

# HEALTHSOUTH CORP

## FORM 10-Q

(Quarterly Report)

Filed 11/04/09 for the Period Ending 09/30/09

Address	3660 GRANDVIEW PARKWAY SUITE 200 BIRMINGHAM, AL 35243
Telephone	205-967-7116
CIK	0000785161
Symbol	HLS
SIC Code	8060 - Hospitals
Industry	Healthcare Facilities
Sector	Healthcare
Fiscal Year	12/31

---

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

---

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

**OR  
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 001-10315

---

**HealthSouth Corporation**

(Exact name of Registrant as specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

63-0860407  
(I.R.S. Employer  
Identification No.)

3660 Grandview Parkway, Suite 200  
Birmingham, Alabama  
(Address of Principal Executive Offices)

35243  
(Zip Code)

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

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 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 registrant had 93,305,496 shares of common stock outstanding, net of treasury shares, as of October 30, 2009.

---

## TABLE OF CONTENTS

	<u>Page</u>	
<b>PART I</b>	<b>Financial Information</b>	
Item 1.	Financial Statements (Unaudited)	1
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	38
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	60
Item 4.	Controls and Procedures	61
<b>PART II</b>	<b>Other Information</b>	
Item 1.	Legal Proceedings	62
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	62
Item 5.	Other Matters	62
Item 6.	Exhibits	64

---

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to future events, our business strategy, our future financial performance, or our projected business results. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “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 or forecasts based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. 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. 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*, of our Annual Report on Form 10-K for the year ended December 31, 2008, as well as uncertainties and factors discussed elsewhere in this Form 10-Q, in our other filings from time to time with the United States Securities and Exchange Commission, or in materials incorporated therein by reference;
- changes 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;
- 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 shortages;
- changes in the regulations of the healthcare industry at either or both of the federal and state levels;
- competitive pressures in the healthcare industry and our response to those pressures;
- our ability to successfully access the credit markets on favorable terms; and
- general conditions in the economy and capital markets.

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 1. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

HealthSouth Corporation and Subsidiaries  
Condensed Consolidated Balance Sheets  
(Unaudited)

	September 30, 2009	December 31, 2008 (As Adjusted)
	(In Millions, Except Share Data)	
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 117.3	\$ 32.2
Restricted cash	88.1	154.0
Current portion of restricted marketable securities	7.7	20.3
Accounts receivable, net of allowance for doubtful accounts of \$33.6 in 2009; \$31.1 in 2008	216.2	235.8
Insurance recoveries receivable	-	182.8
Other current assets	55.0	57.6
Total current assets	484.3	682.7
Property and equipment, net	671.5	673.9
Goodwill	414.7	414.7
Intangible assets, net	37.7	42.8
Investments in and advances to nonconsolidated affiliates	27.6	36.7
Income tax refund receivable	8.6	55.9
Other long-term assets	110.0	91.5
<b>Total assets</b>	<u>\$ 1,754.4</u>	<u>\$ 1,998.2</u>
<b>Liabilities and Shareholders' Deficit</b>		
<b>Current liabilities:</b>		
Current portion of long-term debt	\$ 21.9	\$ 23.6
Accounts payable	50.6	45.6
Accrued expenses and other current liabilities	369.8	408.5
Government, class action, and related settlements	6.1	268.5
Total current liabilities	448.4	746.2
Long-term debt, net of current portion	1,674.8	1,789.6
Other long-term liabilities	165.7	162.2
	<u>2,288.9</u>	<u>2,698.0</u>
Commitments and contingencies		
Convertible perpetual preferred stock, \$.10 par value; 1,500,000 shares authorized; 400,000 shares issued; liquidation preference of \$1,000 per share	387.4	387.4
<b>Shareholders' deficit:</b>		
HealthSouth shareholders' deficit:		
Common stock, \$.01 par value; 200,000,000 shares authorized; issued: 97,238,725 in 2009; 96,890,924 in 2008	1.0	1.0
Capital in excess of par value	2,888.4	2,956.5
Accumulated deficit	(3,756.0)	(3,812.2)
Accumulated other comprehensive income (loss)	0.9	(3.2)
Treasury stock, at cost (3,926,639 shares in 2009 and 8,872,121 shares in 2008)	(137.0)	(311.5)
Total HealthSouth shareholders' deficit	(1,002.7)	(1,169.4)
Noncontrolling interests	80.8	82.2
Total shareholders' deficit	(921.9)	(1,087.2)
<b>Total liabilities and shareholders' deficit</b>	<u>\$ 1,754.4</u>	<u>\$ 1,998.2</u>

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed balance sheets.

**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(As Adjusted)		(As Adjusted)	
	(In Millions, Except Per Share Data)			
Net operating revenues	\$ 472.7	\$ 455.5	\$ 1,431.5	\$ 1,376.3
Operating expenses:				
Salaries and benefits	235.4	236.3	709.2	700.8
Other operating expenses	66.8	68.6	201.6	201.0
General and administrative expenses	26.0	25.5	76.4	78.8
Supplies	27.7	26.2	83.9	81.1
Depreciation and amortization	18.1	17.9	53.4	65.3
Impairment of long-lived assets	4.0	-	4.0	0.6
Occupancy costs	11.8	12.6	35.9	36.8
Provision for doubtful accounts	7.9	6.6	25.5	20.5
Loss on disposal of assets	0.7	0.2	3.0	0.6
Government, class action, and related settlements expense	8.5	17.1	41.3	(27.9)
Professional fees—accounting, tax, and legal	3.5	4.0	5.0	12.9
Total operating expenses	410.4	415.0	1,239.2	1,170.5
Loss (gain) on early extinguishment of debt	-	2.1	(3.1)	5.8
Interest expense and amortization of debt discounts and fees	29.5	40.3	95.0	131.1
Other income	(0.6)	(0.4)	(1.4)	(2.1)
Loss on interest rate swaps	7.9	8.0	16.7	16.1
Equity in net income of nonconsolidated affiliates	(3.0)	(2.7)	(2.8)	(7.8)
Income (loss) from continuing operations before income tax benefit	28.5	(6.8)	87.9	62.7
Provision for income tax benefit	(1.7)	(22.5)	(0.8)	(21.7)
Income from continuing operations	30.2	15.7	88.7	84.4
(Loss) income from discontinued operations, net of tax	(5.4)	(2.9)	(6.8)	7.2
<b>Net income</b>	24.8	12.8	81.9	91.6
Less: Net income attributable to noncontrolling interests	(8.0)	(6.2)	(25.7)	(21.1)
<b>Net income attributable to HealthSouth</b>	16.8	6.6	56.2	70.5
Less: Convertible perpetual preferred stock dividends	(6.5)	(6.5)	(19.5)	(19.5)
<b>Net income attributable to HealthSouth common shareholders</b>	\$ 10.3	\$ 0.1	\$ 36.7	\$ 51.0
<b>Weighted average common shares outstanding:</b>				
Basic	87.6	87.4	87.6	81.6
Diluted	102.2	101.0	101.6	95.1
<b>Basic and diluted earnings per common share:</b>				
Income from continuing operations				
attributable to HealthSouth common shareholders	\$ 0.18	\$ 0.04	\$ 0.50	\$ 0.53
(Loss) income from discontinued operations, net of tax,				
attributable to HealthSouth common shareholders	(0.06)	(0.04)	(0.08)	0.10
Net income per share attributable to HealthSouth common shareholders	\$ 0.12	\$ 0.00	\$ 0.42	\$ 0.63
<b>Amounts attributable to HealthSouth:</b>				
Income from continuing operations	\$ 22.2	\$ 9.8	\$ 63.5	\$ 62.7
(Loss) income from discontinued operations, net of tax	(5.4)	(3.2)	(7.3)	7.8
Net income attributable to HealthSouth	\$ 16.8	\$ 6.6	\$ 56.2	\$ 70.5

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Comprehensive Income**  
(Unaudited)

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(As Adjusted)</b>		<b>(As Adjusted)</b>	
	<b>(In Millions)</b>			
<b>COMPREHENSIVE INCOME</b>				
Net income	\$ 24.8	\$ 12.8	\$ 81.9	\$ 91.6
Other comprehensive income (loss), net of tax:				
Net change in foreign currency translation adjustments	-	-	-	0.8
Net change in unrealized gain (loss) on available-for-sale securities:				
Unrealized net holding gain (loss) arising during the period	2.0	(0.6)	2.1	(0.1)
Reclassification adjustment for gains (losses) included in net income	-	-	1.6	(1.3)
Net change in unrealized (loss) gain on forward-starting interest rate swaps:				
Unrealized net holding (loss) gain arising during the period	(1.6)	-	0.2	-
Reclassification adjustment for gains included in net income	-	-	0.2	-
Other comprehensive income (loss), net of tax	0.4	(0.6)	4.1	(0.6)
<b>Comprehensive income</b>	<b>25.2</b>	<b>12.2</b>	<b>86.0</b>	<b>91.0</b>
Comprehensive income attributable to noncontrolling interests	(8.0)	(6.2)	(25.7)	(21.1)
<b>Comprehensive income attributable to HealthSouth</b>	<b>\$ 17.2</b>	<b>\$ 6.0</b>	<b>\$ 60.3</b>	<b>\$ 69.9</b>

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Shareholders' Deficit**  
(Unaudited)

Nine Months Ended September 30, 2009

(In Millions)

HealthSouth Common Shareholders									
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Noncontrolling Interests	Total	Comprehensive Income
<b>Balance at beginning of period</b>	88.0	\$ 1.0	\$ 2,956.5	\$ (3,812.2)	\$ (3.2)	\$ (311.5)	82.2	\$(1,087.2)	
Comprehensive income:									
Net income	-	-	-	56.2	-	-	25.7	81.9	\$ 81.9
Other comprehensive income, net of tax	-	-	-	-	4.1	-	-	4.1	4.1
Comprehensive income									<u>\$ 86.0</u>
Common stock issued under Securities Litigation									
Settlement	5.0	-	(58.7)	-	-	175.3	-	116.6	
Dividends declared on convertible perpetual preferred stock	-	-	(19.5)	-	-	-	-	(19.5)	
Stock-based compensation	-	-	9.9	-	-	-	-	9.9	
Distributions declared	-	-	-	-	-	-	(26.0)	(26.0)	
Other	0.3	-	0.2	-	-	(0.8)	(1.1)	(1.7)	
<b>Balance at end of period</b>	<u>93.3</u>	<u>\$ 1.0</u>	<u>\$ 2,888.4</u>	<u>\$ (3,756.0)</u>	<u>\$ 0.9</u>	<u>\$ (137.0)</u>	<u>\$ 80.8</u>	<u>\$ (921.9)</u>	

(Continued)



**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Shareholders' Deficit (Continued)**  
(Unaudited)

Nine Months Ended September 30, 2008									
(In Millions)									
HealthSouth Common Shareholders									
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Comprehensive Other Loss	Treasury Stock	Noncontrolling Interests	Total	Comprehensive Income
<b>Balance at beginning of period</b>	78.7	\$ 0.9	\$ 2,820.4	\$ (4,064.6)	\$ (0.8)	\$ (310.4)	97.2	\$(1,457.3)	
Comprehensive income:									
Net income	-	-	-	70.5	-	-	21.1	91.6	\$ 91.6
Other comprehensive loss, net of tax	-	-	-	-	(0.6)	-	-	(0.6)	(0.6)
Comprehensive income									<u>\$ 91.0</u>
Dividends declared on convertible perpetual preferred stock	-	-	(19.5)	-	-	-	-	(19.5)	
Issuance of common stock	8.8	0.1	150.1	-	-	-	-	150.2	
Stock-based compensation	-	-	8.5	-	-	-	-	8.5	
Distributions declared	-	-	-	-	-	-	(25.0)	(25.0)	
Settlements with partners	-	-	-	-	-	-	4.2	4.2	
Government, class action, and related settlements	-	-	-	-	-	-	(5.3)	(5.3)	
Transfer of surgery centers to ASC	-	-	-	-	-	-	(6.8)	(6.8)	
Other	0.5	-	0.2	-	-	(1.0)	(0.7)	(1.5)	
<b>Balance at end of period</b>	<u>88.0</u>	<u>\$ 1.0</u>	<u>\$ 2,959.7</u>	<u>\$ (3,994.1)</u>	<u>\$ (1.4)</u>	<u>\$ (311.4)</u>	<u>84.7</u>	<u>\$(1,261.5)</u>	

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(As Adjusted)</b>	
	<b>(In Millions)</b>	
<b>Cash flows from operating activities:</b>		
Net income	\$ 81.9	\$ 91.6
Loss (income) from discontinued operations	6.8	(7.2)
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	25.5	20.5
Provision for government, class action, and related settlements	41.3	(27.9)
UBS Settlement proceeds, gross	100.0	-
Depreciation and amortization	53.4	65.3
Amortization of debt issue costs, debt discounts, and fees	4.8	4.9
Impairment of long-lived assets	4.0	0.6
Loss on disposal of assets	3.0	0.6
(Gain) loss on early extinguishment of debt	(3.1)	5.8
Loss on interest rate swaps	16.7	16.1
Equity in net income of nonconsolidated affiliates	(2.8)	(7.8)
Distributions from nonconsolidated affiliates	6.5	7.6
Stock-based compensation	9.9	8.5
Deferred tax provision	2.4	2.0
Other	0.6	0.2
(Increase) decrease in assets—		
Accounts receivable	(5.9)	(27.4)
Other assets	1.3	6.4
Income tax refund receivable	47.3	(10.4)
Increase (decrease) in liabilities—		
Accounts payable	5.0	(9.3)
Accrued fees and expenses for derivative plaintiffs' attorneys in UBS Settlement	(26.2)	-
Other liabilities	10.3	18.2
Government, class action, and related settlements	(11.0)	(7.4)
Net cash used in operating activities of discontinued operations	(9.6)	(1.6)
Total adjustments	273.4	64.9
<b>Net cash provided by operating activities</b>	<b>362.1</b>	<b>149.3</b>

(Continued)

**HealthSouth Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows (Continued)**  
(Unaudited)

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(As Adjusted)</b>	
	<b>(In Millions)</b>	
<b>Cash flows from investing activities:</b>		
Capital expenditures	(54.7)	(39.4)
Acquisition of business, net of cash acquired	-	(14.6)
Acquisition of intangible assets	(0.4)	(18.2)
Proceeds from disposal of assets	0.9	53.8
Net change in restricted cash	(32.0)	20.5
Net settlements on interest rate swaps	(30.3)	(13.9)
Net investment in interest rate swap	(6.4)	-
Other	(1.7)	(0.3)
Net cash provided by investing activities of discontinued operations	0.2	0.2
<b>Net cash used in investing activities</b>	<b>(124.4)</b>	<b>(11.9)</b>
<b>Cash flows from financing activities:</b>		
Checks in excess of bank balance	-	(11.4)
Change in restricted cash for amounts in escrow related to debt	-	(30.3)
Principal payments on debt, including pre-payments	(62.9)	(121.5)
Borrowings on revolving credit facility	10.0	88.0
Payments on revolving credit facility	(50.0)	(150.0)
Principal payments under capital lease obligations	(9.9)	(9.3)
Issuance of common stock	-	150.2
Dividends paid on convertible perpetual preferred stock	(19.5)	(19.5)
Distributions paid to noncontrolling interests of consolidated affiliates	(22.8)	(26.3)
Other	1.1	(0.3)
Net cash provided by (used in) financing activities of discontinued operations	1.4	(3.0)
<b>Net cash used in financing activities</b>	<b>(152.6)</b>	<b>(133.4)</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>-</b>	<b>0.8</b>
<b>Increase in cash and cash equivalents</b>	<b>85.1</b>	<b>4.8</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>32.2</b>	<b>19.8</b>
<b>Cash and cash equivalents of divisions and facilities held for sale at beginning of period</b>	<b>-</b>	<b>0.4</b>
<b>Less: Cash and cash equivalents of divisions and facilities held for sale at end of period</b>	<b>-</b>	<b>(0.1)</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 117.3</b>	<b>\$ 24.9</b>
<b>Supplemental schedule of noncash financing activities:</b>		
Securities Litigation Settlement	\$ 299.3	\$ -

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**1. Basis of Presentation:**

HealthSouth Corporation, incorporated in Delaware in 1984, including its subsidiaries, is the largest provider of inpatient rehabilitative healthcare services in the United States. We operate inpatient rehabilitation hospitals and long-term acute care hospitals and provide treatment on both an inpatient and outpatient basis. References herein to "HealthSouth," the "Company," "we," "our," or "us" refer to HealthSouth Corporation and its subsidiaries unless otherwise stated or indicated by context.

The accompanying unaudited condensed consolidated financial statements of HealthSouth Corporation and Subsidiaries should be read in conjunction with the consolidated financial statements and accompanying notes filed with the United States Securities and Exchange Commission (the "SEC") in HealthSouth's Annual Report on Form 10-K filed on February 24, 2009 (the "2008 Form 10-K"). The unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the SEC applicable to interim financial information. Certain information and note disclosures included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been omitted in these interim statements, as allowed by such SEC rules and regulations. The condensed consolidated balance sheet as of December 31, 2008 has been derived from audited financial statements, as adjusted for our recharacterization of minority interests to noncontrolling interest and classification of noncontrolling interest as a component of equity, but it does not include all disclosures required by GAAP. However, we believe the disclosures are adequate to make the information presented not misleading.

The unaudited results of operations for the interim periods shown in these financial statements are not necessarily indicative of operating results for the entire year. In our opinion, the accompanying condensed consolidated financial statements recognize all adjustments of a normal recurring nature considered necessary to fairly state the financial position, results of operations, and cash flows for each interim period presented.

Subsequent events have been evaluated through November 4, 2009, which represents the issuance date of these unaudited condensed consolidated financial statements.

**Reclassifications —**

Certain financial results have been reclassified to conform to the current year presentation. Such reclassifications primarily relate to rental properties where we terminated the leases associated with certain properties during the first quarter of 2009. We reclassified our condensed consolidated balance sheet as of December 31, 2008, our condensed consolidated statements of operations for the three and nine months ended September 30, 2008, and our condensed consolidated statement of cash flows for the nine months ended September 30, 2008 to include these properties and their results of operations in discontinued operations.

As of January 1, 2009, we reclassified our noncontrolling interests (formerly known as "minority interests") as a component of equity and now report net income and comprehensive income attributable to our noncontrolling interests separately from net income and comprehensive income attributable to HealthSouth.

**Out-of-Period Adjustments —**

During the preparation of our condensed consolidated financial statements for the quarterly period ended June 30, 2009, we identified an error in our consolidated financial statements as of and for the year ended December 31, 2008 and prior periods and our condensed consolidated financial statements as of and for the quarterly period ended March 31, 2009. We corrected this error in our financial statements by adjusting *Equity in net income of nonconsolidated affiliates*, which resulted in an understatement of both our *Income (loss) from continuing operations before income tax benefit* and our *Net income* of approximately \$4.5 million for the nine months ended September 30, 2009. This error related primarily to an approximate \$9.6 million overstatement of our investment in a joint venture hospital we account for using the equity method of accounting due to the understatement of prior period income tax provisions of this joint venture hospital and the adjustment of certain liabilities due to this joint venture hospital. We also adjusted *Accrued expenses and other current liabilities* by approximately \$4.7 million due to changes in amounts due to us for expenses paid on behalf of this joint venture hospital. We do not believe these adjustments are material to the condensed consolidated financial statements as of September 30, 2009 and for the nine months then ended or to any prior years' consolidated financial statements. As a result, we have not restated any prior period amounts.

**Stock-Based Compensation —**

In February 2009, we granted 1.7 million shares of restricted common stock to members of our management team and our board of directors. Approximately 0.5 million shares of the restricted stock granted contain only a service condition, while the remaining 1.2 million shares contain a service and either a performance or market condition. Additionally, we granted 0.3 million stock options to members of our management team. The fair value of these awards and options were determined using the policies described in the 2008 Form 10-K.

**Recent Accounting Pronouncements —**

In April 2009, the Financial Accounting Standards Board ("FASB") updated the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance was effective for interim and annual reporting periods ended after June 15, 2009, with early adoption permitted. HealthSouth elected to adopt this amended guidance in the first quarter of 2009. While its adoption did not have a material impact on our financial position, results of operations, or cash flows, it does require interim disclosures related to our available-for-sale equity securities. See Note 3, *Cash and Marketable Securities*.

In April 2009, the FASB also issued updated guidance on disclosures about fair value of financial instruments. This guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements and was effective for interim reporting periods ended after June 15, 2009, with early adoption permitted. HealthSouth elected to adopt this amended guidance in

the first quarter of 2009. Its adoption resulted in additional interim disclosures only. See Note 7, *Fair Value Measurements*.

In May 2009, the FASB issued authoritative guidance on subsequent events to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance was effective for interim or annual financial periods ended after June 15, 2009. Our adoption of this guidance resulted only in additional disclosure regarding the date through which subsequent events have been evaluated in each set of interim or annual financial statements and had no impact on our financial position, results of operations, or cash flows.

In June 2009, the FASB established the FASB Accounting Standards Codification (the "Codification") as the single authoritative source for GAAP. The Codification was effective for financial statements that cover interim and annual periods ended after September 15, 2009. While not intended to change GAAP, the Codification significantly changed the way in which the accounting literature is organized. Because the Codification completely replaced existing standards, it affected the way GAAP is referenced by companies in their financial statements and accounting policies. Our adoption and our use of the Codification beginning in the third quarter of 2009 did not have an impact on our financial position, results of operations, or cash flows.

Since the filing of our 2008 Form 10-K, 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. Liquidity:

We continue to make progress in improving our leverage and liquidity.

During the nine months ended September 30, 2009, we reduced our total debt by approximately \$117 million and increased our *Cash and cash equivalents* by approximately \$85 million. In February 2009, we used our federal income tax refund for tax years 1995 through 1999 (see Note 17, *Income Taxes*), to the consolidated financial statements accompanying our 2008 Form 10-K) along with available cash to reduce our Term Loan Facility (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K) by \$24.5 million and amounts outstanding under our revolving credit facility to zero. In addition, we have used a portion of the net proceeds from our settlement with UBS (see Note 11, *Settlements*) to redeem \$36.4 million of our Floating Rate Senior Notes due 2014 (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K). See also Note 5, *Long-term Debt*.

As of September 30, 2009, we had \$117.3 million in *Cash and cash equivalents*. This amount excludes \$88.1 million in *Restricted cash* and \$23.3 million of restricted marketable securities. Our restricted assets pertain to various obligations we have under partnership agreements and other arrangements, primarily related to our captive insurance company. As of December 31, 2008, our *Restricted cash* included \$97.9 million related to our settlement with UBS (see Note 11, *Settlements*).

We have scheduled principal payments of \$6.2 million and \$24.9 million in the remainder of 2009 and 2010, respectively, related to long-term debt obligations (see Note 5, *Long-term Debt*). We do not face substantial near-term refinancing risk, as our revolving credit facility does not expire until 2012, a portion of our Term Loan Facility does not mature until 2013, with the remainder maturing in 2015, depending on certain conditions (see Note 5, *Long-term Debt*, for a discussion of an amendment and extension related to our Credit Agreement), and the majority of our bonds are not due until 2014 and 2016.

Our Credit Agreement (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K) governs the vast majority of our senior secured borrowings and contains financial covenants that include a leverage ratio and an interest coverage ratio. As of September 30, 2009, we were in compliance with the covenants under our Credit Agreement. 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 not be on terms as favorable to those in our existing Credit Agreement. Under such circumstances, there is also the potential our lenders would not grant relief to us which, among other things, would depend on the state of the credit markets at that time. However, we believe we have reduced this risk by significantly lowering our senior secured leverage ratio since the inception of our Credit Agreement.

Our Credit Agreement also contains excess cash flow provisions. To the extent we have available cash at the end of 2009 that has not been used to make qualified capital expenditures or debt reductions, and depending upon our leverage ratio under our Credit Agreement, we may be required to use a portion of our excess cash to reduce amounts outstanding on our Term Loan Facility.

Our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility. We monitor the financial strength of our depositories, creditors, insurance carriers, and other counterparties using publicly available information, as well as qualitative inputs. Based on our current borrowing capacity and compliance with the financial covenants under our Credit Agreement, we do not believe there is significant risk in our ability to make draws under our revolving credit facility, if needed. However, no such assurances can be provided. We continue to analyze our capital structure, and we will use our available cash in a manner that provides the most beneficial impact to our capital structure, including deleveraging.

See Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K for a discussion of risks and uncertainties facing us. Changes in our business or other factors may occur that might have a material adverse impact on our financial position, results of operations, and cash flows.

## 3. Cash and Marketable Securities:

As of September 30, 2009 and December 31, 2008, our investments consist of cash and cash equivalents and marketable securities. Our investments in marketable securities are classified as available-for-sale.

The components of our investments as of September 30, 2009 are as follows (in millions):

<u>Cash &amp; Cash Equivalents</u>	<u>Restricted Cash</u>	<u>Nonrestricted Marketable Securities</u>	<u>Restricted Marketable Securities</u>	<u>Total</u>
--	----------------------------	--	---	--------------

Cash	\$ 117.3	\$ 88.1	\$ -	\$ -	\$ 205.4
Equity securities	-	-	0.5	23.3	23.8
Total	<u>\$ 117.3</u>	<u>\$ 88.1</u>	<u>\$ 0.5</u>	<u>\$ 23.3</u>	<u>\$ 229.2</u>

The components of our investments as of December 31, 2008 are as follows (in millions):

	Cash & Cash Equivalents	Restricted Cash	Nonrestricted Marketable Securities	Restricted Marketable Securities	Total
Cash	\$ 32.2	\$ 154.0	\$ -	\$ -	\$ 186.2
Equity securities	-	-	0.2	20.3	20.5
Total	<u>\$ 32.2</u>	<u>\$ 154.0</u>	<u>\$ 0.2</u>	<u>\$ 20.3</u>	<u>\$ 206.7</u>

Approximately \$15.6 million of restricted marketable securities are included in *Other long-term assets* in our condensed consolidated balance sheet as of September 30, 2009. *Restricted cash* as of December 31, 2008 includes cash associated with the UBS Settlement discussed in Note 11, *Settlements*. Nonrestricted marketable securities are included in *Other current assets* in our condensed consolidated balance sheets.

A summary of our restricted marketable securities as of September 30, 2009 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	\$ 21.4	\$ 2.0	\$ (0.1)	\$ 23.3

A summary of our restricted marketable securities as of December 31, 2008 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	\$ 21.9	\$ 0.4	\$ (2.0)	\$ 20.3

Cost in the above tables includes adjustments made to the cost basis of our equity securities for other-than-temporary impairments. During the nine months ended September 30, 2009, we recorded \$0.8 million of impairments related to our restricted marketable securities. These impairment charges are included in *Other income* in our condensed consolidated statement of operations for the nine months ended September 30, 2009. No impairments were recorded during the three months ended September 30, 2009 or the three or nine months ended September 30, 2008.

Investing information related to our marketable securities is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Nonrestricted:</b>				
Gross realized gains - nonrestricted	\$ -	\$ -	\$ -	\$ 0.6
<b>Restricted:</b>				
Proceeds from sales of restricted available-for-sale securities	\$ 0.3	\$ 1.1	\$ 1.9	\$ 2.4
Gross realized gains - restricted	\$ 0.1	\$ 0.1	\$ 0.3	\$ 0.2
Gross realized losses - restricted	\$ -	\$ (0.5)	\$ (0.2)	\$ (0.7)

The following table shows the fair value and gross unrealized losses of our marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by the length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2009 and December 31, 2008 (in millions):

	As of September 30, 2009	As of December 31, 2008
Less than 12 months:		
Fair value	\$ 0.4	\$ 15.5
Gross unrealized losses	\$ -	\$ (1.9)
12 months or greater:		
Fair value	\$ 0.6	\$ 0.1
Gross unrealized losses	\$ (0.1)	\$ (0.1)
Total:		
Fair value	\$ 1.0	\$ 15.6
Gross unrealized losses	\$ (0.1)	\$ (2.0)

Our portfolio of marketable securities is comprised of numerous individual equity securities and mutual funds across a variety of industries. For our marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, we examined the severity and duration of the impairments in relation to the cost of the individual investments. We also considered the industry in which each investment is held and the near-term prospects for a recovery in each specific industry. Based on our evaluation and our ability and intent to hold these investments for a reasonable period of

time sufficient for a potential recovery of fair value, we do not believe these investments are other-than-temporarily impaired at September 30, 2009.

#### 4. Investments in and Advances to Nonconsolidated Affiliates:

*Investments in and advances to nonconsolidated affiliates* as of September 30, 2009 represents our investment in 16 partially owned subsidiaries, of which 11 are general or limited partnerships, limited liability companies, or joint ventures in which HealthSouth or one of our 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 4% to 51%. We account for these investments using the cost and equity methods of accounting.

The following summarizes the combined results of operations of our equity method affiliates (on a 100% basis, in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net operating revenues	\$ 19.3	\$ 17.9	\$ 54.8	\$ 55.2
Operating expenses	(11.3)	(11.2)	(34.5)	(26.1)
Income from continuing operations	6.5	5.7	16.8	26.2
Net income	6.5	5.7	16.8	26.2

See also Note 1, *Basis of Presentation*, "Out-of-Period Adjustments."

#### 5. Long-term Debt

Our long-term debt outstanding consists of the following (in millions):

	September 30, 2009	December 31, 2008
Advances under \$400 million revolving credit facility	\$ -	\$ 40.0
Term Loan Facility	753.2	783.6
Bonds Payable—		
8.375% Senior Notes due 2011	0.3	0.3
7.625% Senior Notes due 2012	1.5	1.5
Floating Rate Senior Notes due 2014	329.6	366.0
10.75% Senior Notes due 2016	494.7	494.3
Other notes payable at interest rates from 8.1% to 12.9%	12.5	12.8
Capital lease obligations	104.9	114.7
	1,696.7	1,813.2
Less: Current portion	(21.9)	(23.6)
Long-term debt, net of current portion	\$ 1,674.8	\$ 1,789.6

For a description of our indebtedness, see Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K. See Note 2, *Liquidity*, for a discussion of debt reductions during 2009.

In October 2009, we entered into an agreement with the lenders in our Credit Agreement to extend the maturity of a portion of our Term Loan Facility and to amend certain provisions of the Credit Agreement. The extension provides for a \$300.0 million tranche of the Term Loan Facility to have its maturity extended from March 2013 to September 2015 in exchange for a higher interest rate spread on that portion of the loan. In the event we have not fully redeemed or refinanced the Floating Rate Senior Notes due 2014 by March 15, 2014, the extended portion of the Term Loan Facility will mature on that date. The extended portion of the loan now accrues interest at a rate of LIBOR plus 3.75% while the remainder of the Term Loan Facility continues to accrue interest at LIBOR plus 2.25%. Both portions of the Term Loan Facility continue to amortize at the same 0.25% of the principal outstanding per quarter rate. The other amendments to the Credit Agreement primarily allow us to issue senior secured and unsecured notes in the bond market and increase amounts we can spend for acquisitions and selected debt repurchases.

The following chart shows scheduled principal payments due on long-term debt for the next five years and thereafter after the extension of \$300.0 million of the Term Loan Facility in October 2009, as discussed above (in millions):

	Face Amount	Net Amount
October 1 through December 31, 2009	\$ 6.2	\$ 6.2
2010	24.9	24.9
2011	24.2	24.2
2012	23.6	23.6
2013	440.5	440.5
2014	623.3	623.3
Thereafter	559.9	554.0
Total	\$ 1,702.6	\$ 1,696.7

The following table provides information regarding our *Interest expense and amortization of debt discounts and fees* presented in our condensed consolidated statements of operations (in millions):

	Three Months Ended September 30,	Nine Months Ended September 30,
--	-------------------------------------	------------------------------------



	2009	2008	2009	2008
Interest expense	\$ 27.9	\$ 38.7	\$ 90.2	\$ 126.2
Amortization of debt discounts and fees	1.6	1.6	4.8	4.9
Interest expense and amortization of debt discounts and fees	<u>\$ 29.5</u>	<u>\$ 40.3</u>	<u>\$ 95.0</u>	<u>\$ 131.1</u>

#### *Interest Rate Swaps—*

##### Interest Rate Swaps Not Designated as Hedging Instruments

In March 2006, we entered into an interest rate swap to effectively convert the floating rate of a portion of our Credit Agreement to a fixed rate in order to limit the variability of interest-related payments caused by changes in LIBOR. Under this interest rate swap agreement, we pay a fixed rate of 5.2% on an amortizing notional principal of \$1.1 billion, while the counterparties to this agreement pay a floating rate based on 3-month LIBOR. The termination date of this swap is March 10, 2011. The fair market value of this swap as of September 30, 2009 and December 31, 2008 was (\$64.7) million and (\$78.2) million, respectively, and is included in *Accrued expenses and other current liabilities* in our condensed consolidated balance sheets. See Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K for additional information related to this interest rate swap.

In June 2009, we entered into a receive-fixed swap as a mirror offset to \$100.0 million of the \$1.1 billion interest rate swap discussed above in order to reduce our effective fixed rate to total debt ratio. Under this interest rate swap agreement, we pay a variable rate based on 3-month LIBOR, while the counterparty to this agreement pays a fixed rate of 5.2% on a notional principal of \$100.0 million. Net settlements commenced in September 2009 and are made quarterly on the same settlement schedule as the \$1.1 billion interest rate swap discussed above. The termination date of this swap is March 10, 2011. Our initial net investment in this swap was \$6.4 million. The fair market value of this swap as of September 30, 2009 was \$6.5 million. Of this amount, \$4.7 million is included in *Other current assets* with the remainder included in *Other long-term assets* in our condensed consolidated balance sheet.

These interest rate swaps are not designated as hedges. Therefore, changes in the fair value of these interest rate swaps during the three and nine months ended September 30, 2009 and 2008 have been included in current-period earnings as *Loss on interest rate swaps*.

During the three and nine months ended September 30, 2009, we made net cash settlement payments of \$11.2 million and \$30.3 million, respectively, to our counterparties. During the three and nine months ended September 30, 2008, we made net cash settlement payments of \$7.3 million and \$13.9 million, respectively, to our counterparties. Net settlement payments or receipts on these swaps are included in the line item *Loss on interest rate swaps* in our condensed consolidated statements of operations.

##### Forward-Starting Interest Rate Swaps Designated as Cash Flow Hedges

In December 2008, we entered into a \$100 million forward-starting interest rate swap as a cash flow hedge of future interest payments on our Term Loan Facility. Under this swap agreement, we will pay a fixed rate of 2.6% while the counterparty will pay a floating rate based on 3-month LIBOR. Net settlements will commence on June 10, 2011. The termination date of this swap is December 12, 2012. The fair market value of this swap as of September 30, 2009 and December 31, 2008 was \$0.4 million and (\$0.2) million, respectively, and is included in *Other long-term assets* and *Accrued expenses and other current liabilities*, respectively, in our condensed consolidated balance sheets.

In March 2009, we entered into an additional \$100 million forward-starting interest rate swap as a cash flow hedge of future interest payments on our Term Loan Facility. Under this swap agreement, we will pay a fixed rate of 2.9% while the counterparty will pay a floating rate based on 3-month LIBOR. Net settlements will commence on June 10, 2011. The termination date of this swap is September 12, 2012. The fair market value of this swap as of September 30, 2009 was (\$0.2) million and is included in *Accrued expenses and other current liabilities* in our condensed consolidated balance sheet.

Both forward-starting swaps are designated as cash flow hedges and are accounted for under the policies described in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K. The effective portion of changes in the fair value of these cash flow hedges is deferred as a component of other comprehensive income and is reclassified into earnings as part of interest expense in the same period in which the forecasted transaction impacts earnings.

See also Note 7, *Fair Value Measurements*.

## **6. Guarantees:**

Primarily in conjunction with the sale of certain facilities, including the sale of our surgery centers, outpatient, and diagnostic divisions during 2007, HealthSouth assigned, or remained as a guarantor on, the leases of certain properties and equipment to certain purchasers and, as a condition of the lease, agreed to act as a guarantor of the purchaser's performance on the lease. HealthSouth also remained as a guarantor to certain purchase contracts that were assigned to the buyer of our diagnostic division in connection with the sale. Should the purchaser fail to pay the obligations due on these leases or contracts, the lessor or vendor would have contractual recourse against us.

As of September 30, 2009, we were secondarily liable for 84 such guarantees. The remaining terms of these guarantees ranged from one month to 117 months. If we were required to perform under all such guarantees, the maximum amount we would be required to pay approximated \$51.9 million.

We have not recorded a liability for these guarantees, as we do not believe it is probable we will have to perform under these agreements. If we are required to perform under these guarantees, we could potentially have recourse against the purchaser for recovery of any amounts paid. In addition, the purchasers of our surgery centers, outpatient, and diagnostic divisions have agreed to seek releases from the lessors and vendors in favor of HealthSouth with respect to the guarantee obligations associated with these divestitures. To the extent the purchasers of these divisions are unable to obtain releases for HealthSouth, the purchasers have agreed to indemnify HealthSouth for damages incurred under the guarantee obligations, if any.

These guarantees are not secured by any assets under the agreements. As of September 30, 2009, we have not been required to make any material payments under these agreements.



## 7. 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					Valuation Technique <sup>(1)</sup>
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>September 30, 2009</b>						
Current portion of restricted marketable securities	\$ 7.7	\$ 7.7	\$ -	\$ -		M
Other current assets:						
Marketable securities	0.5	0.5	-	-		M
June 2009 trading swap	4.7	-	4.7	-		I
Other long-term assets:						
Restricted marketable securities	15.6	15.6	-	-		M
December 2008 forward-starting swap	0.4	-	0.4	-		I
June 2009 trading swap	1.8	-	1.8	-		I
Accrued expenses and other current liabilities:						
March 2006 trading swap	(64.7)	-	(64.7)	-		I
March 2009 forward-starting swap	(0.2)	-	(0.2)	-		I

<sup>(1)</sup> The three valuation techniques are: market approach (M), cost approach (C), and income approach (I).

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. Assets measured at fair value on a nonrecurring basis are as follows (in millions):

	Net Carrying Value as of September 30, 2009	Fair Value Measurements at Reporting Date Using			Total Losses	
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
Property and equipment	\$ 671.5	\$ -	\$ 671.5	\$ -	\$ 4.0	\$ 4.0
Investments in and advances to nonconsolidated affiliates	1.7	-	-	1.7	0.4	0.4
Other long-term assets:						
Assets held for sale	28.0	-	28.0	-	0.4	0.9

The above losses represent our write-down of certain assets to their estimated fair value based on offers we received from third parties to acquire the assets or other market conditions. The \$4.0 million charge related to *Property and equipment* is included in *Impairment of long-lived assets* in our condensed consolidated statements of operations for the three and nine months ended September 30, 2009. The loss related to *Investments in and advances to nonconsolidated affiliates* is included in *Other Income* in our condensed consolidated statements of operations for the three and nine months ended September 30, 2009. The losses related to assets held for sale are included in *Loss on disposal of assets* in our condensed consolidated statements of operations for the three and nine months ended September 30, 2009. In addition, during the nine months ended September 30, 2008, we recorded an impairment charge of \$0.6 million. This charge represented our write-down of certain long-lived assets associated with one of our hospitals to their estimated fair value based on an offer we received from a third party to acquire the assets. During the three and nine months ended September 30, 2008, we also recorded \$8.4 million and \$9.0 million, respectively, of impairment charges as part of our results of discontinued operations. See Note 16, *Assets Held for Sale and Results of Discontinued Operations*, to the consolidated financial statements included in our 2008 Form 10-K.

The loss associated with *Investments in and advances to nonconsolidated affiliates* resulted from an other-than-temporary impairment of an investment accounted for using the cost method of accounting. The investment was valued using its published net asset value discounted due to recent market fluctuations, the illiquid nature of the investment, and proposed changes to the investment's structure. More specifically, and because we elected a liquidation option with regard to this investment, we discounted the net asset value of our holdings to account for anticipated sales of assets within this investment at prices lower than the currently stated net asset value.

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 condensed consolidated balance sheets. The carrying amounts and estimated fair values for all of our other financial instruments are presented in the following table (in millions):

	As of September 30, 2009		As of December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Interest rate swap agreements:				
March 2006 trading swap	\$ (64.7)	\$ (64.7)	\$ (78.2)	\$ (78.2)

December 2008 forward-starting swap	0.4	0.4	(0.2)	(0.2)
March 2009 forward-starting swap	(0.2)	(0.2)	-	-
June 2009 trading swap	6.5	6.5	-	-
<b>Long-term debt:</b>				
Advances under \$400 million revolving credit facility	-	-	40.0	28.4
Term Loan Facility	753.2	722.1	783.6	597.5
8.375% Senior Notes due 2011	0.3	0.3	0.3	0.3
7.625% Senior Notes due 2012	1.5	1.5	1.5	1.5
Floating Rate Senior Notes due 2014	329.6	321.4	366.0	292.1
10.75% Senior Notes due 2016	494.7	542.5	494.3	459.0
Other notes payable	12.5	12.5	12.8	12.8
<b>Financial commitments:</b>				
Letters of credit	-	94.1	-	152.7

## 8. Assets Held for Sale and Results of Discontinued Operations:

During the first quarter of 2009, we terminated the leases associated with certain rental properties. As a result, we reclassified our condensed consolidated balance sheet as of December 31, 2008, our condensed consolidated statements of operations for the three and nine months ended September 30, 2008, and our condensed consolidated statement of cash flows for the nine months ended September 30, 2008 to include these properties and their results of operations in discontinued operations.

The operating results of discontinued operations are as follows (in millions):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net operating revenues	\$ 2.3	\$ 8.7	\$ 8.0	\$ 27.1
Costs and expenses	8.4	3.1	15.2	30.2
Impairments	-	8.4	-	9.0
Loss from discontinued operations	(6.1)	(2.8)	(7.2)	(12.1)
Gain (loss) on disposal of assets of discontinued operations	0.7	(0.1)	0.4	(0.1)
Gain on divestitures of divisions	-	-	-	18.7
Income tax benefit	-	-	-	0.7
(Loss) income from discontinued operations, net of tax	<u>\$ (5.4)</u>	<u>\$ (2.9)</u>	<u>\$ (6.8)</u>	<u>\$ 7.2</u>

Assets and liabilities held for sale consist of the following (in millions):

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
<b>Assets:</b>		
Current assets	\$ 2.0	\$ 2.8
Long-term assets	28.0	24.9
Total assets	<u>\$ 30.0</u>	<u>\$ 27.7</u>
<b>Liabilities:</b>		
Current liabilities	\$ 32.7	\$ 36.9
Long-term liabilities	5.5	4.7
Total long-term liabilities	<u>\$ 38.2</u>	<u>\$ 41.6</u>

Assets and liabilities held for sale in the above table primarily relate to the one surgery facility that is awaiting transfer to ASC, as defined and discussed below, as of September 30, 2009.

Current assets and long-term assets in the above table are included in *Other current assets* and *Other long-term assets*, respectively, in our condensed consolidated balance sheets. Current liabilities and long-term liabilities in the above table are included in *Accrued expenses and other current liabilities* and *Other long-term liabilities*, respectively, in our condensed consolidated balance sheets.

### ***Surgery Centers Division—***

As discussed in Note 16, *Assets Held for Sale and Results of Discontinued Operations*, to the consolidated financial statements accompanying our 2008 Form 10-K, the transaction to sell our surgery centers division to ASC Acquisition LLC (“ASC”) closed on June 29, 2007, other than with respect to certain facilities for which approvals for the transfer to ASC had not yet been received as of such date. In connection with the closing, HealthSouth and ASC agreed, among other things, that HealthSouth would retain its ownership interest in certain surgery centers until regulatory approvals for the transfer of such surgery centers to ASC were received. In that regard, ASC would manage the operations of such surgery centers until such approvals had been received, and HealthSouth and ASC entered into arrangements designed to place them in approximately the same economic position, whether positive or negative, they would have occupied had all regulatory approvals been received prior to closing. Upon receipt of such approvals, HealthSouth’s ownership interest in such facilities would be transferred to ASC. No portion of the purchase price was withheld at closing pending the transfer of these facilities. In the event regulatory approval for the transfer of any such facility is not received prior to December 31, 2009, HealthSouth would be required to return to ASC a portion of the purchase price allocated to such facility.

As of September 30, 2009, one facility in Illinois remained pending due to a relocation project that was completed during the second quarter of

2009. While the transfer of this facility pended, we maintained our management agreement with ASC. In October 2009, we received approval for the transfer of this facility to ASC, and the transfer to ASC became effective as of November 1, 2009.

The assets and liabilities for the surgery centers division as of September 30, 2009 and December 31, 2008 include the assets and liabilities associated with the facility that had not been transferred as of those dates, as these assets were not transferred to ASC until November 2009, once approval for such transfer had been obtained. As of both balance sheet dates, we had deferred \$26.5 million of cash proceeds received at closing associated with this facility. The results of operations of this facility will be reported in discontinued operations through its November 2009 transfer date.

During the first quarter of 2008, we recorded a \$19.3 million post-tax gain on disposal associated with five Illinois facilities that were transferred during the quarter. We expect to record an additional post-tax gain of approximately \$14 million for the facility that was transferred to ASC during the fourth quarter of 2009.

## 9. Income Taxes:

Our *Provision for income tax benefit* of \$1.7 million for the three months ended September 30, 2009 includes the following: (1) current income tax benefit of \$3.9 million primarily attributable to state income tax refunds received, or expected to be received, offset by (2) current income tax expense of \$1.7 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of \$0.5 million attributable to increases in basis differences of certain indefinite-lived assets.

Our *Provision for income tax benefit* of \$0.8 million for the nine months ended September 30, 2009 includes the following: (1) current income tax benefit of \$9.1 million primarily attributable to state income tax refunds received, or expected to be received, offset by (2) current income tax expense of \$5.9 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of \$2.4 million attributable to increases in basis differences of certain indefinite-lived assets and a decrease in our deferred tax asset related to the Alternative Minimum Tax Refundable Tax Credit.

We have significant federal and state net operating loss carryforwards (“NOLs”) that expire in various amounts at varying times through 2028. We assess the realization of our deferred tax assets quarterly to determine whether an adjustment to our valuation allowance is required. After consideration of all evidence, both positive and negative, management concluded it is more likely than not we will not realize a portion of our deferred tax assets. Therefore, a valuation allowance has been established on substantially all of our net deferred tax assets. No valuation allowance has been provided on deferred assets and liabilities attributable to subsidiaries not included within the federal consolidated group.

Our utilization of NOLs is subject to the Internal Revenue Code Section 382 (“Section 382”) limitation and may be limited in the event of certain cumulative changes in ownership interests of significant shareholders over a three-year period in excess of 50%. Section 382 imposes an annual limitation on the use of these losses to an amount equal to the value of a company at the time of an ownership change multiplied by the long-term tax exempt rate. At this time, we do not believe these limitations will limit our ability to use any NOLs before they expire. However, no such assurances can be provided.

Our *Provision for income tax benefit* of \$22.5 million for the three months ended September 30, 2008, includes the following: (1) current income tax benefit of approximately \$25.1 million primarily attributable to state income tax refunds received, or expected to be received, and changes in the amount of unrecognized tax benefits offset by (2) current income tax expense of approximately \$2.0 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of approximately \$0.6 million attributable to increases in the basis difference of certain indefinite-lived assets.

Our *Provision for income tax benefit* of \$21.7 million for the nine months ended September 30, 2008, includes the following: (1) current income tax benefit of approximately \$44.2 million primarily attributable to state income tax refunds received, or expected to be received, and changes in the amount of unrecognized tax benefits offset by (2) current income tax expense of approximately \$20.5 million attributable to a revision in previously estimated federal income tax refunds and related interest as a result of our settlement with the Internal Revenue Service (the “IRS”) for the tax years 2000 through 2003, state income tax expense of subsidiaries which have separate state filing requirements, and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of approximately \$2.0 million attributable to increases in the basis difference of certain indefinite-lived assets.

As of December 31, 2008, total remaining gross unrecognized tax benefits were \$61.1 million, all of which would affect our effective tax rate if recognized. Total accrued interest expense related to unrecognized tax benefits was \$2.9 million as of December 31, 2008. During the nine months ended September 30, 2009, the amount of unrecognized benefits changed due primarily to the issuance of a Revenue Agent’s Report by the IRS in April 2009 related to the 2004 tax year which reopened statutes of limitation in certain states where amended returns are required to be filed. Total remaining gross unrecognized tax benefits were \$59.4 million as of September 30, 2009, all of which would affect our effective tax rate if recognized. Total accrued interest expense related to unrecognized tax benefits as of September 30, 2009 was \$3.0 million.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. For the three and nine months ended September 30, 2009 and 2008, we recorded \$0.4 million and \$1.9 million, respectively, of net interest income as part of our income tax provision. For the three and nine months ended September 30, 2008, we recorded \$0.7 million and \$(2.1) million, respectively, of net interest income (expense) as part of our income tax provision. Total accrued interest income was \$1.3 million and \$17.5 million as of September 30, 2009 and December 31, 2008, respectively.

HealthSouth and its subsidiaries’ federal and state income tax returns are periodically examined by various regulatory taxing authorities. In connection with such examinations, we have settled federal income tax examinations with the IRS for all tax years through 2004. In April 2009, the IRS initiated an audit of the 2005 to 2007 tax years.

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. However, at this time, we cannot estimate a range of the reasonably possible change that may occur.

We continue to actively pursue the maximization of our remaining state income tax refund claims. The process of resolving these tax matters

with the applicable taxing authorities will continue in 2009. Although management believes its estimates and judgments related to these claims are reasonable, depending on the ultimate resolution of these tax matters, actual amounts recovered could differ from management's estimates, and such differences could be material.

## 10. 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 of diluted earnings per common share recognizes the effect of all dilutive potential common shares that were outstanding during the respective periods, unless their impact would be antidilutive. The following table sets forth the computation of basic and diluted earnings per common share (in millions, except per share amounts):

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
<b>Numerator:</b>				
Income from continuing operations	\$ 30.2	\$ 15.7	\$ 88.7	\$ 84.4
Less: Net income attributable to noncontrolling interests included in continuing operations	(8.0)	(5.9)	(25.2)	(21.7)
Less: Convertible perpetual preferred stock dividends	(6.5)	(6.5)	(19.5)	(19.5)
Income from continuing operations attributable to HealthSouth common shareholders	15.7	3.3	44.0	43.2
(Loss) income from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(5.4)	(3.2)	(7.3)	7.8
Net income attributable to HealthSouth common shareholders	<u>\$ 10.3</u>	<u>\$ 0.1</u>	<u>\$ 36.7</u>	<u>\$ 51.0</u>
<b>Denominator:</b>				
Basic weighted average common shares outstanding	<u>87.6</u>	<u>87.4</u>	<u>87.6</u>	<u>81.6</u>
Diluted weighted average common shares outstanding	<u>102.2</u>	<u>101.0</u>	<u>101.6</u>	<u>95.1</u>
<b>Basic and diluted earnings per common share:</b>				
Income from continuing operations attributable to HealthSouth common shareholders	\$ 0.18	\$ 0.04	\$ 0.50	\$ 0.53
(Loss) income from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.06)	(0.04)	(0.08)	0.10
Net income attributable to HealthSouth common shareholders	<u>\$ 0.12</u>	<u>\$ 0.00</u>	<u>\$ 0.42</u>	<u>\$ 0.63</u>

Diluted earnings per share report the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. These potential shares include dilutive stock options, restricted stock awards, restricted stock units, and convertible perpetual preferred stock. For the three months ended September 30, 2009 and 2008, the number of potential shares approximated 14.6 million and 13.6 million, respectively. For the nine months ended September 30, 2009 and 2008, the number of potential shares approximated 14.0 million and 13.5 million, respectively. For the three and nine months ended September 30, 2009 and 2008, approximately 13.1 million of the potential shares related to our *Convertible perpetual preferred stock*. For the three and nine months ended September 30, 2009 and 2008, adding back the dividends for the *Convertible perpetual 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. Therefore, basic and diluted earnings per common share are the same for the three and nine months ended September 30, 2009 and 2008.

Options to purchase 2.4 million shares of common stock were outstanding during each period presented but were not included in the computation of diluted weighted-average shares because to do so would have been antidilutive.

On September 30, 2009, we issued 5.0 million shares of common stock and 8.2 million common stock warrants associated with our class action securities litigation. For additional information, see Note 11, *Settlements*, "Securities Litigation Settlement."

See Note 18, *Earnings (Loss) per Common Share*, to the consolidated financial statements accompanying our 2008 Form 10-K for additional information related to common stock, common stock warrants, and convertible perpetual preferred stock.

## 11. Settlements

### *Securities Litigation Settlement—*

On June 24, 2003, the United States District Court for the Northern District of Alabama consolidated a number of separate securities lawsuits filed against us under the caption *In re HealthSouth Corp. Securities Litigation*, Master Consolidation File No. CV-03-BE-1500-S (the "Consolidated Securities Action"), which the court divided into two subclasses:

- Complaints based on purchases of our common stock were grouped under the caption *In re HealthSouth Corp. Stockholder Litigation*, Consolidated Case No. CV-03-BE-1501-S, which was further divided into complaints based on purchases of our common stock in the open

market (grouped under the caption *In re HealthSouth Corp. Stockholder Litigation*, Consolidated Case No. CV-03-BE-1501-S) and claims based on the receipt of our common stock in mergers (grouped under the caption *HealthSouth Merger Cases*, Consolidated Case No. CV-98-2777-S); and

- Complaints based on purchases of our debt securities were grouped under the caption *In re HealthSouth Corp. Bondholder Litigation*, Consolidated Case No. CV-03-BE-1502-S.

The Consolidated Securities Action and the related settlement of that litigation are more fully described in Note 20, *Settlements*, “Securities Litigation Settlement,” and Note 21, *Contingencies and Other Commitments*, “Securities Litigation,” to the consolidated financial statements accompanying our 2008 Form 10-K.

Despite approval of the Consolidated Securities Action settlement, there are class members who have elected to opt out of the settlement and pursue claims individually. In addition, AIG Global Investment Corporation (“AIG”), which failed to opt out of the class settlement on a timely basis, has requested that the court allow it to opt out despite missing the district court’s deadline. In an order dated January 11, 2007, the court denied AIG’s request for an expansion of time to opt out. On April 17, 2007, AIG filed a notice of appeal with the Eleventh Circuit Court of Appeals. The appeal was consolidated with the appeal by Mr. Scrushy of one provision in the bar order in the Consolidated Securities Action settlement. On June 17, 2009, the Eleventh Circuit Court of Appeals rejected the two appeals and affirmed the district court’s approval of the settlement.

Under the settlement, the claims brought in the Consolidated Securities Action against us and certain of our former directors and officers were settled in exchange for aggregate consideration of \$445.0 million, consisting of HealthSouth common stock and warrants valued at \$215.0 million and cash payments by our insurance carriers of \$230.0 million. The opportunity for Mr. Scrushy and AIG to seek review of the June 17, 2009 decision by the Eleventh Circuit Court of Appeals lapsed on September 15, 2009. Accordingly, on September 30, 2009, we issued an aggregate of 5,023,732 shares of common stock and 8,151,265 warrants to purchase our common stock in full satisfaction of our obligation to do so under the Consolidated Securities Action settlement. Pursuant to the Consolidated Securities Action settlement, the process for final distribution of the cash and securities to qualified claimants will be handled by counsel for the plaintiffs and the administrator of the settlement funds.

In connection with the Consolidated Securities Action settlement, we recorded a charge of \$215.0 million as *Government, class action, and related settlements expense* in our 2005 consolidated statement of operations. During each quarter subsequent to the initial recording of this liability, we reduced or increased our liability for this settlement based on the value of our common stock and the associated common stock warrants underlying the settlement. During the three and nine months ended September 30, 2009, we increased our liability for this settlement by \$8.2 million and \$41.9 million, respectively, based on the value of our common stock and the associated common stock warrants at each period end. During the three and nine months ended September 30, 2008, we increased (reduced) our liability for this settlement by \$14.7 million and (\$28.6) million, respectively, based on the value of our common stock and the associated common stock warrants at each period end. When the underlying common stock and warrants were issued on September 30, 2009, the corresponding liability included in *Government, class action, and related settlements* was \$116.5 million. The corresponding liability included in *Government, class action, and related settlements* in our condensed consolidated balance sheet as of December 31, 2008 was \$74.6 million.

In addition, in order to state the total liability related to the Consolidated Securities Action settlement at the aggregate value of the consideration to be exchanged for the securities to be issued by us and the cash to be paid by the insurers, we recorded a \$230.0 million liability in *Government, class action, and related settlements*. We also recorded a related receivable from our insurers in the amount of \$230.0 million as *Insurance recoveries receivable*. During 2008, the United States District Court for the Northern District of Alabama issued three court orders awarding attorneys’ fees and expenses to the stockholder plaintiffs’ lead counsel, bondholder plaintiffs’ counsel, and merger subclass counsel. A portion of the fees and expenses awarded under these court orders was disbursed from the cash portion of the settlement, which was funded by the insurance carriers and was held in escrow by the lead attorneys for the federal plaintiffs. We reduced our liability and corresponding receivable by \$48.2 million, including \$1.0 million in the first quarter of 2009, for disbursements made per these court orders. During the third quarter of 2009, we removed this liability and corresponding receivable from our condensed consolidated balance sheet when our total liability related to the Securities Litigation Settlement was extinguished in conjunction with the issuance of the common stock and warrants described above.

#### ***UBS Litigation Settlement—***

In August 2003, claims on behalf of HealthSouth were brought in the *Tucker* derivative litigation (described below in Note 12, *Contingencies*, “Derivative Litigation,”) against various UBS entities, alleging that from at least 1998 through 2002, when those entities served as our investment bankers, they breached their duties of care, suppressed information, and aided and abetted in the ongoing fraud. The claims and counterclaims between HealthSouth and various UBS entities and the related settlement (the “UBS Settlement”) are more fully described in Note 20, *Settlements*, “UBS Litigation Settlement,” and Note 21, *Contingencies and Other Commitments*, “Derivative Litigation,” to the consolidated financial statements accompanying our 2008 Form 10-K.

On January 13, 2009, the Circuit Court of Jefferson County, Alabama entered an order approving the UBS Settlement under which we received \$100.0 million in cash and a release of all claims by the UBS entities. That order also awarded to the derivative plaintiffs’ attorneys fees and expenses of \$26.2 million to be paid from the \$100.0 million in cash we received. Pursuant to the Consolidated Securities Action settlement, we are obligated to pay 25% of the net settlement proceeds, after deducting all of our costs and expenses in connection with the *Tucker* derivative litigation including fees and expenses of the derivative counsel and our counsel, to the plaintiffs in the Consolidated Securities Action. The UBS Settlement does not release our claims against any other defendants in the *Tucker* derivative litigation, or against our former independent auditor, Ernst & Young, which remain pending in arbitration.

#### ***Capstone Litigation Settlement—***

In August 2002, claims on behalf of HealthSouth were brought in the *Tucker* derivative litigation (described below in Note 12, *Contingencies*, “Derivative Litigation,”) against Capstone Capital Corporation, now known as HR Acquisition I Corp. (“Capstone”), alleging misrepresentations, conspiracy, and aiding and abetting the breach of fiduciary duties by certain of our former executives. In particular, the claims pursued against Capstone relate to the sale and leaseback of 14 properties that we initially owned. On May 8, 2009, the Circuit Court of Jefferson County, Alabama entered an order approving a settlement agreement among us, the derivative plaintiffs and Capstone (the “Capstone Settlement”). The settlement is final as the deadline for an appeal has passed.

Under the settlement, all claims against Capstone in the *Tucker* litigation were released, and Capstone agreed to the following:

- our existing leases on four properties have been restructured on terms more favorable and beneficial to us;
- our financial obligations on certain other properties have been terminated and liquidated at an amount equal to 70% of the net present value of the future outstanding lease payment, with credit given toward that obligation for existing subtenant rental income assigned to a Capstone affiliate;
- our obligation on the building lease for another property, and all obligations on an associated ground lease, terminated in June 2009 upon payment by us of \$0.5 million and the transfer of unimproved land, valued at \$1.5 million, near that property to a Capstone affiliate; and
- we have been released as guarantor or primary obligor on leases for three other properties previously assigned to third-party purchasers.

Under the settlement, we also paid \$1.2 million in fees and expenses to the derivative plaintiffs' attorneys, and Capstone reimbursed us for half of those fees and expenses.

Amounts recorded during the nine months ended September 30, 2009 related to the Capstone Settlement did not have a material effect on our financial position, results of operations, or cash flows. The Capstone Settlement does not release our claims against any other defendants in the *Tucker* derivative litigation, or against our former independent auditor, Ernst & Young, which remain pending in arbitration.

## 12. Contingencies:

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.

### *Derivative Litigation—*

All lawsuits purporting to be derivative complaints filed in the Circuit Court of Jefferson County, Alabama since 2002 have been consolidated and stayed in favor of the first-filed action captioned *Tucker v. Scrushy*, CV-02-5212, filed August 28, 2002. Derivative lawsuits in other jurisdictions have been stayed. The *Tucker* complaint named as defendants a number of our former officers and directors. *Tucker* also asserted claims on our behalf against Ernst & Young and UBS entities, as well as against MedCenterDirect.com, Capstone, and G.G. Enterprises. When originally filed, the primary allegations in the *Tucker* case involved self-dealing by Mr. Scrushy and other insiders through transactions with various entities allegedly controlled by Mr. Scrushy. The complaint was amended four times to add additional defendants and include claims of accounting fraud, improper Medicare billing practices, and additional self-dealing transactions. On June 18, 2009, the court found Mr. Scrushy liable for, and awarded us, \$2.9 billion in damages as a result of breaches of fiduciary duty and fraud he perpetrated from 1996 to 2003. On July 24, 2009, Mr. Scrushy filed a notice of appeal of the trial court's decision. No assurances can be given as to whether or when any amounts will be received from Mr. Scrushy, nor can we provide any assurances as to the collectability of any amounts owed from Mr. Scrushy. Therefore, no amounts related to this award are included in our condensed consolidated financial statements. The *Tucker* derivative litigation and the related settlements to date are more fully described in Note 11, *Settlements*, to these condensed consolidated financial statements and Note 20, *Settlements*, and Note 21, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying our 2008 Form 10-K.

On January 13, 2009, the Circuit Court of Jefferson County, Alabama approved the agreement among us, the derivative plaintiffs, and UBS Securities to settle the claims against and by UBS Securities in the *Tucker* litigation. See Note 11, *Settlements*, "UBS Litigation Settlement," to these condensed consolidated financial statements and Note 20, *Settlements*, "UBS Litigation Settlement," and Note 21, *Contingencies and Other Commitments*, "Derivative Litigation," to the consolidated financial statements accompanying our 2008 Form 10-K for further discussion of the UBS Settlement. On May 8, 2009, the Circuit Court of Jefferson County, Alabama approved the agreement among us, the derivative plaintiffs, and Capstone to settle the claims against Capstone in the *Tucker* litigation. See Note 11, *Settlements*, "Capstone Litigation Settlement," for further discussion.

The settlements with UBS Securities and Capstone do not release our claims against any other defendants in the *Tucker* litigation, or against our former independent auditor, Ernst & Young, which remain pending in arbitration. The *Tucker* derivative claims against Ernst & Young and other defendants listed above remain pending and have moved through fact discovery on an expedited schedule that was coordinated with the federal securities claims by our former stockholders and bondholders against Mr. Scrushy, Ernst & Young, and UBS. We are no longer a party in the federal securities claims action (described in Note 11, *Settlements*, "Securities Litigation Settlement") by our former stockholders and bondholders against Mr. Scrushy, Ernst & Young, and UBS and are not a party to or beneficiary of any settlements between the plaintiffs and the remaining defendants.

### *Litigation By and Against Richard M. Scrushy—*

On December 9, 2005, Mr. Scrushy filed a complaint in the Circuit Court of Jefferson County, Alabama, captioned *Scrushy v. HealthSouth*, CV-05-7364. The complaint alleged that, as a result of Mr. Scrushy's removal from the position of chief executive officer in March 2003, we owed him "in excess of \$70 million" pursuant to an employment agreement dated as of September 17, 2002. On December 28, 2005, we counterclaimed against Mr. Scrushy, asserting claims for breaches of fiduciary duty and fraud arising out of Mr. Scrushy's tenure with us, and seeking compensatory damages, punitive damages, and disgorgement of wrongfully obtained benefits. We also asserted that any employment agreements with Mr. Scrushy should be void and unenforceable. On July 7, 2009, we filed a motion for summary judgment on all claims by Mr. Scrushy based upon the *Tucker* court's June 18, 2009 ruling that Mr. Scrushy's employment agreements are void and rescinded. We understand that the court does not intend to rule on this motion at the present time.

On June 18, 2009, the Circuit Court of Jefferson County, Alabama ruled on our derivative claims against Mr. Scrushy presented during a non-jury trial held May 11 to May 26, 2009. The court held Mr. Scrushy responsible for fraud and breach of fiduciary duties and awarded us \$2.9 billion in damages. On July 24, 2009, Mr. Scrushy filed a notice of appeal of the trial court's decision and briefing in the Supreme Court of Alabama is expected to follow. At this time, we cannot predict when and to what extent this judgment can be collected. We will pursue collection aggressively and to the fullest extent permitted by law. We, in coordination with derivative plaintiffs' counsel, are attempting to locate, in order to collect the judgment, Mr. Scrushy's

current assets and other assets we believe were improperly disposed. Part of this effort is a fraudulent transfer complaint filed on July 2, 2009 against Mr. Scrushy and a number of related entities by derivative plaintiffs for the benefit of HealthSouth in the Circuit Court of Jefferson County, Alabama, captioned *Tucker v. Scrushy et al.*, CV-09-902145. In that same case, on August 26, 2009, Mr. Scrushy's wife, Leslie Scrushy, filed a counterclaim against the plaintiffs and HealthSouth seeking a declaration that certain personal property belongs to her or her children and not to Mr. Scrushy. HealthSouth filed an answer in this case on September 24, 2009, denying Mrs. Scrushy's entitlement to the relief she seeks. While these proceedings continue, some of Mr. Scrushy's assets have been seized and sold at auction pursuant to the state law procedure for collection of a judgment. Other assets will likewise be sold from time to time. We do not anticipate that any of his assets, or the proceeds from their sale, will be distributed to us or any other party until the final disposition of Mr. Scrushy's appeal of the verdict. We are obligated to pay 35% of any recovery from Mr. Scrushy along with reasonable out-of-pocket expenses to the attorneys for the derivative shareholder plaintiffs. Under the Consolidated Securities Action settlement, we must also pay the federal plaintiffs 25% of any net recovery from Mr. Scrushy. After payment of these obligations and other amounts related to professional fees and expenses, we expect our recovery to be between 40% and 45% of any amounts collected.

In March 2009, Mr. Scrushy filed an arbitration demand claiming that we are obligated under a separate indemnification agreement to indemnify him for certain costs associated with litigation and to advance to him his attorneys' fees and costs. On May 14, 2009, the arbitrator ruled that we should deposit certain funds for attorneys' fees in escrow until after a ruling in the *Tucker* litigation. As a result of the *Tucker* court's June 18, 2009 ruling that Mr. Scrushy committed fraud and breached his fiduciary duties, the arbitrator allowed us to withdraw all funds from the escrow. Any future obligation to pay such fees would be tied to the success of his appeal of the June 18, 2009 ruling. As of December 31, 2008, we included an estimate of those legal fees in *Accrued expenses and other current liabilities* in our condensed consolidated balance sheet. As a result of the court ruling that Mr. Scrushy committed fraud and breached his fiduciary duties, we have no obligation to indemnify him for any litigation costs. Therefore, we removed this accrual from our balance sheet and recorded an approximate \$6.5 million gain in *Professional fees – accounting, tax, and legal* during the nine months ended September 30, 2009.

#### ***Litigation By and Against Former Independent Auditor—***

In March 2003, claims on behalf of HealthSouth were brought in the *Tucker* derivative litigation against Ernst & Young, alleging that from 1996 through 2002, when Ernst & Young served as our independent auditor, Ernst & Young acted recklessly and with gross negligence in performing its duties, and specifically that Ernst & Young failed to perform reviews and audits of our financial statements with due professional care as required by law and by its contractual agreements with us. The claims further allege Ernst & Young either knew of or, in the exercise of due care, should have discovered and investigated the fraudulent and improper accounting practices being directed by certain officers and employees, and should have reported them to our board of directors and the Audit Committee. The claims seek compensatory and punitive damages, disgorgement of fees received from us by Ernst & Young, and attorneys' fees and costs. On March 18, 2005, Ernst & Young filed a lawsuit captioned *Ernst & Young LLP v. HealthSouth Corp.*, CV-05-1618, in the Circuit Court of Jefferson County, Alabama. The complaint asserts that the filing of the claims against us was for the purpose of suspending any statute of limitations applicable to those claims. The complaint alleges we provided Ernst & Young with fraudulent management representation letters, financial statements, invoices, bank reconciliations, and journal entries in an effort to conceal accounting fraud. Ernst & Young claims that as a result of our actions, Ernst & Young's reputation has been injured and it has and will incur damages, expense, and legal fees. On April 1, 2005, we answered Ernst & Young's claims and asserted counterclaims related or identical to those asserted in the *Tucker* action. Upon Ernst & Young's motion, the Alabama state court referred Ernst & Young's claims and our counterclaims to arbitration pursuant to a clause in the engagement agreements between HealthSouth and Ernst & Young. On July 12, 2006, we and the derivative plaintiffs filed an arbitration demand on behalf of HealthSouth against Ernst & Young. On August 7, 2006, Ernst & Young filed an answering statement and counterclaim in the arbitration reasserting the claims made in state court. In August 2006, we and the derivative plaintiffs agreed to jointly prosecute the claims against Ernst & Young in arbitration.

We are vigorously pursuing our claims against Ernst & Young and defending the claims against us. The three-person arbitration panel that will adjudicate the claims and counterclaims in arbitration has been selected under rules of the American Arbitration Association (the "AAA"). The arbitration process has begun. However, pursuant to an order of the AAA panel, all aspects of the arbitration are confidential. Accordingly, we will not discuss the arbitration until there is a resolution. Based on the stage of litigation, and review of the current facts and circumstances, it is not possible to estimate the amount of loss, if any, or range of possible loss that might result from an adverse judgment or a settlement of this case.

#### ***Certain Regulatory Actions—***

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 generally sealed by the court at the time of filing. The only parties 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 we are unaware of such filings or have been ordered by the presiding court not to discuss or disclose the filing of such lawsuits. We may be subject to liability under one or more undisclosed *qui tam* cases brought pursuant to the False Claims Act.

#### ***General Medicine Action—***

On August 16, 2004, General Medicine, P.C. ("General Medicine") filed a lawsuit against us captioned *General Medicine, P.C. v. HealthSouth Corp.* seeking the recovery of allegedly fraudulent transfers involving assets of Horizon/CMS Healthcare Corporation ("Horizon/CMS"), a former subsidiary of HealthSouth. The lawsuit was filed in the Circuit Court of Shelby County, Alabama, but was transferred to the Circuit Court of Jefferson County, Alabama on February 28, 2005, where it was assigned case number CV-05-1483 (the "Alabama Action").

The 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 six months after it was executed, and General Medicine then initiated a lawsuit 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. ("Meadowbrook") in 2001 pursuant to a stock purchase agreement. In 2004, Meadowbrook consented to the entry of a final judgment in the Michigan Action in the amount of \$376 million (the "Consent Judgment") in favor of General Medicine against Horizon/CMS for the alleged wrongful termination of the contract with General Medicine. We were not a party to the Michigan Action or the settlement negotiated by Meadowbrook. The settlement agreement which was the basis for the Consent Judgment provided that Meadowbrook would pay only \$0.3 million to General Medicine to settle the Michigan Action. The settlement agreement further provided that General Medicine would seek to recover the remaining balance of the Consent Judgment solely from us. The Alabama Action and the Michigan Action are more fully described in Note 21, *Contingencies and*



*Other Commitments* , “General Medicine Action,” to the consolidated financial statements accompanying our 2008 Form 10-K.

On May 21, 2009, the court in the Michigan Action granted our motion to set aside the Consent Judgment on grounds that it was the product of fraud on the court and collusion by the parties. In its order setting aside the Consent Judgment, the court directed General Medicine and Horizon/CMS to confer with each other and the court’s case manager to determine what further proceedings are appropriate in the Michigan Action. On June 16, 2009, Horizon/CMS filed a motion for clarification requesting the court rule that Horizon/CMS has fully complied with its obligations under the settlement agreement and is therefore not required to participate in any further proceedings. On June 17, 2009, we filed a motion to intervene in the Michigan Action for the limited purpose of protecting our interests and a motion to dismiss the Michigan Action as settled and as a sanction for General Medicine’s fraud on the court. The court has not yet ruled on the pending motions.

Based on the stage of litigation, and review of the current facts and circumstances, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or settlement of this case.

#### ***United HealthCare Services Litigation—***

On March 19, 2009, United HealthCare Services, Inc. and certain affiliates (“United”) filed an initial arbitration demand with the AAA against us relating to disputes over therapy service claims paid from 1997 through 2003. United alleges that during that period we submitted fraudulent claims, or claims otherwise in breach of various provider agreements, for reimbursement of therapy services for patients insured under plans provided or administered by United. United requests an accounting and seeks compensatory damages in excess of \$10 million, punitive damages, interest, and attorneys’ fees.

On April 14, 2009, we filed an action in Circuit Court in Jefferson County, Alabama, captioned *HealthSouth Corp. v. United Healthcare Services, Inc.* , CV-2009-901288, seeking a declaratory judgment that we are not required to arbitrate the claims alleged in United’s arbitration demand, seeking an order enjoining the AAA arbitration, and reserving our claims against United for underpayment and breach of contract. We assert that the AAA lacks jurisdiction to arbitrate these claims because we did not agree to arbitration and because, among other reasons, United’s arbitration demand disregards the conditions precedent to arbitration and other terms contained in the provider agreements upon which United relies, seeks damages expressly excluded from arbitration, and violates state insurance laws which prohibit United from seeking to recoup claims many years after they were submitted and paid. United has not yet answered our complaint, but on May 18, 2009, United filed a motion with the court to compel arbitration of the claims presented in their AAA arbitration demand. On July 9, 2009, the court heard oral argument on United’s motion to compel arbitration. At this time, we do not know when the court will rule on the matters pending before it.

On May 1, 2009, we filed our answer requesting that the AAA arbitration be stayed pending the outcome of our action filed in Circuit Court in Jefferson County, challenging, as a preliminary matter, the AAA’s jurisdiction to arbitrate the claims alleged by United, denying the claims asserted by United, raising defenses and asserting counterclaims including breaches of contract, breach of implied covenant of good faith and fair dealing. In connection with our counterclaim, we are seeking restitution for, among other things, United’s wrongful recoupment and underpayment of paid claims submitted and compensatory damages in excess of \$10 million, together with interest and the costs, fees and expenses of arbitration.

On May 16, 2009, United filed with AAA an amended arbitration demand adding certain Select Medical Corporation (“Select”) subsidiaries as named respondents, which, with one exception, are successors to HealthSouth entities that signed one or more of the provider agreements at issue in United’s demand. Pursuant to the Stock Purchase Agreement between us and Select, we are obligated to defend and indemnify Select and its affiliates named in United’s amended arbitration demand. See Note 16, *Assets Held for Sale and Results of Discontinued Operations* , and Note 21, *Contingencies and Other Commitments* , “Other Matters,” to the consolidated financial statements accompanying our 2008 Form 10-K and Note 8, *Assets Held for Sale and Results of Discontinued Operations* , to these condensed consolidated financial statements. On June 11, 2009, answers were filed with AAA on behalf of all HealthSouth and Select respondents. These answers reiterated the denials, defenses, jurisdictional objections and challenges, and counterclaims previously asserted in our initial answer. The Select entities did not assert any counterclaims. AAA has indicated it will request that the parties file contentions regarding the specific locales the parties believe would be appropriate to hear any arbitrations and from where any potential arbitration panels may be selected. Should the arbitration proceed, we intend to vigorously defend ourselves.

We intend to vigorously defend ourselves against United’s claims and to vigorously prosecute our counterclaims against United. Although we continue to believe in the merit of our claims and counterclaims and the lack of merit in United’s, we have included an estimate of this potential liability in our results of discontinued operations for the three and nine months ended September 30, 2009, as this claim relates primarily to our former outpatient division. We consider this estimate to be adequate for these liability risks. However, there can be no assurance the ultimate liability, if any, will not exceed our estimate.

#### ***Other Litigation—***

We have been named as a defendant in a lawsuit brought by individuals in the Circuit Court of Jefferson County, Alabama, *Nichols v. HealthSouth Corp.* , CV-03-2023, filed March 28, 2003. The plaintiffs alleged that we, some of our former officers, and our former auditor engaged in a scheme to overstate and misrepresent our earnings and financial position. The plaintiffs sought compensatory and punitive damages. The *Nichols* lawsuit is more fully described in Note 21, *Contingencies and Other Commitments* , “Other Litigation,” to the consolidated financial statements accompanying our 2008 Form 10-K. The *Nichols* lawsuit is currently stayed in the Circuit Court. On January 12, 2009, the plaintiffs in that case filed a motion to lift the stay which the court subsequently denied. We intend to vigorously defend ourselves in this case. Based on the stage of litigation, and review of the current facts and circumstances, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this case.

#### ***Other Matters—***

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 United States Department of Health and Human Services Office of Inspector General 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. See Note 20, *Settlements* , to the consolidated financial statements accompanying our 2008 Form 10-K for additional information.



The reconstruction of our historical financial records resulted in the restatement of not only our 2001 and 2000 consolidated financial statements, but also the financial statements of certain of our subsidiary partnerships, including partnerships of our divested surgery centers division. We have completed settlement negotiations with outside partners in the majority of our inpatient rehabilitation hospital partnerships. However, negotiations continue with certain of our former subsidiary partnerships, primarily within our surgery centers division. We have and may continue to incur additional charges to reduce the economic impact to our former partners.

We also face certain financial risks and challenges relating to our 2007 divestiture transactions (see Note 16, *Assets Held for Sale and Results of Discontinued Operations*, to the consolidated financial statements accompanying our 2008 Form 10-K and Note 8, *Assets Held for Sale and Results of Discontinued Operations*, to these condensed consolidated financial statements) following their closing. These include indemnification obligations, disputes with former partners (as discussed above), and certain contract termination or repurchase rights that may have been triggered by the divestitures, which in the aggregate could have a material adverse effect on our financial position, results of operations, and cash flows. In addition, we continue to seek regulatory approval for the transfer of one surgery center included in the divestiture transactions from the applicable agency.

### **13. 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. HealthSouth's investments in its consolidated subsidiaries, as well as guarantor subsidiaries' investments in non-guarantor subsidiaries and non-guarantor subsidiaries' investments in guarantor subsidiaries, are presented under the equity method of accounting.

As described in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K, the terms of our Credit Agreement restrict us from declaring or paying cash dividends on our common stock unless: (1) we are not in default under our Credit Agreement and (2) the amount of the dividend, when added to the aggregate amount of certain other defined payments made during the same fiscal year, does not exceed certain maximum thresholds. However, as described in Note 9, *Convertible Perpetual Preferred Stock*, to the consolidated financial statements accompanying our 2008 Form 10-K, our Series A Preferred Stock generally provides for the payment of cash dividends, subject to certain limitations.

---

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Balance Sheet**

	As of September 30, 2009				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries (In Millions)	Eliminating Entries	HealthSouth Consolidated
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$ 113.1	\$ 1.2	\$ 3.0	\$ -	\$ 117.3
Restricted cash	2.5	-	85.6	-	88.1
Restricted marketable securities	-	-	7.7	-	7.7
Accounts receivable, net	10.8	140.2	65.2	-	216.2
Other current assets	42.2	61.5	53.7	(102.4)	55.0
Total current assets	168.6	202.9	215.2	(102.4)	484.3
Property and equipment, net	40.0	481.2	150.3	-	671.5
Goodwill	-	264.1	150.6	-	414.7
Intangible assets, net	0.4	31.0	6.3	-	37.7
Investments in and advances to nonconsolidated affiliates	3.3	20.6	3.7	-	27.6
Income tax refund receivable	8.6	-	-	-	8.6
Other long-term assets	55.2	212.8	90.7	(248.7)	110.0
Intercompany receivable	1,082.9	-	-	(1,082.9)	-
<b>Total assets</b>	<b>\$ 1,359.0</b>	<b>\$ 1,212.6</b>	<b>\$ 616.8</b>	<b>\$ (1,434.0)</b>	<b>\$ 1,754.4</b>
<b>Liabilities and Shareholders' (Deficit) Equity</b>					
<b>Current liabilities:</b>					
Current portion of long-term debt	\$ 8.2	\$ 10.0	\$ 3.7	\$ -	\$ 21.9
Accounts payable	10.9	29.1	10.6	-	50.6
Accrued expenses and other current liabilities	260.8	56.5	70.3	(17.8)	369.8
Government, class action, and related settlements	6.1	-	-	-	6.1
Total current liabilities	286.0	95.6	84.6	(17.8)	448.4
Long-term debt, net of current portion	1,599.1	73.1	28.6	(26.0)	1,674.8
Other long-term liabilities	89.2	11.2	77.0	(11.7)	165.7
Intercompany payable	-	933.5	1,214.2	(2,147.7)	-
	1,974.3	1,113.4	1,404.4	(2,203.2)	2,288.9
Commitments and contingencies					
Convertible perpetual preferred stock	387.4	-	-	-	387.4
<b>Shareholders' (deficit) equity</b>					
HealthSouth shareholders' (deficit) equity	(1,002.7)	99.2	(868.4)	769.2	(1,002.7)
Noncontrolling interests	-	-	80.8	-	80.8
Total shareholders' (deficit) equity	(1,002.7)	99.2	(787.6)	769.2	(921.9)
<b>Total liabilities and shareholders' (deficit) equity</b>	<b>\$ 1,359.0</b>	<b>\$ 1,212.6</b>	<b>\$ 616.8</b>	<b>\$ (1,434.0)</b>	<b>\$ 1,754.4</b>

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Balance Sheet**

	As of December 31, 2008				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries (In Millions)	Eliminating Entries	HealthSouth Consolidated
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$ 23.1	\$ 0.9	\$ 8.2	\$ -	\$ 32.2
Restricted cash	100.2	-	53.8	-	154.0
Restricted marketable securities	-	-	20.3	-	20.3
Accounts receivable, net	12.6	156.6	66.6	-	235.8
Insurance recoveries receivable	182.8	-	-	-	182.8
Other current assets	37.3	62.9	45.9	(88.5)	57.6
Total current assets	356.0	220.4	194.8	(88.5)	682.7
Property and equipment, net	45.9	467.5	160.5	-	673.9
Goodwill	-	264.1	150.6	-	414.7
Intangible assets, net	-	34.7	8.1	-	42.8
Investments in and advances to nonconsolidated affiliates	2.8	29.6	4.3	-	36.7
Income tax refund receivable	55.9	-	-	-	55.9
Other long-term assets	57.0	209.3	77.2	(252.0)	91.5
Intercompany receivable	1,091.2	-	-	(1,091.2)	-
<b>Total assets</b>	\$ 1,608.8	\$ 1,225.6	\$ 595.5	\$ (1,431.7)	\$ 1,998.2
<b>Liabilities and Shareholders' (Deficit) Equity</b>					
<b>Current liabilities:</b>					
Current portion of long-term debt	\$ 10.2	\$ 10.0	\$ 3.4	\$ -	\$ 23.6
Accounts payable	11.8	23.8	10.0	-	45.6
Accrued expenses and other current liabilities	300.7	60.0	57.8	(10.0)	408.5
Government, class action, and related settlements	268.5	-	-	-	268.5
Total current liabilities	591.2	93.8	71.2	(10.0)	746.2
Long-term debt, net of current portion	1,706.5	80.6	31.5	(29.0)	1,789.6
Other long-term liabilities	93.1	12.2	62.8	(5.9)	162.2
Intercompany payable	-	956.6	1,207.6	(2,164.2)	-
	2,390.8	1,143.2	1,373.1	(2,209.1)	2,698.0
Commitments and contingencies					
Convertible perpetual preferred stock	387.4	-	-	-	387.4
<b>Shareholders' (deficit) equity</b>					
HealthSouth shareholders' (deficit) equity	(1,169.4)	82.4	(859.8)	777.4	(1,169.4)
Noncontrolling interests	-	-	82.2	-	82.2
Total shareholders' (deficit) equity	(1,169.4)	82.4	(777.6)	777.4	(1,087.2)
<b>Total liabilities and shareholders' (deficit) equity</b>	\$ 1,608.8	\$ 1,225.6	\$ 595.5	\$ (1,431.7)	\$ 1,998.2

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Operations**

	Three Months Ended September 30, 2009				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries (In Millions)	Eliminating Entries	HealthSouth Consolidated
Net operating revenues	\$ 21.8	\$ 317.5	\$ 142.5	\$ (9.1)	\$ 472.7
Operating expenses:					
Salaries and benefits	14.1	154.4	70.0	(3.1)	235.4
Other operating expenses	4.0	44.7	21.8	(3.7)	66.8
General and administrative expenses	26.0	-	-	-	26.0
Supplies	1.8	18.2	7.7	-	27.7
Depreciation and amortization	2.4	11.6	4.1	-	18.1
Impairment of long lived assets	-	4.0	-	-	4.0
Occupancy costs	0.8	8.7	4.6	(2.3)	11.8
Provision for doubtful accounts	0.8	5.1	2.0	-	7.9
Loss on disposal of assets	-	0.7	-	-	0.7
Government, class action, and related settlements expense	8.5	-	-	-	8.5
Professional fees—accounting, tax, and legal	3.5	-	-	-	3.5
Total operating expenses	61.9	247.4	110.2	(9.1)	410.4
Interest expense and amortization of debt discounts and fees	26.7	2.0	0.9	(0.1)	29.5
Other expense (income)	0.2	(0.1)	(0.8)	0.1	(0.6)
Loss on interest rate swaps	7.9	-	-	-	7.9
Equity in net income of nonconsolidated affiliates	(0.8)	(2.1)	(0.1)	-	(3.0)
Equity in net income of consolidated affiliates	(38.9)	(3.0)	(0.8)	42.7	-
Management fees	(20.8)	15.6	5.2	-	-
(Loss) income from continuing operations before income tax (benefit) expense	(14.4)	57.7	27.9	(42.7)	28.5
Provision for income tax (benefit) expense	(36.6)	27.1	7.8	-	(1.7)
Income from continuing operations	22.2	30.6	20.1	(42.7)	30.2
(Loss) income from discontinued operations, net of tax	(5.4)	(0.5)	0.5	-	(5.4)
<b>Net income</b>	16.8	30.1	20.6	(42.7)	24.8
Less: Net income attributable to noncontrolling interests	-	-	(8.0)	-	(8.0)
<b>Net income attributable to HealthSouth</b>	<u>\$ 16.8</u>	<u>\$ 30.1</u>	<u>\$ 12.6</u>	<u>\$ (42.7)</u>	<u>\$ 16.8</u>

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Operations**

	Three Months Ended September 30, 2008				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries (In Millions)	Eliminating Entries	HealthSouth Consolidated
Net operating revenues	\$ 23.3	\$ 305.2	\$ 135.8	\$ (8.8)	\$ 455.5
Operating expenses:					
Salaries and benefits	14.6	155.3	69.2	(2.8)	236.3
Other operating expenses	4.9	45.7	21.5	(3.5)	68.6
General and administrative expenses	25.5	-	-	-	25.5
Supplies	1.9	17.1	7.2	-	26.2
Depreciation and amortization	2.8	10.9	4.2	-	17.9
Occupancy costs	1.0	9.1	4.7	(2.2)	12.6
Provision for doubtful accounts	0.3	4.2	2.1	-	6.6
Loss on disposal of assets	0.2	-	-	-	0.2
Government, class action, and related settlements expense	15.7	-	1.4	-	17.1
Professional fees—accounting, tax, and legal	4.0	-	-	-	4.0
Total operating expenses	70.9	242.3	110.3	(8.5)	415.0
Loss on early extinguishment of debt	2.1	-	-	-	2.1
Interest expense and amortization of debt discounts and fees	37.4	2.0	1.1	(0.2)	40.3
Other expense (income)	0.3	(0.1)	(0.8)	0.2	(0.4)
Loss on interest rate swap	8.0	-	-	-	8.0
Equity in net income of nonconsolidated affiliates	(0.8)	(1.7)	(0.2)	-	(2.7)
Equity in net income of consolidated affiliates	(31.9)	(3.8)	(0.5)	36.2	-
Management fees	(20.7)	15.4	5.3	-	-
(Loss) income from continuing operations before income tax (benefit) expense	(42.0)	51.1	20.6	(36.5)	(6.8)
Provision for income tax (benefit) expense	(50.0)	21.9	5.6	-	(22.5)
Income from continuing operations	8.0	29.2	15.0	(36.5)	15.7
(Loss) income from discontinued operations, net of tax	(1.4)	(5.3)	3.5	0.3	(2.9)
<b>Net income</b>	<b>6.6</b>	<b>23.9</b>	<b>18.5</b>	<b>(36.2)</b>	<b>12.8</b>
Less: Net income attributable to noncontrolling interests	-	-	(6.2)	-	(6.2)
<b>Net income attributable to HealthSouth</b>	<b>\$ 6.6</b>	<b>\$ 23.9</b>	<b>\$ 12.3</b>	<b>\$ (36.2)</b>	<b>\$ 6.6</b>

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Operations**

	Nine Months Ended September 30, 2009				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
	(In Millions)				
Net operating revenues	\$ 68.2	\$ 965.2	\$ 425.5	\$ (27.4)	\$ 1,431.5
Operating expenses:					
Salaries and benefits	42.5	467.5	208.5	(9.3)	709.2
Other operating expenses	13.9	133.0	65.9	(11.2)	201.6
General and administrative expenses	76.4	-	-	-	76.4
Supplies	5.4	55.4	23.1	-	83.9
Depreciation and amortization	6.8	34.3	12.3	-	53.4
Impairment of long lived assets	-	4.0	-	-	4.0
Occupancy costs	3.0	26.0	13.8	(6.9)	35.9
Provision for doubtful accounts	2.3	16.4	6.8	-	25.5
Loss on disposal of assets	-	2.9	0.1	-	3.0
Government, class action, and related settlements expense	41.3	-	-	-	41.3
Professional fees—accounting, tax, and legal	5.0	-	-	-	5.0
Total operating expenses	196.6	739.5	330.5	(27.4)	1,239.2
Gain on early extinguishment of debt	(3.1)	-	-	-	(3.1)
Interest expense and amortization of debt discounts and fees	86.6	6.1	2.5	(0.2)	95.0
Other expense (income)	0.9	(0.2)	(2.3)	0.2	(1.4)
Loss on interest rate swaps	16.7	-	-	-	16.7
Equity in net income of nonconsolidated affiliates	(1.7)	(0.9)	(0.2)	-	(2.8)
Equity in net income of consolidated affiliates	(120.9)	(8.3)	(2.6)	131.8	-
Management fees	(62.6)	47.1	15.5	-	-
(Loss) income from continuing operations before income tax (benefit) expense	(44.3)	181.9	82.1	(131.8)	87.9
Provision for income tax (benefit) expense	(108.2)	84.7	22.7	-	(0.8)
Income from continuing operations	63.9	97.2	59.4	(131.8)	88.7
(Loss) income from discontinued operations, net of tax	(7.7)	(0.8)	1.7	-	(6.8)
<b>Net income</b>	<b>56.2</b>	<b>96.4</b>	<b>61.1</b>	<b>(131.8)</b>	<b>81.9</b>
Less: Net income attributable to noncontrolling interests	-	-	(25.7)	-	(25.7)
<b>Net income attributable to HealthSouth</b>	<b>\$ 56.2</b>	<b>\$ 96.4</b>	<b>\$ 35.4</b>	<b>\$ (131.8)</b>	<b>\$ 56.2</b>

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Operations**

	<b>Nine Months Ended September 30, 2008</b>				
	<b>HealthSouth Corporation</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries</b>	<b>Eliminating Entries</b>	<b>HealthSouth Consolidated</b>
	<b>(In Millions)</b>				
Net operating revenues	\$ 71.2	\$ 926.8	\$ 398.2	\$ (19.9)	\$ 1,376.3
Operating expenses:					
Salaries and benefits	42.5	462.5	202.6	(6.8)	700.8
Other operating expenses	15.8	133.5	58.0	(6.3)	201.0
General and administrative expenses	78.8	-	-	-	78.8
Supplies	5.9	53.1	22.1	-	81.1
Depreciation and amortization	20.4	32.1	12.8	-	65.3
Impairment of long-lived assets	-	0.6	-	-	0.6
Occupancy costs	3.0	26.5	13.9	(6.6)	36.8
Provision for doubtful accounts	1.4	14.7	4.4	-	20.5
(Gain) loss on disposal of assets	(0.3)	1.2	(0.3)	-	0.6
Government, class action, and related settlements expense	(29.1)	(0.2)	1.4	-	(27.9)
Professional fees—accounting, tax, and legal	12.9	-	-	-	12.9
Total operating expenses	151.3	724.0	314.9	(19.7)	1,170.5
Loss on early extinguishment of debt	5.8	-	-	-	5.8
Interest expense and amortization of debt discounts and fees	122.4	6.1	3.6	(1.0)	131.1
Other expense (income)	0.6	(0.2)	(3.5)	1.0	(2.1)
Loss on interest rate swap	16.1	-	-	-	16.1
Equity in net income of nonconsolidated affiliates	(2.1)	(5.5)	(0.2)	-	(7.8)
Equity in net income of consolidated affiliates—					
Gain on sale of consolidated affiliates	(18.8)	-	-	18.8	-
Income from operations of consolidated affiliates	(101.0)	(13.3)	(0.9)	115.2	-
Management fees	(62.4)	46.6	15.8	-	-
(Loss) income from continuing operations before income tax (benefit) expense	(40.7)	169.1	68.5	(134.2)	62.7
Provision for income tax (benefit) expense	(119.1)	78.0	19.4	-	(21.7)
Income from continuing operations	78.4	91.1	49.1	(134.2)	84.4
Income (loss) from discontinued operations, net of tax	(7.9)	(6.5)	2.6	19.0	7.2
<b>Net income</b>	<b>70.5</b>	<b>84.6</b>	<b>51.7</b>	<b>(115.2)</b>	<b>91.6</b>
Less: Net income attributable to noncontrolling interests	-	-	(21.1)	-	(21.1)
<b>Net income attributable to HealthSouth</b>	<b>\$ 70.5</b>	<b>\$ 84.6</b>	<b>\$ 30.6</b>	<b>\$ (115.2)</b>	<b>\$ 70.5</b>

**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Cash Flows**

	<b>Nine Months Ended September 30, 2009</b>				
	<b>HealthSouth Corporation</b>	<b>Guarantor Subsidiaries</b>	<b>Non Guarantor Subsidiaries (In Millions)</b>	<b>Eliminating Entries</b>	<b>HealthSouth Consolidated</b>
<b>Net cash provided by operating activities</b>	\$ 242.3	\$ 161.6	\$ 93.0	\$ (134.8)	\$ 362.1
<b>Cash flows from investing activities:</b>					
Capital expenditures	(7.3)	(39.6)	(7.8)	-	(54.7)
Acquisition of intangible assets	(0.4)	-	-	-	(0.4)
Proceeds from disposal of assets	-	0.9	-	-	0.9
Net change in restricted cash	(0.2)	-	(31.8)	-	(32.0)
Net settlements on interest rate swap	(30.3)	-	-	-	(30.3)
Net investments in interest rate swap	(6.4)	-	-	-	(6.4)
Other	-	-	(1.7)	-	(1.7)
Net cash provided by (used in) investing activities of discontinued operations	-	1.0	(0.8)	-	0.2
<b>Net cash used in investing activities</b>	(44.6)	(37.7)	(42.1)	-	(124.4)
<b>Cash flows from financing activities:</b>					
Principal payments on debt, including pre-payments	(65.7)	(0.2)	-	3.0	(62.9)
Borrowings on revolving credit facility	10.0	-	-	-	10.0
Payments on revolving credit facility	(50.0)	-	-	-	(50.0)
Principal payments under capital lease obligations	(0.2)	(7.2)	(2.5)	-	(9.9)
Dividends paid on convertible perpetual preferred stock	(19.5)	-	-	-	(19.5)
Distributions paid to noncontrolling interests of consolidated affiliates	-	-	(22.8)	-	(22.8)
Other	(0.1)	-	1.2	-	1.1
Change in intercompany advances	18.3	(116.2)	(33.9)	131.8	-
Net cash (used in) provided by financing activities of discontinued operations	(0.5)	-	1.9	-	1.4
<b>Net cash used in financing activities</b>	(107.7)	(123.6)	(56.1)	134.8	(152.6)
<b>Increase (decrease) in cash and cash equivalents</b>	90.0	0.3	(5.2)	-	85.1
<b>Cash and cash equivalents at beginning of period</b>	23.1	0.9	8.2	-	32.2
<b>Cash and cash equivalents at end of period</b>	\$ 113.1	\$ 1.2	\$ 3.0	\$ -	\$ 117.3



**HealthSouth Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**

**Condensed Consolidating Statement of Cash Flows**

	Nine Months Ended September 30, 2008				
	HealthSouth Corporation	Guarantor Subsidiaries	Non Guarantor Subsidiaries (In Millions)	Eliminating Entries	HealthSouth Consolidated
<b>Net cash provided by operating activities</b>	\$ 52.1	\$ 132.4	\$ 84.4	\$ (119.6)	\$ 149.3
<b>Cash flows from investing activities:</b>					
Capital expenditures	(15.4)	(19.4)	(4.6)	-	(39.4)
Acquisition of business, net of cash acquired	-	(14.6)	-	-	(14.6)
Acquisition of intangible assets	-	(18.2)	-	-	(18.2)
Proceeds from disposal of assets	43.9	9.9	-	-	53.8
Net change in restricted cash, excluding cash in escrow related to debt	0.2	-	20.3	-	20.5
Net settlements on interest rate swap	(13.9)	-	-	-	(13.9)
Other	-	-	(0.3)	-	(0.3)
Net cash (used in) provided by investing activities of discontinued operations	-	(0.4)	0.6	-	0.2
<b>Net cash provided by (used in) investing activities</b>	14.8	(42.7)	16.0	-	(11.9)
<b>Cash flows from financing activities:</b>					
Checks in excess of bank balances	(16.7)	-	-	5.3	(11.4)
Change in restricted cash for amounts in escrow related to debt	(30.3)	-	-	-	(30.3)
Principal payments on debt, including pre-payments	(126.5)	(4.1)	-	9.1	(121.5)
Borrowings on revolving credit facility	88.0	-	-	-	88.0
Payments on revolving credit facility	(150.0)	-	-	-	(150.0)
Principal payments under capital lease obligations	(0.2)	(6.8)	(2.3)	-	(9.3)
Issuance of common stock	150.2	-	-	-	150.2
Dividends paid on convertible perpetual preferred stock	(19.5)	-	-	-	(19.5)
Distributions paid to noncontrolling interests of consolidated affiliates	-	-	(26.3)	-	(26.3)
Other	(0.3)	-	-	-	(0.3)
Change in intercompany advances	51.0	(88.6)	(72.9)	110.5	-
Net cash used in financing activities of discontinued operations	(1.9)	-	(1.1)	-	(3.0)
<b>Net cash used in financing activities</b>	(56.2)	(99.5)	(102.6)	124.9	(133.4)
<b>Effect of exchange rate changes on cash and cash equivalents</b>	-	-	0.8	-	0.8
<b>Increase (decrease) in cash and cash equivalents</b>	10.7	(9.8)	(1.4)	5.3	4.8
<b>Cash and cash equivalents at beginning of period</b>	2.0	13.8	9.3	(5.3)	19.8
<b>Cash and cash equivalents of divisions and facilities held for sale at beginning of period</b>	-	-	0.4	-	0.4
<b>Less: cash and cash equivalents of divisions and facilities held for sale at end of period</b>	-	(0.1)	-	-	(0.1)
<b>Cash and cash equivalents at end of period</b>	\$ 12.7	\$ 3.9	\$ 8.3	\$ -	\$ 24.9

## Item 2. 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") relates to HealthSouth Corporation and its subsidiaries and should be read in conjunction with our condensed consolidated financial statements included under Part I, Item 1, *Financial Statements (Unaudited)*, of this report and our audited consolidated financial statements for the year ended December 31, 2008 and *Management's Discussion and Analysis of Financial Condition and Results of Operations* which are included in our Annual Report on Form 10-K for the year ended December 31, 2008 (the "2008 Form 10-K"). As used in this report, the terms "HealthSouth," "we," "our," "us," and the "Company" refer to HealthSouth Corporation and its subsidiaries, unless otherwise stated or indicated by context.

This MD&A is designed to provide the reader with information that will assist in understanding our condensed consolidated financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our condensed consolidated financial statements.

### Executive Overview

#### *Our Business*

We operate inpatient rehabilitation hospitals and long-term acute care hospitals ("LTCHs") and provide treatment on both an inpatient and outpatient basis. As of September 30, 2009, we operated 94 inpatient rehabilitation hospitals (including 3 hospitals that operate as joint ventures which we account for using the equity method of accounting), 6 freestanding LTCHs, 44 outpatient rehabilitation satellites (operated by our hospitals), and 25 licensed, hospital-based home health agencies. In addition to HealthSouth hospitals, we manage six inpatient rehabilitation units and one outpatient satellite through management contracts. Our inpatient hospitals are located in 26 states, with a concentration of hospitals in Texas, Pennsylvania, Florida, Tennessee, and Alabama. We also have two hospitals in Puerto Rico.

We are the nation's largest provider of inpatient rehabilitative healthcare services in terms of revenues, number of hospitals, and patients treated and discharged. Our inpatient rehabilitation hospitals offer specialized rehabilitative care across a wide array of diagnoses and deliver comprehensive patient care services. The majority of patients we serve experience significant physical disabilities due to medical conditions, such as strokes, hip fractures, head injury, spinal cord injury, and neurological disorders, that are non-discretionary in nature and which require rehabilitative services in an inpatient setting. Our team of highly skilled physicians, nurses, and physical, occupational, and speech therapists utilize the latest in equipment and techniques to return patients to home and work. Patient care is provided by nursing and therapy staff as directed by a physician order. Internal case managers monitor each patient's progress and provide documentation of patient status, achievement of goals, discharge planning, and functional outcomes. Our hospitals provide a comprehensive interdisciplinary clinical approach to treatment that leads to what we believe is a higher level of care and superior outcomes.

Period-over-period comparisons for the nine months ended September 30, 2009 are not on an equal basis to the prior year due to a Medicare pricing roll-back that occurred in the second quarter of 2008. The first quarter of 2008 contained a Medicare market basket update that went into effect October 1, 2007 but was "rolled-back" from our Medicare reimbursement on April 1, 2008. The roll-back ended on September 30, 2009, and, as discussed below, we received a 2.5% increase to our reimbursement from Medicare (i.e., a "market basket update") effective October 1, 2009. However, as a result of various healthcare reform initiatives being discussed, this market basket update may be reduced by Congress effective January 1, 2010. For additional information on the Medicare pricing roll-back, see Item 1, *Business*, "Sources of Revenues – Medicare Reimbursement," and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, to our 2008 Form 10-K. For additional information on the market basket update and the impact of healthcare reform, see the "Key Challenges" section of this Item.

Net patient revenue from our hospitals was 4.8% and 5.0% higher for the three and nine months ended September 30, 2009, respectively, than the same periods of 2008. Inpatient discharges increased 5.3% and 5.5% during the three and nine months ended September 30, 2009 compared to the same periods of 2008. Operating earnings (as defined in Note 22, *Quarterly Data (Unaudited)*, to the consolidated financial statements accompanying our 2008 Form 10-K, as adjusted for the reclassification of noncontrolling interests) for the three and nine months ended September 30, 2009 were \$57.3 million and \$169.9 million, respectively, compared to \$37.3 million and \$191.9 million for the same periods of 2008, respectively. Operating earnings for the three and nine months ended September 30, 2009 included charges of \$8.5 million and \$41.3 million, respectively, associated with *Government, class action, and related settlements expense*, as discussed in the "Results of Operations" section of this Item. Operating earnings for the three and nine months ended September 30, 2008 included charges (gains) of \$17.1 million and (\$27.9) million, respectively, associated with *Government, class action, and related settlements expense*. *Net cash provided by operating activities* was \$362.1 million and \$149.3 million for the nine months ended September 30, 2009 and 2008, respectively. Cash flows during 2009 included \$73.8 million related to the net cash proceeds from the UBS Settlement and the receipt of an approximate \$42 million additional federal income tax refund for tax years 1995 through 1999. See Note 9, *Income Taxes*, and Note 11, *Settlements*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of the report.

As discussed in the "Business Outlook" section below and throughout this report, our primary emphasis, especially during this period of global economic uncertainty, remains on debt reduction and further deleveraging. During the nine months ended September 30, 2009, we reduced our total debt outstanding by approximately \$117 million (see Note 2, *Liquidity*, and Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report).

We believe the demand for inpatient rehabilitative healthcare services will increase as the U.S. population ages. In addition, the number of Medicare "compliant patients" (i.e., a patient who qualifies for inpatient rehabilitative care under Medicare rules) is expected to grow approximately 2% per year for the foreseeable future, creating an attractive market. We believe these market factors align with our strengths in and focus on inpatient rehabilitative care. Unlike many of our competitors that may offer inpatient rehabilitation as one of many secondary services, inpatient rehabilitation is our core business.

#### *Key Challenges*

While we met our operational goals in 2008 and are meeting our goals in 2009, the following are some of the challenges we are addressing:

- **Leverage and Liquidity**. Our primary sources of liquidity are cash on hand, cash flows from operations (which were \$362.1 million during the nine months ended September 30, 2009), and borrowings under our \$400 million revolving credit facility. As of September 30, 2009, we had \$117.3 million in *Cash and cash equivalents*. This amount excluded \$88.1 million in *Restricted cash* and \$23.3 million of restricted marketable securities. As of September 30, 2009, no amounts were drawn on our revolving credit facility. In addition, and while no assurances can be provided, we anticipate cash flows from certain non-operating sources.

Reducing debt is a primary strategic focus, and our leverage and liquidity are improving. During the nine months ended September 30, 2009, we reduced our total debt outstanding by approximately \$117 million and increased our *Cash and cash equivalents* by approximately \$85 million. We believe our higher Adjusted Consolidated EBITDA and our strong cash flows from operations will allow us to continue to reduce our debt and leverage. However, our leverage remains higher than we would like and, consequently, we will continue to emphasize debt reduction.

For additional information regarding our leverage and liquidity, see the “Liquidity and Capital Resources” section of this Item and Note 2, *Liquidity*, and Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report. See Item 1A, *Risk Factors*, of our 2008 Form 10-K and Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K for a discussion of risks and uncertainties facing us.

- **Highly Regulated Industry**. Over the last several years, changes in regulations governing inpatient rehabilitation reimbursement have created a challenging operating environment for inpatient rehabilitative 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, and as reported previously, while The Medicare, Medicaid and State Children’s Health Insurance Program (SCHIP) Extension Act of 2007 signed on December 29, 2007 may have stabilized much of the volatility in patient volumes created by setting the compliance threshold of the 75% Rule at 60%, it also included a reduction in the pricing of services eligible for Medicare reimbursement to a pricing level that existed in the third quarter of 2007 (the Medicare pricing “roll-back”). See Item 1, *Business*, “Sources of Revenue – Medicare Reimbursement,” of our 2008 Form 10-K for additional information. During the period of the Medicare pricing roll-back, we incurred increased costs, including costs associated with providing annual merit increases and benefits to our employees.

On August 7, 2009, the Centers for Medicare and Medicaid Services (“CMS”) published in the federal register the fiscal year 2010 notice of final rulemaking for inpatient rehabilitation facilities under the prospective payment system (“IRF-PPS”). This rule contains Medicare pricing changes as well as new coverage requirements. The pricing changes are effective for Medicare discharges between October 1, 2009 and September 30, 2010 and include a 2.5% market basket update, which is the first market basket update we have received in 18 months. However, as discussed below, the various healthcare bills being discussed in Congress include reductions to market basket updates for providers as a means of helping to pay for healthcare reform. Accordingly, it is possible this market basket update could be reduced by Congress. We have analyzed the other aspects of the pricing changes and believe the remaining pricing changes will have a neutral to slightly positive impact on our *Net operating revenues*. The new coverage requirements under the rule will be effective for discharges occurring on or after January 1, 2010, which allows hospitals adequate time to make any necessary operational adjustments. Our hospitals already operate using many of the new requirements, and these changes will not result in material modifications to our clinical or business models. In addition, when the final rule was released, CMS indicated there were several areas related to the new coverage requirements where additional discussion and clarification was necessary. Along with other providers, we participated in these discussions with CMS, and we anticipate further clarification will come from CMS later this year. Based on what we know at this juncture, we expect to be in full compliance with all new coverage requirements, including any additional clarifications released by CMS, by the required date.

Additionally, we are required to comply with extensive and complex laws and regulations at the federal, state, and local government levels. These rules and regulations affect our business activities by controlling the reimbursement we receive for services provided, requiring licensure or certification of our hospitals, regulating our relationships with physicians and other referral sources, regulating the use of our properties, and controlling our growth. Ensuring continuous compliance with these laws and regulations is an operating requirement for all healthcare providers.

We have invested substantial time, effort, and expense in implementing 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 important for us to remain compliant with the laws and regulations governing the Medicare program. If we were unable to remain compliant with these regulations, our financial position, results of operations, and cash flows could be materially, adversely impacted.

**Potential Impact of Healthcare Reform**. President Obama has identified healthcare reform as a major domestic priority, and Congress is devoting considerable effort to drafting healthcare reform legislation. At the time of this writing, no specific healthcare reform legislation has been adopted, though all relevant committees of jurisdiction have passed major healthcare reform legislation or legislative concepts. Many issues are being discussed within the context of healthcare reform, several of which could have an impact on our business. The three issues with the greatest potential impact are: (1) reducing annual market basket updates to providers, (2) combining, or “bundling,” of acute care hospital and post-acute Medicare reimbursement at some point in the future, and (3) creating an Independent Medicare Commission.

With respect to future reductions to market basket updates, and as previously noted, while no specific healthcare legislation has been adopted at this time, the healthcare reform bills that have been passed out of Congressional committees include some kind of payment reductions to providers. While we cannot be certain of the magnitude of these potential market basket reductions, or if they will be enacted, we will be working with other providers, as well as other parties who have a vested interest, to help ensure they do not compromise our ability to provide high-quality services to the patients we serve.

The probability of enacting a “bundled” payment system is difficult to predict at this time. The major healthcare reform bills being contemplated currently by Congress include provisions to examine the feasibility of bundling, including the potential for a voluntary bundling pilot program to test and evaluate alternative payment methodologies. We will continue to work with the acute hospital and post-acute care provider communities on this important issue.

There has also been discussion of establishing an “Independent Medicare Commission” (“IMC”) that would be charged with presenting

proposals to Congress to reduce Medicare expenditures upon the occurrence of Medicare expenditures exceeding a certain level. At this point, it is difficult to determine whether an IMC will be enacted into law, and, if so, how it would function. Similar to the reform concerns discussed above, we will continue to work with other providers, as well as other parties who have a vested interest, to help ensure they do not compromise our ability to provide high-quality services to the patients we serve.

- **Staffing** . Our operations are dependent on the efforts, abilities, and experience of our medical support personnel, such as physical therapists, nurses, and other healthcare professionals. In some markets, the lack of availability of physical therapists, nurses, and other medical support personnel is an operating issue to healthcare providers, although the weak economy has mitigated this issue to some degree. We have refined our comprehensive benefits package to remain competitive in this challenging staffing environment while also being consistent with our goal of being a high quality, cost-effective provider of inpatient rehabilitative services. As a result of our efforts, we are experiencing improved retention rates and reduced turnover. Going forward, recruiting and retaining qualified personnel for our hospitals will remain a high priority for us.

We also are monitoring efforts in Congress that could make it more difficult for employees to avoid or reject labor organization. At this time, it is not clear whether, when, or in what form, such legislation might be enacted into law, nor are we able to predict the impact, if any, this legislation would have on our business, if enacted.

### *Business Outlook*

As previously noted, the inpatient rehabilitation sector of the healthcare industry is an attractive market: the aging demographics of the U.S. population coupled with an approximate 2% projected annual growth rate in the number of compliant patients create a favorable business environment for us. As the nation's largest provider of inpatient rehabilitative healthcare services, we believe we differentiate ourselves from our competitors based on the quality of our clinical outcomes, our broad base of clinical expertise, the application and leverage of rehabilitative technology, and the standardization of best practices that result in high-quality, cost-effective care for the patients we serve.

Our ability to continue to create shareholder value in the near term will be predicated on our ability to: (1) deleverage our balance sheet; (2) adapt to regulatory changes affecting our industry; (3) grow organically; (4) provide high-quality, cost-effective care; and, to a much lesser extent in the immediate-term, (5) pursue acquisitions on a disciplined, opportunistic basis – all within the context of uncertain economic times.

During the nine months ended September 30, 2009, we reduced our total debt outstanding by approximately \$117 million, and we believe our higher Adjusted Consolidated EBITDA and our strong cash flows from operations will allow us to continue to reduce our debt and leverage. Further, we believe we have adequate sources of liquidity due to our *Cash and cash equivalents* and the availability of our revolving credit facility. In addition, and as discussed in the "Liquidity and Capital Resources" section of this Item, we do not face substantial near-term refinancing risk.

As discussed previously, healthcare always has been a highly regulated industry, and the inpatient rehabilitation segment is no exception. Successful healthcare providers are those who provide high-quality care and have the capabilities to adapt to changes in the regulatory environment. We believe we have the necessary capabilities – scale, infrastructure, and management – to adapt and succeed in a highly regulated industry, and we have a proven track record of being able to do so. The healthcare reform proposals that are being discussed are fluid and changing. However, we are confident, based on our track record, we will be able to adapt to whatever changes may impact our industry.

We believe our ability to continue to grow at a faster rate than the rest of the industry is attributable to our higher level of care and is sustainable. In addition, the majority of patients we serve have medical conditions, such as strokes, hip fractures, and neurological disorders, that are non-discretionary in nature and which require rehabilitative services in an inpatient setting. Consequently, we believe we are well positioned to grow volumes, despite the challenging economic environment. The area of our business at the most risk for decreases in discretionary spending is outpatient services. However, this area of our business represents less than 10% of our consolidated *Net operating revenues*, so we anticipate minimal impact to our overall results.

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 will continue to focus on ensuring we provide high-quality care and finding efficiencies in our cost structure at both the corporate and operational levels in an effort to remain competitive. Our largest costs are our *Salaries and benefits*, and they represent our investment in our most valuable resource: our employees. We continue to actively manage these expenses. We will continue to monitor the labor market and will make any necessary adjustments to remain competitive in this challenging environment while also being consistent with our goal of being a high-quality, cost-effective provider of inpatient rehabilitative services.

In recognition of the current economic uncertainty, we will continue to be disciplined in our approach to development opportunities, carefully evaluating these opportunities against our deleveraging priority. For the foreseeable future, reducing our long-term debt will be our key objective. We will continue to pursue bed expansions in existing hospitals as they provide immediate earnings growth and will pursue acquisitions and market consolidations where we can do so with minimal initial cash outlays. For any de-novo project we decide to pursue, we may work with third parties willing to assume the majority of the financing risks associated with these projects.

In summary, we believe the business outlook remains positive, despite the current economic environment, and, based on the discharge growth we have experienced thus far in 2009, we continue to believe our volumes will not be materially adversely impacted by the current economy. We will continue to monitor the economic climate and focus on initiatives designed to control costs. We plan to continue to use the majority of our excess cash flow to reduce debt. We also anticipate we will be able to generate cash flows to fund additional debt reduction as well as disciplined, opportunistic development activities, which we believe will bring long-term, sustainable growth and returns to our stockholders. Finally, we will continue to work with the acute hospital and post-acute care provider communities, as well as other parties who have a vested interest, to bring positive healthcare reform that rewards healthcare providers, like HealthSouth, that strive to provide high-quality, cost-effective services to patients who need these services.

### **Results of Operations**

During the three and nine months ended September 30, 2009 and 2008, we derived consolidated *Net operating revenues* from the following payor sources:

**Three Months Ended**

**Nine Months Ended**

	September 30,		September 30,	
	2009	2008	2009	2008
Medicare	67.6%	66.2%	67.5%	67.1%
Medicaid	2.1%	2.2%	2.2%	2.2%
Workers' compensation	1.7%	2.2%	1.7%	2.2%
Managed care and other discount plans	23.4%	23.0%	23.2%	22.3%
Other third-party payors	2.5%	3.8%	2.8%	3.6%
Patients	1.4%	1.1%	1.2%	1.0%
Other income	1.3%	1.5%	1.4%	1.6%
Total	100.0%	100.0%	100.0%	100.0%

Our payor mix is weighted heavily towards Medicare, and Medicare patients are segmented into two categories: (1) "traditional" Medicare and (2) "managed" Medicare. Our hospitals receive traditional Medicare reimbursements under IRF-PPS. With IRF-PPS, our hospitals receive fixed payment amounts per discharge based on certain rehabilitation impairment categories established by the United States Department of Health and Human Services. Under 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 high quality, low cost providers. For additional information regarding Medicare reimbursement, please see the "Sources of Revenues" section of Item 1, *Business*, of our 2008 Form 10-K.

Over the past few years, we have experienced an increase in managed Medicare and private fee-for-service plans that are included in the "managed care and other discount plans" category in the above table. 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, Medicare+Choice, 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 sponsored organization, or an insurance plan operated in conjunction with a medical savings account. While we expect our payor mix will remain heavily weighted towards traditional Medicare, we expect this increase of patients in managed Medicare and private fee-for-service plans will continue. However, the future of Medicare Part C will be determined, ultimately, by Congress, and any changes to Medicare Part C may have an impact on this trend.

Under IRF-PPS, hospitals are reimbursed on a "per discharge" basis. Thus, the number of patient discharges is a key metric utilized by management to monitor and evaluate our performance. The number of outpatient visits is also tracked in order to measure the volume of outpatient activity each period.

Certain financial results have been reclassified to conform to the current year presentation. Such reclassifications primarily relate to rental properties where we terminated the leases associated with certain properties. As a result, we reclassified our condensed consolidated balance sheet as of December 31, 2008, our condensed consolidated statements of operations for the three and nine months ended September 30, 2008, and our condensed consolidated statement of cash flows for the nine months ended September 30, 2008 to include these properties and their results of operations in discontinued operations.

As of January 1, 2009 we reclassified our noncontrolling interests (formerly known as "minority interests") as a component of equity and now report net income and comprehensive income attributable to our noncontrolling interests separately from net income and comprehensive income attributable to HealthSouth.

During the preparation of our condensed consolidated financial statements for the quarterly period ended June 30, 2009, we identified an error in our consolidated financial statements as of and for the year ended December 31, 2008 and prior periods and our condensed consolidated financial statements as of and for the quarterly period ended March 31, 2009. We corrected this error in our financial statements by adjusting *Equity in net income of nonconsolidated affiliates*, which resulted in an understatement of both our *Income (loss) from continuing operations before income tax benefit* and our *Net income* of approximately \$4.5 million for the nine months ended September 30, 2009. This error related primarily to an approximate \$9.6 million overstatement of our investment in a joint venture hospital we account for using the equity method of accounting due to the understatement of prior period income tax provisions of this joint venture hospital and the adjustment of certain liabilities due to this joint venture hospital. We also adjusted *Accrued expenses and other current liabilities* by approximately \$4.7 million due to changes in amounts due to us for expenses paid on behalf of this joint venture hospital. We do not believe these adjustments are material to the condensed consolidated financial statements as of September 30, 2009 and for the nine months then ended or to any prior years' consolidated financial statements. As a result, we have not restated any prior period amounts.

For the three and nine months ended September 30, 2009 and 2008, our consolidated results of operations were as follows:

	Three Months Ended September 30,		Percentage Change 2009 vs. 2008	Nine Months Ended September 30,		Percentage Change 2009 vs. 2008
	2009	2008		2009	2008	
	(As Adjusted)			(As Adjusted)		
	(In Millions)			(In Millions)		
Net operating revenues	\$ 472.7	\$ 455.5	3.8%	\$ 1,431.5	\$ 1,376.3	4.0%
Operating expenses:						
Salaries and benefits	235.4	236.3	(0.4%)	709.2	700.8	1.2%
Other operating expenses	66.8	68.6	(2.6%)	201.6	201.0	0.3%
General and administrative expenses	26.0	25.5	2.0%	76.4	78.8	(3.0%)
Supplies	27.7	26.2	5.7%	83.9	81.1	3.5%
Depreciation and amortization	18.1	17.9	1.1%	53.4	65.3	(18.2%)
Impairment of long-lived assets	4.0	-	N/A	4.0	0.6	566.7%
Occupancy costs	11.8	12.6	(6.3%)	35.9	36.8	(2.4%)
Provision for doubtful accounts	7.9	6.6	19.7%	25.5	20.5	24.4%
Loss on disposal of assets	0.7	0.2	250.0%	3.0	0.6	400.0%
Government, class action, and						

related settlements expense	8.5	17.1	(50.3%)	41.3	(27.9)	(248.0%)
Professional fees—accounting, tax, and legal	3.5	4.0	(12.5%)	5.0	12.9	(61.2%)
Total operating expenses	410.4	415.0	(1.1%)	1,239.2	1,170.5	5.9%
Loss (gain) on early extinguishment of debt	-	2.1	(100.0%)	(3.1)	5.8	(153.4%)
Interest expense and amortization of debt discounts and fees	29.5	40.3	(26.8%)	95.0	131.1	(27.5%)
Other income	(0.6)	(0.4)	50.0%	(1.4)	(2.1)	(33.3%)
Loss on interest rate swaps	7.9	8.0	(1.3%)	16.7	16.1	3.7%
Equity in net income of nonconsolidated affiliates	(3.0)	(2.7)	11.1%	(2.8)	(7.8)	(64.1%)
Income (loss) from continuing operations before income tax benefit	28.5	(6.8)	(519.1%)	87.9	62.7	40.2%
Provision for income tax benefit	(1.7)	(22.5)	(92.4%)	(0.8)	(21.7)	(96.3%)
Income from continuing operations	30.2	15.7	92.4%	88.7	84.4	5.1%
(Loss) income from discontinued operations, net of tax	(5.4)	(2.9)	86.2%	(6.8)	7.2	(194.4%)
<b>Net income</b>	24.8	12.8	93.8%	81.9	91.6	(10.6%)
Less: Net income attributable to noncontrolling interests	(8.0)	(6.2)	29.0%	(25.7)	(21.1)	21.8%
<b>Net income attributable to HealthSouth</b>	<u>\$ 16.8</u>	<u>\$ 6.6</u>	<u>154.5%</u>	<u>\$ 56.2</u>	<u>\$ 70.5</u>	<u>(20.3%)</u>

## Operating Expenses as a % of Net Operating Revenues

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Salaries and benefits	49.8%	51.9%	49.5%	50.9%
Other operating expenses	14.1%	15.1%	14.1%	14.6%
General and administrative expenses	5.5%	5.6%	5.3%	5.7%
Supplies	5.9%	5.8%	5.9%	5.9%
Depreciation and amortization	3.8%	3.9%	3.7%	4.7%
Impairment of long-lived assets	0.8%	0.0%	0.3%	0.0%
Occupancy costs	2.5%	2.8%	2.5%	2.7%
Provision for doubtful accounts	1.7%	1.4%	1.8%	1.5%
Loss on disposal of assets	0.1%	0.0%	0.2%	0.0%
Government, class action, and related settlements expense	1.8%	3.8%	2.9%	(2.0%)
Professional fees—accounting, tax, and legal	0.7%	0.9%	0.3%	0.9%
Total	<u>86.8%</u>	<u>91.1%</u>	<u>86.6%</u>	<u>85.0%</u>

Additional information regarding our operating results for the three and nine months ended September 30, 2009 and 2008 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In Millions)		(In Millions)	
Net patient revenue—inpatient	\$ 431.3	\$ 411.5	\$ 1,303.4	\$ 1,241.1
Net patient revenue—outpatient and other revenues	41.4	44.0	128.1	135.2
Net operating revenues	<u>\$ 472.7</u>	<u>\$ 455.5</u>	<u>\$ 1,431.5</u>	<u>\$ 1,376.3</u>
	(Actual Amounts)		(Actual Amounts)	
Discharges	28,241	26,827	84,542	80,126
Outpatient visits	283,229	310,279	861,594	936,152
Average length of stay	14.3 days	14.7 days	14.4 days	14.9 days
Occupancy %	66.5%	65.6%	67.8%	66.4%
# of licensed beds	6,587	6,556	6,587	6,556
Full-time equivalents*	15,622	15,744	15,625	15,590

\* Excludes 392 and 396 full-time equivalents for the three months ended September 30, 2009 and 2008, respectively, and 390 and 413 full-time equivalents for the nine months ended September 30, 2009 and 2008, respectively, who are considered part of corporate overhead with their salaries and benefits included in *General and administrative expenses* in our condensed 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.

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 periods and throughout the full 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.

### *Net Operating Revenues*

Our consolidated *Net operating revenues* consist primarily of revenues derived from patient care services. *Net operating revenues* also include other revenues generated from management and administrative fees and other non-patient care services. These other revenues approximated 1.3% and 1.5% of consolidated *Net operating revenues* for the three months ended September 30, 2009 and 2008, respectively, and 1.4% and 1.6% of consolidated *Net operating revenues* for the nine months ended September 30, 2009 and 2008, respectively.

Net patient revenue from our hospitals was 4.8% higher for the three months ended September 30, 2009 than the three months ended September 30, 2008. This increase was primarily attributable to a 5.3% quarter-over-quarter increase in patient discharges on both a consolidated and same store basis. Pricing was comparable quarter over quarter.

Net patient revenue from our hospitals was 5.0% higher for the nine months ended September 30, 2009 than the same period of 2008. Higher revenue resulted from a 5.5% period-over-period increase in patient discharges. Same store discharges were 4.9% higher in the nine months ended September 30, 2009 compared to the same period of 2008. Net patient revenue per discharge decreased in the year-to-date period of 2009 compared to the same period of 2008. As noted above, period-over-period comparisons for the nine months ended September 30, 2009 are not on an equal basis to the prior year due to the Medicare pricing roll-back. The first quarter of 2008 contained a Medicare market basket update that became effective October 1, 2007 but was “rolled-back” from our Medicare reimbursement on April 1, 2008.

Decreased outpatient volumes in all periods presented resulted primarily from the closure of outpatient satellites, but challenges in securing therapy staffing for these outpatient satellites in certain markets and continued competition from physicians offering physical therapy services within their



own offices also contributed to the decline. As of September 30, 2009, we operated 44 outpatient satellites, while as of September 30, 2008, we operated 55 outpatient satellites. We continuously monitor the performance of our outpatient satellites and will take appropriate action with respect to underperforming facilities, including closure.

### *Salaries and Benefits*

*Salaries and benefits* represent 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* were 49.8% and 49.5% of *Net operating revenues* during the three and nine months ended September 30, 2009, respectively, which is a decrease from 51.9% and 50.9% of *Net operating revenues* during the three and nine months ended September 30, 2008, respectively. This improvement was despite an approximate 3% merit increase provided to our employees effective October 1, 2008 and, for the year-to-date period, despite the Medicare market basket update that was included in our *Net operating revenues* during the first quarter of 2008. Also, as a result of our recruiting and retention efforts, costs associated with contract labor decreased in both periods of 2009.

We continue to actively manage the productive component of our *Salaries and benefits*, with employees per occupied bed, or “EPOB,” decreasing from 3.69 and 3.62 during the three and nine months ended September 30, 2008, respectively, to 3.58 and 3.52 during the three and nine months ended September 30, 2009, respectively. This represents an improvement of 3.0% and 2.8% for the quarter and year-to-date periods, respectively. As discussed previously, we have also addressed the non-productive component of our *Salaries and benefits* and, with the transition to a new benefit year on January 1, 2009, are realizing the benefits of refinements made to our comprehensive benefits package. Such refinements included, but were not limited to, passing along a portion of the increased costs associated with medical plan benefits to our employees and reducing certain aspects of our paid-time-off program.

As it is routine to provide merit increases to our employees on October 1 of each year, which normally coincides with our annual Medicare pricing adjustment, we provided an approximate 2.3% merit increase to our employees effective October 1, 2009.

See Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operations*, “Results of Operations,” of our 2008 Form 10-K for the calculation of EPOB.

### *Other Operating Expenses*

*Other operating expenses* include costs associated with managing and maintaining our hospitals. These expenses include such items as contract services, utilities, professional fees, insurance, and repairs and maintenance.

*Other operating expenses* were lower in the three months ended September 30, 2009 than the three months ended September 30, 2008 primarily due to the effect of hurricanes, primarily in the form of higher repairs and maintenance costs, on some of our hospitals in Texas and Louisiana during the third quarter of 2008.

During the nine months ended September 30, 2008, we experienced a reduction in self-insurance costs due to revised actuarial estimates that resulted from current claims history and industry-wide loss development trends. These reductions were primarily included in *Other operating expenses* in our condensed consolidated statement of operations for the nine months ended September 30, 2008. This reduction in costs was somewhat mitigated by costs associated with the implementation of our TeamWorks initiative during the nine months ended September 30, 2008. See Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operations*, of our 2008 Form 10-K for additional information related to TeamWorks.

### *General and Administrative Expenses*

*General and administrative expenses* primarily include administrative expenses such as corporate accounting, internal audit and controls, legal, and information technology services that are managed from our corporate headquarters in Birmingham, Alabama. These expenses also include all stock-based compensation expenses recorded for all eligible employees.

Our *General and administrative expenses* increased quarter over quarter due primarily to non-cash expenses associated with stock-based compensation. *General and administrative expenses* as a percent of *Net operating revenues* decreased in all periods presented due to a reduction in corporate-related, full-time equivalents and moving certain processes “in-house” versus using external consultants and other professionals. *General and administrative expenses* were 5.5% and 5.3% of *Net operating revenues* for the three and nine months ended September 30, 2009, respectively. Excluding non-cash expenses associated with stock-based compensation of \$3.4 million and \$9.9 million during the three and nine months ended September 30, 2009, respectively, our *General and administrative expenses* would have been 4.8% and 4.6%, respectively, of *Net operating revenues*.

### *Supplies*

*Supplies* expense includes all costs associated with supplies used while providing patient care. These costs include pharmaceuticals, food, needles, bandages, and other similar items. The increase in *Supplies* expense in each period was due to an increase in the number of patients treated.

### *Depreciation and Amortization*

*Depreciation and amortization* for the nine months ended September 30, 2008 included an approximate \$11.0 million charge related to the accelerated depreciation of our corporate campus so that the net book value of the corporate campus equaled the net proceeds we received on the transaction’s closing date. See Note 5, *Property and Equipment*, to the consolidated financial statements accompanying our 2008 Form 10-K for additional information.

### *Impairment of Long-Lived Assets*

During the three and nine months ended September 30, 2009, we recorded an impairment charge of \$4.0 million. This charge represented our



write-down of certain long-lived assets associated with one of our hospitals to their estimated fair value based on an offer we received from a third party to acquire the assets. During the nine months ended September 30, 2008, similar charges were \$0.6 million.

#### *Occupancy Costs*

*Occupancy costs* include amounts paid for rent associated with leased hospitals, including common area maintenance and similar charges. These costs did not change significantly in the periods presented.

#### *Provision for Doubtful Accounts*

As disclosed previously, we have experienced denials of certain diagnosis codes by Medicare contractors based on medical necessity. We appeal most of these denials and have experienced a strong success rate for claims that have completed the appeals process. While our success rate is a positive reflection of the medical necessity of the applicable patients, the appeal process can take in excess of one year, and we cannot provide assurance as to the ongoing and future success of our appeals. As such, we have made provisions against these receivables in accordance with our accounting policy that necessarily considers the age of the receivables under appeal as part of our *Provision for doubtful accounts*. The aging of these types of claims has resulted in an increase in our *Provision for doubtful accounts* as a percent of *Net operating revenues* during 2009.

#### *Loss on Disposal of Assets*

The *Loss on disposal of assets* in each period presented primarily resulted from various equipment disposals throughout each period. For the three and nine months ended September 30, 2009, it also included losses associated with our write-down of certain assets held for sale to their estimated fair value based on offers we received from third parties to acquire the assets, as well as the write-off of certain assets as we updated, or “refreshed,” some of our hospitals. For additional information, see Note 7, *Fair Value Measurements*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

#### *Government, Class Action, and Related Settlements Expense*

The majority of the amounts recorded as *Government, class action, and related settlements expense* in each period resulted from changes in the fair value of our common stock and the associated common stock warrants underlying our securities litigation settlement. Prior to the issuance of these shares of common stock and common stock warrants on September 30, 2009, at each quarter end, we adjusted our liability for this settlement based on the value of our common stock and the associated common stock warrants. To the extent the price of our common stock increased, we would increase our liability and record losses. When the price of our common stock decreased, we would reduce our liability and record gains. The final fair value adjustment related to these shares and warrants was made on September 30, 2009 at the time of issuance of the underlying common stock and common stock warrants. For additional information related to the Securities Litigation Settlement and the issuance of our common stock and the associated common stock warrants underlying this settlement, see Note 11, *Settlements*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

*Government, class action, and related settlements expense* for the three and nine months ended September 30, 2009 included an \$8.2 million and \$41.9 million, respectively, increase in the liability associated with our securities litigation based on the value of our common stock and the associated common stock warrants underlying this settlement. *Government, class action, and related settlements expense* for the three months ended September 30, 2009 also included a net charge of \$0.3 million associated with certain settlements and other matters discussed in Note 11, *Settlements*, and Note 12, *Contingencies*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report. Similar items resulted in a net gain of \$0.6 million during the nine months ended September 30, 2009.

*Government, class action, and related settlements expense* for the three and nine months ended September 30, 2008 included a \$14.7 million and (\$28.6) million, respectively, increase (reduction) in the liability associated with our securities litigation based on the value of our common stock and the associated common stock warrants underlying this settlement. *Government, class action, and related settlements expense* also included a net charge of \$2.4 million during the three months ended September 30, 2008 for certain settlements and indemnification obligations. Similar items resulted in a net charge of \$0.7 million during the nine months ended September 30, 2008.

#### *Professional Fees—Accounting, Tax, and Legal*

Based on our bylaws and certain indemnification agreements, we accrued an estimate of legal fees associated with Mr. Scrushy’s criminal defense in *Professional fees – accounting, tax, and legal* in our 2005 and 2004 consolidated statements of operations. In October 2006, an arbitrator issued a final award to Mr. Scrushy for such fees, and we offset that award against the approximate \$48 million judgment we received for repayment of bonuses he received during his time as chairman and chief executive officer during the historic fraudulent reporting periods. Based on the arbitrator’s ruling, we continued to maintain an accrual for certain costs associated with then-ongoing litigation involving Mr. Scrushy.

As discussed in Note 12, *Contingencies*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, in June 2009, a court ruled that Mr. Scrushy committed fraud and breached his fiduciary duties during his time with HealthSouth. Based on this judgment, we have no obligation to indemnify him for any litigation costs. Therefore, we reversed the remainder of this accrual for his legal fees during the second quarter of 2009, which resulted in a reduction in *Professional fees – accounting, tax, and legal* of \$6.5 million during the nine months ended September 30, 2009.

Excluding the reversal of accrued fees discussed above, *Professional fees – accounting, tax, and legal* for the three and nine months ended September 30, 2009 and 2008 related primarily to legal and consulting fees for continued litigation defense and support matters arising from prior reporting and restatement issues and income tax return preparation and consulting fees for various tax projects related to our pursuit of our remaining income tax refund claims.

#### *Loss (Gain) on Early Extinguishment of Debt*

As disclosed previously and throughout this report, during 2009 and 2008, we used the net proceeds from various non-operating sources of cash, as well as available cash, to pay down long-term debt. As a result of these pre-payments and bond redemptions, we allocated a portion of the debt

discounts or premiums and fees associated with this debt to the debt that was extinguished. The amounts included in *Loss (gain) on early extinguishment of debt* in each period presented are a result of these debt reductions.

#### *Interest Expense and Amortization of Debt Discounts and Fees*

As discussed in Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, as well as in Part I, Item 3, *Quantitative and Qualitative Disclosures about Market Risk*, of this report, we have effectively converted \$1.0 billion of variable rate interest to a fixed rate via interest rate swaps that are not designated as hedges. Because these swaps are not designated as hedges, the line item *Interest expense and amortization of debt discounts and fees* benefits from lower interest rates. However, lower rates generate increased payments on our interest rate swaps and increase amounts included in the line item *Loss on interest rate swaps*.

Approximately \$7.1 million of the quarter-over-quarter decrease in *Interest expense and amortization of debt discounts and fees* was due to a decrease in our average interest rate quarter over quarter. Our average interest rate was 8.2% during the three months ended September 30, 2008 compared to an average rate of 6.6% during the three months ended September 30, 2009. The remainder of the decrease was due to lower average borrowings which resulted from the debt reductions discussed in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K and Note 2, *Liquidity*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

Approximately \$22.9 million of the decrease in *Interest expense and amortization of debt discounts and fees* during the nine months ended September 30, 2009 compared to the same period of 2008 was due to a decrease in our average interest rate period over period. Our average interest rate was 8.6% during the nine months ended September 30, 2008 compared to an average rate of 6.9% during the nine months ended September 30, 2009. The remainder of the decrease was due to lower average borrowings which resulted from the debt reductions discussed in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K and Note 2, *Liquidity*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

#### *Other Income*

*Other income* is primarily comprised of interest income and gains and losses on sales of investments. *Other income* for the nine months ended September 30, 2009 included \$0.8 million of impairment charges associated with our marketable equity securities. See Note 3, *Cash and Marketable Securities*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

#### *Loss on Interest Rate Swaps*

Our *Loss on interest rate swaps* in each period represents amounts recorded related to the fair value adjustments and quarterly settlements recorded for our interest rate swaps that are not designated as hedges. The loss or gain recorded in each period presented represents the change in the market's expectations for interest rates over the remaining term of the swap agreements. To the extent the expected LIBOR rates increase, we will record net gains. When expected LIBOR rates decrease, we will record net losses.

During the three and nine months ended September 30, 2009, we made net cash settlement payments of \$11.2 million and \$30.3 million, respectively, to our counterparties under these interest rate swap agreements. During the three and nine months ended September 30, 2008, we made net cash settlement payments of \$7.3 million and \$13.9 million, respectively, to our counterparties under these interest rate swap agreements. For additional information regarding these interest rate swap agreements, see Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, and Part I, Item 3, *Quantitative and Qualitative Disclosures about Market Risk*, of this report.

#### *Equity in Net Income of Nonconsolidated Affiliates*

As discussed above and in Note 1, *Basis of Presentation*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, *Equity in net income of nonconsolidated affiliates* for the nine months ended September 30, 2009 included an out-of-period adjustment associated with a facility we account for using the equity method of accounting. This adjustment created a charge of approximately \$4.5 million for the nine months ended September 30, 2009.

#### *Income (Loss) from Continuing Operations Before Income Tax Benefit*

Our *Income (loss) from continuing operations before income tax benefit* for the three and nine months ended September 30, 2009 included \$8.5 million and \$41.3 million, respectively, of net charges associated with *Government, class action, and related settlements expense*, while during the three and nine months ended September 30, 2008, we experienced net charges (gains) of \$17.1 million and (\$27.9) million, respectively, related to *Government, class action, and related settlements expense*. Excluding this line item, the improvement in pre-tax income from continuing operations in all periods presented primarily resulted from the increase in *Net operating revenues* and the decrease in interest expense, as discussed above. Pre-tax income from continuing operations for the nine months ended September 30, 2009 also benefitted from a decrease in depreciation and the reduction in *Professional fees – accounting, tax, and legal* due to the judgment against Mr. Scrushy, as discussed above.

#### *Provision for Income Tax Benefit*

Our *Provision for income tax benefit* of \$1.7 million for the three months ended September 30, 2009 includes the following: (1) current income tax benefit of \$3.9 million primarily attributable to state income tax refunds received, or expected to be received, offset by (2) current income tax expense of \$1.7 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of \$0.5 million attributable to increases in basis differences of certain indefinite-lived assets.

Our *Provision for income tax benefit* of \$0.8 million for the nine months ended September 30, 2009 includes the following: (1) current income tax benefit of \$9.1 million primarily attributable to state income tax refunds received, or expected to be received, offset by (2) current income tax expense of \$5.9 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (3) deferred income tax expense of \$2.4 million attributable to increases in basis differences of certain indefinite-lived assets and a decrease in our deferred tax asset related to the Alternative Minimum Tax Refundable Tax Credit.

Our *Provision for income tax benefit* of \$22.5 million for the three months ended September 30, 2008, included the following: (1) current income tax expense of approximately \$2.0 million attributable to state income tax expense of subsidiaries which have separate state filing requirements and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (2) deferred income tax expense of approximately \$0.6 million attributable to increases in the basis difference of certain indefinite-lived assets offset by (3) current income tax benefit of approximately \$25.1 million primarily attributable to state income tax refunds received, or expected to be received, and changes in the amount of unrecognized tax benefits, as discussed in Note 9, *Income Taxes*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

Our *Provision for income tax benefit* of \$21.7 million for the nine months ended September 30, 2008, included the following: (1) current income tax expense of approximately \$20.5 million attributable to a revision in previously estimated federal income tax refunds and related interest as a result of our settlement with the Internal Revenue Service for the tax years 2000 through 2003, state income tax expense of subsidiaries which have separate state filing requirements, and federal income taxes for subsidiaries not included in our federal consolidated income tax return and (2) deferred income tax expense of approximately \$2.0 million attributable to increases in the basis difference of certain indefinite-lived assets offset by (3) current income tax benefit of approximately \$44.2 million primarily attributable to state income tax refunds received, or expected to be received, and changes in the amount of unrecognized tax benefits, as discussed in Note 9, *Income Taxes*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

#### *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. Fluctuations in these amounts are primarily driven by the financial performance of the applicable hospital population each period.

#### **Results of Discontinued Operations**

During the nine months ended September 30, 2009, we terminated the leases associated with certain rental properties. As a result, we reclassified our condensed consolidated balance sheet as of December 31, 2008, our condensed consolidated statements of operations for the three and nine months ended September 30, 2009 and 2008, and our condensed consolidated statement of cash flows for the nine months ended September 30, 2008 to include these properties and their results of operations in discontinued operations.

The operating results of discontinued operations, by division and in total, are as follows (in millions):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>HealthSouth Corporation:</b>				
Net operating revenues	\$ 0.1	\$ 6.4	\$ 0.8	\$ 16.2
Costs and expenses	1.0	6.2	4.2	19.4
Impairments	-	7.7	-	7.7
Loss from discontinued operations	(0.9)	(7.5)	(3.4)	(10.9)
Loss on disposal of assets of discontinued operations	-	(0.1)	(0.4)	(0.2)
Income tax benefit	-	-	0.1	-
Loss from discontinued operations, net of tax	\$ (0.9)	\$ (7.6)	\$ (3.7)	\$ (11.1)
<b>Surgery Centers:</b>				
Net operating revenues	\$ 2.2	\$ 2.2	\$ 6.7	\$ 8.5
Costs and expenses	1.6	1.7	4.4	11.2
Impairments	-	0.3	-	0.9
Income (loss) from discontinued operations	0.6	0.2	2.3	(3.6)
Gain on disposal of assets of discontinued operations	0.7	-	0.7	0.1
Gain on divestiture of division	-	-	-	19.3
Income tax (expense) benefit	-	-	(0.1)	0.7
Income from discontinued operations, net of tax	\$ 1.3	\$ 0.2	\$ 2.9	\$ 16.5
<b>Other:</b>				
Net operating revenues	\$ -	\$ 0.1	\$ 0.5	\$ 2.4
Costs and expenses	5.8	(4.8)	6.6	(0.4)
Impairments	-	0.4	-	0.4
(Loss) income from discontinued operations	(5.8)	4.5	(6.1)	2.4
Gain on disposal of assets of discontinued operations	-	-	0.1	-
Loss on divestiture of diagnostic division	-	-	-	(0.6)
(Loss) income from discontinued operations, net of tax	\$ (5.8)	\$ 4.5	\$ (6.0)	\$ 1.8
<b>Total:</b>				
Net operating revenues	\$ 2.3	\$ 8.7	\$ 8.0	\$ 27.1
Costs and expenses	8.4	3.1	15.2	30.2
Impairments	-	8.4	-	9.0
Loss from discontinued operations	(6.1)	(2.8)	(7.2)	(12.1)
Gain (loss) on disposal of assets of discontinued operations	0.7	(0.1)	0.4	(0.1)
Gain on divestitures of divisions	-	-	-	18.7
Income tax benefit	-	-	-	0.7
(Loss) income from discontinued operations, net of tax	\$ (5.4)	\$ (2.9)	\$ (6.8)	\$ 7.2

*HealthSouth Corporation.* Our results of discontinued operations primarily included the operations of our Dallas Medical Center, which we

closed in October 2008. The decrease in net operating revenues and costs and expenses in each period presented were due primarily to the performance and eventual closure of this hospital.

*Surgery Centers* . We closed the transaction to sell our surgery centers division to ASC Acquisition LLC (“ASC”) on June 29, 2007, other than with respect to certain facilities for which approvals for the transfer to ASC had not yet been received as of such date. As of December 31, 2007, approval for six facilities in Illinois remained pending. In January 2008, we received approval for the change in control of five of the six Illinois facilities. The sixth facility had an outstanding relocation project which was completed during the second quarter of 2009. In October 2009, we received approval for the transfer of this facility to ASC, and the transfer to ASC became effective as of November 1, 2009. No portion of the purchase price was withheld at closing pending the transfer of these facilities. As of September 30, 2009, we had deferred \$26.5 million of cash proceeds received at closing associated with the facility that was still awaiting approval for the transfer to ASC as of September 30, 2009.

As a result of the transfer of the five Illinois facilities during the first quarter of 2008, we recorded a gain on disposal of \$19.3 million during the nine months ended September 30, 2008. We expect to record an additional gain of approximately \$14 million for the facility that was transferred to ASC during the fourth quarter of 2009. For additional information, see Note 8, *Assets Held for Sale and Results of Discontinued Operations* , to our condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report.

The change in operating results for this division for all periods presented resulted from the divestiture activity discussed above.

*Other* . Results of operations in “other” primarily include the results of operations of our former outpatient and diagnostic divisions. Costs recorded during the three and nine months ended September 30, 2009 primarily relate to indemnification obligations and matters discussed in Note 12, *Contingencies* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report. See also Note 16, *Assets Held for Sale and Results of Discontinued Operations* , to the consolidated financial statements accompanying our 2008 Form 10-K for additional information.

## **Liquidity and Capital Resources**

We continue to make progress in improving our leverage and liquidity. Our progress was confirmed during the second quarter of 2009 when Moody’s upgraded our corporate credit rating to B2, allowing the spread on our Term Loan Facility to be reduced by 25 basis points effective June 10, 2009. In addition, Standard and Poor’s moved our outlook to “positive” from “stable.”

During the nine months ended September 30, 2009, we reduced our total debt outstanding by approximately \$117 million and increased our *Cash and cash equivalents* by approximately \$85 million. See Note 2, *Liquidity* , and Note 5, *Long-term Debt* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report for additional information regarding debt reductions. Our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility. As of September 30, 2009, we had \$117.3 million in *Cash and cash equivalents* . This amount excludes \$88.1 million in *Restricted cash* and \$23.3 million of restricted marketable securities. Our restricted assets pertain to various obligations we have under partnership agreements and other arrangements, primarily related to our captive insurance company. *Cash and cash equivalents* as of September 30, 2009 included net proceeds associated with the UBS Settlement. See Note 2, *Liquidity* , and Note 11, *Settlements* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report for additional information.

As of September 30, 2009, we had all \$400 million available to us under our revolving credit facility. We monitor the financial strength of our depositories, creditors, insurance carriers, and other counterparties using publicly available information, as well as qualitative inputs. Based on our current borrowing capacity and compliance with the financial covenants under our Credit Agreement, we do not believe there is significant risk in our ability to make draws under our revolving credit facility, if needed. However, no such assurances can be provided. In addition, we anticipate cash flows from certain non-operating sources, such as those related to certain legal matters discussed in Note 11, *Settlements* , and Note 12, *Contingencies* , including the judgment against Mr. Scrushy. However, no assurances can be given as to whether or when such non-operating cash flows will be received, nor can we provide any assurances as to the collectability of any amounts owed from Mr. Scrushy.

We have scheduled principal payments of \$6.2 million and \$24.9 million in the remainder of 2009 and 2010, respectively, related to long-term debt obligations (see Note 5, *Long-term Debt* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report). We do not face substantial near-term refinancing risk, as our revolving credit facility does not expire until 2012, a portion of our Term Loan Facility does not mature until 2013, with the remainder maturing in 2015, depending on certain conditions (see Note 5, *Long-term Debt* , for a discussion of an amendment and extension related to our Credit Agreement), and the majority of our bonds are not due until 2014 and 2016.

Our Credit Agreement governs the vast majority of our senior secured borrowings and contains financial covenants that include a leverage ratio and an interest coverage ratio. As of September 30, 2009, we were in compliance with the covenants under our Credit Agreement. 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 not be on terms as favorable to those in our existing Credit Agreement. Under such circumstances, there is also the potential our lenders would not grant relief to us which, among other things, would depend on the state of the credit markets at that time. However, we believe we have reduced this risk by significantly lowering our senior secured leverage ratio since the inception of our Credit Agreement.

See Item 1A, *Risk Factors* , and Note 1, *Summary of Significant Accounting Policies* , to the consolidated financial statements accompanying our 2008 Form 10-K for a discussion of risks and uncertainties facing us. See also Note 2, *Liquidity* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report.

### *Sources and Uses of Cash*

As noted above, our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility. The following table shows the cash flows provided by or used in operating, investing, and financing activities for the nine months ended September 30, 2009 and 2008, as well as the effect of exchange rates for those same periods (in millions):

**Nine Months Ended  
September 30,**

---

	2009	2008
Net cash provided by operating activities	\$ 362.1	\$ 149.3
Net cash used in investing activities	(124.4)	(11.9)
Net cash used in financing activities	(152.6)	(133.4)
Effect of exchange rate changes	-	0.8
Increase in cash and cash equivalents	<u>\$ 85.1</u>	<u>\$ 4.8</u>

*Operating activities* . Net cash provided by operating activities increased period over period due to the increase in *Net operating revenues* , as discussed above, and a decrease in cash interest expense. *Net cash provided by operating activities* for the nine months ended September 30, 2009 included \$73.8 million in net cash proceeds related to the UBS Settlement and the receipt of an approximate \$42 million additional federal income tax refund for tax years 1995 through 1999. See Note 11, *Settlements* , and Note 9, *Income Taxes* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report.

*Investing activities* . Decreased proceeds from asset disposals, increased restricted cash, increased capital expenditures, and increased payments associated with interest rate swaps not designated as cash flow hedges in 2009 caused the change in *Net cash used in investing activities* period over period. *Net cash used in investing activities* for the nine months ended September 30, 2008 included \$53.8 million from asset disposals, including our corporate campus (see Note 5, *Property and Equipment* , to the consolidated financial statements accompanying our 2008 Form 10-K).

*Financing activities* . Net debt payments during the nine months ended September 30, 2009 and 2008 were \$112.8 million and \$192.8 million, respectively. Net debt payments during the nine months ended September 30, 2009 primarily resulted from receipt of the net cash proceeds related to the UBS Settlement and the receipt of the additional federal income tax refund discussed above. Net debt payments during the nine months ended September 30, 2008 resulted primarily from the sale of our corporate campus and the net proceeds from our June 2008 equity offering. Proceeds of \$150.2 million related to our June 2008 equity offering were included in financing activities for the nine months ended September 30, 2008. For additional information regarding these transactions, see Note 5, *Property and Equipment* , and Note 10, *Shareholders' Deficit* , to the consolidated financial statements accompanying our 2008 Form 10-K.

#### Adjusted Consolidated EBITDA

Management continues to believe Adjusted Consolidated EBITDA as defined in our Credit Agreement is a measure of leverage capacity, our ability to service our debt, and our ability to make capital expenditures.

We use Adjusted Consolidated 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 consolidated financial statements accompanying our 2008 Form 10-K. These covenants are material terms of the Credit Agreement, and the Credit Agreement represents a substantial portion of our capitalization. Non-compliance 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 not be on terms favorable to 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, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted Consolidated EBITDA is critical to our assessment of our liquidity.

In general terms, the definition of Adjusted Consolidated EBITDA, per our Credit Agreement, allows us to add back to consolidated *Net income* unusual non-cash or non-recurring items. These items include, but may not be limited to, (1) amounts associated with government, class action, and related settlements, (2) fees, costs, and expenses related to our recapitalization transactions, (3) any losses from discontinued operations and closed locations, (4) charges in respect of professional fees for reconstruction and restatement of financial statements, including fees paid to outside professional firms for matters related to internal controls and legal fees for continued litigation defense and support matters discussed in Note 11, *Settlements* , and Note 12, *Contingencies* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report, (5) stock-based compensation expense recorded for eligible employees , (6) investment and other income (including interest income), and (7) fees associated with our divestiture activities. We reconcile Adjusted Consolidated EBITDA to *Net income* and to *Net cash provided by operating activities* .

However, Adjusted Consolidated EBITDA is not a measure of financial performance under generally accepted accounting principles in the United States of America (“GAAP”), and the items excluded from Adjusted Consolidated EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted Consolidated EBITDA should not be considered a substitute for *Net income* or cash flows from operating, investing, or financing activities. Because Adjusted Consolidated EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted Consolidated 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 our 2008 Form 10-K.

Our Adjusted Consolidated EBITDA for the three and nine months ended September 30, 2009 and 2008 was as follows (in millions):

#### Reconciliation of Net Income to Adjusted Consolidated EBITDA

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
<b>Net income</b>	\$ 24.8	\$ 12.8	\$ 81.9	\$ 91.6
Loss (income) from discontinued operations, net of tax, attributable to HealthSouth	5.4	3.2	7.3	(7.8)
Provision for income tax benefit	(1.7)	(22.5)	(0.8)	(21.7)
Loss on interest rate swaps	7.9	8.0	16.7	16.1
Interest expense and amortization of debt discounts and fees	29.5	40.3	95.0	131.1

Loss (gain) on early extinguishment of debt	-	2.1	(3.1)	5.8
Professional fees—accounting, tax, and legal	3.5	4.0	5.0	12.9
Government, class action, and related settlements expense	8.5	17.1	41.3	(27.9)
Net noncash loss on disposal of assets	0.7	0.2	3.0	0.8
Depreciation and amortization	18.1	17.9	53.4	65.3
Impairment charges, including investments	4.3	-	5.2	0.6
Stock-based compensation expense	3.4	2.5	9.9	8.5
Net income attributable to noncontrolling interests	(8.0)	(6.2)	(25.7)	(21.1)
<b>Adjusted Consolidated EBITDA</b>	<u>\$ 96.4</u>	<u>\$ 79.4</u>	<u>\$ 289.1</u>	<u>\$ 254.2</u>

In accordance with our Credit Agreement, we are allowed to add certain other items to the calculation of Adjusted Consolidated EBITDA, and there may also be certain other deductions required. As these adjustments may not be indicative of our ongoing performance, they have been excluded from the above table.

## Reconciliation of Adjusted Consolidated EBITDA to Net Cash Provided by Operating Activities

	Nine Months Ended September 30,	
	2009	2008
<b>Adjusted Consolidated EBITDA</b>	\$ 289.1	\$ 254.2
Provision for doubtful accounts	25.5	20.5
Professional fees—accounting, tax, and legal	(5.0)	(12.9)
Interest expense and amortization of debt discounts and fees	(95.0)	(131.1)
UBS Settlement proceeds, gross	100.0	-
Equity in net income of nonconsolidated affiliates	(2.8)	(7.8)
Net income attributable to noncontrolling interests	25.7	21.1
Amortization of debt discounts and fees	4.8	4.9
Distributions from nonconsolidated affiliates	6.5	7.6
Current portion of income tax benefit	3.2	23.7
Change in assets and liabilities	31.8	(22.5)
Change in government, class action, and related settlements	(11.0)	(7.4)
Other operating cash used in discontinued operations	(9.6)	(1.6)
Other	(1.1)	0.6
<b>Net cash provided by operating activities</b>	<u>\$ 362.1</u>	<u>\$ 149.3</u>

The increase in Adjusted Consolidated EBITDA for all periods presented was due primarily to the increase in *Net operating revenues* discussed above.

### *Funding Commitments*

We have scheduled principal payments of \$6.2 million and \$24.9 million in the remainder of 2009 and 2010, respectively, related to long-term debt obligations (see Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report). For additional information about our long-term debt obligations, see Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K.

During the nine months ended September 30, 2009, we made capital expenditures of \$54.7 million. The total amounts expected for capital expenditures and development efforts for 2009 approximate \$70 million to \$85 million, net of any potential proceeds from sale-leaseback transactions. Actual amounts spent will be dependent upon the timing of development projects and receipt of non-operating cash flows associated with certain matters discussed in Note 12, *Contingencies*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report. These expenditures include IT initiatives, new business opportunities, bed expansions, hospital refresh programs, and equipment upgrades and purchases. Approximately \$35 million of this budgeted amount is non-discretionary.

For a discussion of risk factors related to our business and our industry, please see Item 1A, *Risk Factors*, of our 2008 Form 10-K and Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K.

### **Off-Balance Sheet Arrangements**

Other than the guarantees discussed below and in Note 6, *Guarantees*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, there have been no material changes to the off-balance sheet arrangements described in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, of our 2008 Form 10-K.

We are secondarily liable for certain lease obligations primarily associated with sold facilities, including the sale of our surgery centers, outpatient, and diagnostic divisions during 2007. Also, in connection with the closing of the transaction to sell our diagnostic division, HealthSouth remained as a guarantor to certain purchase contracts that were assigned to the buyer in connection with the sale.

As of September 30, 2009, we were secondarily liable for 84 such guarantees. The remaining terms of these guarantees ranged from one month to 117 months. If we were required to perform under all such guarantees, the maximum amount we would be required to pay approximated \$51.9 million.

We have not recorded a liability for these guarantees, as we do not believe it is probable we will have to perform under these agreements. If we are required to perform under these guarantees, we could potentially have recourse against the purchaser for recovery of any amounts paid. In addition, the purchasers of our surgery centers, outpatient, and diagnostic divisions have agreed to seek releases from the lessors and vendors in favor of HealthSouth with respect to the guarantee obligations associated with these divestitures. To the extent the purchasers of these divisions are unable to obtain releases for HealthSouth, the purchasers have agreed to indemnify HealthSouth for damages incurred under the guarantee obligations, if any. For additional information regarding these guarantees, see Note 6, *Guarantees*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

### **Contractual Obligations**

Our consolidated contractual obligations as of September 30, 2009 are as follows (in millions):

	Total	October 1 through December 31, 2009	2010 – 2011	2012 – 2013	2014 and Thereafter
Long-term debt obligations:					



Long-term debt, excluding revolving credit facility and capital lease obligations <sup>(a)</sup>	\$ 1,591.8	\$ 2.0	\$ 16.2	\$ 736.8	\$ 836.8
Interest on long-term debt <sup>(b)</sup>	552.1	24.6	196.0	179.8	151.7
Capital lease obligations <sup>(c)</sup>	162.8	5.4	40.2	31.0	86.2
Operating lease obligations <sup>(d)(e)</sup>	209.7	8.5	58.6	39.9	102.7
Purchase obligations <sup>(e)(f)</sup>	28.8	2.7	22.4	2.6	1.1
Other long-term liabilities <sup>(g)</sup>	3.7	0.2	0.5	0.4	2.6
Total	<u>\$ 2,548.9</u>	<u>\$ 43.4</u>	<u>\$ 333.9</u>	<u>\$ 990.5</u>	<u>\$ 1,181.1</u>

- (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 consolidated financial statements accompanying our 2008 Form 10-K. As discussed in Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, in October 2009, we entered into an agreement with the lenders in our Credit Agreement to extend the maturity of a portion of our Term Loan Facility and to amend certain provisions of the Credit Agreement. Amounts in the above table for long-term debt obligations do not include the extended maturity for \$300.0 million of our Term Loan Facility from 2013 to 2015, contingent on certain conditions.
- (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 September 30, 2009. Interest related to capital lease obligations is excluded from this line. 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 condensed consolidated statements of operations. Amounts also exclude the impact of our interest rate swaps. In addition, as discussed in Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, the October 2009 amendment and extension of our Credit Agreement includes provisions to increase the interest rate for the \$300.0 million extended portion of our Term Loan Facility from LIBOR plus 2.25% to LIBOR plus 3.75%. The impact of this increase in rates for a portion of our Term Loan Facility has not been included in the above table.
- (c) Amounts include the interest portion of future minimum capital lease payments.
- (d) We lease many of our hospitals as well as other property and equipment under operating leases in the normal course of business. Some of our hospital leases require percentage rentals on patient revenues above specified minimums and contain escalation clauses. 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 consolidated financial statements accompanying our 2008 Form 10-K. In addition, as of September 30, 2009, these amounts exclude \$1.8 million of operating lease obligations associated with facilities that are reported in discontinued operations.
- (e) Future operating lease obligations and purchase obligations are not recognized in our condensed 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, medical supplies, certain equipment, and telecommunications.
- (g) Because their future cash outflows are uncertain, the following noncurrent liabilities are excluded from the table above: medical malpractice and workers' compensation risks, deferred income taxes, and our estimated liability for unsettled litigation. For more information, see Note 1, *Summary of Significant Accounting Policies*, "Self-Insured Risks," Note 17, *Income Taxes*, and Note 21, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying our 2008 Form 10-K. Also, at September 30, 2009 we had \$59.4 million of total gross unrecognized tax benefits. In addition, we had an accrual for related interest income of \$3.0 million as of September 30, 2009. We continue to actively pursue the maximization of our remaining state income tax refund claims. The process of resolving these tax matters with the applicable taxing authorities will continue throughout 2009. At this time, we cannot estimate a range of the reasonably possible change that may occur.

### Indemnifications

In the ordinary course of business, HealthSouth enters into contractual arrangements under which HealthSouth may agree to indemnify another party to such arrangement from any losses incurred relating to the services they perform on behalf of HealthSouth or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. For additional information related to indemnifications, see Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Contractual Obligations," to our 2008 Form 10-K and Note 11, *Settlements*, and Note 12, *Contingencies*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

### Critical Accounting Policies

Our significant accounting policies are discussed in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K. Of those significant accounting policies, those that we consider to be the most critical to aid in fully understanding and evaluating our reported financial results, as they require management's most difficult, subjective, or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain, are disclosed in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Critical Accounting Policies," to our 2008 Form 10-K.

Since the filing of our 2008 Form 10-K, there have been no material changes to our critical accounting policies.

### Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, see Note 1, *Basis of Presentation*, to our condensed consolidated financial



statements included under Part I, Item 1, *Financial Statements (Unaudited)* , of this report.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary exposure to market risk is to changes in interest rates on our long-term debt. We use sensitivity analysis models to evaluate the impact of interest rate changes on these items.

Changes in interest rates have different impacts on the fixed and variable rate portions of our debt portfolio. A change in interest rates impacts the net fair value of our fixed rate debt but has no impact on interest expense or cash flows. Interest rate changes on variable rate debt impacts our interest expense and cash flows, but does not impact the net fair value of the underlying debt instruments. Our fixed and variable rate debt (excluding capital lease obligations and other notes payable) as of September 30, 2009 is shown in the following table (in millions):

	As of September 30, 2009			
	Carrying Amount	% of Total	Estimated Fair Value	% of Total
Fixed rate debt	\$ 496.6	31.4%	\$ 544.4	34.3%
Variable rate debt	1,082.8	68.6%	1,043.5	65.7%
Total long-term debt	<u>\$ 1,579.4</u>	<u>100.0%</u>	<u>\$ 1,587.9</u>	<u>100.0%</u>

As discussed in Note 5, *Long-term Debt* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report, in March 2006, we entered into an interest rate swap to effectively convert the floating rate of a portion of our Credit Agreement to a fixed rate in order to limit the variability of interest-related payments caused by changes in LIBOR. Under this interest rate swap agreement, we pay a fixed rate of 5.2% on an amortizing notional principal of \$1.1 billion, while the counterparties to this interest rate swap agreement pay a floating rate based on 3-month LIBOR. As also discussed in Note 5, *Long-term Debt* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report, in June 2009, we entered into a receive-fixed swap as a mirror offset to \$100.0 million of the \$1.1 billion interest rate swap discussed above in order to reduce our effective fixed rate to total debt ratio.

Our variable-rate interest expense increases or decreases as interest rates change. However, the net settlement payments or receipts on interest rate swaps described above offset a majority of those changes. Because these swaps are not designated as hedges, net settlements are included in the line item *Loss on interest rate swaps* in our condensed consolidated statements of operations and are not included in interest expense.

Based on the size of our variable rate debt as of September 30, 2009 and inclusive of the impact of the net conversion of \$1.0 billion of variable rate interest to a fixed rate via interest rate swaps, as discussed above, a 1% increase in interest rates would result in an incremental negative cash flow of approximately \$1.3 million over the next 12 months, while a 1% decrease in interest rates would result in an incremental positive cash flow of approximately \$2.1 million over the next twelve months.

A 1% increase in interest rates would result in an approximate \$17.4 million decrease in the estimated net fair value of our fixed rate debt, and a 1% decrease in interest rates would result in an approximate \$7.8 million increase in its estimated net fair value.

We also maintain two forward-starting interest rate swaps that are designated as cash flow hedges. See Note 5, *Long-term Debt* , to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* , of this report. There will be no cash flow impact associated with these forward-starting swaps over the next 12 months because net settlements do not begin until June 2011.

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.

### Item 4. 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. Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

#### Changes in Internal Control Over Financial Reporting

There have been no changes in our Internal Control over Financial Reporting during the quarter ended September 30, 2009 that have a material effect on our Internal Control over Financial Reporting.

---

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Information relating to certain legal proceedings in which we are involved is included in Note 11, *Settlements*, and Note 12, *Contingencies*, to the condensed consolidated financial statements contained in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and is incorporated herein by reference and should be read in conjunction with the related disclosure previously reported in our Quarterly Reports on Form 10-Q for the quarters ended June 30, 2009 and March 31, 2009 and our Annual Report on Form 10-K for the year ended December 31, 2008.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes our repurchases of equity securities during the three months ended September 30, 2009:

Period	Total Number of Shares (or Units) Purchased <sup>(1)</sup>	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
July 1 through July 31, 2009	119	\$ 13.41	-	-
August 1 through August 30, 2009	576	14.40	-	-
September 1 through September 30, 2009	-	-	-	-
Total	695	14.23	-	-

<sup>(1)</sup> Shares in this column were tendered by employees as payment of tax liability incident to the vesting of previously awarded shares of restricted stock.

### Item 5. Other Matters

#### Compensatory Arrangements of Certain Officers

On November 2, 2009, our board of directors, acting by unanimous written consent, approved and adopted the final form of a senior management compensation recoupment policy applicable to awards granted and bonus 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 participating in the senior management bonus plan, as may be amended from time to time, was a significant contributing factor to the Company having to restate all or a portion of its financial statement(s), the board may, to the extent permitted by applicable law and to the extent it determines in its sole judgment that it is in the best interests of the Company to do so, (a) require reimbursement of any bonus or incentive compensation paid to such officer, (b) cause the cancellation of such officer's restricted or deferred stock awards and outstanding stock options, and (c) require reimbursement of any gains realized on the exercise of stock options attributable to incentive awards, if and to the extent that (x) the amount of such compensation was calculated based upon the achievement of certain financial results that were subsequently reduced due to a restatement and (y) the amount of such compensation that would have been awarded to such officer had the financial results been properly reported would have been lower than the amount actually awarded. Additionally, if such an officer is found to have committed fraud or engaged in intentional misconduct in the performance of his or her duties for the Company, as determined by a final, non-appealable judgment of a court of competent jurisdiction, and the board determines in its sole judgment that such action caused substantial harm to the Company, the board may, to the extent permitted by applicable law and to the extent it determines in its sole judgment that it is in the best interests of the Company to do so, (A) require reimbursement of any bonus or incentive compensation paid to such officer, (B) cause the cancellation of such officer's restricted or deferred stock awards and outstanding stock options, and (C) require reimbursement of any gains realized on the exercise of stock options attributable to incentive awards.

#### Amendments to Bylaws

Effective as of October 30, 2009, our board of directors, acting by unanimous written consent, approved and adopted the final form of our Amended and Restated Bylaws (the "Bylaws"), previously approved in principle at the October 22, 2009 meeting. The following summary does not purport to be complete and is qualified in its entirety by reference to the full text of the Bylaws, as amended and restated October 30, 2009, which are attached hereto as Exhibit 3.1 and incorporated herein by reference. A description of the material amendments is set forth below.

1) Article II, Section 2.1 has been modified to provide that the annual meeting of stockholders shall be held on such date and at such time as shall be designated from time to time by the board of directors. The prior provision provided for a specific date and time for the annual meeting in the event that the board of directors did not otherwise specify.

2) Article II, Section 2.2 has been modified to provide that special meetings of stockholders may be called at any time in accordance with the requirements of our Certificate of Incorporation. The prior provision provided that special meetings of stockholders, unless otherwise required by law, may only be called by the chairman of the board, the president or by order of the board of directors.

3) Article II, Section 2.5 has been modified to reference expressly the discretion to adjourn any meeting of stockholders if the board of directors determines that such adjournment is necessary or appropriate to enable stockholders to fully consider information presented at such meeting or is otherwise determined to be in the best interest of stockholders.

4) Article II, Section 2.7 has been modified with respect to the appointment of inspectors of election and provides authority to appoint alternate inspectors of election, as needed, and for emergency appointments in the event that the appointed or alternate inspectors of election are not able to act or

who fail to act.

5) Article II, Section 2.9 has been modified with respect to the exclusive means by which stockholders may propose business at an annual meeting of stockholders. Under the new provisions, a stockholder must provide additional information in its notice to the secretary of the Company and must update such information prior to the applicable meeting. In addition, information must be provided with respect to any beneficial owners on whose behalf the proposed business is being made. The notice requirements are immediately applicable and supersede the requirements disclosed in our definitive proxy statement dated April 2, 2009.

6) Article III, Section 3.4, paragraph (b), has been modified with respect to the exclusive means by which stockholders may nominate directors for election. Under the new provisions, a stockholder must provide additional information in its notice to the secretary of the company and must update such information prior to the applicable meeting. In addition, information must be provided with respect to any beneficial owners on whose behalf the nomination is being made. The notice requirements are immediately applicable and supersede the requirements disclosed in our definitive proxy statement dated April 2, 2009.

7) Article III, Section 3.4, paragraph (c), has been modified to 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, subject to certain conditions including the board of director's determination that reimbursement is consistent with its fiduciary duties.

8) Article IV has been modified to (a) expand the officer positions that are and may be designated as principal officers of the Company in Section 4.1, (b) expand Section 4.3 to give the chief executive officer express authority to appoint subordinate officers of the Company as may be deemed necessary, desirable or appropriate where the board of directors has not otherwise acted, (c) clarify the provisions for the removal of officers under Section 4.5, and (d) expressly set forth a description of the office, if any, of each of the vice chairman of the board, the chief executive officer, the chief financial officer and the chief operating officer under Sections 4.7, 4.8, 4.9, and 4.11, respectively.

9) Article V, Section 5.8 has been modified to provide that the board of directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of any meeting of stockholders, nor more than sixty days prior to any other action, for the purpose of determining stockholders entitled to notice of such meeting of stockholders or any adjournment thereof, or to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action. The prior provision provided for fifty days rather than sixty days for these record date matters. The board of directors may also elect to fix a separate record date for determining the stockholders entitled to vote at such meeting.

10) Article VII has been modified (a) with respect to the use of the corporate seal and acceptable substitutes therefore under Section 7.1, (b) to clarify the operation of the waiver of notice by stockholders that attend the applicable meeting under Section 7.3 and (c) to insert previously omitted Section 7.4 regarding the manner and authority to execute instruments, contracts and other arrangements in the name of the company with private and governmental parties.

11) Article VIII regarding amendments to the Bylaws, previously omitted, has been inserted. Section 8.1 provides that the Bylaws may be amended, altered or repealed, or new Bylaws may be adopted, at any meeting of stockholders by the vote of the holders of not less than a majority of the outstanding shares of stock entitled to vote thereat, provided that, in the case of a special meeting, notice that an amendment is to be considered and acted upon shall be inserted in the notice or waiver of notice of said meeting. Section 8.2 provides that to the extent permitted by the Certificate of Incorporation, the Bylaws may be amended, altered or repealed, or new Bylaws may be adopted, at any regular or special meeting of the board of directors by the affirmative vote of a majority of the board of directors.

12) Other minor amendments were made to the Bylaws that involved immaterial language changes, clarifying or conforming changes in the Sections above and in the following provisions: Article III and Sections 4.12, 4.13, 4.14 and 4.15.

## **Item 6. Exhibits**

The exhibits required by Regulation S-K are set forth in the following list and are filed by attachment to this report unless otherwise noted.

<b>No.</b>	<b>Description</b>
3.1	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 (incorporated by reference to HealthSouth's Annual Report on Form 10-K filed with the SEC on June 27, 2005).
3.2	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).
3.3	Amended and Restated Bylaws of HealthSouth Corporation, effective as of October 30, 2009.
3.4	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).
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 ).
10.1	Amendment No. 2, dated as of October 23, 2009, to the Credit Agreement, dated March 10, 2006, among HealthSouth Corporation, the lenders party thereto, JPMorgan Chase Bank, N.A., as the administrative agent and the collateral agent, and the other parties thereto, attaching and effecting the Amended and Restated Credit Agreement, by and among HealthSouth, the lenders party thereto, JPMorgan Chase Bank, N.A., as the administrative agent and the collateral agent, Citicorp North America, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as co-syndication agents; and Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Wachovia

Bank, National Association, as co-documentation agents (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on October 27, 2009).

- 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.
-



## EXHIBIT INDEX

<b>No.</b>	<b>Description</b>
3.1	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 (incorporated by reference to HealthSouth's Annual Report on Form 10-K filed with the SEC on June 27, 2005).
3.2	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).
3.3	Amended and Restated Bylaws of HealthSouth Corporation, effective as of October 30, 2009.
3.4	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).
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 ).
10.1	Amendment No. 2, dated as of October 23, 2009, to the Credit Agreement, dated March 10, 2006, among HealthSouth Corporation, the lenders party thereto, JPMorgan Chase Bank, N.A., as the administrative agent and the collateral agent, and the other parties thereto, attaching and effecting the Amended and Restated Credit Agreement, by and among HealthSouth, the lenders party thereto, JPMorgan Chase Bank, N.A., as the administrative agent and the collateral agent, Citicorp North America, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as co-syndication agents; and Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Wachovia Bank, National Association, as co-documentation agents (incorporated by reference to Exhibit 10.1 to HealthSouth's Current Report on Form 8-K filed on October 27, 2009).
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.

---







Amended and Restated Bylaws of HealthSouth Corporation, October 30, 2009

---

AMENDED AND RESTATED  
BYLAWS  
OF  
HEALTHSOUTH CORPORATION  
(a Delaware corporation)

---



## TABLE OF CONTENTS\*

		<u>Page</u>
 <u>ARTICLE I</u>		
 <u>OFFICES</u>		
<u>Section 1.1</u>	Location	1
<u>Section 1.2</u>	Change of Location	1
 <u>ARTICLE II</u>		
 <u>MEETINGS OF STOCKHOLDERS</u>		
<u>Section 2.1</u>	Annual Meeting	1
<u>Section 2.2</u>	Special Meetings	1
<u>Section 2.3</u>	List of Stockholders Entitled to Vote	2
<u>Section 2.4</u>	Notice of Meetings	2
<u>Section 2.5</u>	Adjourned Meetings and Notice Thereof	2
<u>Section 2.6</u>	Quorum	3
<u>Section 2.7</u>	Voting	3
<u>Section 2.8</u>	Action by Consent of Stockholders	3
<u>Section 2.9</u>	Nature of Business at Meetings of Stockholders	4
 <u>ARTICLE III</u>		
 <u>BOARD OF DIRECTORS</u>		
<u>Section 3.1</u>	General Powers	6
<u>Section 3.2</u>	Number of Directors	6
<u>Section 3.3</u>	Qualification	6
<u>Section 3.4</u>	Election	6
<u>Section 3.5</u>	Term	12
<u>Section 3.6</u>	Resignation and Removal	12
<u>Section 3.7</u>	Vacancies	12
<u>Section 3.8</u>	Quorum and Voting	13
<u>Section 3.9</u>	Regulations	13
<u>Section 3.10</u>	Annual Meeting	13
<u>Section 3.11</u>	Regular Meetings	13
<u>Section 3.12</u>	Special Meetings	14
<u>Section 3.13</u>	Notice of Meetings; Waiver of Notice	14
<u>Section 3.14</u>	Committees of Directors	14
<u>Section 3.15</u>	Powers and Duties of Committees	15
<u>Section 3.16</u>	Compensation of Directors	15
<u>Section 3.17</u>	Action Without Meeting	15
 <u>ARTICLE IV</u>		
 <u>OFFICERS</u>		
<u>Section 4.1</u>	Principal Officers	15
<u>Section 4.2</u>	Election of Principal Officers; Term of Office	16
<u>Section 4.3</u>	Subordinate Officers, Agents and Employees	16
<u>Section 4.4</u>	Delegation of Duties of Officers	16
<u>Section 4.5</u>	Removal of Officers	17
<u>Section 4.6</u>	Resignations	17
<u>Section 4.7</u>	Chairman and Vice Chairman of the Board	17
<u>Section 4.8</u>	Chief Executive Officer.	17
<u>Section 4.9</u>	Chief Financial Officer.	17
<u>Section 4.10</u>	President	17
<u>Section 4.11</u>	Chief Operating Officer.	18
<u>Section 4.12</u>	Vice President	18
<u>Section 4.13</u>	Secretary	18

<u>Section 4.14</u>	Treasurer	18
<u>Section 4.15</u>	Controller.	19
<u>Section 4.16</u>	Bond	19

ARTICLE V

CAPITAL STOCK

<u>Section 5.1</u>	Issuance of Certificates of Stock; Uncertificated Stock	19
<u>Section 5.2</u>	Signatures on Stock Certificates	19
<u>Section 5.3</u>	Stock Ledger	19
<u>Section 5.4</u>	Regulations Relating to Transfer	20
<u>Section 5.5</u>	Transfers	20
<u>Section 5.6</u>	Cancellation	20
<u>Section 5.7</u>	Lost, Destroyed, Stolen and Mutilated Certificates	20
<u>Section 5.8</u>	Fixing of Record Dates	21

ARTICLE VI

INDEMNIFICATION

<u>Section 6.1</u>	Indemnification	22
<u>Section 6.2</u>	Indemnification Insurance	23

ARTICLE VII

MISCELLANEOUS PROVISIONS

<u>Section 7.1</u>	Corporate Seal	23
<u>Section 7.2</u>	Fiscal Year	23
<u>Section 7.3</u>	Waiver of Notice	23
<u>Section 7.4</u>	Execution of Instruments, Contracts, Etc.	23

ARTICLE VIII

AMENDMENTS

<u>Section 8.1</u>	By Stockholders	24
<u>Section 8.2</u>	By Directors	24

\* The Table of Contents appears here for convenience only and should not be considered a part of the Amended and Restated Bylaws.

---

**AMENDED AND RESTATED**  
**BYLAWS**  
**OF**  
**HEALTHSOUTH CORPORATION**

**ARTICLE I**

**OFFICES**

Section 1.1 Location. The address of the registered office of HealthSouth Corporation (the "Corporation") in the State of Delaware and the name of the registered agent at such address shall be as specified in the Certificate of Incorporation or, if subsequently changed, as specified in the most recent Statement of Change filed pursuant to law. The Corporation may also have other offices at such places within or without the State of Delaware as the Board of Directors may from time to time designate or the business of the Corporation may require.

Section 1.2 Change of Location. In the manner permitted by law, the Board of Directors or the registered agent may change the address of the Corporation's registered office in the State of Delaware and the Board of Directors may make, revoke or change the designation of the registered agent.

**ARTICLE II**

**MEETINGS OF STOCKHOLDERS**

Section 2.1 Annual Meeting. The annual meeting of the stockholders of the Corporation for the election of Directors and for the transaction of such other business as may properly come before the meeting shall be held at the registered office of the Corporation, or at such other place within or without the State of Delaware as the Board of Directors may fix by resolution or as set forth in the notice of the meeting. The annual meeting shall be held on such date and at such time as shall be designated from time to time by the Board of Directors.

Section 2.2 Special Meetings. Special meetings of stockholders, unless otherwise prescribed by law, may be called at any time in accordance with the requirements of the Certificate of Incorporation. Special meetings of stockholders prescribed by law for the election of Directors shall be called by the Board of Directors, the Chairman of the Board, the President, or the Secretary whenever required to do so pursuant to applicable law. Special meetings of stockholders shall be held at such time and such place, within or without the State of Delaware, as shall be designated in the notice of meeting.

Section 2.3 List of Stockholders Entitled to Vote. The officer who has charge of the stock ledger of the Corporation shall prepare and make, or cause to be prepared and made, at least ten days before every meeting of stockholders, a complete list, based upon the record date for such meeting determined pursuant to Section 5.8, of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if such place shall not be so specified, at the place where the meeting is to be held. The list also shall be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

The stock ledger shall be the only evidence as to who are the stockholders entitled to examine the stock ledger, the list of stockholders entitled to vote at any meeting, or to inspect the books of the Corporation, or to vote in person or by proxy at any meeting of stockholders.

Section 2.4 Notice of Meetings. Written notice of each annual and special meeting of stockholders, other than any meeting the giving of notice of which is otherwise prescribed by law, stating the place, date and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered or mailed, in writing, at least ten but not more than fifty days before the date of such meeting, to each stockholder entitled to vote thereat. If mailed, such notice shall be deposited in the United States mail, postage prepaid, directed to such stockholder at his address as the same appears on the records of the Corporation. An affidavit of the Secretary, an Assistant Secretary or the transfer agent of the Corporation that notice has been duly given shall be evidence of the facts stated therein.

Section 2.5 Adjourned Meetings and Notice Thereof. Any meeting of stockholders may be adjourned to another time or place, and the Corporation may transact at any adjourned meeting any business which might have been transacted at the original meeting. The person presiding over a meeting of stockholders shall have the power to adjourn the meeting at the request of the Board of Directors if the Board of Directors determines that adjournment is necessary or appropriate to enable stockholders to fully consider information which the Board of Directors determines has not been made sufficiently or timely available to stockholders or is otherwise in the best interest of stockholders. Notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken, unless (a) any adjournment or series of adjournments caused the original meeting to be adjourned for more than thirty days after the date originally fixed therefor, or (b) a new record date is fixed for the adjourned meeting. If notice of an adjourned meeting is given, such notice shall be given to each stockholder of record entitled to vote at the adjourned meeting in the manner prescribed in Section 2.4 for the giving of notice of meetings.

Section 2.6 Quorum. At any meeting of stockholders, except as otherwise expressly required by law or by the Certificate of Incorporation, the holders of record of at least a majority of the outstanding shares of capital stock entitled to vote or act at such meeting shall be present or represented by proxy in order to constitute a quorum for the transaction of any business, but less than a quorum shall have power to adjourn any meeting until a quorum shall be present. When a quorum is once present to organize a meeting, the quorum cannot be destroyed by the subsequent withdrawal or revocation of the proxy of any stockholder. Shares of capital stock owned by the Corporation or by another corporation, if a majority of the

shares of such other corporation entitled to vote in the election of Directors is held by the Corporation, shall not be counted for quorum purposes or entitled to vote.

**Section 2.7 Voting.** At any meeting of stockholders, each stockholder holding, as of the record date for determining the stockholders entitled to vote at such meeting, shares of stock entitled to be voted on any matter at such meeting shall have one vote on each such matter submitted to vote at such meeting for each such share of stock held by such stockholder, as of such record date, as shown by the list of stockholders entitled to vote at the meeting, unless the Certificate of Incorporation provides for more or less than one vote for any share, on any matter, in which case every reference in these Bylaws to a majority or other proportion of stock shall refer to such majority or other proportion of the votes of such stock.

Each stockholder entitled to vote at a meeting of stockholders or to express consent or dissent to corporate action in writing without a meeting may authorize another person or persons to act for him by proxy, provided that no proxy shall be voted or acted upon after three years from its date, unless the proxy provides for a longer period. A duly executed proxy shall be irrevocable if it states that it is irrevocable and if, and only so long as, it is coupled with an interest, whether in the stock itself or in the Corporation generally, sufficient in law to support an irrevocable power.

In advance of any meeting of the stockholders, the Board of Directors, the Chairman of the Board, the President or the person presiding at a meeting of stockholders shall appoint one or more inspectors to act at the meeting and make a written report thereof. One or more other persons may be designated as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of the stockholders, the person presiding at the meeting shall appoint one or more inspectors to act at the meeting. Unless otherwise required by applicable law, inspectors may be officers, employees or agents of the Corporation. Each inspector, before entering upon the discharge of the duties of inspector, shall take and sign an oath to execute faithfully the duties of inspector with strict impartiality and according to the best of such inspector's ability. The inspector shall have the duties prescribed by law and shall take charge of the polls and, when the vote is completed, shall make a certificate of the result of the vote taken and of such other facts as may be required by applicable law.

**Section 2.8 Action by Consent of Stockholders.** Unless otherwise provided in the Certificate of Incorporation, whenever any action by the stockholders at a meeting thereof is required or permitted by law, the Certificate of Incorporation, or these Bylaws, such action may be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by all of the holders of the outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of such action without a meeting and by less than unanimous written consent shall be given to those stockholders who have not consented in writing.

#### **Section 2.9 Nature of Business at Meetings of Stockholders.**

Only such business (other than nominations for election to the Board of Directors, which must comply with the provisions of Section 3.4 (b)) may be transacted at an annual meeting of stockholders as is either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors (or any duly authorized committee thereof), (b) otherwise properly brought before the annual meeting by or at the direction of the Board of Directors (or any duly authorized committee thereof), or (c) otherwise properly brought before the annual meeting by any stockholder of the Corporation (i) who is a stockholder of record on the date of the giving of the notice provided for in this Section 2.9 and on the record date or dates for the determination of stockholders entitled to notice of and to vote at such annual meeting and (ii) who complies with the notice procedures set forth in this Section 2.9.

In addition to any other applicable requirements, for business to be properly brought before an annual meeting by a stockholder, such stockholder must have given timely notice thereof in proper written form to the Secretary of the Corporation. For avoidance of doubt, this Section 2.9 shall be the exclusive means for a stockholder to propose business (other than business included in the Corporation's proxy materials pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) at an annual meeting of stockholders.

To be timely, a stockholder's notice must be delivered to or be mailed and received by the Secretary at the principal executive offices of the Corporation not less than ninety days nor more than one hundred twenty days prior to the anniversary date of the immediately preceding annual meeting of stockholders; provided, however, that in the event that the annual meeting is called for a date that is not within thirty days before or after such anniversary date, notice by the stockholder in order to be timely must be so 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. In no event shall the adjournment or postponement of an annual meeting, or the public announcement of such an adjournment or postponement, commence a new time period (or extend any time period) for the giving of a stockholder's notice as described above.

To be in proper written form, a stockholder's notice to the Secretary must set forth the following information: (a) as to each matter such stockholder proposes to bring before the annual meeting, a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, and (b) as to the stockholder giving notice and the beneficial owner, if any, on whose behalf the proposal is being made, (i) the name and address of such person, (ii) (A) the class or series and number of all shares of stock of the Corporation which are owned beneficially or of record by such person and any affiliates or associates of such person, (B) the name of each nominee holder of shares of all stock of the Corporation owned beneficially but not of record by such person or any affiliates or associates of such person, and the number of such shares of stock held by each such nominee holder, (C) 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 such person, or any affiliates or associates of such person, with respect to a security issued by the Corporation and (D) whether and the extent to which any other transaction, agreement, arrangement or understanding (including any short position or any borrowing or lending of shares of stock of the Corporation) has been made by or on behalf of such person, or any affiliates or associates of such person, the effect or intent of any of the foregoing being to mitigate loss to, or to manage risk or benefit of price changes for, such person or any affiliates or associates of such person or to increase or decrease the voting power or pecuniary or economic interest of such person or any affiliates or associates of such person with respect to a security issued by the Corporation; (iii) a description of all agreements, arrangements, or understandings (whether written or oral) between or among such person or any affiliates or associates of such person and any other person or persons (including their names) in connection with the proposal of such business and any material interest of such person or any affiliates or associates of such person, in such business, including any anticipated benefit therefrom to such person or any affiliates or associates of such person; (iv) 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 (v) any other information relating to such person that would be required to be disclosed in a proxy statement or other filing required to be made in connection with the solicitation of proxies by such person with respect to the proposed business to be brought by such person before the annual meeting pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder.

A stockholder providing notice of business proposed to be brought before an annual meeting shall further update and supplement such notice, if necessary, so that the information provided or required to be provided in such notice pursuant to this Section 2.9 shall be true and correct as of the record date or dates for determining the stockholders entitled to receive notice of and to vote at the annual meeting and any update and supplement to such information shall be delivered to or be mailed and received by the Secretary at the principal executive offices of the Corporation not later than four business days after (i) the record date for determining the stockholders entitled to receive notice of the annual meeting and (ii) a date that is ten days prior to the annual meeting.

No business shall be conducted at the annual meeting of stockholders except business brought before the annual meeting in accordance with the procedures set forth in this Section 2.9; provided, however, that, once business has been properly brought before the annual meeting in accordance with such procedures, nothing in this Section 2.9 shall be deemed to preclude discussion by any stockholder of any such business. If the chairman of an annual meeting determines that business was not properly brought before the annual meeting in accordance with the foregoing procedures, the chairman shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

Nothing contained in this Section 2.9 shall be deemed to affect any rights of stockholders to request inclusion of proposals in the Corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act.

## ARTICLE III

### BOARD OF DIRECTORS

Section 3.1 General Powers. The property, business and affairs of the Corporation shall be managed by or under the direction of a Board of Directors. The Board of Directors may exercise all such powers of the Corporation and have such authority and do all such lawful acts and things as are permitted by law, the Certificate of Incorporation or these Bylaws.

Section 3.2 Number of Directors. The Board of Directors of the Corporation shall consist of one or more members. The exact number of Directors which shall constitute the whole Board of Directors shall be fixed from time to time by resolution adopted by a majority of the whole Board of Directors. Until the number of Directors has been so fixed by the Board of Directors, the number of Directors constituting the whole Board of Directors shall be three. After fixing the number of Directors constituting the whole Board of Directors, the Board of Directors may, by resolution adopted by a majority of the whole Board of Directors, from time to time change the number of Directors constituting the whole Board of Directors.

Section 3.3 Qualification. Directors must be natural persons but need not be stockholders of the Corporation. Directors who willfully neglect or refuse to produce a list of stockholders entitled to vote at any meeting for the election of Directors shall be ineligible for election to any office at such meeting.

Section 3.4 Election.

(a) Except as otherwise provided by law, the Certificate of Incorporation or these Bylaws, after the first meeting of the Corporation at which Directors are elected, Directors of the Corporation shall be elected in each year at the annual meeting of stockholders, or at a special meeting in lieu of the annual meeting called for such purpose, by the vote of the majority of the votes cast at any meeting for the election of Directors at which a quorum is present; provided, however, that Directors shall be elected by a plurality of the votes cast at any meeting of stockholders for which (i) the Secretary of the Corporation received a notice that a stockholder has nominated a person for election to the Board of Directors in compliance with the advance notice requirements for stockholder nominees for Director set forth in Section 3.4(b) of these Bylaws and (ii) such nomination has not been withdrawn by such stockholder on or prior to the tenth (10<sup>th</sup>) day preceding the date the Corporation first mails its notice of meeting for such meeting to the stockholders. For purposes of this Bylaw, a majority of votes cast shall mean that the number of shares voted "for" a nominee exceeds fifty percent (50%) of the number of votes cast with respect to such nominee. Votes cast with respect to a nominee shall include votes to withhold authority and exclude abstentions with respect to such nominee. The voting on Directors at any such meeting shall be by written ballot unless otherwise provided in the Certificate of Incorporation.

(b) Only persons who are nominated in accordance with the following procedures shall be eligible for election as Directors of the Corporation, except as may be otherwise provided in the Certificate of Incorporation with respect to the right of holders of preferred stock of the Corporation to nominate and elect a specified number of Directors in certain circumstances. Nominations of persons for election to the Board of Directors may be made at any annual meeting of stockholders, or at any special meeting of stockholders called for the purpose of electing Directors, (a) by or at the direction of the Board of Directors (or any duly authorized committee thereof) or (b) by any stockholder of the Corporation (i) who is a stockholder of record on the date of the giving of the notice provided for in this Section 3.4(b) and on the record date for the determination of stockholders entitled to notice of and to vote at such annual meeting or special meeting and (ii) who complies with the notice procedures set forth in this Section 3.4(b).

In addition to any other applicable requirements, for a nomination to be made by a stockholder, such stockholder must have given timely notice thereof in proper written form to the Secretary of the Corporation.

To be timely, a stockholder's notice to the Secretary must be delivered to or be mailed and received at the principal executive offices of the Corporation (a) in the case of an annual meeting, not less than ninety days nor more than one hundred twenty days prior to the anniversary date of the immediately preceding annual meeting of stockholders; provided, however, that in the event that the annual meeting is called for a date that is not within thirty days before or after such anniversary date, notice by the stockholder in order to be timely must be so 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; and (b) in the case of a special meeting of stockholders called for the purpose of electing Directors, not later than the close of business on the tenth day following the day on which notice of the date of the special meeting was mailed or public disclosure of the date of the special meeting was made, whichever first occurs. In no event shall the adjournment or postponement of an annual meeting or a special meeting called for the purpose of electing Directors, or the public announcement of such an adjournment or postponement, commence a new time period (or extend any time period) for the giving of a stockholder's notice as described above.

To be in proper written form, a stockholder's notice to the Secretary must set forth the following information: (a) as to each person whom the stockholder proposes to nominate for election as a Director (i) the name, age, business address and residence address of such person, (ii) the

principal occupation or employment of such person, (iii) (A) the class or series and number of all shares of stock of the Corporation which are owned beneficially or of record by such person and any affiliates or associates of such person, (B) the name of each nominee holder of shares of all stock of the Corporation owned beneficially but not of record by such person or any affiliates or associates of such person and the number of such shares of stock of the Corporation held by each such nominee holder, (C) 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 such person or any affiliates or associates of such person with respect to a security issued by the Corporation and (D) whether and the extent to which any other transaction, agreement, arrangement or understanding (including any short position or any borrowing or lending of shares of stock of the Corporation) has been made by or on behalf of such person or any affiliates or associates of such person the effect or intent of any of the foregoing being to mitigate loss to, or to manage risk or benefit of price changes for, such person or any affiliates or associates of such person or to increase or decrease the voting power or pecuniary or economic interest of such person, or any affiliates or associates of such person, with respect to a security issued by the Corporation; and (iv) any other information relating to such person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of Directors pursuant to Section 14 of the Exchange Act, and the rules and regulations promulgated thereunder; and (b) as to the stockholder giving the notice, and the beneficial owner, if any, on whose behalf the nomination is being made, (i) the name and record address of such person; (ii) (A) the class or series and number of all shares of stock of the Corporation which are owned beneficially or of record by such person and any affiliates or associates of such person, (B) the name of each nominee holder of shares of the Corporation owned beneficially but not of record by such person or any affiliates or associates of such person and the number of shares of stock of the Corporation held by each such nominee holder, (C) 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 such person or any affiliates or associates of such person with respect to a security issued by the Corporation and (D) whether and the extent to which any other transaction, agreement, arrangement or understanding (including any short position or any borrowing or lending of shares of stock of the Corporation) has been made by or on behalf of such person, or any affiliates or associates of such person, the effect or intent of any of the foregoing being to mitigate loss to, or to manage risk or benefit of price changes for, such person or any affiliates or associates of such person or to increase or decrease the voting power or pecuniary or economic interest of such person or any affiliates or associates of such person with respect to a security issued by the Corporation; (iii) a description of all agreements, arrangements, or understandings (whether written or oral) between such person or any affiliates or associates of such person and any proposed nominee or any other person or persons (including their names) pursuant to which the nomination(s) are being made by such person, and any material interest of such person or any affiliates or associates of such person in such nomination, including any anticipated benefit therefrom to such person or any affiliates or associates of such person; (iv) a representation that the stockholder giving notice intends to appear in person or by proxy at the annual meeting or special meeting to nominate the persons named in its notice; and (v) any other information relating to such person that would be required to be disclosed in a proxy statement or other filings required to be made in connection with the solicitation of proxies for election of Directors pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder. Such notice must be accompanied by a written consent of each proposed nominee to being named as a nominee and to serve as a Director if elected.

A stockholder providing notice of any nomination proposed to be made at an annual meeting or special meeting shall further update and supplement such notice, if necessary, so that the information provided or required to be provided in such notice pursuant to this Section 3.4(b) shall be true and correct as of the record date or dates for determining the stockholders entitled to receive notice of and to vote at the annual meeting or special meeting and any update and supplement to such information shall be delivered to or be mailed and received by the Secretary at the principal executive offices of the Corporation not later than four business days after (i) the record date for determining the stockholders entitled to receive notice of such meeting and (ii) a date that is ten days prior to such meeting.

No person shall be eligible for election as a Director of the Corporation unless nominated in accordance with the procedures set forth in this Section 3.4(b). If the Chairman of the meeting determines that a nomination was not made in accordance with the foregoing procedures, the Chairman shall declare to the meeting that the nomination was defective and such defective nomination shall be disregarded.

(c)(i) Following the annual meeting, the Board of Directors shall cause the Corporation to reimburse the Expenses that a stockholder or group of stockholders (the "Nominating Stockholders") has incurred in connection with nominating a candidate (the "Nominee") for election to the Board of Directors (the "Nomination") if the following conditions are met:

(A) None of the Nominating Stockholders shall have nominated for election to the Board of Directors at the annual meeting any individual other than the Nominee;

(B) None of the Nominating Stockholders shall have engaged in a "solicitation" within the meaning of Rule 14a-1(l) of the Exchange Act in support of the election of any individual as a Director at the annual meeting other than the Nominee (or a nominee of the Board of Directors), and shall not have distributed to any stockholder any form of proxy for the annual meeting other than a form including only the Nominee and individuals nominated by the Board of Directors;

(C) Each Nominating Stockholder and the Nominee shall have otherwise complied with all of the provisions of these Bylaws applicable to the nomination of a candidate for election to the Board of Directors;

(D) The election of fewer than 30% of the Directors to be elected shall be contested in the election (rounded down to the nearest whole number but not less than one);

(E) Each Nominating Stockholder shall have been the Beneficial Owner of shares of capital stock of the Corporation entitled to vote in the election of Directors (the "Required Voting Interest") from the date that is one year prior to the date on which the Corporation receives notice of the Nomination through the conclusion of the annual meeting at which the Nomination was made (such period, the "Holding Period");

(F) None of the Nominating Stockholders shall have received reimbursement of proxy expenses from the Corporation, pursuant to this Bylaw or otherwise, in any of the preceding three calendar years;

(G) The Nominee shall have received a number of votes cast in favor of his or her election equal to at least 40% of the number of all votes cast, including "for," "against" and "withheld" votes, for the nominee receiving the most such votes of any nominee in the election of Directors (such number of votes, the "Total Votes Cast");

(H) The Nominee shall not have been included on the proxy cards solicited by the Corporation or by any person other than the Nominating Stockholders who nominated the Nominee;

(I) The Nominee shall be Independent;

(J) The proxy statement included in the proxy materials solicited by or on behalf of any Nominating Stockholder (the “Proxy Materials”) shall include a statement disclosing each member of the Nominating Stockholders group and the other information required to be delivered to the Secretary pursuant to Section 3.4(b); and

(K) During the Holding Period, none of the Nominating Stockholders nor the Nominee shall have Beneficially Owned any securities of the Corporation for the purpose, or with the effect, of changing or influencing the control of the Corporation, or in connection with or as a participant in any transaction having that purpose or effect, including any transaction referred to in Rule 13d-3(b) of the Exchange Act, other than solely by reason of seeking the election as a Director of the Nominee.

(ii) If a Nominating Stockholder is eligible for reimbursement under this Section 3.4(c), then (A) if the Nominee is not elected, the proportion of the Expenses reimbursed shall equal the proportion of votes that the Nominee received in favor of his or her election to the Total Votes Cast, and (B) if the Nominee is elected, all Expenses shall be reimbursed; provided, however, in each case, the other terms and conditions of this Section 3.4(c) are satisfied. In no event shall the amount paid to a Nominating Stockholder pursuant to this Section 3.4(c) exceed the amount of corresponding expenses incurred by the Corporation in soliciting proxies in connection with the election of Directors at the same annual meeting. The Corporation shall pay at the direction of the Nominating Stockholders the amount due under this Section 3.4(c) after receipt of reasonably detailed, written invoices documenting the Expenses, as well as any documentation reasonably requested by the Corporation demonstrating their eligibility for reimbursement. Notwithstanding any other provision hereof, there shall be no reimbursement under this Section 3.4(c) in the event the Board of Directors determines that any such reimbursement is not in the best interests of the Corporation or would result in a breach of the fiduciary duties of the Board of Directors to the Corporation and its stockholders or that making such a payment would render the Corporation insolvent or cause it to breach a material obligation incurred without reference to the obligations imposed by this Section 3.4(c).

(iii) For purposes of this Section 3.4(c):

(A) “Expenses” shall mean 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 (in each case, only such costs, fees and expenses that are reasonably incurred by the Nominating Stockholders), so long as: (x) the Nominating Stockholders shall be liable for such amounts regardless of the outcome of the election of Directors or the receipt of reimbursement by the Corporation; and (y) any party to which such amounts are payable is not an Affiliate or Associate (wherever used in this Section 3.4(c), as defined in the Exchange Act) of any of the Nominating Stockholders.

(B) A person shall be the “Beneficial Owner” of or “Beneficially Own” only those shares of common stock of the Corporation as to which the person possesses both (x) the full voting rights pertaining to the shares and (y) after giving effect to any swap, hedging, derivative or synthetic ownership contract or arrangement with respect to securities of the Corporation or its Affiliates to which the person or any of its Affiliates or Associates is a party or is bound or is the beneficiary, the full economic interest in (including the right to dispose of and the opportunity for profit and risk of loss on) such shares. A person shall Beneficially Own shares held in the name of a nominee or other intermediary so long as the person retains the right to instruct how the shares are voted with respect to the election of Directors and possesses the full economic interest in the shares. A person’s Beneficial Ownership of shares shall be deemed to continue during any period in which the person has delegated any voting power by means of a proxy, power of attorney or other instrument or arrangement which is revocable at any time by the person or in which any fiduciary, attorney-in-fact or distributee succeeds to or otherwise acts for such person by reason of the death, disability, liquidation or occurrence of a comparable event with respect to such person. The percentage of shares Beneficially Owned by a stockholder in connection with a Nomination shall be based upon the number of outstanding voting securities most recently disclosed, prior to the delivery of the notice of nomination by the Nominating Stockholders to the Corporation in accordance with Section 3.4(b) of these Bylaws, by the Corporation in a filing with the Securities and Exchange Commission (the “Commission”).

(C) “Independent” with respect to a Nominee shall mean (a) that the Nominee would be considered an independent director in accordance with the listing standards of the principal U.S. securities market in which the common stock of the Corporation trades or, if no such listing standards are applicable at the time, in accordance with the standards used by the Board of Directors or a duly authorized committee thereof in determining and disclosing the independence of the Corporation’s Directors in accordance with the rules of the Commission and (b) the Nominee is not an employee or officer of, or consultant to, and is not party to any agreement providing such Nominee compensation from, the Nominating Stockholders or any of their respective Affiliates or Associates and has no other material association, by agreement, understanding or familial or other relationship, with the Nominating Stockholders or any of their respective Affiliates or Associates.

Section 3.5 Term. Each Director shall hold office until his successor is duly elected and qualified, except in the event of the earlier termination of his term of office by reason of death, resignation, removal or other reason.

Section 3.6 Resignation and Removal. Any Director may resign at any time upon written notice to the Board of Directors, the Chairman of the Board, the President or the Secretary. The resignation of any Director shall take effect upon receipt of notice thereof or at such later time as shall be specified in such notice, and unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

Any Director or the entire Board of Directors may be removed, with or without cause, by the holders of a majority of the shares of capital stock then entitled to vote at an election of Directors, except as otherwise provided by applicable law.

Section 3.7 Vacancies. Vacancies in the Board of Directors and newly created Directorships resulting from any increase in the authorized number of Directors shall be filled by the vote of a majority of the Directors then in office, though less than a quorum, or by a sole remaining Director.

If one or more Directors shall resign from the Board of Directors effective at a future date, a majority of the Directors then in office, including those who have so resigned at a future date, shall have power to fill such vacancy or vacancies, the vote thereon to take effect and the vacancy to



be filled when such resignation or resignations shall become effective, and each Director so chosen shall hold office as provided in this Section 3.7 in the filling of other vacancies.

Each Director chosen to fill a vacancy on the Board of Directors shall hold office until the next annual election of Directors and until his successor shall be elected and qualified.

Section 3.8 Quorum and Voting. Unless the Certificate of Incorporation, provides otherwise, at all meetings of the Board of Directors, a majority of the total number of Directors shall be present to constitute a quorum for the transaction of business. A Director interested in a contract or transaction may be counted in determining the presence of a quorum at a meeting of the Board of Directors which authorizes the contract or transaction. In the absence of a quorum, a majority of the Directors present may adjourn the meeting until a quorum shall be present.

Unless the Certificate of Incorporation provides otherwise, members of the Board of Directors or any committee designated by the Board of Directors may participate in a meeting of the Board of Directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and participation in such a meeting shall constitute presence in person at such meeting.

The vote of the majority of the Directors present at a meeting at which a quorum is present shall be the act of the Board of Directors unless the Certificate of Incorporation or these Bylaws shall require a vote of a greater number.

Section 3.9 Regulations. The Board of Directors may adopt such rules and regulations for the conduct of the business and management of the Corporation, not inconsistent with law or the Certificate of Incorporation or these Bylaws, as the Board of Directors may deem proper. The Board of Directors may hold its meetings and cause the books and records of the Corporation to be kept at such place or places within or without the State of Delaware as the Board of Directors may from time to time determine. A member of the Board of Directors, or a member of any committee designated by the Board of Directors shall, in the performance of his duties, be fully protected in relying in good faith upon the books of account or reports made to the Corporation by any of its officers, by an independent certified public accountant, or by an appraiser selected with reasonable care by the Board of Directors or any committee of the Board of Directors or in relying in good faith upon other records of the Corporation.

Section 3.10 Annual Meeting. An annual meeting of the Board of Directors shall be called and held for the purpose of organization, election of officers and transaction of any other business. If such meeting is held promptly after and at the place specified for the annual meeting of stockholders, no notice of the annual meeting of the Board of Directors need be given. Otherwise, such annual meeting shall be held at such time (not more than thirty days after the annual meeting of stockholders) and place as may be specified in a notice of the meeting.

Section 3.11 Regular Meetings. Regular meetings of the Board of Directors shall be held at the time and place, within or without the State of Delaware, as shall from time to time be determined by the Board of Directors. After there has been such determination and notice thereof has been given to each member of the Board of Directors, no further notice shall be required for any such regular meeting. Except as otherwise provided by law, any business may be transacted at any regular meeting.

Section 3.12 Special Meetings. Special meetings of the Board of Directors may, unless otherwise prescribed by law, be called from time to time by the Chairman of the Board or the President, and shall be called by the Chairman of the Board, the President or the Secretary upon the written request of a majority of the whole Board of Directors directed to the Chairman of the Board, the President or the Secretary. Except as provided below, notice of any special meeting of the Board of Directors, stating the time, place and purpose of such special meeting, shall be given to each Director.

Section 3.13 Notice of Meetings; Waiver of Notice. Notice of any meeting of the Board of Directors shall be deemed to be duly given to a Director (i) if mailed to such Director addressed to him at his address as it appears upon the books of the Corporation, or at the address last made known in writing to the Corporation by such Director as the address to which such notices are to be sent, at least five days before the day on which such meeting is to be held, or (ii) if sent to him at such address by telegraph, cable, radio or wireless not later than the day before the day on which such meeting is to be held, or (iii) if delivered to him personally or orally, by telephone or otherwise, not later than the day before the day on which such meeting is to be held. Each such notice shall state the time and place of the meeting and the purposes thereof.

Notice of any meeting of the Board of Directors need not be given to any Director if waived by him in writing (or by telegram, cable, radio or wireless and confirmed in writing) whether before or after the holding of such meeting, or if such Director is present at such meeting. Any meeting of the Board of Directors shall be a duly constituted meeting without any notice thereof having been given if all Directors then in office shall be present thereat.

Section 3.14 Committees of Directors. The Board of Directors may, by resolution or resolutions passed by a majority of the whole Board of Directors, designate one or more committees, each committee to consist of one or more of the Directors of the Corporation.

Except as hereinafter provided, vacancies in membership of any committee shall be filled by the vote of a majority of the whole Board of Directors. The Board of Directors may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of any member of a committee (and his alternate appointed pursuant to the immediately preceding sentence, if any), the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member. Members of a committee shall hold office for such period as may be fixed by a resolution adopted by a majority of the whole Board of Directors, subject, however, to removal at any time by the vote of a majority of the whole Board of Directors.

Section 3.15 Powers and Duties of Committees. Any committee, to the extent provided in the resolution or resolutions creating such committee, shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it. No such committee shall have the power or authority with regard to amending the Certificate of Incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the Corporation's property and assets, recommending to the stockholders a dissolution of the Corporation or a revocation of a dissolution, or amending the Bylaws. The Board of Directors may, in the resolution creating a committee, grant to such committee the power and authority to declare a dividend or authorize the issuance of stock.

Each committee may adopt its own rules of procedure and may meet at stated times or on such notice as such committee may determine. Except as otherwise permitted by these Bylaws, each committee shall keep regular minutes of its proceedings and report the same to the Board of Directors when required.

Section 3.16 Compensation of Directors. Each Director shall be entitled to receive for attendance at each meeting of the Board of Directors or any duly constituted committee thereof which he attends, such fee as is fixed by the Board and in connection therewith shall be reimbursed by the Corporation for travel expenses. The fees to such Directors may be fixed in unequal amounts among them, taking into account their respective relationships to the Corporation in other capacities. These provisions shall not be construed to preclude any Director from receiving compensation in serving the Corporation in any other capacity.

Section 3.17 Action Without Meeting. Unless otherwise restricted by the Certificate of Incorporation, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting if a written consent thereto is signed by all members of the Board of Directors or of such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the Board of Directors or such committee.

## ARTICLE IV

### OFFICERS

Section 4.1 Principal Officers. The principal officers of the Corporation shall be elected by the Board of Directors and shall include a Chairman of the Board, a Chief Executive Officer, a Chief Financial Officer, a Chief Operating Officer, a President, a General Counsel and a Secretary and may, at the discretion of the Board of Directors, also include a Vice Chairman of the Board, a Chief Accounting Officer, one or more Executive Vice Presidents, Senior Vice Presidents and Vice Presidents, a Treasurer and a Controller. Except as otherwise provided in the Certificate of Incorporation or these Bylaws, one person may hold the offices and perform the duties of any two or more of said principal offices except the offices and duties of President and Vice President or of Chairman of the Board or President and Secretary. None of the principal officers need be Directors of the Corporation.

Section 4.2 Election of Principal Officers; Term of Office. The principal officers of the Corporation shall be elected annually by the Board of Directors at such annual meeting of the Board of Directors. Failure to elect any principal officer annually shall not dissolve the Corporation.

If the Board of Directors shall fail to fill any principal office at an annual meeting, or if any vacancy in any principal office shall occur, or if any principal office shall be newly created, such principal office may be filled at any regular or special meeting of the Board of Directors.

Each principal officer shall hold office until his successor is duly elected and qualified, or until his earlier death, resignation or removal, provided that the terms of office of all Vice Presidents shall terminate at any annual meeting of the Board of Directors at which the President is elected.

Section 4.3 Subordinate Officers, Agents and Employees. In addition to the principal officers, the Corporation may have one or more subordinate officers, agents and employees as the Board of Directors may deem advisable. The Chief Executive Officer also may appoint subordinate officers of the Corporation if not previously elected by the Board of Directors, including one or more of each of the following: Chief Accounting Officer, Executive Vice President, Senior Vice President, Vice President, Treasurer, Controller, Assistant Secretary, Assistant Treasurer or such other officers as the Chief Executive Officer may deem to be necessary, desirable or appropriate. The Board of Directors at any time may appoint and remove, or may delegate to any principal officer the power to appoint and to remove, any subordinate officer, agent or employee of the Corporation. Each subordinate officer shall hold office for such period and have such authority and perform such duties as are provided in these Bylaws or as the Board of Directors, the Chairman of the Board, the Chief Executive Officer, or any officer designated by the Board of Directors, may from time to time determine. Any person appointed under this Section 4.3 to serve in any of the foregoing positions shall be deemed by reason of such appointment or service in such capacity to be an "officer" of the Corporation.

Section 4.4 Delegation of Duties of Officers. The Board of Directors may delegate the duties and powers of any officer of the Corporation to any other officer or to any Director for a specified period of time for any reason that the Board of Directors may deem sufficient.

Section 4.5 Removal of Officers. Any officer of the Corporation elected by the Board of Directors maybe removed, with or without cause, by resolution adopted by a majority of the Directors then in office at any regular or special meeting of the Board of Directors or by a written consent signed by all of the Directors then in office. Any other officer may be removed from such position at any time by the Board (as set forth above), the Chief Executive Officer, the person making such appointment or his/her successor, either with or without cause.

Section 4.6 Resignations. Any officer may resign at any time by giving written notice of resignation to the Board of Directors, to the Chairman of the Board, to the President or to the Secretary. Any such resignation shall take effect upon receipt of such notice or at any later time specified therein. Unless otherwise specified in the notice, the acceptance of a resignation shall not be necessary to make the resignation effective.

Section 4.7 Chairman and Vice Chairman of the Board. The Chairman of the Board shall preside at all meetings of stockholders and of the Board of Directors at which he is present. The Chairman of the Board shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors. In the absence of the Chairman, a Vice Chairman, if one has been elected, shall preside at all meetings of the Board of Directors and stockholders and exercise and perform such other powers and duties as from time to time may be assigned by the Board of Directors.

Section 4.8 Chief Executive Officer. Subject to the oversight of the Board of Directors, the Chief Executive Officer shall, in the absence of the Chairman and the Vice Chairman of the Board, preside at all meetings of the stockholders and of the Board of Directors at which he is present. The Chief Executive Officer shall have general supervision over the business and affairs of the Corporation and shall be responsible for carrying out the policies and objectives established by the Board of Directors. The Chief Executive Officer shall have all powers and duties usually incident to the office of chief executive officer, except as specifically limited by a resolution of the Board of Directors. The Chief Executive Officer shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors.

Section 4.9 Chief Financial Officer. The Chief Financial Officer shall exercise direction and control of the financial affairs of the

Corporation, including the preparation of the Corporation's financial statements. The Chief Financial Officer shall have the general powers and duties usually vested in the office of the chief financial officer of a corporation and such other powers and duties as may be assigned by the Board of Directors or the Chief Executive Officer.

Section 4.10 President. In the absence or disability of the Chief Executive Officer or if the office of Chief Executive Officer be vacant, the President shall perform all of the duties of the Chief Executive Officer and when so acting shall have all the powers and be subject to all the restrictions upon the Chief Executive Officer, including the power to sign all instruments and to take all actions that the Chief Executive Officer is authorized to perform by the Board of Directors or these Bylaws. A President shall have the general powers and duties usually vested in the office of president of a corporation and such other powers and duties as may be assigned by the Board of Directors or the Chief Executive Officer.

Section 4.11 Chief Operating Officer. Subject to the oversight of the Chief Executive Officer and the President, the Chief Operating Officer shall exercise direction and control over the day-to-day operations of the Corporation. The Chief Operating Officer shall have the general powers and duties of management usually vested in the office of the chief operating officer of a corporation and such other powers and duties as from time to time may be assigned to the Chief Operating Officer by the Board of Directors or the Chief Executive Officer.

Section 4.12 Vice President. In the absence or disability of the President or if the office of President be vacant, the Vice Presidents in the order determined by the Board of Directors, or if no such determination has been made, in the order of their seniority, shall perform the duties and exercise the powers of the President, subject to the right of the Board of Directors at any time to extend or confine such powers and duties or to assign them to others. Any Vice President may have such additional designation in his title as the Board of Directors may determine. The Vice Presidents shall generally assist the President in such manner as the President shall direct. Each Vice President shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors, the Chief Executive Officer or the President.

Section 4.13 Secretary. The Secretary shall act as Secretary of all meetings of stockholders and of the Board of Directors at which he is present, shall record all the proceedings of all such meetings in a book to be kept for that purpose, shall have supervision over the giving and service of notices of the Corporation, and shall have supervision over the care and custody of the records and seal of the Corporation. The Secretary shall be empowered to affix the corporate seal to documents, the execution of which on behalf of the Corporation under its seal is duly authorized, and when so affixed may attest the same. The Secretary shall have all powers and duties usually incident to the office of Secretary, except as specifically limited by a resolution of the Board of Directors. The Secretary shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors, the Chief Executive Officer or the President.

Section 4.14 Treasurer. The Treasurer shall have general supervision over the care and custody of the funds and over the receipts and disbursements of the Corporation and shall cause the funds of the Corporation to be deposited in the name of the Corporation in such banks or other depositories as the Board of Directors may designate. The Treasurer shall have supervision over the care and safekeeping of the securities of the Corporation. The Treasurer shall have all powers and duties usually incident to the office of Treasurer, except as specifically limited by a resolution of the Board of Directors. The Treasurer shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors, the Chief Executive Officer or the President.

Section 4.15 Controller. The Controller shall be the chief accounting officer of the Corporation and shall have supervision over the maintenance and custody of the accounting operations of the Corporation, including the keeping of accurate accounts of all receipts and disbursements and all other financial transactions. The Controller shall have all powers and duties usually incident to the office of Controller, except as specifically limited by a resolution of the Board of Directors. The Controller shall have such other powers and perform such other duties as may be assigned to him from time to time by the Board of Directors, the Chief Executive Officer or the President.

Section 4.16 Bond. The Board of Directors shall have power, to the extent permitted by law, to require any officer, agent or employee of the Corporation to give bond for the faithful discharge of his duties in such form and with such surety or sureties as the Board of Directors may determine.

## ARTICLE V

### CAPITAL STOCK

Section 5.1 Issuance of Certificates of Stock ; Uncertificated Stock. The shares of the Corporation shall be represented by certificates, provided that the Board of Directors may establish by resolution or resolutions that some or all of any classes or series of the Corporation's stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Corporation. Every holder of stock represented by certificates shall be entitled to a certificate or certificates in such form as shall be approved by the Board of Directors, certifying the number of shares of capital stock of the Corporation owned by such stockholder.

Section 5.2 Signatures on Stock Certificates. Shares of capital stock of the Corporation represented by certificates shall be signed by, or in the name of the Corporation by, the Chairman of the Board, the President or a Vice President and by, or in the name of the Corporation by, the Secretary, the Treasurer, an Assistant Secretary or an Assistant Treasurer. Any of or all the signatures on the certificates may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, such certificate may be issued by the Corporation with the same effect as if such signer were such officer at the date of issue.

Section 5.3 Stock Ledger. A record of all shares of all capital stock issued by the Corporation shall be kept by the Secretary or any other officer or employee of the Corporation designated by the Secretary or by any transfer clerk or transfer agent appointed pursuant to Section 5.4 hereof. Such record shall show the name and address of each person, firm or corporation in which capital stock is registered, and the number of shares owned by such person, firm or corporation.

The Corporation shall be entitled to treat the holder of record of shares of capital stock as shown on the stock ledger as the owner thereof and as the person entitled to receive dividends thereon, to vote such shares and to receive notice of meetings, and for all other purposes. The Corporation shall not be bound to recognize any equitable or other claim to or interest in any share of capital stock on the part of any other person whether or not the Corporation shall have express or other notice thereof.

#### Section 5.4 Regulations Relating to Transfer.

(a) The Board of Directors may make such rules and regulations as it may deem expedient, not inconsistent with law, the Certificate of Incorporation or these Bylaws, concerning issuance, transfer and registration of certificates for shares of capital stock of the Corporation. The Board of Directors may appoint, or authorize any principal officer to appoint, one or more transfer clerks or one or more transfer agents and one or more registrars and may require all certificates for capital stock to bear the signature or signatures of any of them.

(b) If the Board of Directors authorizes any class of capital stock of the Corporation to be issued in uncertificated form, it shall make such rules and regulations as it may deem expedient, not inconsistent with law, the Certificate of Incorporation or these Bylaws, concerning issuance, transfer and registration of such uncertificated shares of capital stock.

Section 5.5 Transfers. Transfers of certificated shares of capital stock shall be made on the books of the Corporation only upon delivery to the Corporation or its transfer agent of (i) a written direction of the registered holder named in the certificate or such holder's attorney lawfully constituted in writing, (ii) the certificate for the shares of capital stock being transferred, and (iii) a written assignment of the shares of capital stock evidenced thereby. Transfers of uncertificated shares of capital stock shall be made in accordance with the rules and regulations established by the Board of Directors pursuant to Section 5.4(b) of these Bylaws.

Section 5.6 Cancellation. Each certificate for capital stock surrendered to the Corporation for exchange or transfer shall be canceled and no new certificate or certificates (or substitutive uncertificated shares) shall be issued in exchange for any existing certificate (other than pursuant to Section 5.7) until such existing certificate shall have been canceled.

Section 5.7 Lost, Destroyed, Stolen and Mutilated Certificates. In the event that any certificate for shares of capital stock of the Corporation shall be mutilated, the Corporation may issue a new certificate or uncertificated shares in place of such mutilated certificate. In case any such certificate shall be lost, stolen or destroyed, the Corporation may, in the discretion of the Board of Directors or a committee designated thereby with power so to act, issue a new certificate for capital stock or uncertificated shares in the place of any such lost, stolen or destroyed certificate. The applicant for any substituted certificate or certificates (or substitutive uncertificated shares) shall surrender any mutilated certificate or, in the case of any lost, stolen or destroyed certificate, furnish satisfactory proof of such loss, theft or destruction of such certificate and of the ownership thereof. The Board of Directors or such committee may, in its discretion, require the owner of a lost or destroyed certificate, or his representatives, to furnish to the Corporation a bond with an acceptable surety or sureties and in such sum as will be sufficient to indemnify the Corporation against any claim that may be made against it on account of the lost, stolen or destroyed certificate or the issuance of such new certificate. A new certificate or uncertificated shares may be issued without requiring a bond when, in the judgment of the Board of Directors, it is proper to do so.

#### Section 5.8 Fixing of Record Dates.

(a) The Board of Directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of any meeting of stockholders, nor more than sixty days prior to any other action, for the purpose of determining stockholders entitled to notice of such meeting of stockholders or any adjournment thereof, or to receive payment of any dividend or other distribution or allotment of any rights, or to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action. If the Board of Directors fixes a record date for the purpose of determining stockholders entitled to notice of such meeting of stockholders or any adjournment thereof, such date shall also be the record date for determining the stockholders entitled to vote at such meeting unless the Board of Directors determines, at the time it fixes such record date, that a later date on or before the date of such meeting shall be the date for making such determination.

(b) Except as provided in Section 5.8(c), if no record date is fixed by the Board of Directors, (i) the record date for determining stockholders entitled to notice of and to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held and (ii) the record date for determining stockholders for any other purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

(c) In order that the Corporation may determine the stockholders entitled to consent to corporate action in writing without a meeting, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which date shall not be more than ten days after the date upon which the resolution fixing the record date is adopted by the Board of Directors. Any stockholder of record seeking to have the stockholders authorize or take corporate action by written consent shall, by written notice to the Secretary of the Corporation, request the Board of Directors to fix a record date. The Board of Directors shall promptly, but in all events within ten days after the date on which such a request is received, adopt a resolution fixing the record date. If no record date has been fixed by the Board of Directors within ten days of the date on which such a request is received, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting, when no prior action by the Board of Directors is required by applicable law, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the Corporation by delivery to its registered office in the State of Delaware, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of the stockholders are recorded, to the attention of the Secretary of the Corporation. Delivery made to the Corporation's registered office shall be by hand or by certified or registered mail, return receipt requested. If no record date has been fixed by the Board of Directors and prior action by the Board of Directors is required by applicable law, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be at the close of business on the date on which the Board of Directors adopts the resolution taking such prior action.

(d) A determination of stockholder's of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided that the Board of Directors may fix a new record date for the adjourned meeting.

### ARTICLE VI

#### INDEMNIFICATION

Section 6.1 Indemnification. The Corporation shall, to the full extent permitted by applicable law, indemnify any person (and the heirs, executors and administrators of such person) who, by reason of the fact that he is or was a Director, officer, employee or agent of the Corporation or

of a constituent corporation absorbed by the Corporation in a consolidation or merger or is or was serving at the request of the Corporation or such constituent corporation as a director, officer, employee or agent of any other corporation, partnership, joint venture, trust or other enterprise, was or is a party or is threatened to be a party to:

(a) any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Corporation), against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with any such action, suit or proceeding, or

(b) any threatened, pending or completed action or suit by or in the right of the Corporation to procure a judgment in its favor, against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit.

Any indemnification by the Corporation pursuant hereto shall be made only in the manner and to the extent authorized by applicable law, and any such indemnification shall not be deemed exclusive of any other rights to which those seeking indemnification may otherwise be entitled.

Section 6.2 Indemnification Insurance. The Corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a Director, officer, employee or agent of the Corporation, or is or was serving at the request of the Corporation as a Director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Corporation would have the power to indemnify him against such liability under applicable law.

## ARTICLE VII

### MISCELLANEOUS PROVISIONS

Section 7.1 Corporate Seal. The seal of the Corporation shall be circular in form with the name of the Corporation in the circumference and the words "Corporate Seal, Delaware" in the center. Whenever the Corporation is permitted or required to affix its seal to a document, it shall be sufficient to meet the requirements of any law, rule or regulation relating to a seal to place the designation "(SEAL)" adjacent to the signature of the person authorized to execute the document on behalf of the Corporation. Additionally, the seal may be used by causing it to be affixed or impressed, or a facsimile thereof may be reproduced or otherwise used in any other manner as the Board of Directors may determine.

Section 7.2 Fiscal Year. The fiscal year of the Corporation shall be from January 1 to December 31, inclusive, in each year, or such other twelve consecutive months as the Board of Directors may designate.

Section 7.3 Waiver of Notice. Whenever any notice is required to be given under any provision of law, the Certificate of Incorporation, or these Bylaws, a written waiver thereof, signed by the person or persons entitled to such notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the stockholders, Directors, or members of a committee of Directors, need be specified in any written waiver of notice unless so required by the Certificate of Incorporation.

Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

#### Section 7.4 Execution of Instruments, Contracts, Etc.

(a) All checks, drafts, bills of exchange, notes or other obligations or orders for the payment of money shall be signed in the name of the Corporation by any principal officers or such other officer or officers person or persons, as the Board of Directors may from time to time designate.

(b) Except as otherwise provided by law, the Board of Directors, any committee given specific authority in the premises by the Board of Directors, or any committee given authority to exercise generally the powers of the Board of Directors during the intervals between meetings of the Board of Directors, may authorize any officer, employee or agent, in the name of and on behalf of the Corporation, to enter into or execute and deliver deeds, bonds, mortgages, contracts and other obligations or instruments, and such authority may be general or confined to specific instances.

(c) All applications, written instruments and papers required by or filed with any department of the United States Government or any state, county, municipal or other governmental official or authority, may, if permitted by applicable law, be executed in the name of the Corporation by any principal officer or subordinate officer of the Corporation, or, to the extent designated for such purpose from time to time by the Board of Directors, by an employee or agent of the Corporation. Such designation may contain the power to substitute, in the discretion of the person named, one or more other persons.

## ARTICLE VIII

### AMENDMENTS

Section 8.1 By Stockholders. These Bylaws may be amended, altered or repealed, or new Bylaws may be adopted, at any meeting of stockholders by the vote of the holders of not less than a majority of the outstanding shares of stock entitled to vote thereat, provided that, in the case of a special meeting, notice that an amendment is to be considered and acted upon shall be inserted in the notice or waiver of notice of said meeting.

Section 8.2 By Directors. To the extent permitted by the Certificate of Incorporation, these Bylaws may be amended, altered or repealed, or new Bylaws may be adopted, at any regular or special meeting of the Board of Directors by the affirmative vote of a majority of the Board of Directors.





**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 quarterly report on Form 10-Q 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: November 4, 2009

By: /s/ JAY GRINNEY  
Jay Grinney  
President and Chief Executive Officer



**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John L. Workman, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: November 4, 2009

By: /s/ JOHN L. WORKMAN  
John L. Workman  
Executive Vice President and  
Chief Financial Officer

**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 Quarterly Report of HealthSouth Corporation on Form 10-Q for the period ended September 30, 2009, 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, 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: November 4, 2009

By: /S/ JAY GRINNEY  
Jay Grinney  
President and Chief Executive Officer

A signed original of this written statement required by Section 906 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.

**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 Quarterly Report of HealthSouth Corporation on Form 10-Q for the period ended September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John L. Workman, 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, 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: November 4, 2009

By:           /S/ JOHN L. WORKMAN            
John L. Workman  
Executive Vice President and  
Chief Financial Officer

A signed original of this written statement required by Section 906 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.