HEALTHSOUTH

Q1 2016 EARNINGS CALL

April 27, 2016

PARTICIPANTS

Corporate Participants

Crissy Buchanan Carlisle – Chief Investor Relations Officer, HealthSouth Corp.
Jay F. Grinney – President, Chief Executive Officer & Director, HealthSouth Corp.
Douglas E. Coltharp – Chief Financial Officer & Executive Vice President, HealthSouth Corp.
Mark J. Tarr – Chief Operating Officer & Executive Vice President, HealthSouth Corp.

Other Participants

Whit Mayo – Analyst, Robert W. Baird & Co., Inc. (Broker)
Gary Lieberman – Analyst, Wells Fargo Securities LLC
Sheryl R. Skolnick – Analyst, Mizuho Securities USA, Inc.
John W. Ransom – Analyst, Raymond James & Associates, Inc.
Joshua Raskin – Analyst, Barclays Capital, Inc.
A.J. Rice – Analyst, UBS Securities LLC
Chris Rigg – Analyst, Susquehanna Financial Group LLLP
Joanna S. Gajuk – Analyst, Bank of America Merrill Lynch

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to HealthSouth First Quarter 2016 Earnings Conference Call. At this time, I would like to inform all participants that their lines will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] You will be limited to one question and one follow-up question. Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

I will now turn the call over to Crissy Carlisle, HealthSouth's Chief Investor Relations Officer.

Crissy Buchanan Carlisle, Chief Investor Relations Officer

Thank you, operator, and good morning, everyone. Thank you for joining HealthSouth's first quarter 2016 earnings call. With me on the call in Birmingham today are: Jay Grinney, President and Chief Executive Officer; Doug Coltharp, Chief Financial Officer; Mark Tarr, Chief Operating Officer; Patrick Darby, General Counsel and Corporate Secretary; Andy Price, Chief Accounting Officer; Ed Fay, Treasurer; and Julie Duck, Senior Vice President of Financial Operations.

Before we begin, if you do not already have a copy, the first quarter earnings release, supplemental slides and related Form 8-K filed with the SEC are available on our website at www.healthsouth.com. On page two of the supplemental slides, you will find the safe harbor statements, which are also set forth in greater detail on the last page of the earnings release. During the call, we will make forward-looking statements which are subject to risk and uncertainties, many of which are beyond our control.

Certain risks, uncertainties and other factors that could cause actual results to differ materially from management's projections, forecasts, estimates and expectations are discussed in the company's SEC filings, including the earnings release and related Form 8-K. The Form 10-K for the year ended December 31, 2015, and the Form 10-Q for the quarter ended March 31, 2016 when filed. We encourage you to read them. You are cautioned not to place undue reliance on the estimates, projections, guidance and other forward-looking information presented.

Statements made throughout this presentation are based on current estimates of future events and speak only as of today. The company does not undertake a duty to update these forward-looking statements. Our slide presentation and discussion on this call will include certain non-GAAP financial measures. For such measures, reconciliation to the most directly comparable GAAP measure is available at the end of the slide presentation, at the end of the related press release and is part of the Form 8-K filed yesterday with the SEC, all of which are available on our website.

Before I turn it over to Jay, I would like to remind everyone that we will adhere to the one question and one follow-up question rule to allow everyone to submit a question. If you have additional questions, please feel free to put yourself back in the queue.

With that, I'll turn the call over to Jay.

Jay F. Grinney, President, Chief Executive Officer & Director

Great. Thank you, Crissy, and good morning to everyone joining today's call. We're very pleased to report HealthSouth had a strong first quarter, has net operating revenues increased 22.8%, adjusted EBITDA increased 23.1%, adjusted earnings per share increased 19.6% and adjusted free cash flow increased 63.1% quarter-over-quarter.

These results were achieved through strong volume growth pricing that was generally in line with expectations and solid expense management in both segments. Discharges in our inpatient rehabilitation segment increased 17%, due in large part to our acquisition of Reliant, while same-store discharges grew 2.8%, consistent with the solid same-store growth we achieved throughout 2015.

Volumes at Encompass agencies also were strong. Admissions and episodes increased 56.1% and 48.6%, respectively. And while the acquisitions of care – acquisition of CareSouth was a significant contributor to this growth, same-store admissions increased 12.6% and same-store episodes grew 12.3% in the quarter.

We were very pleased that the management teams at our hospitals and at Encompass agencies managed this increased volume in a disciplined manner, resulting in $192.1 million of adjusted EBITDA and an adjusted EBITDA margin of 21.1%, $0.61 of adjusted earnings per share and $129.5 million of adjusted free cash flow. And we were able to invest this cash in a variety of value-enhancing ways.

First, we continued to invest in the growth of the company, as we expanded our existing bed complement by 50 beds, completed the construction of our joint venture hospital in Savannah, Georgia and continued the development of eight additional hospitals, all of which will help drive revenue and earnings growth into the future.

We also reduced our debt by $55.3 million, bringing our leverage to 4.3 times compared to 4.6 times at year end, paid a $0.23 per share cash dividend and repurchased 314,532 of common stock for approximately $11 million.

As we mentioned on our previous call, a major focus for the company in 2016 is to ensure we successfully integrate our three significant acquisitions. And I'm pleased to report, we made excellent progress with the integration of all three in the quarter. With respect to Encompass, our focus on

continuity of care resulted in a significant increase in the number of patients discharged from our hospitals and admitted to Encompass agencies.

In the first quarter, we had 2,918 home health admits from our hospitals, representing growth of 77% over Q1 2015, and 7% over Q4 2015. We continue to realize the benefits of this partnership and expect a steady increase in the number of patients being served by Encompass agencies throughout the remainder of the year. Encompass' integration of CareSouth also progressed nicely in the quarter. The planned system conversions, including transitioning the former CareSouth agencies to the Encompass home care, home-based platform, were completed successfully in the quarter.

Key leadership positions were filled, and these agencies began adopting Encompass' "Better Way to Care" operating philosophy and culture. The integration of the former Reliant hospitals is also on track. All of these hospitals are now using our internal management and reporting system and have adopted HealthSouth's paper clinical documentation platform, which will help ensure a smooth transition when they convert to our electronic clinical information system.

Four of these hospitals have already converted to this electronic system, and all will be converted by year end. From a teamwork's perspective, approximately 80% of the former Reliant hospitals completed the sales and marketing training in the quarter and began the patient experience training in March. New beds, new wheelchairs, and other equipment have been ordered and should be in place by Q3. Finally, we've made good progress on transitioning these hospitals to our staffing models and we expect this process to be complete in the second half of the year.

As a result of this strong start to the year, we are raising the bottom and top ends of our full-year guidance ranges as follows: we're increasing net operating revenues by $30 million to a range of $3.58 billion to $3.68 billion; we're increasing adjusted EBITDA by $5 million to a range of $770 million to $790 million; and we're increasing adjusted earnings per share by $0.05 to a range of $2.37 per share to $2.49 per share. Before I turn the agenda over to Doug, I want to note that effective June 1, we will no longer operate a hospital in Beaumont, Texas. The Beaumont hospital lease expired in April and the hospital is in the market we have determined to be non-strategic from an inpatient prospective. We sold the business to another operator who plans to run the hospital and retain a substantial number of the existing employees. Doug?

Douglas E. Coltharp, Chief Financial Officer & Executive Vice President

Thank you, Jay, and good morning, everyone. As Jay just outlined, we got off to a very solid start in 2016 with good performances in both of our business segments. The integration of Reliant and CareSouth tracked to plan during the quarter, we made continued progress on the clinical collaboration between our inpatient and home health service offerings. Our Q1 consolidated net operating revenues grew 22.8% over Q1 last year, driving a 23.1% increase in consolidated adjusted EBITDA. Adjusted free cash flow for Q1 of $129.5 million was up 63.1% over the same period in the prior year. Adjusted free cash flow for the first quarter benefited from timing issues that impacted maintenance CapEx, cash taxes and working capital.

We continue to expect adjusted free cash flow for 2016 to be in a range of $360 million to $445 million. Please refer to slide 19 of the supplemental slides for the key assumptions related to our full year 2016 adjusted free cash flow.

The continued strength of our free cash flow generation facilitated an approximately $55 million reduction in funded debt during the quarter, contributing to a 0.3 times reduction in our leverage ratio from year end 2015. As Jay mentioned, we ended Q1 with our leverage ratio at 4.3 times.

During the quarter, we completed the call of $50 million of our 7.75% senior notes due 2022, reducing the balance of those notes at quarter-end to approximately $126 million. We have subsequently issued a call on an additional $50 million of these notes and we'll complete that redemption in May. The interest

expense savings related to this incremental call has been incorporated into a revised adjusted EPS guidance that Jay just outlined a moment ago.

We also continued our strategy of augmenting the returns from our operating investments with shareholder distributions by paying a common dividend of approximately $21.3 million and repurchasing approximately $11 million of common stock. At the end of Q1, we had approximately $149 million remaining under our existing share repurchase authorization.

Adjusted EPS for Q1, $0.61, increased by 19.6% as higher adjusted EBITDA was partially offset by the increase in interest expense related to the acquisition funding for Reliant and CareSouth, and increased D&A resulting from recent acquisitions and capital investments.

Turning now to the business segment results and beginning with the IRF segment. Adjusted EBITDA for Q1 was $196.9 million, an increase of 19.8% over Q1 2015. The growth in adjusted EBITDA was driven by an 18.9% increase in net operating revenues, which resulted from discharge volume growth of 17% and a 1.3% increase in revenue per discharge.

We posted another strong quarter of same-store discharge growth at 2.8%. New store discharge growth included our 2015 acquisitions of Cardinal Hill and Reliant, our joint ventures in Savannah and Hot Springs, and our de novo in Franklin, Tennessee. Revenue per discharge was impacted by the ramp up of Franklin and Hot Springs.

As we have discussed on prior occasions as part of the Medicare certification process, new IRFs are required to treat 30 patients without compensation. Revenue per discharge for the quarter was also negatively impacted by a $1.8 million revenue reserve for post payment claims reviews. The majority of these claims relate to recent ZPIC and supplemental medical review contractor audits, which we view as is routine in nature and we do not currently expect these to become widespread. Our Q1 payer mix was consistent with that exhibited in the second half of 2015, and our average pace and acuity was comparable to the same period a year ago.

Bad debt expense for Q1 was 2.1% of net operating revenues, an increase of 40 basis points over Q1 2015. The rate of new prepayment claims denials was comparable to that we experienced in the second half of 2015, and there has been no tangible improvement in the backlog of claims in the adjudication process. Bad debt expense for Q1 was also impacted by an increase in our aging based reserve attributable to administrative payment delays at Cahaba, as well as continued payment delays from non-Medicare payors, which appear to be related to the adoption of ICD-10. The administrative delays at Cahaba have been documented on that company's website and is being attributable to issues such as staffing and training.

Although we are optimistic that this increase in our aging based reserve is simply a timing issue, we do not currently have sufficient information to make that determination. Q1 SWB was 49.4% of net operating revenues compared to 48.6% in Q1 2015. The increase in the SWB percentage was attributable to merit and benefit cost increases, as well as the previously discussed ramping up of new stores and the post payment claims review revenue reserve. The year-over-year increase in group medical expense for Q1 was in line with our expectations.

Other operating expenses for the quarter declined by 110 basis points from Q1 last year. Approximately half of this decrease was attributable to the inclusion of an approximately $4 million litigation settlement in the 2015 quarter, with the balance derived from operating leverage against the revenue increase. We also experienced 40 basis points of leverage in supplies during Q1, generating savings in areas such as generic drug utilization. Conversely, occupancy cost increased by 40 basis points due to the acquisition of Reliant.

Our home health and hospice segment posted another strong quarter with Q1 net operating revenues of $160.6 million, up 45.6% over Q1 last year and adjusted EBITDA of $22.6 million, up 33.7% over Q1 last

year. Revenue growth was driven by strong same-store and new store volume growth. Total admissions increased 56.1%, 12.6% on a same-store basis; and episodes increased 48.6%, 12.3% same-store basis.

Revenue per episode for the quarter decreased by 2.2%, owing largely to the Medicare price decrease effective on January 1, and the patient mix of the former CareSouth agencies. We currently have a home health presence at approximately 58% of our IRF markets.

As Jay mentioned in his remarks, we continue to make tangible progress in the clinical collaboration activities between our facility-based and our home-based service offerings. We believe this provision of a continuum of care results in better patient outcomes and satisfaction, as well as improved cost effectiveness.

And now we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Whit Mayo of Robert Baird.

<Q – Whit Mayo – Robert W. Baird & Co., Inc. (Broker)>: Hey, thanks. Good morning.

<A – Jay Grinney – HealthSouth Corp.>: Good morning.

<Q – Whit Mayo – Robert W. Baird & Co., Inc. (Broker)>: Doug, maybe just – hey, Jay. Maybe back on just the bad debt increase. I think I get it. It sounds like things just slowed with the ICD-10 conversion and you had just simple administrative delays impacting the adjudication process. But to me, it doesn't seem like the actual underlying collectability of the receivable has changed, this is just like timing or aging. So do you just have to add a reserve because this is strictly aging out? I guess I'm just trying to understand the issue a little bit more because it really seems more timing than an issue to me?

<A – Doug Coltharp – HealthSouth Corp.>: I think you've summarized it well, Whit. If you look at the portion of our bad debt expense attributable to the ADR activity that really was very consistent from a gross denials perspective with the level that we saw in Q3 and Q4 of 2015. So the increment that bumped us up over 2% was really that additional aging-based reserve. And as I mentioned, we do believe that that is a timing issue. It should reverse itself, but we don't have sufficient visibility. And so the addition of that aging-based reserve is really formulaic.

<Q – Whit Mayo – Robert W. Baird & Co., Inc. (Broker)>: Okay. And my second question just back on the clinical collaboration strategy with Encompass. It looks like about 11% of your total admission scheme from HealthSouth rehab hospitals, and that's meaningfully higher than where you were last year. Just curious what the recertification rate is on those patients. And presumably, you're somewhat bandwidth constrained to manage too much volume. But just any color around those trends and just so we can understand them better.

And just maybe one last one, just the 2.2% decline in revenue per episode; Just want to make sure that's mostly in line with expectations?

<A – Doug Coltharp – HealthSouth Corp.>: Yeah, so I'll address the second question first which is the 2.2% revenue per episode decline was in line with expectations. You've got, in addition to the Medicare pricing decrease that went in effect on January 1, which accounts for the lion's share of that. We knew coming in that there were two characteristics of the CareSouth patient fix – patient-mix that would weigh on that ratio. The first is that generally, they have addressed a lower acuity patient. We think over time, particularly in the more dense CareSouth markets, there is the opportunity to move that acuity up, but some of the markets in which CareSouth operates which are very favorable don't have the patient density to allow the average acuity to rise to the level that is exhibited across the Encompass platform.

And then the second thing there is the pay or mix is a little bit different. It's a little bit less heavily oriented towards Medicare. With regard to the recertification on those discharges coming out of HealthSouth, I don't have the specific statistic in front of me, but generally speaking, the reset rate is lower. You're obviously dealing with a patient that has come out, there's a more of a therapy orientation for those patients and there is a nursing orientation and the conditions that are being treated are less chronic resulting in lower recertifications.

Operator: Our next question comes from the line of Gary Lieberman of Wells Fargo.

<A – Doug Coltharp – HealthSouth Corp.>: Good morning, Gary.

<Q – Gary Lieberman – Wells Fargo Securities LLC>: Hey, how are you guys doing? Maybe just to follow up on the last question a little bit, if you're kind of in that 11 to low-teens percentage of the admits

coming out of the IRFs going to encompass where do you think you can get that to, and over what period of time?

<A – Doug Coltharp – HealthSouth Corp.>: Maybe trying to – that's come out of a couple of different ways on that Gary. I think this will triangulate on your question. First, I think it's important to look predominantly just at the Medicare discharges coming out of our IRFs and into the home health setting because, that's the prioritization that we've established, the Medicare beneficiary. And so, you look – if you look at Q1 2015, there were 14,909 Medicare discharges out of our IRFs that required home health care. We captured between Encompass and legacy home health agencies 1,652 of those. So, that was about an 11.1% capture rate. If you look at the same statistics for Q1 2016, there were 17,552 Medicare discharges from our IRF's required home health.

As Jay mentioned, we captured 2,918 of those in our home health business, which is a 16.6 rate. So that shows I think very tangible progress. In terms of where that can go, in the existing overlap markets, obviously, we'd like to see that percentage continue to increase. And as I mentioned in my remarks, we currently have an overlap situation in 58% of our IRF markets and we'd like to see that number continue to push north. Over which time that happens, it's really dependent on two things. Obviously, we think we can continue.

We think the pieces are in place in those 58% of the overlap markets to continue to demonstrate the value proposition of our two service offerings being coupled and therefore market share increases are readily available to us, in the markets where we don't currently have an overlap, we're going to have to find ways to gain a presence in those markets either by acquiring one-off agencies, something which you've seen as do over the course of the last five quarters, or in limited situations, we can actually open at De Novo.

<Q – Gary Lieberman – Wells Fargo Securities LLC>: Great. That's very helpful. And then for my follow-up, can you talk about the – any impact you're seeing from BPCI and CJR, even – either negatively in the IRF setting or positively in the home health segment?

<A – Mark Tarr – HealthSouth Corp.>: Hey Gary, its Mark Tarr. I would say that it's still early on. We are not seeing any definitive impact, either positive or negative from CJR or the BPCI bundling.

<Q – Gary Lieberman – Wells Fargo Securities LLC>: Okay. Great. Thanks very much.

Operator: Our next question comes from the line of Sheryl Skolnick of Mizuho.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Thank you. I'm sort of confused, because it sounds like – I think based on – well, let me start off over. First of all, good job. Second, now I'm confused. This was really a great quarter; it's nice to see you guys back in business. But I want to parse out a couple of things. First of all, I'm little bit confused between the numbers that Doug just gave us about the capture in the home health agencies and 2,900 versus the 250 number that we were given earlier on. So, I'll ask you to please set me straight on that.

And then the second question is, where did these patients go before? Is it just simply that they went to competitive agencies? Did they go to a different setting? I suspect there's some substitution of high-skill home health for institutions here. So, if anything, HealthSouth is doing its own little bundling, just based on the conversation I had with Crissy about this. And so I'd like you to please expand on that. Those were the two confusing points.

And then the other thing I'd ask you to parse out is, I know you've said that the transition of the Reliant, especially the Reliant facilities to the CareSouth model, would take time this year. It sounds like you're making good progress. And you've said that it's on plan, but can you give us an underlying sense of that's on plan. Can you give us an underlying sense of how the same-store is performing? So this is part two of the question I asked you last quarter. Tell us about the growth characteristics, if you will, same-store base in terms of margin improvement, et cetera, please?

<A – Doug Coltharp – HealthSouth Corp.>: Sheryl, on the second question, are you referring to – because you mentioned CareSouth and Reliant, you are talking about Health...

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Reliant, I'm talking about the IRF. Thank you.

<A – Doug Coltharp – HealthSouth Corp.>: Okay. Okay.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Thank you. Sorry.

<A – Doug Coltharp – HealthSouth Corp.>: Okay. So on the Reliant transition, as we mentioned, that is going very nicely. It's very much on track with all of the changes that we had contemplated. And our same-store business is also, as you noted, with the 2.8% volume growth, is also doing exceedingly well. And if your question, where these patients went before, if that was related to the IRF segment, I think that the answer to that is what we have answered in the past, which is, a lot of those patients were going to competing IRFs, some of those patients were going into skilled nursing. And as you know, there's a very dynamic process in every market, a patient that is admitted into an acute care hospital that needs post-acute care could conceivably go to a number of different settings based on their acuity, on the physician's desire for either intensive therapy or non-intensive therapy, whether or not the patient can be treated on a high-quality basis at home.

So, in a sense, post-acute patients remain very much a jump ball in terms of the discharge process. Now to the extent that we are able to get into markets and have markets where we have the IRF and the home health, yes, we are in a sense bundling that capability and marketing that bundled capability, if you will, to the acute care discharge planner or to the acute care discharging physician to the families, and to the patients.

So, you're correct that, in a sense, and we said this was our strategy all along. We didn't want to just to be a facility-based post-acute provider. We also wanted to have that home-based care, so we could provide a full continuum. We now are able to do that in almost 60% of our markets and that gives us to the opportunity to then go to the acute care hospitals, the physicians, the care managers, et cetera, and to basically sell the value of that service. So, I don't know if that answers that part of the question.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Yeah, it does. And because it sounded to me like there had to be some substitution of, you're now taking control over this patient in some regard or highly influential. And it sounded to me as if you were taking some share of this post-acute market away from skilled nursing, that it wasn't just that you were no longer referring to an unrelated agency.

<A – Doug Coltharp – HealthSouth Corp.>: I think that's fair. No, I think that's very fair. I mean, clearly there aren't data sources out there that can confirm that, but we do believe that that change is occurring. And what we've said for quite a while is that we think that as this delivery system evolves, the service that is at highest risk, frankly, is going to be the skilled nursing, because a lot of that care can be provided at home, some of that therapy care can be – in fact, a lot of it, we believe can be treated more effectively in an IRF setting. And when the IRF is coupled with the home health that is a very strong value proposition. And in fact, as we are in the CJR markets, we're working on some models that – with some of our hospitals about getting in there and looking at ways to absorb some of that risk and set ourselves up as a preferred post-acute provider.

As you know, there are a lot of legal issues that we have to kind of sort through, but we're finding a receptive audience within the acute care hospital segment on that whole notion that IRF plus home health is a better deal for them financially, for the patients from a quality standpoint, and from a readmission rate perspective, et cetera, than other alternatives that may be available to them.

<A – Jay Grinney – HealthSouth Corp.>: Sheryl, let me try to resolve the confusion regarding the home health capture statistics. And I think much of this really results from the fact that we operate Encompass as a joint venture relationship. We think it's a partnership that is particularly effective in terms of

maintaining a degree of independence and ownership with that management team. We've talked about that unique structure before.

And as a result, when you ask Encompass about the year-over-year change in capture rate, they point to the discharges they were capturing from the IRFs in legacy Encompass issues in quarter one of last year versus this year. And the big difference between the two is that you may recall that we had 25 legacy HealthSouth hospital-based home health agencies. And we integrated those on to the Encompass platform, but that integration was not complete; for the most part, most of those moved over in the third quarter of last year. So when Encompass looks at its legacy agencies, it captured 257 discharges from HealthSouth IRFs in the first quarter of last year. We had an additional 1,395 that were captured by our legacy HealthSouth home health agencies. Those are now have been – those have now been folded into the Encompass platform. But we think, in terms of assessing the true year-over-year progress and patients moving from our IRFs to home health, we have to combine the two.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: ...denominator. Yep. Okay.

<A – Jay Grinney – HealthSouth Corp.>: And that gets to the statistics that we pointed to before, and I apologize for any confusion. I think on a go-forward basis we'll make sure that we're always lining those up on an apples-to-apples basis.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Yeah, that'd be very helpful. And I think, I think...

<A – Doug Coltharp – HealthSouth Corp.>: And when we get through 2016, all that becomes a moot point.
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<A – Jay Grinney – HealthSouth Corp.>: Really by the time we moved through the third quarter, because that most of the agencies will have moved over, so that's – we had a perhaps a little of internal Georgian mixed up with the external and we apologize for that confusion.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: No problem.

<A – Jay Grinney – HealthSouth Corp.>: The second, the final question, I think you had was just, if we look at the IRF segment EBITDA margin improvement, can we say that there was margin improvement on same-store basis, and I think the answer is yes, again, the discharge volume was up there, 2.8%. We had the pricing increase of 1.3%. Although the Reliant hospitals had historically operated at higher EBITDA margin, that margin was coming down based on the staffing and other changes that we're making through the course of quarter. It was still accretive to the margin, but I think if you back into the math, you find that there was not sufficient accretion just from adding in the Reliant hospitals to account for the full differential.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Great. Okay. Perfect. Thank you.

Operator: Our next question comes from the line of John Ransom, Raymond James.

<Q – John Ransom – Raymond James & Associates, Inc.>: Hi, just a couple. The first question is, if you look at the strong volume growth in your home health business, is there any particular mix of patients that you're seeing today that you are seeing a year ago, or is it just as you mentioned before, market share gains and the mix of patients looks like the same as always did?

<A – Jay Grinney – HealthSouth Corp.>: I think it's the – clearly, it's the market share gains that is driving a lot of that volume growth. As you know, Encompass has the clinical specialty programs, they have the care transition team coordinators that are very integral in, A, capturing the higher acuity patients, and B, ensuring that the transition from the acute care hospital or from the IRF into their agencies is smooth and is planned well in advance to ensure a safe outcome when the patient is in their care. So, I think that that's a big driver. And then clearly, those patients that are coming out of our hospitals tend to

be more therapy oriented. And so, that if you're looking just at the overall mix, there is an uptick in the therapy visits and that's driven in large part by the fact that many of those incremental patients that they're seeing are coming from our IRFs.

<Q – John Ransom – Raymond James & Associates, Inc.>: Okay. And then, just the obvious, a follow-up question for Doug. The quarter was better than the Street thought, but you only raised guidance, in essence, by the beat. Is there any reason for that the people have the seasonality off or it's just conservatism or anything what you think about in the out quarters from a new standpoint?

<A – Jay Grinney – HealthSouth Corp.>: I think, generally speaking, John, it probably falls in to latter category although, I would point to three specific things that we are keeping an eye on, first is, we've enjoyed five consecutive quarters at least of very solid volume growth on the IRF side, but we never take that for granted, that's a hand-to-hand combat on a hospital-by-hospital basis on a daily basis.

So we always try to be somewhat guarded with regard to our expectations on continued volume increases. The second, and it's a question that Whit had raised earlier on, which is we saw this increase in bad debt. We think that there's a portion of that that is timing related but you just never know right now and we don't have enough evidence to suggest that that reverses itself during the course of this year, if at all. And then the third thing is that although group medical for the first quarter was in line with our expectations having experienced the unpleasant volatility in that expense item that we did last year, we don't want to get in front of our skies and say, okay, well the trend is -- has leveled and we don't have any further concerns there.

<A – Doug Coltharp – HealthSouth Corp.>: Hey, John, the other thing I might just note, is we've never increased guidance after the first quarter. Typically, in the past, we've taken an ultra-conservative view. We still think that we're conservative in our guidance. We believe that our responsibility is to provide guidance that shareholders can depend on. Clearly, 2015 was a little bit challenging in that respect because of one-time issues, that we have to deal with.

But this is new for us, to put this out in Ray's guidance after just one quarter. And I think that, that should send the signal to shareholders about the confidence level that we have, that we're back on track.

<Q – John Ransom – Raymond James & Associates, Inc.>: Great. Thanks so much.

<A – Doug Coltharp – HealthSouth Corp.>: Yeah.

Operator: Our next question comes from the line of Josh Raskin of Barclays.

<Q – Josh Raskin – Barclays Capital, Inc.>: Hi, thanks. I want to go over the IRF referrals to home health just one more time. The 58% of your IRFs that are covered, I guess the first question is, where you – I assume there are some markets, where they just simply not feasible, maybe it's dominated by a local carrier in the acquisition when work, et cetera. But where do you think that 58% can go? And then, if you look across all of your home health agencies, is there a one specific one, where you could sort of give us okay what's the max referral, just sort of what's the upper limit on that threshold?

<A – Jay Grinney – HealthSouth Corp.>: Yeah, I don't know that we have a max that we'd be able to look at one agency. I will tell you that the long-term goal would be to have home health in every market where we have in IRF. Now, there's a way to go and we are clearly going to be looking at acquiring that incremental home health capacity through Encompass, but that certainly is the long-term goal. Now, from a practical standpoint, there may be some markets where it's going to take five years, 10 years to get there. Others, it may take one year to three years, but the development pipeline within Encompass is focused on the overlap markets that don't have a home health presence today, and to establish a home health presence through an acquisition.

<A – Doug Coltharp – HealthSouth Corp.>: We have a very limited number that I don't have the count in front of me, Josh. But, we have a very limited number of JV markets, where part of our agreement with

the JV operator is to the extent that they own and operate their own home health business, that we won't put up a competing agency, but that's a very small number.

<Q – Josh Raskin – Barclays Capital, Inc.>: Okay. So, it could be let's call, majority. And then, I know, it's a strange metric, but it's your way to look at the same-store home health volumes excluding the HealthSouth preferred sort of, the isolate just a base business. What's that doing if you sort of take out the benefit that you're getting from running these two businesses together?

<A – Doug Coltharp – HealthSouth Corp.>: I mean, clearly that math is available to us. I don't know that it would necessarily give you a more accurate read of what the base business is doing because part of the way that we're capturing these discharges is that Encompass has deliberately focused resources that could otherwise be focused on other referral sources on the care coordination in our markets. So, I don't think it would be fair to simply take those out and say, that's the run rate that would exist – would have existed if not for the partnership.

<Q – Josh Raskin – Barclays Capital, Inc.>: Okay.

<A – Jay Grinney – HealthSouth Corp.>: And also I think it's important to remember, it's not as if we are able to dictate where that patient goes in terms of home health services, I mean we've to earn Encompass has to be there earning that business and persuading the physician, persuading the patient, persuading the family that the care that they can provide is superior to care that they would receive in other home health agencies. So I do think that the – we – like Doug said, yeah, you can do the math, but we don't believe that that really is a meaningful metric, because of the dynamic that we just described.

<Q – Josh Raskin – Barclays Capital, Inc.>: That's fair, I don't think of it like that, so that makes sense. And then, I guess, the last question, just on – the BPCI and bundles and ACOs, in general. I know, it's still early, but are you getting the incoming calls from hospitals and from other – from bundlers in terms of working together and how do we create sort of networks and cost savings, et cetera. Are those conversations even happening?

<A – Doug Coltharp – HealthSouth Corp.>: Conversations that we're having are typically within markets with the acute care hospitals. Are we getting calls from some of the conveners? Yes. It's really very sort of amorphous as to what value they would bring to the equation, especially in the CJR markets when the relationship is already established with the acute care hospital.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. Just as a reminder on BPCI, we have eight of our hospitals are participating in Model 3 bundling. And we have approximately 25 of our hospitals are participating in Model 2 bundling with acute care systems.

<Q – Josh Raskin – Barclays Capital, Inc.>: Okay. Thank you.

<Q>: [indiscernible] (42:44) blah, blah, blah.

<A – Jay Grinney – HealthSouth Corp.>: Somebody was – we overheard something going blah, blah, blah. I'm not sure if that was in reference to us or what was going on in their office, but...

<Q – Josh Raskin – Barclays Capital, Inc.>: Hopefully, not my line. Yeah.

<A – Jay Grinney – HealthSouth Corp.>: Yeah.

<Q – Josh Raskin – Barclays Capital, Inc.>: All right. Thank you.

Operator: Our next question comes from the line of A.J. Rice of UBS.

<A – Jay Grinney – HealthSouth Corp.>: Good morning, A. J.

<Q – A.J. Rice – UBS Securities LLC>: Hi. Hello, everybody. Maybe I'll switch gears. Just give us your updated thoughts on capital deployment. Obviously, good free cash flow in the quarter and reiterating your guidance for the year. You've moderated a little bit on your pace of share repurchases, I just – this quarter, is there other priorities that are coming to the fore? Give us a flavor on that.

<A – Doug Coltharp – HealthSouth Corp.>: Yeah, A. J., I think what we demonstrated in the quarter is that, for us with free cash flow allocation, we're in the enviable position of being able to say and versus or. So we were able to put share repurchase together with the dividend and provide some meaningful returns to our shareholders at the same time that we reduced our funded debt by $55 million and made very significant progress towards our target of reducing leverage below four times by the end of the year.

I think as we progress through the balance of the year, and I do want to remind everybody on the call that as I stated in my comments, we benefited in Q1 from some timing issues. And so even though we had a very strong quarter, some of those timing issues will reverse over the next three quarters. Free cash flow is going to remain very strong, but at a lower level than we saw in the first quarter.

I would expect that you will see the same kind of balance with regard to allocation beyond the capital that's being invested in our growth initiatives; I would expect that you would see a similar balance between shareholder distributions and debt repayment. And obviously, as again I mentioned in my comments, we've already got the $50 million incremental columns, 7.75% notes pending, and we'll fund that redemption in May of this year.

<Q – A.J. Rice – UBS Securities LLC>: Okay. And then maybe just can you update us on what you're seeing at the labor market, tightness of the labor market both for the home health and the IRF side, therapists, aides, nurses and so forth? And what's happening on productivity and turnover and those types of things?

<A – Mark Tarr – HealthSouth Corp.>: Yeah. A. J., this is Mark. I can tell you from a hospital perspective we're seeing about what we expected. There are certain markets where we've had to go in and make some market adjustments. We're seeing it particularly for nurses. We're not seeing it so much for therapists at this point, although we're always conscious of that. We've not seen a widespread, across-the-board, upward pressure on staffing at this point. It's been very market specific with regard to turnover. You've heard us talk in the past, it's a big focus for us. Our turnover right now on nursing has been right at industry standard, around 19% on a year-to-date basis. And our therapy is significantly lower than the market. And I think we're somewhere around 6% on therapy. So it's extremely low.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. And if you looked at the – A. J., if you peel back the nursing turnover and you took one region that is skewing that a little bit, that's our Northeast region. If you looked at the nursing turnover, exclusive of that region, it would actually be quite a bit lower than that 19%.

<Q – A.J. Rice – UBS Securities LLC>: Okay.

<A – Jay Grinney – HealthSouth Corp.>: In the home health, in talking with April Anthony and her team over there, they are not seeing any change in the underlying labor dynamics in terms of availability of quality people. They're certainly not seeing any increase in the turnover. One of the things that was very appealing to us as we establish our partnership with Encompass was the fact that they have a very strong culture, that is a culture that is seen as highly desirable for individuals who've chosen home health as their career path. And so they don't have a situation where they're struggling to find people. And in fact, it's just the opposite. They're really being more selective in making sure they get the right individuals in who are willing to adopt that better-way-to-care culture. And it's something that is real attribute of that company and one of the real strong reasons we were so interested in establishing a partnership with them.

<Q – A.J. Rice – UBS Securities LLC>: Okay, great. Thanks a lot.

Operator: Our next question comes from the line of Chris Rigg of Susquehanna Financial.

<A – Jay Grinney – HealthSouth Corp.>: Good morning, Chris.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Good morning. And I hopped on a little bit late so hopefully you didn't touch on this yet. But when we think about the same store discharge growth in the rehab segment, do you think at this point you're actually taking share from your competitors, or should we think about that growth as just the volume strength and referral sources? And then in that context, do you think the leap year had any kind of impact on the quarter? Thanks.

<A – Jay Grinney – HealthSouth Corp.>: Yeah I think we are taking market share. And we did touch on this in response to a previous question. I think as everybody knows, as a patient is getting ready to be discharge from an acute care hospital, there's a lot of discretion with respect to where that patient might go, the therapy level that is required, the judgment of what provider could provide the best care. And I think that our ability to demonstrate to the physicians and to the care managers, to the patients, to the family members, the efficacy of our care in our hospitals is helping to shift that market share. And I think that that is probably the biggest driver, although we just don't have any real good data sources that everybody can look at and know with certainty where the market share gains are coming from. But we do think that the quality of our care is a significant contributor to that market share shift.

<A – Doug Coltharp – HealthSouth Corp.>: We also believe, as we pointed out for a while, that we benefit from the underlying demographic trends. And specifically, the growth in the portion of the population that is above 65. But with regard to your second question, Chris, the impact of leap year, it's always difficult to quantify that specifically as we did last time around when we triangulated on a number of ways. The best estimate we can give you is that it was probably beneficial to the extent of maybe 80 basis points to 100 basis points.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Okay. And just to clarify that last point, so it was 2.8% you're saying it's roughly 1.8% to 2% without leap year?

<A – Doug Coltharp – HealthSouth Corp.>: Yeah, I think that's a reasonable estimate.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Okay, great. Thanks, guys.

Operator: Our next question comes from the line of Sheryl Skolnick of Mizuho.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Hi. Thanks for letting me back into the queue. So let me ask a question that was actually asked of me and I just want to validate a couple of numbers with you and then follow up with a completely unrelated question. So, prepare.

First of all, as you were talking about the value proposition of a combined episode of IRF plus home health versus discharge to skilled nursing, which may or may not be followed up by at least one episode of home healthcare. Just walking through the math there for a second on how much you estimate within the HealthSouth/Encompass continuum that average episode would cost versus how much that average episode would cost and if the patient's discharged to skilled nursing? Or if it's easier for you, I'll give you some numbers to start off with. I'm happy to do that.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. I mean, I don't have, right now, what that would look like, because what we don't have in all of the calculation is that readmission factor coming out of the SNFs and the IRFs.

<A – Doug Coltharp – HealthSouth Corp.>: Also, it's going to vary based on the type of patient, because based on the conditions that present themselves for a patient admitted to one of our facilities, that's going to impact the payment per discharge. It's also going to impact length of stay.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Sure.

<A – Doug Coltharp – HealthSouth Corp.>: And then by the same token, if that patient were able to bypass the IRF setting, and I think that's a big if because one of the reasons that they're qualifying for medical necessity criteria is because they require hospital-level care on an inpatient setting, which is not available in the SNF setting. But if it were a patient that can serve in either one, we have to know the average length of stay, not just for SNFs in general but for that type of patient. And then we also have to know what the incidence of healthcare is. How many episodes do they need? What's the level of nursing that they require? And then the final piece that Jay mentioned is understanding what the readmission rate is that both entities are experiencing.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Okay.

<A – Doug Coltharp – HealthSouth Corp.>: And we think that that is going to be data and those economic comparisons are going to be very important to draw in the future. It's going to require all parties to have access to equal information.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: All right. I don't doubt it. So here's some quick math that I did. Your average revenue per episode is $17,500, your average revenue per discharge for HealthSouth is $17,500, for Encompass is roughly $3,000. So that's $20,500 in rough numbers, okay? And I'm going to assume that that's probably close to your historic 13-day length of stay, and any patient may be higher or lower acuity than the average, we understand that.

And then if you figure that your patients are pretty acute and they might require 28 days of benefit in a skilled nursing facility, and I can't imagine a skilled nursing facility discharging before that, to tell you the truth, unless it's a managed care patient and we're not talking about that. So let's just say that the cost range runs from $500 to $900, we'll call it $650. That's $18,200. So at $1,350 a day, let's just say you reduced your length of stay by one day, you would be essentially in line with the cost of just the SNF payment, never mind if they needed additional care after that.

And even assuming 28 days they don't needed additional care, if you can prove better outcome with your combination that the patients don't bounce back, it's a no-brainer. You cut your length of stay by one day, you become more effective and efficient, you're discharged to your own home health partner, and there you've got a real value proposition. It just seems to me that the math is that easy.

<A – Jay Grinney – HealthSouth Corp.>: I don't disagree with you on that, Sheryl. The one thing is we could cut our length of stay by a day, but it doesn't change – under the current payment system, it doesn't change the $17,500. We don't get paid on a per-day basis.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Yeah. I understand that. But under bundled payments, there's going to be some, right?

<A – Jay Grinney – HealthSouth Corp.>: Absolutely. If we get that kind of relief, we think we'll win all day along because the reduction in length of stay could be greater than a day, and then you might see more than a single episode on the home health side, but that the shifts between those two would work...

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Especially if the home health acuity goes up to compensate. Those last couple of days the patient might do just as well in the high acuity home health setting. I don't want to suggest that the patient shouldn't be in for the full length of stay, just that they might be able to do just as well on a high acuity setting.

<A – Mark Tarr – HealthSouth Corp.>: Yeah. And what we're doing now is putting together a model that would allow us to go to the acute care hospitals. And in a preferred provider type of arrangement, establish that we will take that risk, if you will, that CJR risk for post acute care off of their shoulders and absorb that ourselves and then we would manage that care with Encompass as our home health provider to actually lower the cost that they would otherwise be encumbered with their target.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Right. And that's what makes sense. Now the data was, where I was going to go, allow me to ask this one other question because this is all about the data. So we recently learned that one of the most significant participants in the hospital industry has a very Big Data initiative. And within the four virtual and physical walls of their entity, which again is large, they have a ton of clinical data and they have a ton of encounter data and they have a lot of which is natural language and some of which is structured.

So they've got a tremendous amount of data, but the one piece they don't have is the post acute data. So, you guys, years ago, very smart implemented an HER. You guys have a ton of data. Are you doing anything to partner with others based on the data as you suggested that you might, including making it available for identification, alteration and prediction of best practices in the IRFs as well as before discharge in the hospital?

<A – Jay Grinney – HealthSouth Corp.>: What we are doing is using that data to predict and to use the analytics to predict things like acute care transfers, patients that are starting to digress and who need intervention, who are using it for medication reconciliation matters. We're also utilizing that as we work on protocols with Encompass. And so what we are doing is we're using the data internally. We're starting to use that data literally this year, a little bit starting last year. What we're not doing yet is using that data proactively with acute care hospitals, except those who are referring patients to us where we can then use the information to help the acute care hospitals see the value of admitting patients to our facilities.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Got it.

<A – Jay Grinney – HealthSouth Corp.>: But I think the point that you're making here is we have an asset that we invested in several years ago in our clinical information system, and we said when we made that decision that we believed it would help differentiate us going forward. We're at the point now where we have – maybe 70%, 75% of our hospitals are on ASIP. So we now are at the point, especially with our partner at Encompass, of looking at how do we use this, A, to improve patient outcomes, and B, to enhance our marketability in this evolving delivery system. And we believe that the investment that we made is going to allow us to do just that.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Right.

<A – Jay Grinney – HealthSouth Corp.>: So we're starting that literally this year going down those paths of using the data, A, internally, and then B, looking at how we can use that with respect to partnerships or with respect to our referral relationships.

<A – Doug Coltharp – HealthSouth Corp.>: We are also beginning the process of trying to determine whether or not we have the resources available to be able to fully develop and analyze the data on which we sit, or whether or not we need an outside vendor to help us through the assimilation of that data.

<A – Jay Grinney – HealthSouth Corp.>: And the good news is on the internal work, that's all being done on a real time basis. So we don't believe we need anybody to come in and help us with that. We've got dedicated resources looking at establishing the predictive models on the acute care transfers and so on. But when you're getting out into managing populations or managing particular diagnoses or cases, then we may want to tap into some additional resources.

<Q – Sheryl Skolnick – Mizuho Securities USA, Inc.>: Perfect. Thank you so much. I really appreciate this.

<A – Jay Grinney – HealthSouth Corp.>: Yeah.

Operator: Our final question comes from the line of Kevin Fischbeck of Bank of America.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Good morning. This is actually Joanna Gajuk joining in for Kevin today. Thanks for taking my question here. I don't want to take up much more time. In

terms of just clarification here on your commentary around not seeing very much of a labor cost pressure. So can just maybe break out or break down why we've seen as that will be increasing year-over-year. I guess, you mentioned typical payroll tax increases and what not, but is there anything else we should be thinking about in terms of any seasonality or anything that just happened this quarter?

<A – Doug Coltharp – HealthSouth Corp.>: Hey, Joanne, it's Doug. Let me see if I can give you a bridge on the SWB increase in the IRF segment on a quarter-over-quarter basis. So you had about 50 basis points to the increase that we would ascribe to the combination of both the merit increase and the benefits cost increase. And the most significant piece of the benefits cost increase was the group medical. Now I'll remind you that we had put out a consideration for the full year that we anticipated group medical cost in 2016 to be 5% to 10% higher than it was last year. But remember, that's not necessarily going to be evenly – the impact to that is not going to be evenly distributed through the quarters. And that's because it was in Q2 of last year that we began increasing the accrual. So if you will, the percentage increase in terms of the catch-up basis was higher in Q1 than we would expect it to be over the balance of the year.

It was another 30 basis points that is attributable to the impact of new stores. And you had two countervailing things happen here. First is the ramp up of Franklin and Hot Springs was responsible for about 50 basis points of the increase in SWB, but that was offset by about 20 basis points from the impact of adding in Reliant. And I know that can sound a little bit confusing because we said we're adding staffing at Reliant, and we are. So on a year-over-year basis, Reliant's SWB as a percentage of its revenue is going up, but it had started at a level significantly lower than our legacy HealthSouth hospitals. And so even as it moved up in this quarter, it was accretive to the SWB.

And then the final piece of the bridge would be roughly 10 basis points that results from that post-payment, that $1.8 million post payment reserve against revenue that I mentioned during my comments. I think those are the main pieces.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Great. Now this is actually helpful. Thank you. And just the last quick one on the free cash flow outlook, the part of that that you're not changing but you're changing your EBITDA and EPS. So anything there in terms of maybe pushing out the CapEx to next year or anything in terms of timing wise?

<A – Doug Coltharp – HealthSouth Corp.>: Not in next year, we did – in the first quarter, we had some timing issues that impacted both our spend on de novos and more significantly our maintenance CapEx. But we believe that those timing issues will reverse themselves in the course of the year as opposed to moving from 2016 to 2017. So our assumptions – and again, we point to the supplemental slide. Slide 19 is one of those. Our assumptions really haven't changed in terms of the full year cash flow considerations.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Great. Thank you. That's all from me. Thank you.

Operator: That was our final question. I would now like to turn the floor back over to Crissy Carlisle for any additional or closing remarks.

Crissy Buchanan Carlisle, Chief Investor Relations Officer

Thank you. If anyone has additional questions, I will be available later today and tomorrow. Please call me at 205-970-5860. Thank you again for joining today's call.

Operator: Thank you, ladies and gentlemen. This does conclude HealthSouth's first quarter 2016 earnings conference call. You may now disconnect.