PARTICIPANTS

Corporate Participants

Mary Ann Arico – 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.
John P. Whittington – Secretary, Executive VP & General Counsel, HealthSouth Corp.

Other Participants

Whit Mayo – Analyst, Robert W. Baird & Co., Inc. (Broker)
Joshua R. Raskin – Analyst, Barclays Capital, Inc.
Chris D. Rigg – Analyst, Susquehanna Financial Group LLLP
Joshua Kalenderian – Analyst, Deutsche Bank Securities, Inc.
A.J. Rice – Analyst, UBS Securities LLC
Gary Lieberman – Analyst, Wells Fargo Securities LLC
Frank G. Morgan – Analyst, RBC Capital Markets LLC
Joanna S. Gajuk – Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to HealthSouth's First Quarter 2015 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 Mary Ann Arico, Chief Investor Relations Officer.

Mary Ann Arico, Chief Investor Relations Officer

Thank you, Laurie, and good morning everyone. Thank you for joining us today for the HealthSouth first quarter 2015 earnings call.

With me on the call today in Birmingham are Jay Grinney, President and Chief Executive Officer; Doug Coltharp, Executive Vice President and Chief Financial Officer; Mark Tarr, Executive Vice President and Chief Operating Officer; John Whittington, Executive Vice President, General Counsel and Corporate Secretary; Andy Price, Chief Accounting Officer; Ed Fay, Treasurer; Julie Duck, Senior Vice President of Financial Operations.

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

Moving to slide 2, the Safe Harbor, which is 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 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 SEC filings, including the Form 10-K for 2014, the Form 10-Q for first quarter 2015 when filed and previous filings with the SEC. 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 or correct the 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 as part of the Form 8-K filed last night 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. If you have additional questions, please feel free to put yourself back in the queue.

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

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

Great. Thank you, Mary Ann. Good morning, everyone. I'd like to begin this morning's call by welcoming the employees and physicians of Cardinal Hill Rehabilitation Hospital in Lexington, Kentucky to the HealthSouth family. Cardinal Hill is a highly respected institution with a proud history of serving the rehabilitative needs of patients in Central Kentucky and beyond. We closed on this acquisition this morning and are delighted Cardinal Hill is now part of HealthSouth.

I'm also very pleased to report that 2015 is off to an excellent start as both segments reported strong volume and top-line growth, in line with our expectations. Discharges in our Inpatient Rehabilitation segment grew 6.8% in the quarter with new store growth of 3.9% and same-store growth of 2.9%. Segment net operating revenues were $630.3 million, reflecting growth of 7.8% quarter-over-quarter.

Our Home Health and Hospice segment revenues were $110.3 million and included approximately $103 million from the acquisition of Encompass Home Health and Hospice. Admissions, recertifications and episodes were up significantly both in agencies owned by Encompass for more than a year and in those acquired in 2014.

For the Encompass agencies that were operational on January 1, 2014, admissions were up 13.8%, recertifications were up 15.4%, and episodes were up 15.1% quarter-over-quarter as these agencies continued to take market share. Agencies that were acquired by Encompass in 2014 contributed 13.9% to admissions growth, 9.4% to recertification growth, and 11.2% to episode growth in the quarter.

Our Inpatient Rehabilitation segment's adjusted EBITDA was impacted in the quarter by several items; two that we discussed when we provided 2015 guidance and two that were not included in this guidance. When we provided full year guidance in February, we stated we were adding approximately $10 million of new incremental costs to our operating platform in 2015. The adjusted EBITDA impact of these investments in the first quarter was approximately $1.5 million.

We also said we expected some margin compression from our four new hospitals as they continued their ramp up in the early part of the year. In the first quarter, these new hospitals operated at essentially a breakeven adjusted EBITDA level.

The first unanticipated item that impacted Inpatient Rehabilitation segment adjusted EBITDA was a settlement totaling approximately $4 million for sexual harassment and other claims brought by eight former employees involving another former employee. While there was strong evidence these claims were without merit, we chose to settle them rather than incur additional legal expenses.

We also did not anticipate the magnitude of the increase in the number of prepayment claim denials, which added approximately $1.5 million of incremental bad debt expense in the quarter, above what we had originally forecasted. Unlike the medical necessity denials we've received and have successfully challenged in the past, we believe the majority of these new denials are based on the MAC's interpretation of Medicare guidelines and rules of thumb, as opposed to compliance with actual law as promulgated in the IRF-PPS final rules.

We have reached out to these MACs involved to seek clarification and express our position that these denials are unwarranted. At this point, it is unclear if we will be persuasive at the local level or we'll have to adjudicate these claims through the ALJ process. While we are confident we will prevail if we do have to adjudicate these claims, the ALJ process is currently taking approximately three years for disputed cases to be fully resolved. And as a result, recoveries have slowed dramatically.

As a consequence, our net AR balance is growing, and we are increasing our estimated 2015 bad debt expense as a percent of net revenues to a range of 1.5% to 1.7%. This range represents our best estimate at this time. But for these two unusual items, our Inpatient Rehabilitation segment's adjusted EBITDA would have been on target for the quarter.

Our Home Health segment has started the year in excellent fashion, and I couldn't be more pleased with our decision to partner with the Encompass team. Home Health and Hospice segment adjusted EBITDA for the quarter was $16.9 million. In addition to strong volume growth in both legacy and acquired agencies, Encompass continues to grow and has closed on two acquisitions thus far in 2015, Integrity Home Health in the Greater Las Vegas market in March and Harvey Home Health in the Greater Houston market in April.

We have a healthy pipeline of other acquisitions that we are pursuing and while some of these development opportunities have been underway for some time, going forward, we will emphasize acquisitions of agencies in markets where we have hospitals.

I'm also pleased to report the integration of our two organizations is well underway. We've begun the process of transitioning the operations of our 25 legacy HealthSouth agencies to Encompass and are taking a disciplined approach to these transactions, preferring to get them done right versus getting them done fast. Encompass has a dedicated and experienced transition team that goes into acquired agencies to train employees on the Homecare Homebase IT system and the Encompass operating model.

19 of our legacy HealthSouth agencies are wholly-owned, 6 are joint ventured with six of our hospital partners. The 19 wholly-owned agencies should be fully transitioned no later than September 1. The joint ventured agencies should be transitioned by year end.

Additionally, we've begun establishing stronger formal relationships between our hospitals and Encompass agencies in overlap markets where we did not have legacy HealthSouth Home Health agencies. We believe we can offer patients a superior level of home healthcare services through our Encompass partnership and are optimistic we can earn the trust of referring physicians, patients, and their families in these services, thereby garnering additional Encompass Home Health market share over time.

Earnings per share for the quarter was $0.44 and was negatively impacted by approximately $0.02 per share for the sexual harassment litigation settlement and approximately $0.07 per share for certain non-recurring items including the General Medicine settlement.

As I mentioned at the beginning of my remarks, we are very pleased with the start of the year. The most important metric, volume, was strong in both segments and generated very solid top line growth. While we did incur certain unusual and non-recurring charges in the quarter, we remain pleased with the strategy and our business execution, and despite these first quarter headwinds, we are reaffirming our full year adjusted EBITDA range of $670 million to $680 million, and our full year EPS range of $2.13 per share to $2.19 per share.

I'll now turn the agenda over to Doug for a more thorough discussion of the quarter's results.

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

Thank you, Jay. Good morning, everyone. As was evident in Jay's remarks, this is the first quarter we are providing our financial results based on two reportable segments, the Inpatient Rehabilitation segment and the Home Health and Hospice segment. The movement to segment reporting was triggered by our acquisition of Encompass, which closed at the end of 2014.

Our segment results for Home Health and Hospice for 2015 include the acquired Encompass business, as well as the 25 legacy HealthSouth Home Health agencies. Because we did not own Encompass in 2014, the segment results for last year include only the legacy HealthSouth agencies. As a result, during this first year segment reporting, the comparability of year-over-year results will be more meaningful for the IRF segment because of the relative consistency in the asset base.

We'll attempt to compensate for this, providing you with some insight into the year-over-year trends within the Encompass business, as Jay just did in his remarks. Also of note, although the legacy HealthSouth agencies are now included in the Home Health and Hospice segment results, those agencies have not yet transitioned to the Encompass operating platform. As Jay mentioned, the plans to complete this transition prior to the end of 2015 have been formulated and execution has begun.

With that preamble, let me begin by reiterating Jay's earlier comment that 2015 got off to a solid start with strong revenue and volume growth in both our operating segments. Our net operating revenues increased 25.3% over Q1 2014 and adjusted EBITDA of $156.1 million increased 8.3% over the prior year period.

IRF segment revenue rose 7.8% in Q1 2015, as compared to Q1 2014. The revenue growth was driven by a 6.8% increase in discharge volume combined with 1.8% increase in revenue per discharge. New store discharge growth of 3.9% benefited from the four new hospitals added in Q4 2014, as well as the increased equity ownership in Fairlawn. Same-store discharge growth of 2.9% was negatively impacted by approximately 30 basis points due to the closure of 40 SNF beds in Q2 2014, but did benefit from a relatively weaker comparison as Q1 of last year was negatively impacted by severe winter weather.

Revenue per discharge for Q1 2015 of 1.8% was lower than expected due to discharge timing issues around quarter-end, as well as shifts in our patient mix. As indicated on slide 14 of the supplemental slides, we continue to estimate revenue per discharge for the balance of the year between 2.3% and 2.6%.

IRF segment adjusted EBITDA for Q1 2015 of $164.4 million was $2.5 million lower than Q1 2014 primarily attributable to three items. First, as Jay mentioned, we incurred an approximate $4 million expense related to an uninsured litigation settlement for an employee sexual harassment case. This was an isolated incident confined to a single hospital.

Second, IRF segment adjusted EBITDA for Q1 was also negatively impacted by an increase in bad debt expense to 1.7% of revenue, as compared to 1.3% in Q1 of 2014. Jay discussed this in some detail, but it bears repeating. The increase in bad debt, again, relates to higher levels of claims denials now predominantly by two fiscal intermediaries, and the continued lengthening of the adjudication process based on a worsening backlog at the Administrative Law Judge hearing level. As I think is now evident, our frustration with this process continues to mount.

With respect to new claims denials, it has become a misnomer to label these as medical necessity disputes. Although medical necessity was a cited rational by CMS for originally initiating these claims reviews, the denials by these fiscal intermediaries are now being made overwhelmingly on the basis of technical documentation issues and interpretations of Medicare guidelines.

This trend is the primary reason for our investment in the new medical services department focused on improving all aspects of documentation across our hospitals. This is not to suggest that we believe we have been operating at an efficient level of documentation. Rather, this is a reflection of a tightened standard against documentation being applied in the claims denials process.

Further, the adjudication backlog continues to lengthen with cases resolved in Q1, having been in the process for approximately three years. As a result of these trends and as can be seen on slide 14, we have revised our assumption for bad debt expense for the remainder of 2015 to 1.5% to 1.7%.

Finally, the investments in our new medical services department, additional hospital staff for quality reporting, and the bundled payment initiative, combined with an increase in our clinical information system expense impacted Q1 2015 IRF segment adjusted EBITDA by approximately $1.5 million.

Notwithstanding these items, we have reaffirmed our consolidated adjusted EBITDA guidance for 2015 of $670 million to $680 million.

Our Home Health and Hospice segment generated Q1 revenue of approximately $110.3 million with the year-over-year increase attributable to our acquisition of Encompass. As Jay detailed, within Encompass, we benefited from strong revenue growth in those agencies owned for all of 2014, as well as the contribution from agencies acquired during 2014.

For Q1 2015, the Encompass Home Health business saw an approximate 28% increase in admissions, and an approximate 25% increase in recertifications as compared to the same period in 2014. We closed on one acquisition in Q1, Integrity Home Health Care with two locations in the Las Vegas area, a market in which we operate three IRFs. And as Jay mentioned, subsequent to the quarter end in April, we closed on a second acquisition in the Houston market.

Home Health and Hospice segment adjusted EBITDA for Q1 of $16.9 million was also primarily attributable to our acquisition of Encompass. And as can be seen on slide 14, we have reiterated our expectation for Encompass to contribute approximately $72 million to our consolidated adjusted EBITDA for 2015.

As expected, Q1 interest expense increased by approximately $4 million and depreciation and amortization expense increased by approximately $5.5 million. The year-over-year increase in interest expense was related to the debt incurred to finance the Encompass acquisition. The increase in D&A is tied to our recent capital investments, including the clinical information system and IRF capacity expansions.

Diluted EPS for Q1 2015 was $0.44, as compared to $0.48 in Q1 2014. During the first quarter, we incurred approximately $11 million or $0.07 per share in certain non-recurring items including the settlement of our General Medicine litigation which, as you know, had been ongoing for quite some time.

We have continued to take a proactive approach to managing our capital structure in support – in order to support the execution of our operating and strategic plans. You may recall that we initially funded the Encompass acquisition with bank debt owing to deterioration in fixed income market conditions in December of 2014.

In January, based on improvements in market conditions, we issued $400 million of additional 5.75% senior notes due 2024 and used the proceeds to repay a portion of our bank debt. In March, we've followed with $300 million issuance of 5.125% senior notes due 2023 effectively funding the call of our $290 million of 8.125% senior notes due 2020, which was completed in April.

As can be seen on slide 20, after giving effect to these transactions, our pro forma leverage ratio at the end of Q1 was 3.4 times, and the unfunded availability under our revolving credit facility was $395 million.

Most recently, the movement in our stock price allowed us to force conversion into common shares of the approximately 96,000 of convertible perpetual preferred stock. The shares underlying the preferred stock were already included in our diluted share count, and thus, the conversion does not impact our EPS. However, the conversion of these shares has a favorable net cash impact of approximately $3.5 million annually based on the current common dividend level. In Q1, we also continued to demonstrate the significant cash flow generating capabilities of our company with adjusted free cash flow of $79.4 million, an increase of 22% over Q1 2014.

Adjusted free cash flow in Q1 2015 benefited from higher adjusted EBITDA and lower maintenance CapEx. You may recall that Q1 of 2014 included approximately $12 million in maintenance CapEx related to equipment purchases made in Q4 of 2013 and paid in early 2014.

These improvements in adjusted free cash flow were partially offset by increased net working capital primarily attributable to the impact on accounts receivable of the previously discussed claims denials and adjudication process, and increased interest expense related to the Encompass acquisition funding.

As you consider adjusted free cash flow for Q2 2015, please note that the quarter will include the semi-annual coupon payment for the $850 million of senior notes due 2024.

And now, we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instruction] Your 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. Maybe just start first with the Cahaba denials. Is there any specific claim or case mix group that they're reviewing? Or is this just an issue more from their widespread targeted pre-pay review across the entire industry?

<A – Mark Tarr – HealthSouth Corp.>: Yeah. Hey, Whit. This is Mark. It's really across the board. There doesn't seem to be a specific clinical group that they're focusing in on. We've had claims against a broad variety of clinical grouping.

<Q – Whit Mayo – Robert W. Baird & Co., Inc. (Broker)>: Yeah. I mean, looking at their website, I mean, they list a lot of the denial rates across a lot of the CMGs they're reviewing. And just as an example, looking at the neurological CMGs back in the fourth quarter, it looks like the prepaid claims in Alabama across 92 providers, they denied 99% of the claims, so it just seems somewhat interesting.

My second question was really just on Encompass and the pipeline and how you think about start-ups versus acquisitions in the HealthSouth legacy markets. And is there a target that you have in mind for the number of markets you'd like to move into this year? I know you've earmarked maybe $30 million to $40 million of capital, but just not sure on the size or the number of markets.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. I think that the markets that we are able to enter is going to be driven, in large part, by opportunistic acquisition opportunities. The plan is not to attempt de novo acquisitions. As you know, many states have moratoria in place on new home health licenses. So, the focus is really on acquiring agencies in existing markets.

<Q – Whit Mayo – Robert W. Baird & Co., Inc. (Broker)>: Okay. Thanks a lot.

<A – Jay Grinney – HealthSouth Corp.>: All right.

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

<Q – Josh Raskin – Barclays Capital, Inc.>: Hi. Thanks. Just want to follow up on the two sort of not in guidance bad guys this quarter. So, first on the litigation, was there any form of accrual or anything previously on the balance sheet or was this all a big surprise? And I guess I'm curious why not sort of a charge or something like that.

And then, just a follow-up on Whit's question on the other one, the collections issue on the IRF side, I'm sorry, did you say – do you think that's more industry-wide or do you think it's HealthSouth, does this relate to anything you guys have seen in the past? Just sort of more color on the history there.

<A – Doug Coltharp – HealthSouth Corp.>: Hey, Josh. It's Doug, and I'll take the first one. And that is, the case was uninsured and there had been no prior accrual. And the fact of the matter is that it came together very quickly. And ultimately, when we looked at the facts and the circumstances, we determined that it was better to settle this thing expeditiously than to incur additional legal expenses in drawn-out litigation, but there was no prior accruals. And it is not something that is typically covered by insurance programs.

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

<A – Jay Grinney – HealthSouth Corp.>: And then, Josh, relative to the second part of your question. We have a high number of our hospitals fall under one particular fiscal intermediary who has been particularly aggressive at their chart reviews and the number of claims that they have denied. So, that is not really different than what we've seen in the past, but they've been particularly aggressive here as of recent quarters.

<Q – Josh Raskin – Barclays Capital, Inc.>: And Mark, is there – there's no sort of recourse you have other than this Administrative Law Judge that could take potentially three years, is that the problem?

<A – Jay Grinney – HealthSouth Corp.>: Well, this is Jay. The recourse that we have is certainly putting these challenged denials into the ALJ process. But we are also reaching out to this particular MAC. And they have expressed an interest and a willingness to at least sit down and to hear our position.

There are no – unfortunately, there are no other remedies. When we have gone to CMS in the past, we have not been told that there's a willingness on Baltimore's part to intervene in decision making at the local MAC level. They rely pretty heavily on the discretion and the judgment of the individual MACs. And they are somewhat reluctant to get in and to second-guess them.

Now, having said that, if we get to the point where we're unable to get a resolution on these matters, especially as it relates to the documentation issue, there's nothing in the final rule that says claims can be denied because of inadequate documentation. And so, our position on this is that they're denying claims that shouldn't be denied. So, if we get to a crossroads there and we're not able to move forward, we'll certainly make efforts to go to CMS central and to try to advocate our case up there. But it's – there isn't an easy, simple, fast solution to this.

<A – Doug Coltharp – HealthSouth Corp.>: And what you're seeing is that the confluence of increased claims denials and the lengthening of the adjudication process is exacerbating the impact on both bad debt expense and ultimately on net working capital. And what we had experienced previously is there would be periods of these widespread probes where we'd see an increase in denials. They would be relatively short-lived and might occur over a number of consecutive months and then the activity of new denials would die down, and those that were already in the queue would move, albeit at a slow pace, but faster than they are today through the adjudication process, and we'd start to see some recoveries come back through which would bring the bad debt number down. Now, what we're seeing are more denials than we had previously seen, particularly over the last three quarters, and very little coming through in the way of recoveries because of the length in the adjudication process.

We continue to hold to the fact that we're going to recover a lot of what is in the denial pool right now. We just don't have a good estimate as to the timeframe.

<A – John Whittington – HealthSouth Corp.>: This is John Whittington. In addition to what Doug and Jay said, I'll just add that there is no adequate legal remedy and we understand that what we have to do is work with the fiscal intermediaries and with CMS. And through the process of engaging them, we have learned more specifically how they are going about the process. For instance, we did our training on the coverage rules, which is the law, and we trained all of our hospitals based on the law, and then we learned subsequently that the intermediaries are using a check-the-box approach based on interpretation of the rules out of the Medicare benefits manual. Well, that surprised us, but now we know that.

So, with the assistance of our new department, we are changing a little bit of our training process. We're focusing more, as Jay said, on documentation. So if there is a check-the-box, the doctor's signature had to be dated on a certain date, we're making sure that happens. If a progress note has to be made by a certain date, we're making sure that happens. But as a physical therapist who primarily do the audit reviews before these intermediaries go through the records and they don't see it dated properly, or a progress report made the exact day as supposed to be due, they deny the entire payment.

And so, we're now learning what they're doing. We're engaging them. We're trying to make suggestions. I think working with them is a very good way to reduce these denials and we're going to continue to try to do that.

<A – Mark Tarr – HealthSouth Corp.>: One final point on documentation. It's been the focus of our electronic clinical information system, which we now have in 67 of our hospitals. Our recent focus has been to modify any of our current templates that our physicians and therapists use to better tighten this documentation around these ongoing areas that seem to lead towards denials. So, from a long-term perspective, we do think that our clinical information system is going to help with this documentation effort. It's early on. We are starting to see some positive signs. But it's something we're continually focused on.

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

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Good morning. Just to stay on the same topic, just some clarification around the numbers. The $1.5 million that you talked about, is that an increase over what you were previously expecting, or is that the total amount in the bad debt in the quarter related to this issue?

<A – Doug Coltharp – HealthSouth Corp.>: The $1.5 million is the difference between the 1.7% bad debt expense number we reported and the 1.5% estimate included in our guidance at the beginning of the year. The delta on a year-over-year basis was approximately $3 million.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Okay. And then the total denial pool thus far for you guys, can you give us a sense for how much that is?

<A – Doug Coltharp – HealthSouth Corp.>: During the quarter, we had about $16 million, $16.5 million of new denials.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Okay.

<A – Doug Coltharp – HealthSouth Corp.>: And the rate has been at a higher level. Really, it's something we started to see spike up in Q3 of last year. It was higher in Q4 and at a level comparable to Q3 of last year and the first quarter of this year.

<Q – Chris Rigg – Susquehanna Financial Group LLLP>: Okay. And then last one, just on M&A. When we think about the strategy going forward, in terms of sort of allocation of M&A dollars, is it going to be now more skewed towards tuck-in Home Health or still primarily focused on the Inpatient Rehab side? Thanks a lot.

<A – Jay Grinney – HealthSouth Corp.>: Actually, both. That's one of the great things about combining our two companies is we have more than enough free cash flow to continue to fund the growth that we see in the IRF space. On top of or in addition to that, we are able to fund the growth for the Encompass operation. So, we're able to fund growth across both segments. And fortunately, we're not in an either/or situation.

Operator: Your next question comes from the line of Dana Nentin of Deutsche Bank.

<Q – Josh Kalenderian – Deutsche Bank Securities, Inc.>: Good afternoon, everybody, or good morning. This is Josh Kalenderian in for Dana here. Just first, at the time you mentioned the Encompass deal, that of your IRF discharges to a home health location, only about 8% or 9% of those were going to a HealthSouth or Encompass Home Health location. Have you started to see any increase in that since the deal closed?

<A – Jay Grinney – HealthSouth Corp.>: Modestly, it has occurred very slowly, in part because we really have not begun that formal process. Although it is underway now, we did not begin that immediately in the January-February timeframe. We were putting our focus more on the integration of the legacy HealthSouth agencies with the Encompass operating platform, but we are certainly looking forward to those relationships firming up. I think as everybody on the call knows, there's always the issue of patient choice. But having said that, we also believe that there is an opportunity.

In fact, I would say that we have a responsibility to our patients to introduce them to the services and the capabilities that our home health company, our partnership company can provide. We believe that those services are superior to home health services that can be provided by any other company out there. And so, we will, over time, look to establish stronger relationships with the referring physicians and to really be very assertive in introducing Encompass's capabilities to our patients and their family members.

<Q – Josh Kalenderian – Deutsche Bank Securities, Inc.>: Okay. Great. Thank you.

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

<Q – A.J. Rice – UBS Securities LLC>: Hi. I know you guys have talked around this, but I just – I'm looking for sort of the simple bridge here in some way. You did $156 million in EBITDA in the first quarter, will add back to $4 million of litigation that's included in that. And to get to your sort of midpoint of your guidance, you need about a $170 million run rate for the next three quarters. I don't think there's great seasonality there, but what would be the couple of things that step you up from the run rate you exit the first quarter at to those? If you can just sort of distill that that would be helpful.

<A – Doug Coltharp – HealthSouth Corp.>: Sure. Hey, A.J., it's Doug. You asked for a couple, but I'll give you four things that kind of...

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

<A – Doug Coltharp – HealthSouth Corp.>: First is, as you mentioned, we had that $4 million settlement on the employee sexual harassment in Q1 that won't repeat itself in the subsequent quarters.

The second is, and this is specific to Q2 really, but if you look at our pricing at 1.8%, I mentioned that that was related to some timing issues. And without dragging you down into the weeds, the timing issue was really that there was one extra workday in the month of March this year versus the prior year.

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

<A – Doug Coltharp – HealthSouth Corp.>: And because we're on an accrual basis, that lowers pricing, you wind up seeing a bounce back in that pricing in the second quarter. So, that factors into its impact predominantly on the same-store contribution.

The third is that you'll have a increasing favorable impact in each subsequent quarter from the four de novos or the four new hospitals – excuse me, that were brought on board in the fourth quarter of last year. As Jay mentioned, those facilities will roughly break even from an EBITDA perspective in Q1. But their contribution will ramp up through the course of the year.

And finally, just based on the composition of the Encompass business and predominantly the same-store growth within their business, as well as the contribution from agencies acquired in 2014, their EBITDA contribution also increases through the course of the year.

<Q – A.J. Rice – UBS Securities LLC>: Okay. That's great. And maybe just a quick follow-up, on the home health deal pipeline you mentioned. Is there some way to think about the order of magnitude of capital you would allocate to that area? What is sort of – how do you think about how much you're likely to grow that acquisition-wise in the next few years?

<A – Doug Coltharp – HealthSouth Corp.>: As was included in the slide that we had in our deck regarding uses of free cash flow at the beginning of the year and has stayed the same, we've got a placeholder for $35 million to $40 million of agency acquisitions in there. We think that that's a good number to factor into your planning, but it's not a limit. So, we see quality opportunities and the Encompass team is comfortable that they have the bandwidth to continue to bring those on board, we can go above that. But right now, we think that the good estimate is something in that $30 million to $40 million range.

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

<Q – Gary Lieberman – Wells Fargo Securities LLC>: Good morning. Thanks for taking the question. Is there any kind of meaningful difference in the revenue per episode or episodes – visits per episode between Home Health – the HealthSouth Home Health operations and Encompass?

<A – Jay Grinney – HealthSouth Corp.>: The Home Health – the legacy Home Health from HealthSouth was predominantly therapy-related. We didn't offer anything, but therapy services. If you look on page 25 of the supplemental slides that were out there, and I realize there was a big deck. But if you go back to the step – that page and you look at the revenue per episode, you can see that – and go to the far right, you can see the 25 legacy home health agencies and the pricing there, revenue per episode was tracking higher than what we saw in the Encompass operations.

<Q – Gary Lieberman – Wells Fargo Securities LLC>: Okay. Great. Thanks for pointing that out. And then, can you talk a little bit about the integration, if there is any, between the HealthSouth sales and marketing teams and the Encompass sales and marketing teams, and maybe just walk us through how a hand-off might work from a HealthSouth facility into Encompass?

<A – Mark Tarr – HealthSouth Corp.>: Yeah. Hey Gary. This is Mark Tarr. Really, yes, the sales teams are collaborating together, but primarily, it happens within the hospitals as we have our directors of case management that are assigned to each one of our patients and responsible for their discharge plans. The degree of which they communicate and coordinate with the liaisons from the Encompass team will better coordinate that discharge and have a smooth transition at the time of discharge from our hospital into the Encompass Home Health segment.

<A – Jay Grinney – HealthSouth Corp.>: And I would say, Gary that we are – to be very candid, we are in the very early stages of that formal relationship and more coordination between the various sales efforts. I think that that's an opportunity that will be there for us to take advantage of over time. But right now, that's in its really early stages.

Operator: Your next question comes from the line of Frank Morgan of RBC Capital Markets.

<Q – Frank Morgan – RBC Capital Markets LLC>: Good morning. I wanted to go back to the discussion around capturing that patient volume [indiscernible] (42:41) to your home health care agencies now from your rehab hospitals. Who is really the main decision maker in that process? Is it really the doctor, the patient, the family, the discharge planner? I'm assuming that has to be sort of a delicate conversation. But who do you see implementing that decision the most, and how difficult do you think it will be to capture all your discharge volume and capture it in your Encompass Home Health?

<A – Jay Grinney – HealthSouth Corp.>: Well, I think that the answer is all of the above. Unfortunately, Frank, there isn't a single individual that, across the board, always is the dominant factor. Physicians certainly play a role. As you know, patient choice is a requirement. Case managers can influence the process. So, when we look at the opportunity to provide a superior level of home care services for patients who are being discharged from our hospitals, we're looking to approach all of those parties to introduce them to the capabilities of Encompass: the higher quality of care, the higher patient satisfaction.

As you know, there are going to be a lot of just on-the-ground, hand-to-hand combat kind of things that we have to overcome. There may be physicians who have medical directorships with the existing home health companies or agencies out there, we'll have to overcome that. There may be existing referral patterns that have to be reassigned, reestablished. But we do think that over time, we'll be able to get a large number of those patients into our home health operations.

And if you think about down the road, to the extent that we get more involved with bundled payments, to the extent that we participate in ACOs, the ability to direct patients is going to be infinitely easier. And we think that – well, frankly, that's one of the reasons why we went into this in the first place is because we do see that as being the future of the delivery system. And we think that having that facility-based as well as home-based capability is going to be very, very important.

So, when we go in and we are talking with patients and family members and physicians, we're certainly recommending Encompass as our preferred provider for home health services. And that's something that, as I mentioned a moment ago, we're really in the early stages of developing, but I think that over time, we'll be able to improve on that. And we look forward to the real – the benefits to the patients that this partnership is going to create.

<A – Doug Coltharp – HealthSouth Corp.>: And I think to appropriately set the expectations, we're very excited, the Encompass team and the HealthSouth team, are collectively very excited about the opportunity to capture the in-market revenue synergies that's present in the discharges to home health coming out of our IRFs.

Having said that, 2015 is going to be a year in which we establish a foundation to do that and probably don't move the needle very much. To begin with, less than a third of those discharged to home health are currently occurring in markets in which we have, either between Encompass or a legacy home health agency, a current home health presence. And within those markets, as Jay mentioned in his comments, the legacy issues are going to spend this year really transitioning over to Encompass. And that's a significant undertaking. They've got to go through some retraining in the Encompass way. They've got to get converted to a new IT platform and so forth.

For those IRFs that are served by an Encompass agency that already exists, for the most part, that Encompass agency has been staffed and oriented towards a different patient population. And as they move to target more of the therapy cases that are coming out of our hospitals, they've got to look at a different staffing complement, they've got to develop the referral relationships with the key decision makers that you referenced in your comments, all of these things are important to have in place before we can really seize the opportunity. So, we are going to aggressively pursue those end market revenue synergies, but it's something that's going to happen over time.

When you get to the roughly two-thirds of those discharges that are going into markets where we don't currently have a home health agency, that means that we have to solve that or put ourselves in a position to capture those discharges with incremental agency acquisitions. And again, you've seen some positive signs there with the two acquisitions that Encompass has made thus far this year that we referenced. I noted in the first quarter, they made the acquisition of Integrity in Las Vegas. That's a market where we have three IRFs. But it's going to take time to consummate those acquisitions.

<Q – Frank Morgan – RBC Capital Markets LLC>: Thanks for all the detail. And then, Jay, since you mentioned BPCI, are you involved, has anybody asked you to participate with them as part of one of the BPCI programs now or are you doing anything on your own? Thanks.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. We have several hospitals participating in the Model 3, and we have several hospitals participating as part of the Model 2. Mark, do you want to elaborate on that?

<A – Mark Tarr – HealthSouth Corp.>: Hey, Frank. We've got five hospitals that as of April 1 are participating in a Model 3, one episode per hospital. We have three others that will be added on effective July 1. So, as of this week, we had 24 patients in the programs, so we'll see where that goes. We'll have to get a better idea about what we will have to do to position ourselves in the future should this take on a larger scale.

Operator: [Operator Instructions] Your next question comes from the line of Kevin Fischbeck of Bank of America Merrill Lynch.

<Q – Joanna Gajuk – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Hey, good morning. This is Joanna Gajuk filling in for Kevin today. Thanks for taking the question here. Just quickly, on the Encompass acquisition and the business itself, you mentioned you expect the EBITDA ramp-up over the year. But I believe it's a function of just the growth of its health plan. So, can you comment on the margin outlook for that business? I guess the numbers you gave for Q1 indicated margin in the 15% range. So, is there something you can talk about the ramp-up in margin over the – through the year and how it compares to prior year?

<A – Jay Grinney – HealthSouth Corp.>: It was a little hard to hear you. I think the question related to what are our expectations for the Home Health and Hospice segment margin over the balance of the year?

<Q – Joanna Gajuk – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Correct.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. And we don't see it moving materially from where it is right now. You'll get a combination of some leverage opportunities as acquisitions that were made previously continue to mature. But that's going to be at least partially offset by new acquisitions coming into the fold. So, it won't be materially different.

<Q – Joanna Gajuk – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: All right. So, it's pretty much – so the growth you're talking about, to A.J.'s question about EBITDA ramping up through the year, it's a function of the top-line growth rather than the margin expansion in that business, correct?

<A – Jay Grinney – HealthSouth Corp.>: That's correct.

<Q – Joanna Gajuk – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Great. And then on that topic, on the deal sort of pipeline in the Home Health business, can you talk about the multiples and the sizes of sort of things you look at in that respect? And is there sort of increased number of sellers that's due to the pressure on reimbursement there, so any additional color you can give on the topic? Thank you.

<A – Jay Grinney – HealthSouth Corp.>: Yeah. Because we're active buyers in the market, we're really not going to talk about how we look at them from an acquisition standpoint. I will say that we are very pleased with the pipeline that the team at Encompass had been developing and brought into this transaction.

As Doug mentioned, we're going to be looking for acquisitions both in markets where we have a hospital, but did not have any home health. We think there are some very nice opportunities there. So, overall, the pipeline is pretty robust. And we feel pretty confident that the growth objectives that we've established for ourselves through Encompass will be realized.

<Q – Joanna Gajuk – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Thank you.

Operator: Thank you. At this time, I will turn the call to Mary Ann Arico for any additional or closing remarks.

Mary Ann Arico, Chief Investor Relations Officer

Thank you. As a reminder, we have an Investor Day scheduled for June 10 in New York City. If you have not already RSVP'd and would like to attend, please let us know. If you have additional questions, I will be available later today. Please call me at 205-969-6175. Thank you.

Operator: Thank you for participating in HealthSouth's first quarter 2015 earnings conference call. You may now disconnect.