Operator: Good morning, everyone, and welcome to the HealthSouth's Third Quarter 2010 Earnings Conference Call. At this time, I would like to welcome everyone to the call and inform all participants that their lines will be in listen-only mode. After the speakers' remarks, there will be a question and answer period. [Operator Instructions] Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

I'd now like to turn the call over to Ms. Mary Ann Arico, Chief Investor Relations Officer. Please go ahead ma'am.

Please go ahead ma'am.

Mary Ann Arico, Chief Investor Relations Officer

Thank you, Christie and good morning everyone. Thank you for joining us today for the HealthSouth third quarter 2010 earnings call. With me on the call in Birmingham today are: Jay Grinney, President and Chief Executive Officer; Doug Coltharp, Executive Vice President and Chief Financial Officer; Mark Tarr, Executive Vice President of Operations; John Whittington, our Executive Vice President and General Counsel and Secretary; Andy Price, Senior Vice President and Chief Accounting Officer; Ed Fay, Senior Vice President and Treasurer; and Julie Duck, Vice President of Financial Operations.

Before we begin, if you do not already have a copy, the press release, financial statement, the related 8-K filing with the SEC, and the supplemental slides are available on our newly redesigned website at www.healthsouth.com.

Moving to slide one, the Safe Harbor. During the call, we will make forward-looking statements which are subject to risks and uncertainties, many of which are beyond our control. Certain risks, uncertainties, and other factors that could cause actual results to differ materially from management's projections, forecasts, estimates, and expectations are discussed in the company's Form 10-Q for the third quarter 2010, which will be filed in the next few days, and its previously filed Form 10-Q for the first and second quarter of 2010, the Form 10-K for 2009 and other SEC filings. We encourage you to read them.

You are cautioned not to place undue reliance on the estimates, projections, guidance and other forward-looking information presented. Statements made throughout the presentation are based on current estimates of future events and speak only as of today. The company does not undertake a duty to update or correct 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 or at the end of the related press release, both of which are available on our website and in part of the Form 8-K filed this morning with the SEC.

Before I turn it over to Jay, I would like to remind you that we will adhere to the one question and one follow-up question rule to allow everyone to submit a question.

And with that, I will turn the call over to Jay.

Jay Grinney, President and Chief Executive Officer

Great, thank you Mary Ann and good morning everyone. The third quarter again demonstrated the fundamental strength of HealthSouth's business model. Compared to last year's third quarter, revenues increased 4.3%, adjusted consolidated EBITDA increased 4.8% and adjusted income from continuing operations increased 9.1%. Discharges, placing and labor costs for the quarter were inline

with expectations, while the continued investment in TeamWorks and higher professional liability accruals were offset by better than anticipated bad debt expense.

The quarter also was a good one from a development standpoint. Our new 25-bed hospital in Bristol, Virginia began accepting patients in early August and this new hospital is across the state line from our Kingsport, Tennessee facility and expands HealthSouth's presence in that combined market.

On September 20th, we closed a previously announced acquisition of a 50-bed hospital in Sugar Land, Texas and on September 30th, we acquired a 30-bed unit in Ft. Smith, Arkansas and consolidated it with our existing hospital in that market. These transactions bring to six, the number of inpatient rehabilitation facilities we've opened or purchased thus far in 2010. Most importantly for the quarter was the fact that we continued to generate strong adjusted free cash flow. The $63.6 million we produced was $4 million higher sequentially and brings the year-to-date total to $172.2 million. Just $1.4 million shy of what we generated in all of 2009.

Finally, as everyone knows we initiated a very successful refinancing of our term loans and revolver in the quarter while securing across the board upgrades from the rating agencies. This refinancing provides a clear path for the repayment of our 10.75 senior notes that are initially callable in June of 2011.

With these highlights in mind Doug will now provide a thorough review of the quarter.

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

Thanks Jay and good morning everyone. I'll attempt and provide some further detail on our operating performance for the quarter and will also discuss the capital structure transactions we completed earlier this month. As Jay stated we had another very solid quarter. Our consolidated net operating revenues grew by 4.3% to 490.7 million driven by both pricing and volume increases. Our inpatient revenues for the quarter were up 5.3%, comprised of 2.5% increase in discharges and a 2.7% increase in net patient revenue per discharge.

Discharge growth was a result of 0.4% same store sales increase and the addition of new hospitals. Improving pricing was driven by the 2.25% Medicare market basket update and increases in our managed care prices. As anticipated the rise in inpatient revenues was partially offset by 5.6% decline in outpatient and other revenues largely attributable to operation of nine fewer satellite clinics in the third quarter of this year versus the third quarter of 2009. As we have previously stated, the outpatient clinics are not a core business for HealthSouth and we will continue to closely monitor the performance of our remaining 35 clinics and where appropriate move to close additional units. I'll also remind you that, as previously disclosed beginning in 2011, our outpatient revenues will be negatively impacted by reductions to our reimbursement under the physician fee schedule for multiple therapy services.

Based on the current composition of our business, we anticipate this new rule could impact our outpatient revenues by approximately $1 million per quarter beginning in 2011.

We continued to exhibit disciplined expense management during the quarter. In line with our expectations, salaries and benefits increased 5.3% and rose to 50.2% of revenue as compared to 49.7% in Q3 of 2009. Approximately, 20 basis points of the decline in operating leverage within salaries and benefits resulted from the ramp up phase of newly acquired or opened hospitals. Typically, it takes several months for new hospital to achieve its run rate occupancy, but the hospital is at or near full staffing during this period. We expect the productivity from these new hospitals to improve in Q4.

The balance of the decline in operating leverage within salaries and benefits was attributable to the increase in our mix of licensed staff related to the adoption of the new CMS patient coverage rules at the beginning of the year and this aforementioned decline in outpatient revenues. Our primary measure

of labor productivity, employees per occupied bed or EPOB declined modestly to 3.57 from 3.58 in Q3 last year despite of the impact of the new hospitals.

Our hospital related expenses increased by 1.3% during Q3 generating 70 basis points of operating leverage. Bad debt expense fell to 0.9% from 1.7% in Q3 2009. As you recall from our comments last quarter we were anticipating bad debt expense for the quarter to approximate the same rate as last year is predominately on the resumption of medical necessity claim reviews or our largest fiscal intermediary beginning in the second quarter of 2010. We did not see the expected buildup of the denied claims during Q3 and continued to recover previously denied claims which had been written off. Recovery of these claims was augmented by our enhanced processes around the recovery and capture of medicare related bad debts during Q3. We expect the level of recoveries against previously denied claims to diminish Q4 as this bucket of claim shrinks and further anticipate that the normal claims denied beginning in Q2 with the resumption of the medical necessity reviews combined because of our bad debt expense to trend in the 1.5% range for Q4. The improvements of hospital related expenses attributable to bad debt was partially offset by our continued investment in TeamWorks and by an increase in our professional and general liability reserve.

Expenses related to the Care Management module of our TeamWorks initiative approximated $770,000 during Q3 as we progressed into the piloting phase. We increased our professional and general liability insurance reserve accrual by $1.5 million over Q3 2009 based on our observations regarding recent claims history. It remains our practice to update our actuarial estimates of future liabilities in June and December of each year.

Our G&A expenses which do not include stock-based compensation for Q3 fell by $1.1 million from the same period last year adding 40 basis points to our operating leverage. This reduction is attributable to a year-over-year reduction in the bonus accrual. The growth in our revenues combined with our vigilant expense management allowed us to increase adjusted consolidated EBITDA by 4.8% to $100.5 million for Q3. The adjusted consolidated EBITDA is net of a $2.1 million increase in the earnings attributable to our non controlling interest.

This increase was attributable to discharge growth at our joint venture structured hospitals, as well as the conversion of our Altoona, Pennsylvania hospital to a JV in the fourth quarter of last year. These are positive developments which from an accounting perspective serve to mute the increase in EBITDA generated by the portfolio of hospitals we manage. For the first nine months of 2010 adjusted consolidated EBITDA increased 7.7% to $310.6 million.

Interest expense for the third quarter rose approximately $1.3 million over the same period last year as a result of higher average rates partially offset by lower average debt levels. Income tax expense associated with the current period decreased by approximately $1 million during the third quarter as compared to the prior year primarily due to a decrease in our accrual or alternative minimum tax related to recent changes in the tax law. We expect this legislative change to reduce our estimated cash pay for taxes by approximately $1-$2 million per year.

Adjusted income from continuing operations of $46.7 million was 9.1% higher than the same period last year. Adjusted income per diluted share for Q3 was $0.43 against $0.42 in Q3 of 09. Weighted average diluted shares outstanding for the quarter were 6.1 million higher than the same period last year, with five million of the increase attributable to the shares issued on September 30, 2009 as part of our securities litigation settlement.

Our adjusted free cash flow for Q3 remained strong at $63.6 million and total of $172.2 million for the first nine months of 2010 versus $163.6 million for the same period in 2009. As has been the case historically, we expect Q4 to be our lowest period for adjusted free cash flow and specifically we anticipate an increase in maintenance capital expenditures, which is based on the timing of certain renovation projects as well as the potential increase in accounts receivable balances related to the previously discussed medical necessity reviews.

Our continued generation of adjusted free cash flow led to an increase in cash on hand to a $190 million at the end of Q3. Our debt to adjusted consolidated EBITDA at the end of Q3 stood at 4.1 times.

Turning now to our recent capital structure initiatives, during our second quarter earnings call, we discussed our objectives of extending the maturity date on a revolving credit facility, reducing refinancing risk by smoothing the maturity profile of our debt instruments and enhancing the flexibility of the credit agreement, governing our revolving credit facilities in term loans.

We suggested that the scale and timing of these initiatives will be dependent on market conditions, as we progressed into the third quarter; we observed increasingly attractive conditions in the debt capital markets and elected to pursue a comprehensive refinancing. Our reception in the debt capital markets was enhanced by upgrades to our corporate family and specific instrument ratings by both Moody's and S&P including multiple notch upgrades to our senior unsecured notes.

Successful completion of our refinancing activities occurred in October and with the exception of the unwind of the forward-started swaps is not reflected in our Q3 financial statements, but is addressed as a subsequent event in our soon to be filed 10-Q. The unwind of the forward-started swaps is included in the loss on interest rate swaps line of our Q3 consolidated statement of operations, but this transaction actually settled in October resulting in a $6.9 million cash outflow for Q4.

Our refinancing involved three new debt issuances. First we issued two new series of senior unsecured notes. $275 million of 7.25% notes maturing in 2018 and $250 million of 7.75% notes maturing in 2022, both notes were issued at par. The size of the notes issuances and the specific maturity windows chosen are consistent with our objective of reducing refinancing risk.

The issuance of these notes was followed by the syndication of a new $500 million revolving credit facility maturing in 2015. The bank group providing the new revolver is comprised of many of the strongest and most capable banks operating in this country today, including Barclays, Goldman Sachs, Bank of America Merrill Lynch, Morgan Stanley, Citi, J.P. Morgan and Wells Fargo. The credit agreement governing the new revolver is significantly less complex and provide substantially more flexibility for activities such as debt pre-payment, stock repurchases and acquisitions.

We utilize the proceeds from the new senior notes together with approximately $129 million of cash on hand and $100 million drawn on the new revolver to completely payoff and extinguish the previous $400 million revolver, the $447 million term loan due in 2013 and the $296 million term loan due in 2015.

Net result was reduced of approximately $188 million of funded debt. As the refinancing involve the substitution of fixed rate debt to floating rate debt that is the term loans were replaced impart with the new senior notes. We deemed unnecessary the two forward starting swaps with a notional amount of $200 million scheduled to begin in the first half of 2011 and elected to terminate those instruments. The net result of these financing activities is a more sustainable and flexible capital structure support the execution of our operating strategies and the pursuit of our growth initiatives.

Importantly, this reset of the capital structure greatly enhances our ability to prepay and/or refinance our expensive 10.75% senior notes due in 2016, which have an initial call date of June 2011. The new senior notes also contain provision allowing us to retire up to 10% of the outstanding principle amount per annum of the new notes at a price of 103 prior to the first call date. The combination of the call protection lapsing on the 10.75% notes the aftermentioned enhanced call flexibility on the new senior notes and the amount funded on the new revolver provides us with ample attractive debt repayment opportunities as we continued to focus on delivering our balance sheet.

The completion of this refinancing activities in our fiscal fourth quarter will have no impact on our adjusted consolidated EBITDA. But, it impacts our adjusted EPS in two ways. First, as a result of the extinguishment of our previous credit agreement, covering the $400 million revolver in the two term loans. We will incur a loss on the early extinguishment of debt of approximately $12 million or $0.11 per diluted share. Second, we estimate the increase in average borrowing rates although partially

offset with more of its debt levels associated with the refinancing with increased interest expense by Q4 by approximately $3.4 million or $0.03 per diluted share. Both of these items have been factored into the revised adjusted EPS guidance provided in our press release yesterday.

On an annualized basis, before giving affect to any further changes to our capital structure including any prepayment or refinancing of the 10.75% notes. And assuming LIBOR trending consistent with the current forward curve, we estimate the refinancing activities will increase reported interest expense by approximately $16 million or $0.15 per diluted share comprised of an estimated $18.1 million increase in cash interest expense and a $2 million reduction in non-cash OID and fees amortization.

The annualized cash impact of the refinancing will approximate $10.6 million as the required annual principal payments on the extinguished term loans are eliminated which approximated $7.5 million. We believe over time both the dilution and adjusted EPS and the cash impact related to these refinancing activities can be offset by prepaying and or refinancing the 10.75% senior notes due in 2016, which remains a priority for us as we move into 2011.

And now I'll turn it back over to Jay.

Now I'll turn back over to Jay.

Jay Grinney, President and Chief Executive Officer

Great. Thank you, Doug. Before we take questions, I'd like our General Counsel, John Whittington to give a status report on the E&Y arbitration. I'll then comeback and discuss our revised guidance and the November 11th Investor Day.

John P. Whittington, Secretary, Executive Vice President and General Counsel

Thank you, Jay. As we previously announced on September 14th both in our Form 8-K and at the Morgan Stanley Global Healthcare Conference in New York, the arbitration with Ernst & Young is progressing, but because of scheduling conflicts which are beyond our control and slower than anticipated pace of the proceedings we no longer expect a resolution in the fourth quarter. We are hopeful that the final resolution will be a 2011 first half event. But we recognize and reiterate that the arbitration schedule is outside of our control.

We realize that everyone including ourselves would like to have had this matter concluded by now. But no matter how long it takes we are committed to this process and we will continue to aggressively assert our claims in this very important and significant legal proceeding. As we have said in previous disclosures, rules of the American Arbitration Association require that all aspects of the arbitration remain confidential and accordingly we are not able to provide further details other than to say again, we remain confident in our claims and we are committed to pursing them aggressively. We appreciate the complexity of this matter and the conscientious work of all who are involved in this process.

Jay Grinney, President and Chief Executive Officer

Great. Thank you, John. With respect to guidance, our solid third quarter allows us to narrow and increase the range of adjusted consolidated EBITDA for the year to 407 to $412 million. This results in forecasted Q4 adjusted consolidated EBITDA of between 96.4 million and a $101.4 million. The main driver of top-line growth for the quarter will be discharge activity, especially discharge activity through the holidays. Despite continued weakness in acute care volumes, we believe we'll be able to achieve 2.5 to 3.5% discharge growth in the fourth quarter.

Our pricing will benefit from a net 2.1% increase in our medicare reimbursement, although as we have done in the past, we also provided an average 2% merit increase to all non-senior management employees effective October 1st.

Finally, as Doug mentioned our bad debt expense is expected to increase as medicare denials phase out. In the absence of the recent refinancings this improved adjusted consolidated EBITDA would have resulted in a revised adjusted EPS range of between $1.71 and a $1.76 per diluted share. However, because of the diluted share impact from the refinancing related activities, our revised adjusted EPS guidance is projected to come in between a $1.57 and a $1.62 per diluted share.

We've had a very good year thus far in 2010 despite a very challenging environment and are pleased to be able to raise our full year adjusted consolidated EBITDA guidance. Despite this difficult operating environment, our hospitals have performed well we are poised to have a good finish of the year.

Finally, as previously announced, we are hosting an inperson and webcast from 8 a.m. to 12 Noon Eastern Time on Thursday, November 11 at the New York Place Hotel. The purpose of this meeting is to share with investors some of the key elements of our business model for the next three year planning horizon. We'll address key operational initiatives, highlight our strong free cash flow generating capabilities and investment alternatives, discuss continued deleveraging opportunities and review our growth strategies. Attending the meeting from HealthSouth will be me, Mark Tarr, Doug Coltharp, Ed Fay, Andy Price, our Chief Information Officer, Randy Carpenter and Mary Ann Arico. We hope all of you will be able to participate either in person or via the webcast for what we are confident will be a very informed with its session.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]. The first question comes from the line of Ann Hynes with Caris & Company.

<Q – Ann Hynes>: Good morning.

<A>: Good morning Ann.

<Q – Ann Hynes>: So, Doug, I guess when we talked about the 10.75%, that's clear that that is a priority for you. Can you give us some more details on may be timing when you're going to tackle those, would it be via refinancing, prepayment, just any more detail would be beneficial.

<A – Douglas Coltharp>: Sure, as you know the first call date on the 10.75% notes is in June of 2011 so that give us a known timeframe and a known price beginning that of 105.385 preminum, it doesn't mean that we don't have access to those notes before that because we could always go into the market if we saw both the liquidity and an attractive price to tender for those note. We haven't seen that opportunity as of yet and we obviously have other priorities with regard to the capital structure which is why we heretherefore have not made a move against those notes.

From the timeframe in terms of the addressing those then I would suggest you that that activity is likely to be initiated sometime between today and June of 2011. It's really going to depend on what's available to us with regard to refinancing alternatives and again liquidity and price of those 10.75% those in the market. In terms of the magnitude we improved against the 10.75% notes and the composition of how we get there it's really going to be depending on the circumstances that exist in time. We believe that we will continue to generate free cash flow long way and obviously get a nice return by pulling those end utilizing cash flow from operations. We have incremental capacity under our new revolving credit facility and there is a nice interest rate arbitrage moving from that 10.75% interest rate into a LIBOR plus 350 type of environment and if the senior notes market stays as buoyant as it

has in over the last couple of months that will certainly be a an avenue continue to explore. So, it's likely to be a combination of all three and again that timing is going to depend very much on just what's available to us in the market.

<Q – Ann Hynes>: Okay, great. And just a follow-up on your credit facility, I know the new credit facility increases your flexibility. You highlighted some debit payment or repurchase acquisition, I guess, now with your new flexibility what will be your priority, would it be more stock repurchase after that repayment, will it be acquisition and was is it the size of the acquisitions you couldn't do with your credit facility. Can you just give us more detail on this increased flexibility?

< A – Douglas Coltharp>: The credit agreement and the schedules are going to be filed as public documents in the very near future. So, you'll be able to look at all the detail. I would say generally that we're moving from having specific dollar basket limitations on the old credit agreement for all the forms of activities you just described to really having a great deal of latitude providing we stay under a certain leverage ratio and that certain leverage ratio is established at an initial level that is substantially higher than where we are today.

<Q – Ann Hynes>: Okay, great. Thanks.

< A – Jay Grinney>: Hey Ann, one of the things that we're going to be addressing at the Investor Day is really the question that you asked about how are we going to be looking at investment alternatives for the free cash flow that we're generating. And you're question was absolutely right, there is a broad range of options available to us and we will want to talk about that and then address the go forward growth strategies with respect to acquisitions. What kind? What are we looking at? What we believe are balance sheet needs to look like before we're going to be comfortable moving into acquisitions in the complementary arena. And try to address that in a pretty comprehensive way in November.

<Q>: Okay. Thank you.

Operator: Thank you. Your next question comes from the line of Arthur Henderson with Jefferies and Company.

<Q – Arthur Henderson>: Hi, good morning. Couple of questions, first and I guess this is directed to Jay or Mark. Could you remind me and I should know this, but where do you stay and with the team work you mentioned of what's been done and what's still to come. And then I think more specifically as far as discharge growth and expense management what are you working on there and is there still some low hanging fruit there that you could talk about?

<A – Jay Grinney>: Let me take the second question first. In terms of lower hanging fruit, we don't believe that there is any lower hanging fruit in our cost structure. That's not to say that there aren't improvements that can be made, there are there are always going to be opportunities to take hospitals that may be in the lower quadrant of our operational profile and move them forward. But for the most part, that's going to be volume driven and the real focus continues to be on taking market share. As you know, this is a tough market, I think as the other acute care companies have reported volume shortfalls quarter-over-quarter from last year 3 to 3.5%. Well that's where we get our admissions from, 95% of our volume comes from acute care hospitals when they're down 3 and 3.5% and we're up on a same-store basis 0.5% we feel pretty good about that. Now, going into say the fourth quarter, I think there are some opportunities and some markets where we have been able to replace some of the management teams. We've got a couple markets where we have to replace some of our sales and marketing teams, our marketing liaisons. So, that's going to be what helps us drive continued growth into our hospitals. Managing those expenses, I think that's just hand-to-hand combat, day-in and day-out but there is really not a lot of low hanging fruit. In terms of the TeamWorks initiative I'm going to ask Mark to review where we are right now. I will just say, we haven't ruled that out yet, but we feel pretty good about this pattern.

<A – Mark Tarr>: Hey, good morning Art. We are in the process-- we have three pilot sites now that are testing the initial phase and we hope to have the full rollout done by Q2 of next year for the Care Management efforts.

<Q – Arthur Henderson>: Okay.

<A – Jay Grinney>: So, what we're doing Art on that is we're looking – as we did with sales and marketing, we looked at the entire process that engages the case manager from the minute a potential patient coming into our hospital is identified once they've gone through the screens of medical necessity, appropriateness, ability to tolerate the three hours of therapy per day. From that moment all the way until the patient is discharged and then for a 72-hour period after the patient is discharged we looked at all of the processes engaged in that care. And the way in which the case manager, who is really sort of the quarterback of that care is involved with the caregiver, with the patient and with the family members, and that's what we're trying to revamp that process. We're looking at information technologies that will keep the case manager at the bed side and with the patient and not in the office. We're looking at ways of making sure that we have the right kind of job description and get the right people in those case manager roles. So, it's really a comprehensive look at that very important function. And that's why we want to pilot it just like we do with sales and marketing. And then we will roll it out on a limited basis. And then probably fine tune it a little bit more and then we'll go out and implement it across the board next year.

<A – Mark Tarr>: We can create what we call a standardized play book to roll out for all of our hospitals and all of our case managers.

<Q – Arthur Henderson>: Okay, that's very helpful and then just one quick add on I know you got Cypress, Texas opening up it looks like Q4 of 2011 and you talk about two to three de novos are we to assume that there is just one next year or when you think about two to three just announcing that you got something in place how do you think about that?

<A – Jay Grinney>: Yeah I think that for 2011 right now it looks like there will be one. But there may be certainly there are going to be additional projects that we'll be able to announce with respect to filings of certificate of need that we will conceivably add more than two in years 2012 and 2013. One of the problems that we face is the fact that many of our markets are CON-controlled and so we can certainly be aggressive in filing the CONs, we are not always going to be able to with 100% certainty managed the timing of that. And that's kind of where we are right now. We've got a couple of CONs that are out there, but because of the process to get them approved, I don't think we're going see that come to fruyition in 2011. But then on the other side as we've heard a minute ago 2011 is going to be a unique year with respect to how we use our free cash flow, because come June of next year the 10.75 are going to be callable and that remains top priority for us to take that down and to get that out of the way. So, we're going to review this a little more detail on November 11th, where we want to look at a full range of uses for that free cash flow and we're certainly going to continue to grow. There is no question about that, but we also want to make sure that we're thoughtful about – continued to be thoughtful about our balance sheet.

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

<Q – Adam Feinstein>: Close enough. Good morning everyone. Thank you.

<A>: All right.

<Q – Adam Feinstein>: So, just I guess Jay, a bigger picture question to start off, and certainly I'm sure something probably address during Analyst Day, but you guys have done so much and I'm just looking at slide 18 that it shows all of the goals and I'm thinking back to the same slide from four years ago and just how much progress you guys have made especially with the balance sheet here. So, as you think about the acquisition opportunities, I mean we're seeing a general thing where we're seeing more M&A throughout the healthcare facility space and certainly with healthcare reform coming we'll probably see more. I guess as you guys are thinking about the acquisitions. For a while you've talked

about looking at other complimentary post-acute care services. Is that something that you're going to continue to evaluate or something that you want wait until the healthcare reform starts, just kind of a general question there because it seems like we're in the beginning of what could be a pretty active environment?

<A – Jay Grinney>: Yeah. The short answer is that we're evaluating those opportunities as we speak. Because we believe that there are going to be buying opportunities driven not so much by healthcare reform as the impact of current and pending regulatory changes in many of those complimentary post acute services. You look at home health and you look at some of the changes that are coming down the pipe for home health services. LTCH is another area where we all know they are going to be some big changes in the next couple of years. Our thinking is that we want, and this has been our strategy all along, is we want to make sure that we are pursuing growth opportunities in the complimentary services area from a position of strength and when you're levered at four times that's not a position to strength. When you down there at three times or maybe even little bit less in that, that's a position of strength we believe that allows us to then look at those opportunities and to take on some of that inevitable M&A integration risk that are always out there. I mean if you look at our space today and it's one thing to buy a company it's another thing to integrate it successfully and have that acquisition be accretive in the long haul. So, we want to be smart about it, but most importantly we want to pursue those opportunities from a position of strength and the great news is we're very close to that point right now and what Doug and Ed Fay and the team did in terms of addressing the near term refinancing needs, giving us more flexibility, giving us that freedom to move a little more aggressively. All is part of what we've been designed and what we've been focused on and what how we've designed this strategy. So, there is definitely going to be I think some buying opportunities, I think some of those are going to be priced differently though in other 12 to 18 months from now, when the impact of some of these regulations are seen.

<Q – Adam Feinstein>: Yeah that totally makes sense. And in terms of just seeing what the regulatory landscape looks like. And then just a quick follow-up here, just on the managed care side, obviously medicare is much bigger for you guys, but there has been a lot of noise out there about managed care and in terms of just contracting in general as lot of the different hospitals have given different points out of feedback, it seems like things are still stable, that everyone is a little bit concerned about. Just curious as what sort of dialogue you guys are having?

<A – Jay Grinney>: Well it's never easy to negotiate a contract with the payer. On the other hand, we have had success over the last several years in first communicating to the payers the value proposition that inpatient rehabilitation offers patients versus maybe a lower per diem in a skilled unit that results in a larger payment, because the patients in the skilled unit for 3.5 to 4 weeks and they are in our hospitals for an average of two weeks. But we haven't seen a huge difference. We've always seen that pricing in the 3 to 5% range. We never had the 5 to 8% managed care lift that some of the acute care hospitals were receiving. Ours has always been in that 3 to 5% range. Its probably a little closer to that 3 to 4 than it is in the 4 to 5, but we're still feeling that the pricing environment is still going to be in that range for the foreseeable future. And again going back to what I said, we're not having to go from 5 to 8 down to 4 to 5, we're going 3 to 5 to maybe the lower end of that, but we feel pretty good about the pricing at this juncture.

Operator: Thank you. Your next question comes from the line of Darren Lehrich with Deutsch Bank.

<Q – Darren Lehrich>: Thanks. Good morning, everybody.

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

<Q – Darren Lehrich>: I want to just ask about one thing you commented on in terms of a trend in the quarter and that was just regarding your professional liability expense and I'm just wondering if you can maybe comment a little bit more about the claims history that you're seeing, is it frequency or is it severity and if its severity was it the one particular case you've cited and perhaps we'd get a chance to revisit that over time? So, just some color there will be great?

<A – Douglas Coltharp>: Yeah, I'd be happy to offer. It's Doug, Darren. For the claims year that is leading to the increase in reserve is 2008. It is more of a severity issue than it is a frequency issue. We're making this judgment for the third quarter in between actuarial estimates based on the observations of our risk management group, which tracks the progress of pending claims very closely. This specific action is not related to the Sulton case that we described in our second quarter call, which led to an increase in the reserve at that time, we don't have enough information right now that suggest that this is an ongoing trend that is going to impact 2009 or beyond will probably get a little bit more inside into that as we perform our semiannual actual realist mid in December right now we haven't seen enough that suggest that there is some kind of big macro change that's going to be an ongoing item but we did feel again based on specific observations related to 2008 that this is proving addition to the reserve.

<Q – Darren Lehrich>: Okay.

<A—Jay Grinney>: Darren just as, an addendum to that there is a sense that things are a little bit more litigious than perhaps several years ago. We're just seeing that the plaintiffs bar is a lot more active, I think, in some way the, the economy and the fact that things are tough in a lot of markets is contributing to potentially contributing to some of these outsize judgments and to answer your question on the Sulton case are we could be able to revisit it, absolutely. We're appealing that as we speak and we feel pretty good about the basis for that appeal and obviously we have to a bunch of it covered by insurance and there is a certain amount that we're liable for, we're appealing this pretty aggressively.

<Q – Darren Lehrich>: Okay, that's helpful. If I could, I just want to clarify something, you referenced bad debt moving up in Q4 and you suggested that on the medical necessity reviews would also have an impact on working capital. Can you just update us on denial trends, it looks like you had good success there with denials but is there anything new to say about that?

<A – Jay Grinney>: Not really, the trends, just to put it into perspective last year, well let's step back even further. The fiscal intermediaries have the flexibility of going in and looking at providers and using their discretion to where they're going to go. We have one fiscal intermediary that currently administers Medicare claims for about 70% of our hospitals and that particular FI has over the years placed a particular emphasis on rehabilitation providers, not just HealthSouth but all rehabilitation providers. CMS asked the FIs to stop those reviews last year, which this FI, the one in question did, and those and I think it was impart because they are putting together these new coverage requirements that came into effect on January 1st. So, in April of this year the FIs were released, if you will, to go back in a face of chose to then begin the focus reviews. This FI decided that it would do so. So, we started seeing the denials not at a unusual clip from prior experience but those denials began resuming and as we've said in the past, the denial are denials of payments. So, it's not retrospective review, it's a prospective review. So, we know that a patient is that particular case has been denied, we start accruing a portion of that balance as bad debts on a month in and month out basis. So, what we saw was that trend building up through September and then very few if any denials in the month of October. And so, we didn't have any aging, any building up of denials in October and obviously we're seeing now that some of those bad debts that were coming in or denials in April are now aging to the point where we anticipate that they'll continue to build. Where we take them back down is when we win. And sometimes that adjudication process takes 12 months or 15 months to work through this very tedious process of claim by claim having to justify the appropriateness. So, that maybe too much information but hopefully it tells you we're really not seeing a big change as much as it is a resumption of the denial activity that we saw before.

Operator: Thank you. Your next question comes from the line of Colleen Lang with Lazard Capital Markets.

<Q – Colleen Lang>: Hi, good morning. I was just wondering…

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

<Q – Colleen Lang>: Good morning. I was just wondering if you could give us an update on the progress you've made at Desert Canyon and Sugar Land just in terms of anything looks on better or if something that maybe doing a little bit worse than your expectations. And I guess the same questions for your two new hospitals in Virginia?

<A – Mark Tarr>: Hi Colleen, good morning. We made nice progress in the volume front on all the de novos and our acquisitions. For instance, at Desert Cayon, today they have over 30 patients when we first took that hospital over I think we start out with some 18 or 19 patients there. It's kind of same story for our de novos and the acquisition at Sugar Land hospital. We're now 35 patients today, I think we started there somewhere around 20, so we've seen a nice volume ramp up at the same time, it gives us an opportunity to go in and address some of the staffing metrics at those hospitals too and get those inline with the rest of the company metrics. So, overall those acquisitions and startups are going very well and as planned.

<Q – Colleen Lang>: Okay, great thanks. And just as a follow-up just given the economic environment, can you give us a little color on how your LTCH facilities are performing in terms of volume and equity?

<A – Jay Grinney>: Yeah the LTCHs are not performing as well as our rehabilitation hospitals. The volumes are weaker there. We're actually in across aboard seeing a year-over-year slight decline in discharges from the LTCHs. That's a tough space to be in right now. And we only have six, so that's I think that's good news and as we've said in the past, while this is a segment that we believe as providers is an integral and important part of the healthcare continuum. Unfortunately, the folks at CMS have a different perspective and we're still concerned about the pending regulations that are out there that'll be coming into effect in 2012 and beyond.

<Q – Colleen Lang>: Great, thanks.

Operator: Thank you. Your next question comes from the line of Kevin Fischbeck with Bank of America/Merrill Lynch.

<A – Jay Grinney>: Good morning Kevin.

<Q – Kevin Fischbeck>: Very good morning. I wanted to follow up on the bad debt question. How do we – how should we think about that going forward if 1.5% number for Q4, is that the right run rate heading into next year?

<A – Douglas Coltharp>: I would suggest that as head into year, a range of 1.5 to 1.8% is a reasonable expectation.

<Q – Kevin Fischbeck>: Okay, so back to normal next year. Okay, that makes sense. And then I just wanted to get as a follow up a little bit more color on the physician role that you mentioned earlier, that $1 million per quarter. Is that as a proposal was written, I guess, people are expecting an improvement in the final role in the next couple of days. I just wanted to make sure that was – as the proposal rather what you expect the final role to look like. And then also that there was some sort of net number may be net of what you might do on the costs side to deal with that, any color there.

<A – Douglas Coltharp>: That's as written in the straight revenue to EBITDA hit, revenue hit excuse me.

<A – Jay Grinney>: Yeah, there is no mitigating factor in there. I mean, really it just if you're providing a service and assuming that we've got a lean structure in place, which we do believe we have. That's just – it's a revenue hit and that just falls with the bottom line and it is as originally in visioned. So, if there is a modification and let's say you get 100% of the first two and then it's a reduction from the third therapy on let's say its 50% or may be there are some other schedule. Obviously, the impact is going to be less than a million a quarter.

Operator: Thank you. Your next question comes from the line A.J. Rice with Susquehanna Financial.

<Q – A.J. Rice>: Thanks. I've a quick question and a follow-up. First of all thanks for the commentary around the financing and all of that was helpful. Can you just update us on where you stand with the swaps and how that will impact you over the next year or so?

<A – Douglas Coltharp>: Yeah, absolutely, the good new is the story around the swaps is about to get a whole lot clear and more simplified. A.J. you recall that there have been two areas of swap activity for us. First, we've got that very large swap, the $800 million plus notional amount that the payments on which don't run through our interest expense, because they don't qualify for hedge accounting and those are swaps that have resulted in quarterly payments of anywhere between 10 and $11 million and those swaps terminate and will not be replaced in March of 2011. So, we will make our last payment on those in the first quarter of next year and then they are going to go away and won't be replaced. The other swap activity we dealt with earlier this month and again that was, there were two forward starting swaps that were intended to be a partial replacement of the big swap, those forward starting swaps together had a notional amount of $200 million. They were to roll on beginning one in March of next year. The other in June of next year and as a result of the refinancing activity we terminated those that resulted in us making a payment of $6.9 million and that $6.9 million will be reflected in our cash flow for Q4.

<Q – A.J. Rice>: Okay. That's great. The other question I had is and I appreciate that you can't talk specifically about the arbitration process with E&Y. But way back when you could talk about it the commentary was made that E&Y asked for summary judgments and then hopefully that would be ruled on fairly quickly and once that summary judgment was ruled on and you'd got to the meat of the case. That all parties would have an incentive to potentially talking about settlement and that leave it up to an arbitrary – not arbitrary, but outcome beyond their control, can you – not commenting about what's going with the arbitration, can you tell us whether there is any discussions at this point between you and E&Y even whether they ultimately going forward or not directly about possibly settling?

<A – John Whittington>: Yeah I think that comes within the definition of confidentiality, it will be albeit for us to comment on that question.

<Q – A.J. Rice>: Okay. You won't give us a chance to hope for a potential settlement.

<A – John Whittington>: Sure, there is nothing wrong with hoping.

Operator: Thank you. Your next question comes from the line of Gary Lieberman of Wells Fargo.

<Q – Gary Lieberman>: Thanks. Good morning.

<A>: Hi Gary.

<Q – Gary Lieberman>: May be I'll just followup on that last point and coming from another angle, in the past you have told us you just kind of where in the process you are whether panel was seated or the panel has chosen, can you give us any details kind of on those lines?

<A – Jay Grinney>: I'll just jump in because we have done that in the past, but that was prior to the panel having been established and the process started. And when we reported that the panel has been seated while the process was underway is that one we were told by the arbitrators that both parties needed to keep the proceedings and the details confidential. So, while we were able to comment previously, it's very hard for us to do that today and honor the commitment we've made to the arbitrators and to the process.

<A – John Whittington>: I will just add to it, I mean, the arbitration is in full process. It is moving forward.

<Q – Gary Lieberman>: Okay. That's helpful. And then Jay, maybe about some of your comments on the denial trends, I think I got a little bit lost in there, I apologize. I thought I heard you say that in October it looked like the denial or the claims had actually decreased, so wouldn't that indicate that maybe the bad debt stays low again in the fourth quarter, how should we think about that?

<A – Jay Grinney>: Well, it will continue to build. I mean we age these over an extended period of time. So, all of the denials in the April, May, June, July, August, September, they're all going to be aging and aging at an increasing rate if you will. So, that should not have an impact on the fourth quarter.

<Q – Gary Lieberman>: Okay. And then I guess in the past you've been fairly successfully if I remember correctly about mitigating those denials from the intermediaries, is that still the case or is anything changed there?

<A – Jay Grinney>: No, no, no, we're still – we're winning 80-some percent of these denials. It takes a lot longer than we would like and in the final analysis a lot of this is really very subjective and some of it is a function of what's in the medical record, what's been documented. So, we feel very good about the fact that we're winning 80-some percent of these and that suggests to us that the care was needed, the care was appropriate and, most importantly it was documented appropriately as well. So, I think long-term we're kind of hoping that this particular FI will understand that they're spending a lot of time and effort on these denials and if we're winning 80-some percent, that means they're loosing 80-some percent. And if it was a business they probably make the decision that the investment of time and effort is really not generating any kind of return for them but one can only hope that that will be the case because we really think this is really more just friction in the process. It's costly on our side. It certainly is expected on their side. There is no evidence that there is any gained to be had. So, it's part of and I guess it is part of the process.

Operator: Thank you. Our final question comes from the line of Nick Leventis, with CRT Capital.

<Q – Nick Leventis>: Good morning.

<A – Jay Grinney>: Nick, how are you?

<Q – Nick Leventis>: Good morning, Nick on for Sheryl this morning.

<A – Jay Grinney>: Yeah.

<Q – Nick Leventis>: Question for you. Can you give a little bit more color on the SWB line? First half of the year we saw some great productivity gain. How should we think about those going forward?

<A – Jay Grinney>: Well, as we said at the – on the second quarter call the second half of the year is always a time where we see our SWB as a percent of net ticking up for couple of different reasons primarily related to the non-productive hours that we pay as our employees take vacations during the summer and then of course during the holiday periods as well. So, we said it on the second quarter call that we expected our SWB as a percent of net to be in that 50% range and not down there in the 48, 49%. I think what added to that this year was the fact that we had quite a few hospitals coming on stream. We had Loudoun, we had Bristol, we had Sugar Land and we had Desert Canyon. In the case of Loudoun, in the case of Bristol and in the case of Sugar Land, we had to treat 30 patients without any reimbursement, fully staffed, before we could get the joint commission to come in and to review the medical records and to begin that medicare certification process. So, we had three of those hitting us all at the same time, and exacerbating the situation in Sugar Land was that we were doing that with a fully loaded hospital. So, you think about it, in Loudoun County, brand new hospital starting it off, we were able to manage those expenses for those first 30 patients pretty carefully. So, we're not getting any revenue, but the costs are a little more manageable. In the case of Sugar Land, we decided not to acquire that license and so, we had to go through that process from the beginning. And in that case, we had a hospital that had been up and running for several years, fully loaded we had to then treat 30

patients without any kind of reimbursement. So, that really is what contributed to some of that increase, which is what we expected it to be. On a go forward basis, certainly for the remainder of this year and the fourth quarter. We expect that to be in that 50% range. Obviously, we're always going to be looking to be as efficient as we can, but I think that's the way you have to look at it from the fourth quarter perspective.

<Q – Nick Leventis>: Great, thanks guys.

<A – Douglas Coltharp>: As you get into next year recognize that the impact of the increase in the licensed staff mix will be anniversaried.

<Q – Nick Leventis>: Excellent, thank you.

<A – Jay Grinney>: Yeah.

Operator: We do not last question from the line of Frank Morgan with RBC Capital Markets.

<Q – Frank Morgan>: Hey, I want to go back to medical necessity issue, I just wanted to clarify that is not the RAC audits from our sales. So, that's a total separate issue, it is that the case?

<A – Jay Grinney>: Yes, that's a completely unrelated – well I say unrelated. It is definitely a separate process.

<Q – Frank Morgan>: Okay I guess with that…. I'm sorry.

<A – Jay Grinney>: Frank, to think about it, the denials are a denial of payment. So, we're aging these as bad debt. The RAC audits are all retrospective.

<Q – Frank Morgan>: Okay, in that plan, have you seen any activity there on the RAC audits side where these contractors are coming in, looking to do the retroactive reviews. Do you see any pick up in that activity?

<A – Jay Grinney>: Very deminimus.

<Q – Frank Morgan>: And then my second…

<A – Jay Grinney>: One of the things that I know that that's clearly in the airwaves people talk about, there people will focus on it and I don't mean for this to be in any way suggested that we don't think that that's a very serious process and so on. It is. On the other hand, we also feel pretty good about the focus that we have placed on coding accuracy over the last seven years – six years since 2004. And I would suggest that that coding accuracy actually predated that. I think that that's always been part of the DNA of this company quite frankly. But if you recall, we're under a corporate integrity agreement and as we previously stated, one of the requirements of that CIA was to have on an annual basis an independent third party come in and review the accuracy of our medical records and coding. And there was a 5% threshold if we had error rate above 5%, we had to report that proactively to the OIG as part of our CIA requirements and we never had to do that. In fact our coding accuracy is better than 1%, so we are better than 99% I should say. We feel very good about our coding, we feel very good about our ability to document that and so while it certainly may be a concern for other providers, the rack audits. At this juncture, we're feeling very good about how we're positioned. We've spent a lot of time on that coding accuracy and the few times that the rack auditors have come in, they haven't found anything.

<A – Mark Tarr>: Another point, Frank, the rack auditors cannot go in and review those charts. They've already been reviewed by the FI.

<A – Jay Grinney>: So, you think about it, you're a rack auditor, what are you, you're basically a bounty hunter, right? I mean you're incentivized to go out and to try to find inaccurate claims and over payments on behalf of the government. You're a bounty hunter. So, where are you going to spend

your time, are you going to spend your time going into hospitals where at least 70% of those hospitals have had a very aggressive fiscal intermediaries going in and denying claims and reviewing claims or so, there is not a lot of potential upside there or are you going to spend your limited resources and go to that big acute care hospital down the road that has three or four times the medicare billings and potentially a greater opportunity to get some recoveries.

<Q – Frank Morgan>: Okay, thank you very much.

Operator: At this time, there are no further questions.

Mary Ann Arico, Chief Investor Relations Officer

Thank you. I would like to conclude this call. If you would like to attend our Investor Day on November 11 at the New York Palace and have not yet responded, please send an email to Ryn Davis at ryn.davis@healthsouth.com. If you have additional questions, we will be available later today, please call me at (205) 969-6175. Thank you.

Jay Grinney, President and Chief Executive Officer

All right, thanks everyone.

Operator: Thank you for participating in today's conference call. You may now disconnect.