S. District Court for the Eastern District of Michigan seeking among other things to set aside the consent judgment dated May 3, 2004, between General Medicine and Horizon/CMS, on which General Medicine relied in asserting its fraudulent transfer claims against us. We have contended and continue to believe that the judgment was based on collusion, is not enforceable against HealthSouth, and should be set aside.

We argued our motion before the court in Michigan on April 23, 2009, and are awaiting the decision by the court. We expect a decision any day. Meanwhile, we continue to vigorously defend the claims asserted against us and we are aggressively pursuing our counter claims against General Medicine. We do not expect a trial of this matter in 2009.

Thank you, Jay.

Jay Grinney, President and Chief Executive Officer

Great, thank you John.

Okay, if we look out in the balance of the year and into 2010 and 2011, our business outlook is predicated on our ability to continue to deleverage our balance sheet, grow organically, effective manage expenses, and longer term, to adapt to regulatory changes affecting our industry.

Healthcare always has been a highly regulated industry and the inpatient rehabilitation segment is no exception. Successful healthcare providers are those who have the capabilities to adapt to changes in the regulatory environment. HealthSouth has a proven track record of being able to do just that. In 2002, inpatient rehabilitation reimbursement for Medicare went from a cost plus to a prospective reimbursement methodology, which was intended to reward efficient providers. Our hospitals adapted to this new payment methodology, and in the first year of implementation we were able to reduce our average length of stay and increase our operating earnings significantly.

In 2004, CMS revised the so-called 75% rule, which had the effect of limiting the types of patients inpatient rehabilitation hospitals could treat. Before this rule was amended as part of the 2007 Medicare Act, the negative impact it had on HealthSouth's volumes was less than half that of the rest of the industry's.

New regulations are introduced and often change the operating landscape. Successful providers learn to adapt. Over the years, HealthSouth has demonstrated we have the scale, infrastructure and management to adapt and to succeed in a regulated environment. Today, we face the prospect of a new regulatory challenge that could affect all acute care and post-acute providers, the proposed bundling of acute care and post-acute Medicare payment.

While the probability of enacting a bundled payment system is difficult to predict at this time, if structured properly, a bundled payment system could be a positive for HealthSouth. Specifically, by creating a payment system that would reward cost-effective post-acute providers, it could serve as a catalyst for consolidating the highly fragmented post-acute industry and facilitating the achievement of our long-term strategy of being a comprehensive provider of post-acute services.

Obviously, a bundled payment system would have to be well thought out and tested before being implemented. Both the President's budget proposal and the recently issued Senate Finance Committee's proposed option contemplate a phased-in approach beginning in fiscal year 2013 and fiscal year 2015, respectively. During this time, HealthSouth will continue to work with industry groups to ensure bundling occurs in a manner that guarantees patients will continue to receive high-quality rehabilitative care and that providers of this care will be appropriately reimbursed.

We also are confident we will be able to continue to reduce our debt and improve our leverage. As John mentioned, our new leverage target is between 3.5 and four times, which should be achievable in advance of any of our debt maturities. Furthermore, we believe we have adequate sources of liquidity due to our cash and cash equivalents and the availability of our revolving credit facility.

We believe our proven track record of growing at a faster rate than the rest of the industry is sustainable. The majority of patients we serve have medical conditions such as strokes, hip fractures and neurological disorders that are non-discretionary in nature and require inpatient rehabilitative services. Consequently, we believe we are well positioned to grow volumes despite the challenging economic environment.

Finally, healthcare providers are under increasing obligation to control healthcare costs. We take this challenge seriously and pride ourselves in our ability to provide high-quality, cost-effective care.

We'll continue to focus on finding efficiencies in our cost structure at both the corporate and operational levels in an effort to remain competitive.

While our outlook on our business is positive, in keeping with our past practice, we are not increasing our guidance at this time. While we certainly believe the high-end of our guidance is achievable, we will wait to get another quarter under our belt before reassessing guidance for the year.

In closing, I want to thank our 22,000 employees and management teams for producing these impressive results. Because of their commitment to providing high-quality, cost-effective care, we were able to treat more patients in our hospitals during the first quarter of 2009 than in any quarter since this management team arrived in 2004. I am very proud of this accomplishment and want to recognize all of the hard work and dedication that went into achieving this milestone.

With that, operator, let's open up the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Your first question comes from the line of Paxton Scott of Jefferies & Company.

<Q>: Hi, very nice quarter. Thanks for taking the call. My first question is kind of staying in line with the guidance. You did about 30% of I guess the high end of your EBITDA range in the first quarter; and so as we look out for the balance of the year, I know Jay, you said that you want to get one more quarter under you belt, but just was wondering what the primary drivers of what could put you a little bit below, at, or exceeding that guidance. Is it revenue based or is it more on the expense side? Thanks.

<A – Jay Grinney>: I think it's going to be basically a combination. We feel, as I mentioned, very confident that we'll continue to achieve the kind of same-store volume increases that we forecasted in that four-plus percent range. But if there is any sensitivity to that of course that will have implications, at least through the third quarter, on our revenues. The second would be the magnitude of pricing that we get in the fourth quarter. We were very pleased to see the market basket update of 2.4%. We are still analyzing the proposed rules. We'll be providing some input on that in the next 60 days. So there is an issue there. And then of course there is always the ability to continue to manage expenses.

So we feel very good about the quarter, we feel very good about our ability to generate the volume growth, to manage our expenses, we are hopeful with respect to pricing. But the bottom line is we've managed this company, I think, in a very appropriate manner. We have not gotten out and have chased quarterly expectations, we are not going to get into that game; we have made that pretty clear from the get-go. And as a result I think the Street can depend and rely on the fact that we are going to meet or exceed what we say.

And so we just want to be a little conservative and just get one more quarter under our belt and then we'll reevaluate guidance.

<A – John Workman>: And Paxton, one other comment, the first quarter typically is our strongest quarter within the year.

<Q>: Okay. Understood, understood. My other question is related to the improvement that you had on the labor front in getting the employees per occupied bed down there. Can you provide a little bit more color there and is that clinical employees or is it more administrative? Is there any impact in the acuity that you are seeing in your business? Just any more color you can provide there would be great. Thanks.

<A – Jay Grinney>: Well, the productivity is really pretty much across the board. We have been focused certainly at the corporate level and we've reduced some FTEs here. But clearly the needle gets moved at the hospital level. And because of our history of having the first quarter be typically the largest quarter, we are always going to see some special productivity in that quarter. I think the real challenge for all healthcare providers, not just HealthSouth, is how well do you manage the labor in the second and third quarter when volumes historically have trended a little bit softer.

So we feel very good about our labor management focus; Mark Tarr and the Regional Presidents and the hospital CEOs have done a great job managing that, and we think that we'll be able to continue to do that in the balance of 2009.

<Q>: Thank you.

<A – Jay Grinney>: You're welcome.

Operator: Your next question comes from the line of David MacDonald of SunTrust.

<Q – David MacDonald>: Morning guys. Jay, just wanted to follow up on the labor a little bit more; is one other thing that we could expect now that TeamWorks has kind of been rolled out and you're starting to comp year-over-year, has it become easier for you guys now to predict your volumes, which is helping you on the staffing level in terms of controlling the labor costs?

<A – Jay Grinney>: I don't know if it's been easier. I think that the way I would characterize that is in – when we rolled out TeamWorks, one part of that initiative was to expand our geographic reach, to expand the number of hospitals we were going to, to see if there were patients appropriate for rehabilitative care, increasing the number of physician offices we visited, again, to see if there were patients appropriate for inpatient rehabilitative care.

And so, that in 2008 helped to really drive that – just almost incredible year-over-year growth. I think on a sustainable basis getting into that 4% range does give us a little more predictability. And of course that helps us in our staffing because we staff at sort of a core level and then use contract labor if we see temporary increases. But one thing that we've done, and Mark and his team have done a fabulous job, is actually reducing our reliance on contract labor. And I do think it gets back to your point, David, when the volumes are a little more predictable you can create more predictable staffing levels.

<Q – David MacDonald>: Okay. And then just anything we should be aware of Jay, in terms of the managed-care pricing environment? I know you guys have historically looked for a couple of percent, is there any reason for us to think about that differently as we move towards 2010?

<A – Jay Grinney>: No, nothing that we're seeing right now. We've said over the last couple of years that on a sustainable, predictable basis we think that a 3 to 5% range for managed-care pricing on an annual basis, that kind of increase is very reasonable. We don't see anything at this juncture that would change that.

Although I think, David, it's fair to say we're pretty early in the year and the negotiations for the January 1 renewals typically don't begin in earnest until the summer time and September timeframe. So – but at this point no, we don't see anything that would want us to change that underlying assumption.

<Q – David MacDonald>: Okay. And then just a couple of housekeeping questions; one, the stock-based comp, is that 3.7 a decent level to think about on a go-forward basis, and then just on the Ernst & Young litigation I want to make sure I heard this properly, the arbitration hearings are normally six to eight weeks and there is typically no appeals, is that correct?

<A – Jay Grinney>: I'll take the last question, and that is yes.

<Q – David MacDonald>: Okay.

<A – Jay Grinney>: Your assumption is correct, six to eight weeks, no appeal.

<Q – David MacDonald>: Okay.

<A – John Workman>: And the first question on stock-based compensation, that's a fair run rate, David, for the quarter.

<Q – David MacDonald>: Okay, so when we think about that edging up, John, it's typically going to be in the first quarter of the following year if you bring on people or something like that?

<A – John Workman>: It does affect when we issue new grants and where the stock price is.

<Q – David MacDonald>: Yes. Okay, thanks, guys, good job.

<A – John Workman>: Thank you. John Whittington, did you want to...

<A – John Whittington>: I was just going to say generally no appeal. There are some exceptions for fraud and a few other exceptions. But generally speaking, arbitrations are not subject to appeal.

Operator: Your next question comes from the line of Adam Feinstein of Barclays Capital.

<A – Jay Grinney>: Good morning, Adam.

<Q – Adam Feinstein>: Hey, good morning everyone, great quarter. Just a few questions here, maybe just to start with volumes. We've seen a trend where we've seen lower volumes for hospitals, LTCHs, nursing homes, it seems like throughout the facilities space we've seen a slowdown, but your volumes are still growing very rapidly here. So just curious to get your thoughts, I mean obviously you guys are taking market share but how much of it do you think is just growth within the rehab hospital segment and how much of it do you think is market share gains? Then a couple of follow-up questions.

<A – Jay Grinney>: Well, as you know on the market share gains, we don't know that with any level of precision until there is the UDS data that comes in, we look at it on a state-by-state basis. And in the fourth quarter certainly we outpaced the rest of the market, as we did throughout 2008. So we won't know with certainty, but we certainly believe we continue to take market share. And when we report Q2, we'll be able to then look back and validate that, but I'm pretty confident that we continue to take market share.

In terms of the reasons why, I think there are two things: One, the demographics continue to work in our favor. Most of our patients are Medicare, and the types of conditions, secondly, that these patients have require the kind of care that we provide. As we've said many times, patients don't choose to have a stroke or a serious neurological condition, and yet when they find themselves with that kind of condition, they go to an acute care hospital, they get stabilized, and then they come to us for their rehabilitation and getting back into their communities. And that's unlike the types of patients that acute care hospitals see, where many of the conditions are going to be more discretionary in nature.

And so I think that the demographics are working in our favor, I think that the fact that it's non-discretionary is working in our favor, and I also believe, although we can't validate it right now, I do believe we are taking market share.

<Q – Adam Feinstein>: Okay, great. And then just a couple questions about Medicare, I guess. First, what do you guys, I guess in your guidance for the fourth quarter, what was the Medicare update that was embedded in there? I just wanted to verify.

And then secondly, in the nursing home reg the other day, there were something in there about concurrent therapy and how CMS is taking a closer look at that. Just curious to get your thoughts whether there's any potential issue within the rehab hospital space in terms of just concurrent therapy, and just, or should we not really think about that as something, as relevant for you guys?

<A – Jay Grinney>: Well, I think that in terms of the concurrent therapy, I would definitely not look at that as being a major issue. We are certainly evaluating the proposed regs. As you know, there were several components to the proposed regulations. One was the, and I think the one that everybody focused on, was the market basket, and that was certainly within the range of what we were hoping for in the fourth quarter. But there's still a lot of ground to cover between now and the end of the year, and Congress may or may not be looking for some cost savings and may or may not come to market baskets to take that away. We don't think that they will in rehab, in part because we've gone for 18 months without any kind of update.

So the other parts of the rule in terms of putting the physician front center in the decision making, we support that. We think that's a great idea. In terms of some of the other changes that are being

proposed, like having a rolling three-year average for LIP adjustments, we think that's very positive. There are many things in the proposed regulation that we believe will be significantly positive for the industry. Another one that's a great example is including Medicare Advantage patients in the 60% rule. We're very appreciative that CMS heard the commentary from the industry and made that recommended change.

So there are a lot of things in there, concurrent therapy is one, but there are many other aspects that we're still analyzing. I think the whole rule is like 215, 217 pages. So we're still going through it, but at this juncture we don't see anything that's of any concern.

Operator: Your next question comes from the line of A.J. Rice of Soleil Securities.

<Q – Chris Rigg>: Good morning. It's actually Chris Rigg filling in for A.J.

<A – Jay Grinney>: Hey Chris, how are you?

<Q – Chris Rigg>: I'm well, thanks. How are you guys?

<A – Jay Grinney>: Good.

<Q – Chris Rigg>: Just again to take a look at the guidance in the first quarter. I mean, $0.39, obviously a very strong number, can you give us a sense for how that compared to your own internal estimates?

<A – Jay Grinney>: No.

<Q – Chris Rigg>: Okay, all right. So we'll leave that one.

<A – Jay Grinney>: Yeah.

<Q – Chris Rigg>: On the salaries and benefits line, you've talked about the productivity increases, you've talked about the lower contract labor, I was wondering if you could give us a sense for just the overall level of wage inflation? We've heard anecdotally that the, at least on the nurse side, it's come down quite a bit, but on the therapist side, how has that been trending?

<A – Jay Grinney>: We are monitoring that very closely. We do see trends that are bringing the rate of growth lower. We monitor this on a market-by-market basis to ensure that we remain competitive.

One thing that we do that is a little different than I think many of our competitors is that we have a single merit increase date of October 1 for all rank and file employees. So everybody but management is in the October 1 timeframe. So as you know, we gave a 3% on October 1 of 2008, and we will monitor what the markets are looking to provide in terms of competitive increases. We'll also evaluate that against the backdrop of what kind of increase we're getting from Medicare and then we'll make decisions. But I certainly expect that the, if things continue as they are right now, that we will see less of an increase being needed to remain competitive come October. But obviously we'll be monitoring that pretty carefully between now and then.

<Q – Chris Rigg>: Okay. On the capital spending side, I think you said in the quarter you spent $9.7 million for sort of non-routine CapEx. Can you give us a sense for how much you expect to spend over the course of the year on sort of development capital spending and give us a sense for what type of bed growth we should see because of the spending?

<A – John Workman>: Two things. One of which is, I think we've disclosed before our annual CapEx expenditures. And I think we said $75 to $80 million. We've also said the maintenance portion of that is roughly $30 million, 30 to 35...

<A – John Workman>: ...including refresh programs 35. So...

<A – Mary Ann Arico>: And IT projects.

<A – John Workman>: And IT projects. So that gives you a feel for what pieces of development. Now that development includes bed expansions. And I don't have that slide, but in the Q4 slide, we did have the number of beds that we would expect to come on board in 2009, and...

<A – Jay Grinney>: ...about 100 beds and we'll be spending between $15 and $20 million.

<A – John Workman>: ...and those don't come on board though until Q4 of '09, basically, and then there'll be some additional beds that come on stream in 2010 from those bed expansions. And as we progress through 2009 and our occupancy continues to creep up, we're going to see more bed expansion opportunities, which will add to the tally for 2010.

But you should expect bed expansions to be that 15 to 20 million component probably going forward for the next several years.

Operator: Your next question comes from the line of Rob Hawkins of Stifel Nicolaus.

<Q – Robert Hawkins>: Good morning.

<A – Jay Grinney>: Good morning, Rob.

<Q – Robert Hawkins>: Okay, one of the questions I have kind of relates a little bit to some of the, the post-acute process. I mean, I realize everybody is kind of in the dark here on what's going on, but I just, I want to understand a little better about some of the market demonstration projects. It looks like, at least where the Senate is coming in, and the way they've got the phase-in, it looks like they're going to involve the industry or listen to the industry on this, maybe on some of the demonstrations or possibly some of the ways this might get shaped. And I understand, and correct me if I'm wrong, is that only non-profits right now are involved in a couple of the demonstrations related to post-acute that are going on.

I'm just wondering what's behind this, why are no for-profits or major changes taking place, and is there a drawback or an advantage to not participating in this and staying on the sideline but not involved, if you will, in the actual demonstration? And then given that, how do you feel about the industry and whether you guys have a real equal place or footing at the table to shape policy in the future regulations?

<A – Jay Grinney>: Okay, first of all we are actually involved in a demonstration project in our Evansville, Indiana, hospital and so, I am not sure...

<Q – Robert Hawkins>: Maybe we got bad information, but I mean this, and then what kind of demonstration is that, then?

<A – Jay Grinney>: It's looking at the continuum of care and readmission rates and looking at trying to offer more seamless care for the patients.

But I think we've been very involved through the American Hospital Association, through the Federation of American Hospitals, through our own advocacy efforts, and we've been pretty successful in getting in front of congressional leaders and advocating for our patients. So I do think both the administration and the option that was put forward by the Senate Finance Committee staff implies a listening to the industry, implies a thoughtful crafting of some type of a bundling system.

It's ironic to me that the most tangible example of where bundling has worked has really been where acute care hospitals and physicians have received bundled payments. There are many more examples there of successful efforts to bundle and get good results. But for whatever reason, we're

now looking at acute care and post-acute, which we are certainly going to want to participate in, we think we have a good shot at that, and we'll continue to be part of this process.

I think the other thing that's important to note is that both the President's budget proposal and the Senate option are envisioning a phase-in that wouldn't begin for many years. So it gives the industry a lot of time to participate in crafting something that works, testing that, making the adjustments that are necessary. And as I mentioned in my comments, we're in a regulated industry, and changes occur all the time. And it's always interesting to me how many people sort of wring their hands and are saying this is doomsday and everything is going to change. This goes back to the '80s when DRGs came by. And you know what? People adapt, organizations adapt, we find ways to be efficient in the provision of care and we succeed, and we're not afraid of this bundling concept.

We want it done right, don't get me wrong. But we're not afraid of that and in fact as I said, I think it could even be a catalyst, get this industry that's so fragmented, we have so many mom and pop operations out there across the post-acute spectrum, being able to set a marker out there, be it 2015 or 2019 that, or 2013, that sort of tells everybody, hey, the world is going to change, that is going to be I think very positive for us.

<Q – Robert Hawkins>: No, don't get me wrong. I mean, I'm supportive and I think the timeline looks great.

<A – Jay Grinney>: No, I know.

<Q – Robert Hawkins>: I guess just one final thought on this is, I'm trying to get a sense of, will CMS, is this administration, do you get a sense that they're going to be collaborative, or is this still kind of us versus them, the way it's been kind of the last four years?

<A – Jay Grinney>: I hope that it is not we versus them. I really do believe all the signals that we are getting is that this will be collaborative. I think that my sense, frankly, is that where the determination is, is in the sense of making something happening. I think that this is in many ways a tipping point. And there needs to be a forceful movement to get the inertia that has been in our industry for the last 30, 40 years, to break that, and I think that's happening. I definitely think that that's happening.

Now beyond that, I also believe that those who are in the role of having to make these decisions and craft these new proposals are going to want to do it in a careful and thoughtful way. I mean, looking at the Senate option, the fact that they're focusing first on readmission rates makes a lot of sense to me, because that's the backdrop for, and the reference point for, the readmission rate, but also post-acute. The idea is hey, we got 18% of the admissions that are unnecessary and they are costing us $12 billion a year and we've got to do something about that. And I think that focusing on readmission rates first makes a lot of sense because that's the underlying problem.

So it's going to be a very interesting several years. We feel very confident that we'll be at the table. We feel very comfortable with our participation with the AHA and the Federation and we feel very confident that both the administration and congressional leaders will want to bring industry leaders in. I don't think they're going to want to bring people in who are just saying, hell no, we don't want to do anything. But I do think they're going to bring people in who say, okay, we're at the tipping point, we get it, we're going to make some changes, we need to make some changes, we want to be part of the solution.

Operator: Your next question comes from the line of Pito Chickering of Deutsche Bank.

<A – Jay Grinney>: Good morning, Pito.

<Q – Philip Chickering>: Good morning guys. Thanks for squeezing me in here. Going back to these productivity questions sort of I guess one more time, the question is more for Mark. What is

your target employee-per-occupied-bed in the middle of the year when the volumes get a little softer? And what have you done to help increase the productivity year-over-year from an operational standpoint?

<A – Mark Tarr>: Yeah, hey Pito. We don't really have a target for the middle of the year. Obviously as we've said, the first quarter is a quarter where volume is typically the highest, so you get some economies. We've also been very careful not to over-hire so that we'll be able to respond once the seasonal adjustments come into play, and we hope that they won't be too significant in the summertime.

I think that we have done a very good job looking at the various elements and efficiencies within our hospitals. We've taken out unnecessary overtime, unnecessary contract labor, additional per diem hours where we didn't really need them. We've worked very closely with our hospitals to respond to drops in volumes on a quick basis and not wait for several days. So it's not just one area that we've put a big focus on, it's really the, it's the day-to-day operations and close management of our labor force.

<Q – Philip Chickering>: Okay. And then, I guess looking at your first quarter of late last year, you obviously had TeamWorks costs embedded within. As you talked about last quarter that as the TeamWorks costs rolled out, you'd have more program initiatives rolling forward. I guess a question for you is, how much of the expense gain this quarter was made from the delta between new initiatives and TeamWorks costs falling out?

<A – Mark Tarr>: There clearly were some savings to the fact that TeamWorks was in full bore last year. I mean, we were really, in the first quarter, we were spending a lot of money and getting this rolled out. We do have some initiatives this year, they're not to the same degree of expense as we had in TeamWorks, but we are, as we mentioned, I think on the last call, as we look out for 2009, one of our TeamWorks initiative is really establishing the groundwork for focusing on labor efficiencies in 2010. We've got to roll out information systems, we've got to put in consistent time clocks and recordkeeping in all of our hospitals. We're doing that in 2009 in anticipation that 2010 will allow us to really then take the next big step with respect to our labor management.

<A – John Workman>: We'd have a few million dollars worth of TeamWorks expenses that dropped out, Pito. To also remind you, we had 7 to $8 million worth of price in last year's number for the first quarter, which would have both fallen through to the bottom line, and when you look at things, the percent of revenue makes this year's performance look even better.

Operator: Your next question comes from the line of Sheryl Skolnick of CRT Capital.

<Q – Sheryl Skolnick>: Thanks very much.

<A – John Workman>: Good morning.

<A – Jay Grinney>: Good morning, Sheryl.

<Q – Sheryl Skolnick>: Good morning, and thank you in public and loudly with great appreciation for that full cash flow statement, makes my life much easier and I think makes the results a lot more easy to – a lot easier to understand.

So my first question will be related to the cash flow statement, since it's there, and now I know. The $47 million, there were a couple of items in there that I would guess you would characterize as one-time, two of them being the UBS settlement of 100 million and then the 26 million or so fees netted against that, and so that's pretty straightforward. But you, therefore, still had a significant increase in cash flow year-over-year. 47 million related to what looks to be cash production from deferred taxes, would that also be kind of one-time and what was that related to?

<A – John Workman>: Yeah, and two things, Sheryl. One is if you look at the slide that we sent out, slide nine, we tried to break that out. And you're exactly right, the UBS settlement, the 100 million less the 26.2 that we paid out in the quarter to attorneys, nets us 73.8 and we're backing that out. And then the 47.8 was actually income tax refund receivable. That was actually cash we collected in the quarter.

<Q – Sheryl Skolnick>: Right.

<A – John Workman>: We just don't obviously think, that's non-recurring, it'd be great if it were, but it's not. And so we also backed that out. So we're showing 38.7 after maintenance CapEx, dividends on preferred stock and swap payments compared to 21.2 a year ago.

<Q – Sheryl Skolnick>: Okay, all right. I just wanted to make sure that I wasn't missing anything on the tax.

And then in conjunction with the commentary so far about, and clearly concerns we all have about a lack of visibility of what the reimbursement environment will look like even in October with the rate increase that by law you're supposed to get, whether that changes or not we don't know, although we haven't heard that it will. But in conjunction with all of that, and with looking at profitability and reimbursement levels within the Medicare sector, are you at all a little worried that your margins are really high and a red flag?

<A – Jay Grinney>: Is it a concern? Surely all of us believe that the fact that we provide cost-effective care is something that we're supposed to do, but on the other hand it could be used in a negative way. The good news is that we're a small part of the inpatient rehabilitation sector. So there is going to have to be somebody who is leading the charge in terms of providing cost-effective care, and we're frankly very proud of the fact that we are doing just that, and I think that's what the expectation is.

So I don't see any kind of punitive action against a single company. I think that our margins are strong. There's no question about it. But if you look at the rest of the industry, they're struggling. So is it an issue? It's always an issue, as you well know. But I do believe that the fact that we are one company and we are one part of the industry, we happen to be the industry leader and that certainly comes with a lot of responsibility, and part of it is we're going to have to defend, if you will, the fact that the margins are strong. We keep looking at not just the EBITDA margin, but most importantly, we still have a lot of debt on our balance sheet. And if we're not generating that EBITDA, if we're not generating the cash from that that will allow us to pay down the debt, our long-term viability then is not going to be as strong.

So we have an obligation not only to our patients to provide high-quality, cost-effective care, but we also have an obligation to our bondholders and to our shareholders to make sure that those margins are strong so that we can have the resources to pay our preferred dividends, to pay down our debt, to meet our quarterly obligations.

So I think the focus on EBITDA margins slowly in Washington is – very slowly, and I see this in MedPAC as they analyze cost of capital and access to capital...

<Q – Sheryl Skolnick>: Yeah.

<A – Jay Grinney>: ...they understand that the EBITDA margin really isn't where we ought to be looking. We ought to be looking at the bottom line.

<Q – Sheryl Skolnick>: And that's pretty obvious, and I would imagine that the credit crisis has made credit analysts out of all of us, including me.

And so can I interpret this as whatever sense of urgency you already had and demonstrated clearly to reduce debt, the confluence of a 2013, say, the earliest possible date being talked about now for

roll-out of bundling and your maturities might make you want to reduce your debt and/or refinance even faster so you're not doing it on top of the implementation of bundling?

<A – John Workman>: Well, I think what we're doing is watching right now, Sheryl. We're analyzing all elements of our capital structure. We realize that we have a revolver and a term loan that comes due before the bonds, and so we're also cognizant of that. And as you know, the bank market is not exactly reopened any time recently and we're not certain when that's going to be.

So we are focused on what is the right capital structure. But clearly continuing to focus on deleveraging is going to be something that we do, but it's in concert with where do we want to be longer term. And so we're continuing to analyze that. We look at all types of alternatives relative to our capital structure and it's not unnoticed. But the big watershed event we're waiting on is what you heard Mr. Whittington talk about, so we can kind of set that table and understand what else do we need to do and that is what might be the proceeds from Ernst & Young.

<A – Jay Grinney>: And the good news on that is that we believe is more of a near-term event and it's really the last big event. If you go all the way back to 2004 and you outline all of the different things that we had to accomplish and all of the things that had to occur before we really had the past behind us, we're now within months of getting that finished. And I think that the E&Y settlement will be something that will be very important for us.

But to your point Sheryl, you bet. Paying down debt continues to be a very top priority. Growing organically is the way that we're going to do that, along with managing our expenses in a very disciplined and prudent manner.

Operator: At this time there are no further questions. I will now turn the call over to Mary Ann Arico for final remarks.

Mary Ann Arico, Senior Vice President, Investor Relations and Corporate Communications

If you have additional questions, we will be available later today. Please call me at 205-969-6175. As a reminder, we will be attending the Robert W. Baird Growth Conference next week and the Deutsche Bank Healthcare Conference the week after. If you are unable to attend HealthSouth's presentations, it will be webcast and available in the Investors section of healthsouth.com. Thank you.

Operator: Thank you. This does conclude today's HealthSouth first quarter 2009 earnings conference call. You may now disconnect.