

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ALABAMA  
SOUTHERN DIVISION

In re HEALTHSOUTH CORPORATION	)	Consolidated Case No. CV-03-BE-1500-S
SECURITIES LITIGATION	)	
<hr/>	)	<u>CLASS ACTION</u>
This Document Relates To:	)	APPENDICES TO JOINT AMENDED
	)	CONSOLIDATED COMPLAINT FOR
ALL ACTIONS.	)	VIOLATIONS OF THE FEDERAL
<hr/>	)	SECURITIES LAWS

In support of the allegations made in the Joint Amended Consolidated Class Action Complaint for Violations of the Federal Securities Laws [Factual Basis], plaintiffs hereby submit the following documents:<sup>1</sup>

- Appendix 1: Members of HealthSouth's Board and Board Committees
- Appendix 2: False and Misleading Statements Re HealthSouth's Financial and Operating Results
- Appendix 3: Defendants' Insider Trading
- Appendix 4: 20A Contemporaneous Trades
- Appendix 5: Board Attendance for Selected Meetings
- Appendix 6: Summary of False Statements by UBS
- Appendix 7: Summary of False Statements by Citi/Salomon
- Appendix 8: HealthSouth's Historical Acquisitions Daily Share Pricing – September 24, 1986 to September 5, 2003
- Appendix 9: Defendants' Insider Selling and Notes Offerings Daily Share Pricing: 10/03/1994 - 4/17/2003
- Appendix 10: HealthSouth Corp. – Salomon Smith Barney Underwritings/Loans/Analyst Reports and Daily Share Prices April 1997 to June 2003
- Appendix 11: HealthSouth Corp. – UBS Underwritings/Loans/Analyst Reports Daily Share Pricing – July 1, 1996 - April 18, 2003
- Appendix 12: Selected False or Misleading Statements Issued by HealthSouth, UBS and Salomon – Daily Share Pricing – January 2, 1997 to June 30, 2003
- Appendix 13: Facts Related to Steve Schlatter
- Appendix 14: Facts Based on the Testimony of Martin Cohen Before the House Committee on Energy and Commerce, October 16, 2003.
- Appendix 15: BBA Provisions

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<sup>1</sup> Pursuant to the Court's January 6, 2004 Order Regarding Electronic Service, oversized documents, Appendices 8 through 12, shall be served by overnight delivery.



**APPENDIX 1**  
**Members of HealthSouth's Board and Board Committees**

<u>Director</u>	<u>Period</u>	<u>Committees</u>
Betsy S. Atkins	3/10/03-3/24/03	
Aaron Beam, Jr.	1993-1997	
James P. Bennett	1993-07/00	Corporate Compliance 1998-1999
P. Daryl Brown	03/95-05/00	
Richard F. Celeste	1991-08/93; 05/95-1997	
John S. Chamberlin	1993-Present	Corporate Compliance 1998-1999; Compensation 2000-2002
C. Sage Givens	1985-Present	Audit/Compensation 1995-March 2000; Audit March 2000-2002; Nominating 2001-2002
Joel C. Gordon	1996-Present	Corporate Compliance 2002
John F. Hanson	9/02-Present	Special Litigation 2002
Lee S. Hillman	8/02-Present	
Larry R. House	2/93-1998	
Jan L. Jones	2000-2/2001	Compensation 2000-Feb. 2001
Michael D. Martin	03/98-02/00	
Robert P. May	10/02-Present	Special Litigation 2002
Charles W. Newhall III	1985-12/2003	Independent Stock 1995; Nominating 2001-2002; Corporate Compliance 1998-2002
William T. Owens	2001-10/9/03	
Richard M. Scrusby	1984-2003	Corporate Compliance 1998-1999
Larry D. Striplin, Jr.	1999-Present	Audit March 2000-2002; Special Litigation 2002; Compensation March 2000-2002
George H. Strong	1984-12/2003	Audit/Compensation 1995-March 2000; Audit March 2000-2002; Nominating 2001-2002
Anthony J. Tanner	02/93-1999	Corporate Compliance 1998-1999
Phillip C. Watkins	1984-2/2003	Audit/Compensation 1995-March 2000; Corporate Compliance 2000-2002; Compensation 2001

**1995**

	<u>Audit/Compensation</u>	<u>Independent Stock</u>
C. Sage Givens	X	X
Charles W. Newhall III		X
George H. Strong	X	
Phillip C. Watkins	X	

**1996**

	<u>Audit/Compensation</u>
C. Sage Givens	X
George H. Strong	X
Phillip C. Watkins	X

**1997**

	<u>Audit/Compensation</u>
C. Sage Givens	X
George H. Strong	X
Phillip C. Watkins	X

**1998**

	<u>Audit/Compensation</u>	<u>Corporate Compliance</u>
James P. Bennett		X
John S. Chamberlin		X
C. Sage Givens	X	
Joel C. Gordon		X
Charles W. Newhall III		X
Richard M. Scrusby		X
George H. Strong	X	
Anthony J. Tanner		X
Phillip C. Watkins	X	

**1999**

	<u>Audit/Compensation</u>	<u>Corporate Compliance</u>
James P. Bennett		X
John S. Chamberlin		X
C. Sage Givens	X	
Joel C. Gordon		X
Charles W. Newhall III		X
Richard M. Scrusby		X
George H. Strong	X	
Anthony J. Tanner		X
Phillip C. Watkins	X	

**2000**

	<u>Audit/Compensation</u>	<u>Corporate Compliance</u>	<u>Audit*</u>	<u>Compensation*</u>
John S. Chamberlin				X
C. Sage Givens	X		X	
Joel C. Gordon		X		
Jan L. Jones				X
Charles W. Newhall III		X		
Larry D. Striplin, Jr.			X	X
George H. Strong	X		X	
Phillip C. Watkins	X	X		

\* In March 2000 the Audit and Compensation Committees became separate committees

**2001**

	<u>Audit</u>	<u>Compensation</u>	<u>Corporate Compliance</u>	<u>Nominating</u>
John S. Chamberlin		X		
C. Sage Givens	X			X
Joel C. Gordon			X	
Jan L. Jones		X		
Charles W. Newhall III			X	X
Larry D. Striplin, Jr.	X	X		
George H. Strong	X			X
Phillip C. Watkins		X*	X	

\* In February 2001 Jones resigned from the Board and Watkins took her seat on the Compensation Committee

**2002**

	<u>Audit</u>	<u>Compensation</u>	<u>Corporate Compliance</u>	<u>Nominating</u>	<u>Special Litigation*</u>
John S. Chamberlin		X			
John F. Hanson					X
C. Sage Givens	X			X	
Joel C. Gordon			X		
Robert P. May					X**
Charles W. Newhall III			X	X	
Larry D. Striplin, Jr.	X	X			X
George H. Strong	X			X	
Phillip C. Watkins		X	X		

\* Committee created 9/2002

\*\* May joined committee in October 2002 upon Striplin's committee resignation

**HealthSouth Audit/Compensation Committee- 1995**

C. Sage Givens	General Partner, First Century Partners, and Director
George H. Strong	Private Investor, Locust, New Jersey, and Director
Phillip C. Watkins	Physician, Birmingham, Alabama, and Director

**HealthSouth Independent Stock Committee- 1995**

C. Sage Givens	General Partner, First Century Partners, and Director
Charles W. Newhall III	Partner, New Enterprise Associates Limited Partnerships, and Director

**HealthSouth Audit/Compensation Committee- 1996**

C. Sage Givens	General Partner, First Century Partners, and Director
George H. Strong	Private Investor, Locust, New Jersey, and Director
Phillip C. Watkins	Physician, Birmingham, Alabama, and Director

**HealthSouth Audit/Compensation Committee- 1997**

C. Sage Givens            General Partner, First Century Partners, and Director

George H. Strong        Private Investor, Locust, New Jersey, and Director

Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Audit/Compensation Committee- 1998**

C. Sage Givens            General Partner, First Century Partners, and Director

George H. Strong        Private Investor, Locust, New Jersey, and Director

Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Corporate Compliance Committee- 1998**

James P. Bennett        President, Chief Operating Officer and Director

John S. Chamberlin      Private Investor, Princeton, New Jersey, and Director

Joel C. Gordon            Private Investor, Nashville, Tennessee, Consultant to the Company and Director

Charles W. Newhall III   Partner, New Enterprise Associates Limited Partnerships, and Director

Richard M. Scruschy     Chairman of the Board, Chief Executive Officer and Director

Anthony J. Tanner        Executive Vice President- Administration, Secretary and Director

**HealthSouth Audit/Compensation Committee- 1999**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director

George H. Strong        Private Investor, Locust, New Jersey, and Director

Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Corporate Compliance Committee- 1999**

James P. Bennett            President, Chief Operating Officer and Director

John S. Chamberlin        Private Investor, Princeton, New Jersey, and Director

Joel C. Gordon             Private Investor, Nashville, Tennessee, Consultant to the Company and Director

Charles W. Newhall III    Partner, New Enterprise Associates Limited Partnerships, and Director

Richard M. Scrusby        Chairman of the Board, Chief Executive Officer and Director

Anthony J. Tanner         Executive Vice President- Administration, Secretary and Director

**HealthSouth Audit/Compensation Committee- Until March 2000**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director

George H. Strong         Private Investor, Locust, New Jersey, and Director

Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Audit Committee- After March 2000**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director

Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director

George H. Strong         Private Investor, Locust, New Jersey, and Director

**HealthSouth Compensation Committee- After March 2000**

John S. Chamberlin        Private Investor, Princeton, New Jersey, and Director

Jan L. Jones                Executive Director, Nevada Resort Partners, and Director

Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director

**HealthSouth Corporate Compliance Committee- 2000**

Joel C. Gordon             Private Investor, Nashville, Tennessee, Consultant to the Company and Director

Charles W. Newhall III    Partner, New Enterprise Associates Limited Partnerships, and Director

Phillip C. Watkins        Physician, Birmingham, Alabama, and Director



**HealthSouth Audit Committee- 2001**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director  
Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director  
George H. Strong          Private Investor, Locust, New Jersey, and Director

**HealthSouth Compensation Committee- 2001**

John S. Chamberlin      Private Investor, Princeton, New Jersey, and Director  
Jan L. Jones              Executive Director, Nevada Resort Partners, and Director  
Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director  
Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Corporate Compliance Committee- 2001**

Joel C. Gordon            Private Investor, Nashville, Tennessee, Consultant to the Company and Director  
Charles W. Newhall III    Partner, New Enterprise Associates Limited Partnerships, and Director  
Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Nominating Committee- 2001**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director  
George H. Strong          Private Investor, Locust, New Jersey, and Director  
Charles W. Newhall III    Partner, New Enterprise Associates Limited Partnerships, and Director

**HealthSouth Audit Committee- 2002**

C. Sage Givens            General Partner, Acacia Venture Partners, and Director  
Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director  
George H. Strong          Private Investor, Locust, New Jersey, and Director

**HealthSouth Compensation Committee- 2002**

John S. Chamberlin      Private Investor, Princeton, New Jersey, and Director  
Larry D. Striplin, Jr.      Chairman and CEO, Nelson-Brantley Glass Contractors, and Director  
Phillip C. Watkins        Physician, Birmingham, Alabama, and Director

**HealthSouth Corporate Compliance Committee- 2002**

Joel C. Gordon Private Investor, Nashville, Tennessee, Consultant to the Company and Director

Charles W. Newhall III Partner, New Enterprise Associates Limited Partnerships, and Director

Phillip C. Watkins Physician, Birmingham, Alabama, and Director

**HealthSouth Nominating Committee- 2002**

C. Sage Givens General Partner, Acacia Venture Partners, and Director

Charles W. Newhall III Partner, New Enterprise Associates Limited Partnerships, and Director

George H. Strong Private Investor, Locust, New Jersey, and Director

**HealthSouth Special Litigation Committee- 2002**

John F. Hanson Chairman of a real estate investment firm, New Jersey, and Director

Robert P. May Private Investor, consultant, and Director

Larry D. Striplin, Jr. Chairman and CEO, Nelson-Brantley Glass Contractors, and Director

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**APPENDIX 2**

**FALSE AND MISLEADING STATEMENTS RE HEALTHSOUTH'S  
FINANCIAL AND OPERATING RESULTS**

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**FALSE AND MISLEADING STATEMENTS RE HEALTHSOUTH'S  
FINANCIAL AND OPERATING RESULTS**

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Third Quarter 1997**

1. On April 24, 1997, HealthSouth issued a press release via PR Newswire, which reported the Company's first quarter 1997 results and was entitled "HEALTHSOUTH Reports 29 Percent Increase In Income Per Share." The release stated:

HEALTHSOUTH Corporation announced today its operating results for the first quarter of 1997. Income per share rose 29% to 22 cents per share for the quarter ended March 31, 1997, compared to 17 cents per share for the same period in 1996....

*"I am pleased to report our 43rd consecutive quarter of meeting or exceeding analysts' expectations," said Richard M. Scrushy ....*

Scrushy also told investors that "we achieved record profitability during the third quarter."

2. On July 17, 1997, HealthSouth issued a press release over PR Newswire announcing its second quarter 1997 results and for the six months including June 30, 1997. The release stated:

HEALTHSOUTH Corporation announced today its operating results for the quarter and six months ended June 30, 1997. Earnings per share rose 28%, to 23 cents per share, for the quarter ended June 30, 1997, compared to 18 cents per share for the same period in 1996. Net income rose 31% to \$81 million for the quarter on revenues of \$723 million, a 15% increase over the same period in 1996.

\* \* \*

"I am extremely pleased to report our operating results for the second quarter of 1997," said Richard M. Scrushy, HEALTHSOUTH's Chairman of the Board and Chief Executive Officer.

3. On October 30, 1997, HealthSouth reported that, for third quarter 1997, its earnings rose to \$0.24 per share from \$0.19 per share in 3Q96. The release stated:

HEALTHSOUTH Corporation announced today its operating results for the quarter and nine months ended September 30, 1997. Income per share before nonrecurring expenses rose 26%, to 24 cents per share, for the quarter ended September 30, 1997, compared to 19 cents per share for the same period in 1996.

Income rose 28%, to \$86 million, for the quarter on revenues of \$748 million, a 15% increase over the same period in 1996.

For the nine months ended September 30, 1997, HEALTHSOUTH's income per share before nonrecurring expenses rose 28%, from 54 cents in the 1996 period to 69 cents in the 1997 period. Income for the period rose 30%, to \$243 million, while revenues increased 14%, from \$1.9 billion to \$2.2 billion. Non-recurring expenses in the 1997 nine-month period associated with the Health Images acquisition reduced income by \$11 million, net of income taxes. Non-recurring expenses in the 1996 period related primarily to the Surgical Care Affiliates, Advantage Health and Professional Sports Care Management acquisitions.

“In the third quarter, we achieved record profitability, continued to execute our internal growth strategy, and closed the ASC Network acquisition,” said Richard M. Scrushy, HEALTHSOUTH's Chairman of the Board and Chief Executive Officer. “Continued same-store growth, increased internal development, and expense controls drove our increased profitability. In addition to opening or acquiring 69 locations within the quarter, including 53 outpatient rehabilitation locations, three outpatient surgery centers, and 13 occupational medicine facilities, we also closed the ASC Network acquisition on September 30, adding 29 outpatient surgery centers and creating six new Integrated Service Markets.

#### **False and/or Misleading Statements Re: HealthSouth's Financial and Operating Results for the Year End 1997**

4. On February 25, 1998, HealthSouth announced via PR Newswire that, for 1997, its earnings rose to \$0.94 from \$0.74 in the previous year. The release stated:

##### **HEALTHSOUTH Reports 34% Increase In Income For 1997**

HEALTHSOUTH Corporation announced operating results for the quarter and year ended December 31, 1997. Excluding non-recurring expenses in each year relating to acquisitions, income for the year rose 34%, to \$342 million, compared to \$256 million in 1996. The corresponding income per share (assuming dilution) was \$0.94 for 1997, a 27% increase as compared to \$0.74 in 1996. Revenues for the year exceeded \$3.0 billion, a 17% increase over 1996. Non-recurring expenses associated with the 1997 acquisition of Health Images, Inc. reduced net income by \$11 million for the year ended December 31, 1997.

For the quarter ended December 31, 1997, revenues exceeded \$854 million, a 26% increase over the 1996 period, with income excluding non-recurring expenses rising 43%, to \$99 million, as compared to the \$69 million generated in the 1996 quarter. On a per share basis (assuming dilution), income excluding non-recurring expenses for the 1997 quarter rose to \$0.25 as compared to \$0.20 in the 1996 quarter, a 25% increase.

“HEALTHSOUTH’s 46th quarter of meeting or exceeding analysts’ expectations demonstrates our ability to consistently produce superior financial results,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer.... On December 31, 1997, HEALTHSOUTH completed the divestiture of the Horizon/CMS long-term care assets for \$1.25 billion. This significantly strengthened our balance sheet, leading to our recent upgrade by both Standard & Poor’s and Moody’s to investment grade.

5. On April 1, 1998, HealthSouth filed its Form 10-K for the year ending December 31, 1997 (the “1997 Form 10-K”) with the SEC. Scrushy, Martin, and Owens signed the 1997 Form 10-K, which reiterated the financial results reported in the February 25 press release. The 1997 Form 10-K stated in part:

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services.... The Company has developed its operational systems to assure compliance with the various standards and requirements of the Medicare program and has established ongoing quality assurance activities to monitor compliance. ***The Company believes that all of such facilities currently meet all applicable Medicare requirements.***

\* \* \*

As part of the Balanced Budget Act of 1997, Congress directed the United States Department of Health and Human Services to develop regulations that would subject inpatient rehabilitation hospital [sic] to a PPS. The prospective rates are to be phased in beginning October 1, 2000, and are to be fully implemented on October 1, 2002. The Act requires that rates must equal 98% of the amount of payments that would have been made if the PPS had not been adopted. In addition, the Act requires the establishment of a PPS for hospital outpatient department services, effective for services furnished beginning in 1999. ***Since the drafting of the regulations covering these initiatives is in very early stages, the Company cannot predict at this time the effect that any such changes may have on its operations.***

Statement of Income (in thousands, except for share data)	1997	1996	1995	1994	1993
Revenue	\$3,017,269	\$2,568,155	\$2,118,681	\$1,726,321	\$1,055,295
Net income	330,608	189,864	98,250	86,948	64,233



Net income per common share	\$0.95	\$0.59	\$0.34	\$0.32	\$0.24
Net income per common share assuming dilution	\$0.91	\$0.55	\$0.32	\$0.30	\$0.23
Statement of Income (in thousands)	1997	1996	1995	1994	1993
Total assets	\$5,401,053	\$3,529,706	\$3,107,808	\$2,355,920	\$2,000,566
Retained earnings	\$853,641	\$525,718	\$355,361	\$273,768	\$195,168
Stockholder equity	\$3,157,428	\$1,569,101	\$1,269,686	\$837,160	\$727,737

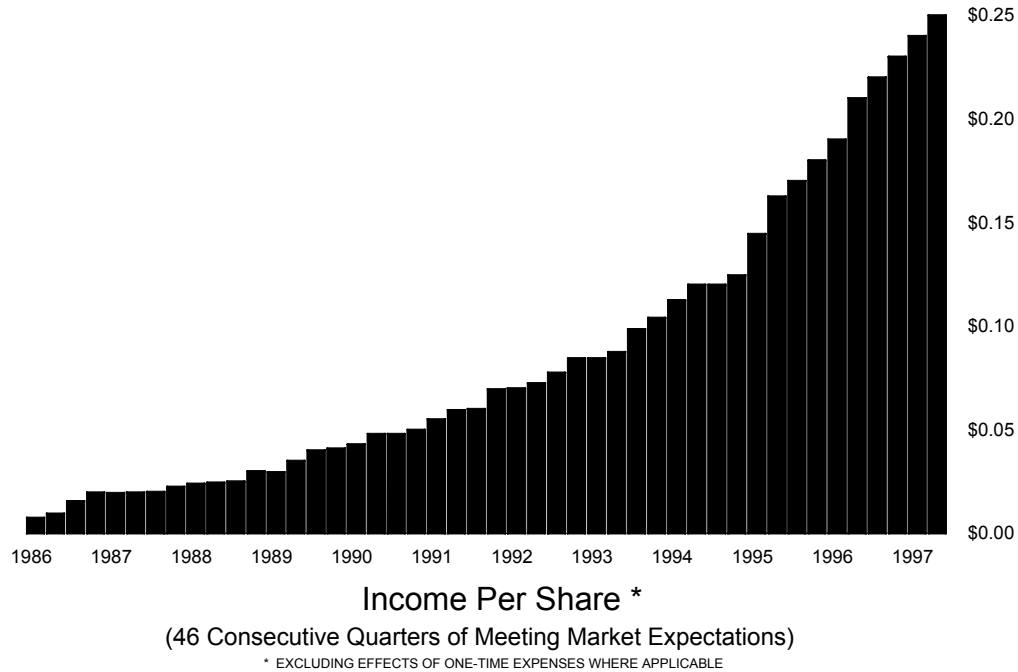
6. On April 28, 1998, HealthSouth distributed its 1997 Annual Report to Shareholders which contained a letter from Scrushy falsely stating:

I am proud to announce that HealthSouth experienced ***another year of outstanding growth and profitability in 1997.***

***This year, we extended our record to 46 quarters of meeting market expectations, with a revenue increase of 17% over 1996.*** Income excluding one-time expenses grew by 34%, while corresponding income per share increased by 27%. Our earnings growth led to share price appreciation of more than 44% for the year ....

7. HealthSouth's 1997 Annual Report contained charts and graphs showing the Company's purported "consistent earnings" growth in income, assets and stockholders equity and that HealthSouth had "46 quarters of meeting market expectations."

8. HealthSouth 97 Report also contained a graph highlighting the Company's supposedly consistent earnings growth over the prior decade:



9. Elsewhere, HealthSouth's 97 Annual Report stated:

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services.... The Company has developed its operational systems to assure compliance with the various standards and requirements of the Medicare program and has established ongoing quality assurance activities to monitor compliance.

\* \* \*

Over the past several years an increasing number of healthcare providers have been accused of violating the federal False Claims Act. That Act prohibits the knowing presentation of a false claim to the United States government. Because the Company performs thousands of similar procedures a year for which it is reimbursed by Medicare and there is a relatively long statute of limitations, a billing error could result in significant civil penalties. ***The Company does not believe that it is or has been in violation of the False Claims Act.***

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for First Quarter 1998**

10. On April 21, 1998, HealthSouth announced over the PR Newswire that, for first quarter 1998, its earnings rose to \$0.27 per share from \$0.22 per share in first quarter 1997. The release stated:

HEALTHSOUTH Corporation announced today its operating results for the first quarter of 1998. Income for the quarter ended March 31, 1998 rose 44%, to \$109 million, compared to income before non-recurring expenses of \$76 million for the same period in 1997. The corresponding income per share (assuming dilution) rose 23%, to 27 cents per share, for the 1998 quarter, compared to 22 cents per share for the 1997 quarter. Revenues for the quarter were \$908 million, a 31% increase over the 1997 quarter.

"I am pleased to report our 47th consecutive quarter of meeting or exceeding analysts' expectations," said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "During the first quarter of 1998, we continued the successful integration of our major 1997 acquisitions and the implementation of our Integrated Service Model. In addition, we added 106 new facilities through our internal development program and continued to recognize strong same-store growth in all divisions. During the quarter, we also received investment-grade ratings from Standard & Poor's and Moody's and capitalized on the upgrade to raise nearly \$568 million in an institutional private placement of convertible debentures. As we move into the second quarter, we have continued to further our strategic plan with last week's announcement of HEALTHSOUTH's pending acquisition of 34 ambulatory surgery centers from Columbia/HCA."

11. In connection with the foregoing announcement, HealthSouth held a conference call, hosted by defendant Scrushy, for institutional investors and securities analysts, including Swenson, Chiarelli and Sullivan. During that call and in follow-up one-on-one conversations thereafter, Scrushy falsely stated:

- Managed care contracts were continuing to drive incremental volume to HealthSouth's facilities and were boosting revenue, margins and earnings growth.
- As a result, HealthSouth could continue to grow its earnings at an annual rate of 20%-25%, and thereby meet EPS estimates of \$1.15-\$1.16 in 1998 and \$1.40 in 1999.

12. On May 15, 1998, HealthSouth filed the SEC Report on Form 10-Q for the quarter ended March 31, 1998 (the "1Q 1998 10-Q"), which was signed by Scrushy and Martin. The 1Q 1998 10-Q reiterated the financial results reported in the April 21 press release. It also falsely represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results of the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Second Quarter 1998**

13. On July 21, 1998, HealthSouth announced over the PR Newswire that, for second quarter 1998, its EPS rose to \$0.28 from \$0.23 in second quarter 1997. The release stated:

HEALTHSOUTH Corporation announced operating results for the quarter and six months ended June 30, 1998. Earnings per share (assuming dilution) rose 23%, to 28 cents per share, for the quarter ended June 30, 1998, compared to 23 cents per share for the same period in 1997. Net income rose 44%, to \$117 million, for the quarter on revenues of \$942 million, a 30% increase over the same period in 1997.

For the six months ended June 30, 1998, HEALTHSOUTH's income per share before non-recurring expenses rose 23%, from 45 cents in the 1997 period to 55 cents in the 1998 period. Income before non-recurring expenses for the period rose 44%, to \$227 million, while revenues increased 31%, from \$1.41 billion to \$1.85 billion. Non-recurring expenses in the 1997 period relate to the Health Images, Inc. acquisition. There were no non-recurring expenses in the 1998 period.

"I am very pleased to report our operating results for the second quarter of 1998," said Richard M. Scrushy, HEALTHSOUTH's Chairman of the Board and Chief Executive Officer. "During the quarter we continued our focus on internal growth as well as agreeing to acquire National Surgery Centers, Inc. and over 30 outpatient surgery centers from Columbia/HCA Healthcare Corporation. Our financial performance remained strong as we benefited from the profitability associated with strong same-store growth, as well as from economies of scale and expense controls.

"We were pleased to close the Columbia/HCA acquisition on July 1, 1998. With an 85% overlap with HEALTHSOUTH markets, we expect that this acquisition will be immediately accretive to earnings and contribute to our integrated service model development. I am also pleased to announce the expected closing of the National Surgery Centers acquisition later this week."

14. In connection with this press release, HealthSouth held a conference call, hosted by defendant Scrusby, for institutional investors and securities analysts. During that call and in private one-on-one conversations with Swenson, Sullivan and Chiarelli thereafter, Scrusby stated:

- The Integrated Services Division, coupled with managed care contracts, was continuing to drive incremental volume to HealthSouth facilities and thereby enhancing revenue, margin and earnings growth.
- As a result, HealthSouth's same-store sales growth remained strong.
- As a result, HealthSouth would be able to grow its revenues at the rate of 15%-20% through the year 2001.
- As a result, HealthSouth would be able to grow its earnings at 20%-25% in 1998 and 1999 and thereby meet EPS estimates of \$1.15 in 1998 and \$1.40 in 1999.

15. On August 14, 1998, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending June 30, 1998 (the "2Q 1998 10-Q"), signed by Scrusby and Martin. The 2Q 1998 10-Q reiterated the financial results reported in the July 21 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

16. On September 30, 1998, HealthSouth announced over the PR Newswire a stock buy back because the "current trading price ... does not reflect appropriate value for our strong fundamentals or our results of operations." The release stated:

HEALTHSOUTH Corporation announced that its Board of Directors has today approved the repurchase of up to 1.6 million shares of its Common Stock through open market purchases, block trades or privately negotiated transactions. Such repurchases, if any, will be effected from time to time in amounts determined by the company's management, depending on market conditions. Any such repurchases will be funded from available working capital and cash flow from operations and will be effected within the next twelve months. The company also announced that members of its senior management and Board of Directors have expressed their intention to purchase up to one million shares of the company's common stock, depending on market conditions.

"HEALTHSOUTH's management and Board of Directors believe that the current trading price of our stock does not reflect appropriate value for our strong

fundamentals or our results of operations,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “We believe that, at existing market levels, this repurchase represents an excellent use of our capital and an opportunity to enhance value for our shareholders.”

**False and/or Misleading Statements Re: HealthSouth’s  
Financial and Operating Results for Third Quarter 1998**

17. On October 27, 1998, HealthSouth issued a press release over the PR Newswire announcing operating results for the quarter and nine months ended 9/30/98. The release stated:

HEALTHSOUTH Corporation announced operating results for the quarter and nine months ended September 30, 1998. Income per share (assuming dilution) from continuing operations before non-recurring expenses rose 17%, to 28 cents per share, for the quarter ended September 30, 1998, compared to 24 cents per share for the same period in 1997. Income from continuing operations before non-recurring expenses rose 46%, to \$123 million, for the quarter on revenues of \$1.024 billion, a 41% increase over the same period in 1997.

For the nine months ended September 30, 1998, HEALTHSOUTH’s income per share (assuming dilution) from continuing operations before non-recurring expenses rose 24%, from 67 cents per share in the 1997 period to 83 cents per share in the 1998 period. Income from continuing operations before non-recurring expenses for the period rose 47%, to \$350 million, while revenues increased 35%, from \$2.1 billion to \$2.824 billion. Non-recurring expenses in the three months and nine months ended September 30, 1998 related to the National Surgery Centers acquisition reduced net income by approximately \$21 million for the periods. Non-recurring expenses in the nine-month period ended September 30, 1997, relate to the Health Images acquisition.

\* \* \*

“Our operating results for the third quarter continue to reflect the strong fundamentals of our business, despite the difficulties that we have faced in the quarter,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “We suffered lost same-store volume and revenues in over 120 facilities located in south Florida and along the Gulf Coast as a result of Hurricane Georges. Our income from continuing operations rose 46% before non-recurring charges, or 17% on a per-share basis.”

18. On November 16, 1998, HealthSouth filed a Report on SEC Form 10-Q for the quarter ending September 30, 1998 (the “3Q 1998 10-Q”), signed by Scrushy and Martin. The 3Q 1998 10-Q reiterated the financial results reported in the October 27 press release. It also

represented that the “consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented.” The report stated:

During the third quarter of 1998, the Company adopted a plan to dispose of or otherwise discontinue substantially all of its home health operations, effective November 1, 1998. Such operations, which were acquired by the Company as portions of larger strategic acquisitions, are inconsistent with the Company’s core business and growth strategy. Accordingly, the Company recorded an impairment loss of approximately \$105,339,000 during the quarter ending September 30, 1998. The loss represents the write-down of the home health assets, including goodwill, to their estimated fair value less the estimated costs to sell or otherwise dispose of the assets.

**False and/or Misleading Statements Re: HealthSouth’s  
Financial and Operating Results for the Year End 1998**

19. On February 8, 1999, HealthSouth issued a press release entitled “HEALTHSOUTH Announces \$1 Billion Stock Repurchase Program And One-Time Charge In Fourth Quarter.” The press release stated:

HEALTHSOUTH Corporation announced today that its Board of Directors had approved the repurchase of up to 70,000,000 shares of its Common Stock (approximately \$1 billion in value at the closing price on February 5, 1999) through open market purchases, block trades or privately negotiated transactions. Such repurchases may be effected from time to time in amounts determined by the Company’s management, depending on market conditions and other factors. Any such repurchases will be funded from available working capital and cash flow from operations and will be effected within the next 36 months. The Company announced that it had completed its previously-announced repurchase of 1,600,000 shares.

“HEALTHSOUTH’s management and Board of Directors continue to believe that the current trading price of our stock does not reflect appropriate value for our strong fundamentals or our results of operations,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “In this environment, we believe that the repurchase of our stock represents a prudent use of our strong cash flow and available working capital.”

HEALTHSOUTH also announced today that it expected to report a one-time charge, net of tax, of approximately \$310 million in the fourth quarter of 1998. This charge, most of which will be non-cash, relates to the value of certain assets obtained through the Company’s major acquisitions. The assets involved in the charge include those relating to the Company’s healthcare staffing, respiratory therapy and durable

medical equipment businesses, which do not fit with the Company's strategic focus and which have been or are being closed or sold, as well as smaller facilities and facilities not located in target markets, which will be consolidated, closed or sold. The exact amount of the one-time charge will be determined over the next few weeks in accordance with FAS 121.

20. On March 4, 1999, HealthSouth issued a press release over the PR Newswire entitled "HEALTHSOUTH Reports 34% Increase in Income for 1998." The press release stated:

HEALTHSOUTH Corporation announced operating results for the quarter and year ended December 31, 1998. Excluding non-recurring expenses in the quarter, income for the fourth quarter of 1998 rose 14%, to \$117 million, compared to \$102 million in the fourth quarter of 1997. The corresponding income per share (assuming dilution) was \$.27 for the 1998 quarter, an 8% increase as compared to \$.25 in the 1997 quarter. Revenues for the quarter exceeded \$1.04 billion, an 18% increase over the 1997 period.

For the year ended December 31, 1998, revenues exceeded \$4.0 billion, a 28% increase over 1997, while income excluding non-recurring expenses rose 34%, to \$474 million, compared to \$355 million in 1997. The corresponding income per share (assuming dilution) was \$1.09 for 1998, an 18% increase as compared to \$.92 in 1997. Non-recurring expenses associated with the discontinuation of substantially all of the Company's home health operations and other businesses and locations not consistent with the Company's strategic focus reduced net income by \$427 million for the year ended December 31, 1998. HEALTHSOUTH's results reflect the inclusion of the results of operations of National Surgery Centers, Inc. for all periods presented. National Surgery Centers was acquired by HEALTHSOUTH in a merger accounted for as a pooling of interests on July 22, 1998. Without giving effect to the National Surgery Centers combination, HEALTHSOUTH's income per share was \$1.10 for 1998.

"Our operating results for the fourth quarter continued to reflect the strong fundamentals of our business, despite the challenges that we faced in the latter part of the year," said Richard M. Scrusby, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "In 1998, we added over 300 new locations through internal development, we completed the acquisition of over 30 ambulatory surgery centers from Columbia/HCA Healthcare Corporation, and we completed our merger with National Surgery Centers, Inc. On February 8, 1999, we announced that our Board of Directors had approved the repurchase of up to 70 million shares of common stock, representing approximately \$1 billion in value at the time of announcement. To date, we have repurchased approximately 7 million shares under the program. HEALTHSOUTH's management and Board of Directors continue to believe that the current trading price of our stock does not reflect appropriate value for the strength of our core business or our results of operations. In this environment, we believe that the repurchase of our stock represents a prudent use of our strong cash flow and available working capital."



21. On March 31, 1999, HealthSouth filed with the SEC a Report on Form 10-K for the year ending December 31, 1998 (the "1998 Form 10-K"). Scrushy, Owens, Martin, Givens, Newhall, Strong, Watkins, Chamberlin, Tanner, Bennett, D. Brown, Gordon, and Striplin signed the 1998 Form 10-K, which reiterated the false financial results reported in the March 4 press release. The 1998 Form 10-K also stated:

The Company's revenues include net patient service revenues and other operating revenues. Net patient service revenues are reported at estimated net realizable amounts from patients, insurance companies, third-party payors ... and others for services rendered.

22. In the 1998 Form 10-K, HealthSouth finally admitted that its closure and write down of its home health operations was a direct result of the BBA and not because they were "inconsistent with the Company's core business and growth strategy." The 10-K belatedly disclosed:

During the third quarter of 1998, the Company adopted a plan to dispose of or otherwise discontinue substantially all of its home health operations. The decision to adopt the plan was prompted in large part by the negative impact of the 1997 Balanced Budget Act (the "BBA"), which placed reimbursement limits on home health businesses. The limits were announced in March 1998 and the Company thereafter began to see the adverse affect on home health margins. The negative trends that occurred as a result in the reduction in reimbursement brought about by the BBA caused the Company to re-evaluate its view of the home health product line. The plan was approved by the Board of Directors on September 16, 1998 and all home health operations covered by the plan were closed by December 31, 1998.

The Company recorded impairment and restructuring charges of approximately \$72,000,000 related to the home health plan. In addition, the Company determined that approximately \$27,768,000 in notes receivable and approximately \$19,228,000 in accounts receivable would not be collectible as a result of the closing of its home health operations. These non-recurring amounts have been recognized in operating unit expenses and the provision for doubtful accounts, respectively. The total non-recurring charges and expenses included in the results of operations for the year ended December 31, 1998 related to the home health plan was approximately \$118,996,000.

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for First Quarter 1999**

23. On April 27, 1999, HealthSouth issued a press release over the PR Newswire, entitled "HEALTHSOUTH Reports First Quarter EPS of \$.26." The report stated:

HEALTHSOUTH Corporation announced operating results for its first quarter ended March 31, 1999. Revenues for the first quarter rose 10%, to \$1.03 billion, compared to \$939 million in the first quarter of 1998. Income for the quarter was \$110 million, approximately level with the first quarter of 1998. The corresponding income per share (assuming dilution) was \$.26 for the 1999 quarter, also equal to the \$.26 reported in the 1998 quarter. HEALTHSOUTH's results reflect the inclusion of the results of operations of National Surgery Centers, Inc. for all periods presented. National Surgery Centers was acquired by HEALTHSOUTH in a merger accounted for as a pooling of interests on July 22, 1998.

"I am pleased to report that HEALTHSOUTH exceeded analysts' expectations for the first quarter of 1999," said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "In the first quarter, we were able to substantially complete the closure of all nonstrategic business units. As reflected in the strength of our first quarter operating results, we believe that we have made significant progress in putting challenges that we faced in the second half of 1998 behind us. During the first quarter, we also announced that our Board of Directors had approved the repurchase of up to 70 million shares of common stock. To date, we have repurchased over 10 million shares under the program, reflecting our belief that the current trading price of our stock still does not reflect appropriate value for the strength of our business or our results of operations."

24. That same day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call and in follow-up conversations with analysts Scrushy and Martin stated:

**RICHARD SCRUSHY:** I am pleased to report that HealthSouth exceeded analysts' expectations for the first quarter of 1999.

In the first quarter we were able to substantially complete the closure of all non-strategic business units as reflected in the strength of our first quarter operating results, we believe that we have made significant progress in putting new challenges that we face in the second half of 1998 behind us.

During the first quarter, we also announced that our Board of Directors had approved the repurchase of up to 70 million shares of common stock. Today, we have repurchased over 10 million shares under the program. Reflecting our belief that the

current trading price of our stock still does not reflect appropriate value for the strength of our business or our results of operations.

\* \* \*

MIKE MARTIN: If you'll look at what we're doing on the cap ex side, maintenance cap ex will range from \$150 to \$250 million. Other capital expenditures, \$300-\$400 million, and that would include a share repurchase.

If you just take the net income for the quarter and the depreciation and amortization, we're on a run-rate to have cash-flow from operations in excess of \$800 million, for the year.

25. On May 17, 1999, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending March 31, 1999 (the "1Q 1999 10-Q") signed by Scrusby and Martin. The 1Q 1999 10-Q reiterated the financial results reported in the April 27 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's Financial and Operating Results for Second Quarter 1999**

26. On August 3, 1999, HealthSouth issues a press release over the PR Newswire, entitled "HEALTHSOUTH Reports Second Quarter EPS of \$.27." The report stated:

HEALTHSOUTH Corporation announced operating results for the quarter and six months ended June 30, 1999. Revenues for the quarter rose 7%, to \$1.048 billion, compared to \$979 million in the second quarter of 1998. Net income for the quarter was \$114 million, compared to \$122 million in the 1998 quarter. Earnings per share (assuming dilution) were \$.27 for the 1999 quarter, down slightly from \$.28 reported in the 1998 quarter but representing an increase of 4% over the first quarter of 1999.

For the six months ended June 30, 1999, HEALTHSOUTH's revenues rose 8%, to \$2.078 billion, as compared to \$1.918 billion in the 1998 period. Net income for the 1999 period was \$224 million, compared to \$235 million in the 1998 period. The corresponding earnings per share (assuming dilution) were \$.52 for the 1999 period, compared to \$.54 reported in the 1998 period. HEALTHSOUTH's results for the quarter and six months reflect the inclusion of the results of operations of National Surgery Centers, Inc. for all periods presented. National Surgery Centers was acquired by HEALTHSOUTH in a merger accounted for as a pooling of interests on July 22, 1998.... "Also in June, we announced a proposed plan to divide

our operations into separate inpatient and outpatient companies, and we continue to make good progress toward completing that plan during the second half of 1999.”

27. On August 16, 1999, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending June 30, 1999 (the “2Q 1999 10-Q”) signed by Scrushy and Martin. The 2Q 1999 10-Q reiterated the financial results reported in the August 3 press release. It also represented that the “consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented.”

**False and/or Misleading Statements Re: HealthSouth’s  
Financial and Operating Results for Third Quarter 1999**

28. On November 3, 1999, HealthSouth issued a press release over the PR Newswire entitled “HEALTHSOUTH Reports Third Quarter Income Per Share of \$.16.” The report stated:

HEALTHSOUTH Corporation announced operating results for the quarter and nine months ended September 30, 1999. Revenues for the quarter were \$993.3 million, compared to \$1.047 billion in the third quarter of 1998. Income before non-recurring expenses for the quarter was \$66.9 million, compared to income before non-recurring expenses of \$122.5 million for the third quarter of 1998. The corresponding income per share (assuming dilution) was \$.16 for the 1999 quarter, compared to income per share (assuming dilution) of \$.28 in the 1998 quarter.

For the nine months ended September 30, 1999, HEALTHSOUTH’s revenues were \$3.072 billion, as compared to \$2.965 billion in the 1998 period. Income before non-recurring expenses for the 1999 period was \$290.8 million, compared to income before non-recurring expenses of \$357.3 million in the 1998 period. The corresponding income per share (assuming dilution) was \$.69 for the 1999 period, compared to income per share (assuming dilution) of \$.82 reported in the 1998 period.

HEALTHSOUTH announced on September 9 that it expected to incur restructuring and other charges ranging from \$250 million to \$300 million during the third and fourth quarters of 1999. In that connection, one-time adjustments reduced net income by \$71.2 million in the 1999 periods. This reflects the provision of additional reserves related to accounts receivable determined by management to be uncollectible during the third quarter of 1999. Those additional reserves primarily relate to accounts receivable of facilities included in the impairment and restructuring charges recognized in 1998. These accounts receivable were determined to be uncollectible by local and regional operations management personnel who assumed collection responsibilities in the third quarter of 1999 in connection with the

elimination of the company's outpatient regional business offices, which had previously been responsible for collection activities.

\* \* \*

Scrushy continued, "In September, we reinstated purchases under our previously announced share repurchase program. We purchased over 28.7 million shares of HEALTHSOUTH Common Stock in September and October, bringing our total purchases under the program to over 36.2 million shares. This reflects management's continued confidence in the long-term value of our company and our belief that our stock remains undervalued. We have done this while remaining committed to our financial policies and the integrity of our balance sheet.

\* \* \*

"Unlike many other providers, however, we face these challenges with strong cash flow, a strong balance sheet, and the best group of assets and one of the most experienced management teams in healthcare."

29. On November 15, 1999, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending September 30, 1999 (the "3Q 1999 10-Q") with the SEC, which was signed by Scrushy and Martin. The 3Q 1999 10-Q reiterated the financial results reported in the November 3 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's Financial and Operating Results for Fourth Quarter 1999 and Year End 1999**

30. On March 7, 2000, HealthSouth announced its purported year-end and quarter results in a press release issued over the PR Newswire entitled "HEALTHSOUTH Operating Results in Line With Wall Street Estimates for Quarter and Year." The press release stated:

HEALTHSOUTH Corporation announced operating results for the quarter and year ended December 31, 1999. For the year, HEALTHSOUTH's revenues were \$4.072 billion, as compared to \$4.006 billion for 1998. Income before unusual and non-recurring expenses for 1999 was \$352.0 million, compared to income before unusual and non-recurring expenses of \$473.8 million in 1998. The corresponding income per share (assuming dilution) was \$.85 for 1999, compared to income per share (assuming dilution) of \$1.09 in 1998.

Revenues for the fourth quarter were \$1.001 billion, compared to \$1.041 billion in the fourth quarter of 1998. Income before unusual and non-recurring expenses for the quarter was \$61.2 million, compared to income before unusual and non-recurring expenses of \$116.5 million for the fourth quarter of 1998. The corresponding income per share (assuming dilution) was \$.16 for the 1999 quarter, compared to income per share (assuming dilution) of \$.27 in the 1998 quarter.

HEALTHSOUTH announced on September 9, 1999, that it expected to incur unusual and non-recurring charges of up to \$300 million during the third and fourth quarters of 1999. In that connection, non-recurring expenses and one-time adjustments reduced net income by \$204.3 million in the fourth quarter of 1999 and by \$275.5 million for the year, net of tax, consistent with the previous announcement. Unusual and non-recurring expenses in the fourth quarter consisted primarily of non-cash expenses arising from the impairment of certain long-lived assets and from a more conservative approach to estimating the allowance for doubtful accounts. Approximately \$16.0 million of the non-recurring expenses were cash expenses relating to Year 2000 remediation efforts.

“While 1999 was a challenging year for HEALTHSOUTH and other healthcare providers, we have continued to execute on our plan to build long-term value for our stockholders and the patients, physicians and payors that we serve,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “Throughout the industry, providers have faced a difficult regulatory and reimbursement environment, and HEALTHSOUTH is no exception. However, we have worked to utilize our exceptional asset base, our experienced management team and our commitment to innovation to adapt to changing conditions and build on the foundation we have established. We are encouraged by improved patient volume trends which were evident in our fourth quarter numbers, even while we have held firm on outpatient pricing. We continue to maintain EBITDA margins well in excess of our competitors. We are also optimistic that the implementation of a prospective payment system for our inpatient rehabilitation facilities beginning later this year will be positive for us, as HEALTHSOUTH will finally be rewarded as the low-cost provider of inpatient rehabilitation services.”

31. On or about March 30, 2000, HealthSouth disseminated its 1999 Annual Report to Shareholders. HealthSouth’s 1999 Annual Report contained the following financial data:

Statement of Income (in thousands, except for per share data)	1999	1998	1997	1996	1995
Revenues	\$4,072,107	\$4,006,074	\$3,123,176	\$2,648,188	\$2,173,012

Net income	\$76,517	\$46,558	\$343,059	\$196,778	\$101,096
	*	*	*		
Net income per common share	\$0.19	\$0.11	\$0.94	\$0.58	\$0.34
	*	*	*		
Statement of income (in thousands)	1999	1998	1997	1996	1995
		*	*	*	
Total assets	6,832,334	6,762,897	5,566,324	3,671,958	3,190,095
	*	*	*		
Retained earnings	\$948,385	\$878,228	\$833,328	\$492,954	\$315,683
Stockholders' equity	3,206,362	3,423,004	3,290,623	1,686,770	1,317,878

32. Elsewhere, HealthSouth's 99 Annual Report stated:

The healthcare industry is subject to regulation by federal, state and local governments. The various levels of regulatory activity affect our business activities by controlling ... the reimbursement to HEALTHSOUTH for services provided.

\* \* \*

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services .... We have developed our operational systems to attempt to assure compliance with the various standards and requirements of the Medicare program and have established ongoing quality assurance activities to monitor compliance.

\* \* \*

Over the past several years an increasing number of healthcare providers have been accused of violating the federal False Claims Act. That Act prohibits the knowing presentation of a false claim to the United States government. Because HEALTHSOUTH performs thousands of similar procedures a year for which it is reimbursed by Medicare and there is a relatively long statute of limitations, a billing error or cost reporting error could result in significant civil or criminal penalties.

33. On March 30, 2000, HealthSouth filed with the SEC a Report on Form 10-K for the year ending December 31, 1999 (the "1999 Form 10-K"), with the SEC. Scrushy, Owens, and Smith

signed the 1999 Form 10-K. The 10-K also contained financial statements for 1999, an unqualified certification by E&Y that the Company had earned \$229.9 million from continuing operations, whereas in fact the Company had in fact suffered a loss of \$160,000,000. The Form 10-K also stated:

Our revenues include net patient service revenues and other operating revenues. Net patient service revenues are reported at estimated net realizable amounts from patients, insurance companies, third-party payors ... and other for services rendered.

34. HealthSouth's audited 1999 financial statements were also included in Appendix A to the Company's Schedule 14A Proxy Statement dated April 14, 2000, which was filed with the SEC and sent to HealthSouth stockholders.

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for First Quarter 2000**

35. On April 24, 2000, HealthSouth issued a press release over the PR Newswire entitled: "HEALTHSOUTH First Quarter Results Exceed Consensus Estimates." The report stated:

HEALTHSOUTH Corporation announced operating results for the quarter ended March 31, 2000. For the first quarter, HEALTHSOUTH's revenues were \$1.021 billion, as compared to \$1.031 billion for the first quarter of 1999. Net income for the 2000 quarter was \$65.3 million, compared to net income of \$109.9 million in the 1999 quarter. Earnings per share (assuming dilution) were \$.17 for the 2000 quarter, compared to \$.26 in the 1999 quarter. On a sequential quarter basis, revenues for the first quarter of 2000 increased 2% over revenues for the fourth quarter of 1999, while net income increased 7% and earnings per share increased 6% compared to income and income per share before unusual and non-recurring expenses in the fourth quarter of 1999. Earnings before interest, taxes, depreciation and amortization increased 5% over the fourth quarter of 1999.

"We are pleased that the management initiatives that we announced in the latter part of 1999 are already beginning to be reflected in our operating results," said Richard M. Scrusby, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "In the first quarter of 2000, our revenues, EBITDA and earnings per share all exceeded consensus Wall Street estimates. We saw improvement in our operating margins after several quarters of downward pressure, and we continued to see a positive trend in accounts receivable days, which decreased between one and two days at March 31, 2000 from December 31, 1999."



Scrushy added, "In this time of rapid change, we have remained committed to prudent financial policies and the integrity of our balance sheet. We are also continuing our efforts to work closely with major managed care payors to improve our collections cycle and get paid full value for our services. Throughout the last year, we have reiterated our commitment to building long-term value for our stockholders. We believe that we are demonstrating the early results of that commitment, and we continue to move forward with new energy and dedication."

36. On April 25, 2000, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrushy and Owens stated:

RICHARD SCRUSHY: The company is proud to announce that our operating results for the quarter ending March 31, 2000, did exceed the analysts' expectations.

On a sequential quarter basis, which really we need to look at these numbers, we believe, because last year -- in the last two years, the company has gone through substantial changes -- as the whole industry has -- based on change due to the Balanced Budget Act, as well as some changes that the company had to go through in the area of pricing with many of its managed-care relationships.

\* \* \*

We are pleased that the management initiatives that we announced in the latter part of 1999 are beginning to be reflected in our operating results.

In the first quarter of 2000 our revenues, EBITDA and earnings-per-share all exceeded the estimates, as I've said. We saw improvement in our operating margins after several quarters of downward pressure, and we continue to see a positive trend in our accounts receivable days, which continued to decrease between 1 and 2 days on this first quarter.

\* \* \*

I'd like to also mention that in this time of rapid change, we have committed to a prudent financial policy and in maintaining the integrity of our balance sheet. We are also continuing our efforts to work closely with major managed-care payors to improve our collection cycle, and get paid full-value for our services.

\* \* \*

Our days sales outstanding continue to show positive improvement. In the 4th Quarter of 1999, we had a decline of 6 days. And, then, we went ahead this morning, and those days continue to climb between 1.5 to 2 days in this 1st Quarter, down to 81 to 81.5 days.

\* \* \*

We did maintain our investment-grade rating, and we continue to maintain a very fine balance sheet.

\* \* \*

But, I think, what's important here is to look at the fact that the company is positioned for that, and as you know, as you bring costs down in this business under cost-based reimbursement, you bring down your revenue. And, people get confused over that on occasions, but your cost is your revenue in a Medicare situation.

So, we have no margin, we have no profit on any of that Medicare business. And, so, as we bring our costs down, we're bringing our revenue down.

Now, under the prospective payment program, we will be paid on a per-discharge basis or a case-basis, which allows us to make a very healthy margin. And, we brought our costs down, so based on what we believe -- and, I what I think everyone believes -- the rates are going to be, which is 98% of what the average cost is on a per-case basis across the board. If you look at HealthSouth, you look at our cost-per-case, you'll see that allows us to have a margin, and for the first time, this company will be able to increase its profitability on the Medicare patients -- or, even have a profit for the first time. And, so we're very excited about -- hopefully, this year, moving into that, and we'll talk about that in a moment.

\* \* \*

RICHARD SCRUSHY: Now, on the PPS side, we do believe that April or so, we're going to see an implementation date, and we think at HealthSouth -- April of next year, we believe HealthSouth is well-positioned to take advantage of this prospective payment program. We've been through those numbers many times, we think that -- and, the information we have as the regulations will be released within the next couple of months.

\* \* \*

BILL OWENS: Howard, I think our position on that is we feel comfortable that we can get the DSO's down to approximately 60 days, by the end of 2001. That's probably somewhat back-end oriented, and that some of the initiatives, as you know, that we have undertaken, in terms of partnering with certain companies to help us electronically in this matter, probably 12 months out from kicking in.

So, I'd see more of a back-end improvement. But, I do feel comfortable with 60 days by the end of '01.

37. On May 15, 2000, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending March 31, 2000 (the "1Q 2000 10-Q") signed by Scrushy and Owens. The 1Q 2000

10-Q reiterated the financial results reported in the April 24 press release. It also falsely represented that the “consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented.”

**False and/or Misleading Statements Re: HealthSouth’s  
Financial and Operating Results for the Second Quarter 2000**

38. On July 18, 2000, HealthSouth announced operating results for the quarter and six months ended June 30, 2000 in a press release issued over the PR newswire entitled: “HEALTHSOUTH Earnings Meet Consensus Estimates; EBITDA Margin, Accounts Receivable Days Improve.” In that press release it was stated:

HEALTHSOUTH Corporation announced operating results for the quarter and six months ended June 30, 2000. For the quarter, HEALTHSOUTH’s revenues were \$1.036 billion, as compared to \$1.048 billion for the second quarter of 1999. Net income for the 2000 quarter was \$65.2 million, compared to net income of \$114.0 million in the 1999 quarter. Earnings per share (assuming dilution) were \$.17 for the 2000 quarter, consistent with consensus Wall Street estimates, compared to \$.27 in the 1999 quarter. For the quarter, the company’s earnings before interest, taxes, depreciation and amortization (EBITDA) margin was 26.6%, marking the second consecutive quarter of increase in its EBITDA margin.

For the six months ended June 30, 2000, HEALTHSOUTH’s revenues were \$2.058 billion, compared to \$2.078 billion in the 1999 period. Net income for the 2000 period was \$130.5 million, compared to \$223.9 million in the 1999 period. Earnings per share (assuming dilution) for the 2000 period were \$.33, compared to \$.52 for the same period in 1999.

“We continue to see positive results from our intense focus on operational improvements,” said Richard M. Scrusby, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “In the second quarter, we saw continued improvement in our EBITDA margin, as well as increases in average pricing in three of our primary lines of business and volume increases in all of our ambulatory lines. In addition, our accounts receivable days continued to decline, to 80.4 days at the end of the quarter. At the same time, our facility acquisitions and start-up development continue on course, and we are in the midst of an extensive new syndication program in our surgery centers. We look forward to moving ahead with our strategic plan in the second half of 2000.”

39. Promptly following the release of the July 18, 2000 press release, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call, Scrushy falsely told the participants:

We did meet the second quarter consensus EPS estimate of \$.17 a share. The company had a second consecutive quarter of EBITDA margin improvement. Our DSOs continue to decline, and we continue to the sequential volume growth across the board with 3 of our core divisions. Our pricing, sequential pricing, also was positive in out-patient rehab surgery and our in-patient operations.

\* \* \*

SCRUSHY: So, really, in summary, we met our consensus estimate of \$.17; the EBITDA margin continued to improve; positive volume and pricing trends in out-patient rehab surgery, in-patient. We've continued to work very close with managed-care players and on our technology initiatives. Continued focus on diagnostic surgery growth initiatives. We've launched our surgery resyndication efforts; we'll continue a proactive stance towards the investment community. Our company continues to have a very strong, and focused management team....

\* \* \*

BILL OWENS: Yes, Howard, on the DSOs, our target is a steady decline in DSOs over the next 6 quarters, of 2-3 days per quarter -- exactly as you asked in your question -- so, that we anticipate that by the end of 2001 we will be in the high-50's to low-60's -- somewhere in the 58-62 day range, by the end of 2001.

But, our projection for the 3rd Quarter is a 3-day decline in DSOs by the end of the third quarter.

So, we're on target. All of our initiatives are set to make that happen. All of our goals are established in order to make that happen.

\* \* \*

RICHARD SCRUSHY: So, that's that. As far as buy-back? I think the best use of our capital right now is to pay down debt. We'd love to be buying back stock at these prices. We think it's extremely low. We think it ought to be much higher than it is, and we would love to be in there.

\* \* \*

DAVE: Yes, it does. The recent road show, there was a forecast or a commitment to a forecast of a 15% earnings growth rate with upside from a number of these specific initiatives that the company was undertaking -- in your minds is the 15% growth rate as a base still a good forecast that you are committed to?

RICHARD SCRUSHY: Right. That's right.

\* \* \*

RICHARD SCRUSHY: I'll tell you what it is. It's our internal budget. I mean, that's the budget. That's what our operating guys are living by. That's what they live and die by every day. That 15% growth rate. That's -- the internal budget's 15% growth rate for this year and next year.

\* \* \*

And, that's what our budgets are tied to. If you look through 2,000+ facilities, plus our internal budget, it's got a 15% growth rate on the bottom line. And, that's what we're all committed to.

40. On August 15, 2000, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending June 30, 2000 (the "2Q 2000 10-Q") signed by Scrushy and Owens. The 2Q 2000 10-Q reiterated the financial results reported in the July 18 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Third Quarter 2000**

41. On October 31, 2000, HealthSouth announced operating results for the quarter and nine months ended September 30, 2000 in a press release issued over the PR newswire entitled: "HEALTHSOUTH Reports Record Revenues; Earnings Per Share Up 13% for Third Quarter." The press release falsely represented:

HEALTHSOUTH Corporation announced operating results for the quarter and nine months ended September 30, 2000. For the quarter, HEALTHSOUTH's revenues were \$1.060 billion, an increase of 7% as compared to \$993.3 million for the third quarter of 1999. Net income for the 2000 quarter was \$71.0 million, compared to income before non-recurring expenses of \$66.9 million in the 1999 quarter. Earnings per share (assuming dilution) were \$.18 for the 2000 quarter, consistent with consensus Wall Street estimates, an increase of 13% as compared to income per share before non-recurring expenses (assuming dilution) of \$.16 in the 1999 quarter. For the quarter, the company's earnings before interest, taxes, depreciation and amortization (EBITDA) margin was 27.0%, marking the third consecutive quarter of increase in its EBITDA margin.

For the nine months ended September 30, 2000, HEALTHSOUTH's revenues were \$3.118 billion, compared to \$3.072 billion in the 1999 period. Net income for the 2000 period was \$201.6 million, compared to income before non-recurring expenses of \$290.8 million in the 1999 period. Earnings per share (assuming dilution) for the 2000 period were \$.52, compared to income per share before non-recurring expenses (assuming dilution) of \$.69 for the same period in 1999.

“We are very pleased with the many positive developments we saw in the third quarter,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “Record quarterly revenues translated into a 13% increase in earnings per share over the same quarter of last year.

We saw strong year-over-year volume growth in all of our product lines, as well as continued positive pricing trends in outpatient and inpatient rehabilitation and outpatient surgery. Our days' sales outstanding continued to decrease, dropping by one-and-a-half days for the quarter. In addition, our \$350 million placement of subordinated debt was well-received by the market. We expect to continue to build on these positive operating and financial trends in the fourth quarter.”

#### **False and/or Misleading Statements Re: Fourth Quarter and Year End 2000 Financial and Operating Results**

42. On March 6, 2001, HealthSouth issued a press release announcing its financial and operating results for the quarter and year ended December 31, 2000 (the “March 6 Press Release”). Income for the quarter was represented to be \$76.9 million, an increase of 26% compared to the \$61.2 million in the 1999 quarter. Reported revenue was \$1.077 billion, an increase of nearly 8% compared to \$1.001 billion for the 1999 quarter. Reported income for the full year was \$278.5 million, or \$0.71 per share, on revenues of \$4.195 billion compared to \$4.072 billion for 1999.

Commenting on fourth quarter and year-end results Scrushy stated:

As we completed our first full year under the streamlined management structure we announced in 1999, we saw another quarter of record revenues and improved EBITDA margins, along with year-over-year volume growth and positive pricing momentum.... We strongly believe that the strides we made in 2000 will help us continue to build upon our franchise in the year ahead.

43. Later that day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrushy, McVay and Owens stated:

RICHARD SCRUSHY: Earnings per share, assuming dilution were \$.19 for the 2000 Quarter consistent with consensus of Wall Street estimates. An increase of 19% as compared to income per share before unusual and non-recurring expenses of \$.16 in the 1999 Quarter.

\* \* \*

I think it's also interesting to note that \$301 million does get us back to the \$1.2 billion run-rate that we were -- we had anticipated prior to the Balanced Budget cuts. So, the company is now fully recovered through that process of those cuts, and is now back to the \$1.2 billion run-rate.

\* \* \*

Now, as far as our rates, the sample database reflects that overall average PPS rate is about \$11,509 per discharge. HealthSouth average cost is well, is below the \$9,600 now, and we believe that we're well-positioned to have a very profitable situation as that program does roll out.

It is also important to note that MediCare relief package does give the provider the option to select 100% of a PPS rate versus multi-year phase-in and our preference, obviously, is 100% PPS rate day one because of our costs and, the fact that it is substantially under the payment rate, which would allow us for the first time to make a very nice profit or, healthy profit, on treating these patients.

And, of course, I think it's important to note that HealthSouth played a major role in bringing down those PPS rates. I mean, we do represent a large volume of business to the MediCare program and the fact that we were able to get our costs in line over the last five years, bring our rates down substantially. As you throw our cases into the mix with the rest of the cases throughout the country, we've had an impact on the pricing.

\* \* \*

As far as financial outlook, you know, we're comfortable with a 28-29% EBITDA margin for this year. We believe that the consensus estimate of \$.81 a share is certainly reasonable and we feel good, also, about a sustained EPS growth rate of 15%.

\* \* \*

TAD McVEIGH [sic]: The DSO number for 4Q was 80.9, that was down from the year earlier figure of 82.6. It was up about 2 days sequentially -- you know, due -- as many of the other providers have said -- just due to year-end situations.

BILL OWENS: And, ... we still remain committed to our goal of getting DSO's into the 60's during this year 2001 and -- you know, as Richard said, we have our full executive team here, and we're all committed to that.

We are committed to reducing our cap ex in 2001 to a goal of in the \$350 million range. And, we are committed to a minimum debt pay-down in 2001 of \$250 million.

So, those goals all remain intact, and through two months of the year, we still feel very good about being able to achieve all of those goals this year.

\* \* \*

TAD MCVEIGH [sic]: What I can tell you, ... is we are, as Richard said, comfortable with the consensus number of \$.81 for this year, \$.93, I believe the number is, for '02. The way that would trend sequentially, we would expect for both '01 and '02, for the 1st Quarter EPS number to be stable; for the 2nd Quarter number to be up slightly; for the 3rd Quarter to be stable, with the 2nd Quarter; and, then, for the 4th Quarter to be higher.

44. On March 6, 2001, Scrusby also appeared on the CNBC financial news show "Squawk Box" to discuss the success of HealthSouth. Scrusby stated:

[Q]uarter to quarter -- each quarter over the last year we've shown very healthy growth. Our revenues are up. Our pricing has stabilized. About 35 percent of our contracts now have shown some pricing increase. Our volumes are up all across the board and our 2000-plus facilities are doing quite well. So this has been a very good year for us. We've come back strong.

45. On March 30, 2001, HealthSouth filed with the SEC a Report on Form 10-K for the year ending December 31, 2000 (the "2000 Form 10-K") signed by Scrusby, Owens, and Smith. That SEC filing reiterated the financial results reported in the March 6 press release and contained an unqualified audit report by E&Y on HealthSouth's financial results for 2000 representing that the Company had income of \$559 million before taxes and minority interests. In fact, HealthSouth had earned just \$209 million. The 2000 Form 10-K also stated:



Our revenues include net patient service revenues and other operating revenues. Net patient service revenues are reported at estimated net realizable amounts from patients, insurance companies, third-party payors ... and others for services rendered....

Substantially all of our revenues are derived from private and governmental third-party payors. Our reimbursement from governmental third-party payors is based upon cost reports and other reimbursement mechanisms which require the application and interpretation of complex regulations and policies, and such reimbursement is subject to various levels of review and adjustment by fiscal intermediaries and others, which may affect the final determination of reimbursement.

46. HealthSouth's 2000 Annual Report contained the following financial data:

Statement of Income Data (in thousands, except for per share data)	2000	1999	1998	1997	1996
Revenue	\$4,195,115	\$4,072,107	\$4,006,074	\$3,123,176	\$2,648,188
Net Income	278,465	76,517	46,558	343,059	196,778
		*	*	*	
Net Income per common share	\$0.72	\$0.19	\$0.11	\$0.94	\$0.58
		*	*	*	
Balance Sheet Data (in thousands)	2000	1999	1998	1997	1996
Total Assets	\$7,380,440	6,890,484	6,788,209	5,566,324	3,671,958
Retained Earnings	1,224,950	949,828	878,228	833,328	492,954
		*	*	*	
Stockholders' Equity	3,526,454	3,206,362	3,423,004	3,290,623	1,686,770

47. Elsewhere, HealthSouth's 2000 Annual Report stated:

The healthcare industry is subject to regulation by federal, state and local governments. The various levels of regulatory activity affect our business activities by controlling ... the reimbursement we receive for services provided.

\* \* \*

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services .... We have developed our operational systems to attempt to assure compliance with the various standards and requirements of the Medicare program and have established ongoing quality assurance activities to monitor compliance.

\* \* \*

Over the past several years an increasing number of healthcare providers have been accused of violating the federal False Claims Act. That Act prohibits the knowing presentation of a false claim to the United States government. Because HEALTHSOUTH performs thousands of similar procedures a year for which it is reimbursed by Medicare and there is a relatively long statute of limitations, a billing error or cost reporting error could result in significant civil or criminal penalties.

48. HealthSouth's audited 2000 financial statements were also included in Appendix A to the Company's Schedule 14A Proxy Statement dated April 17, 2001, which was filed with the SEC and sent to HealthSouth stockholders.

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for First Quarter 2001**

49. On April 26, 2001, HealthSouth issued a press release over the PR newswire entitled: "HEALTHSOUTH Net Income Up 15% for First Quarter." The press release falsely represented:

HEALTHSOUTH Corporation announced operating results for the quarter ended March 31, 2001. For the first quarter, HEALTHSOUTH's revenues were \$1.090 billion, an increase of 7% as compared to \$1.021 billion for the first quarter of 2000. Net income for the 2001 quarter was \$75.3 million, an increase of 15% compared to net income of \$65.3 million in the 2000 quarter. Earnings per share (assuming dilution) were \$.19 for the 2001 quarter, consistent with consensus Wall Street estimates, an increase of 12% as compared to earnings per share (assuming dilution) of \$.17 in the 2000 quarter. For the quarter, the company's earnings before interest, taxes, depreciation and amortization (EBITDA) margin was 27.3%, compared to 26.4% in the first quarter of 2000.

“The first quarter of 2001 showed a continuation of the improvement in key operating statistics that we saw in 2000,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “In addition to continued growth in revenues, net income and earnings per share, we saw favorable same-store volume and pricing trends in the quarter, despite the effects of having an extra business day in the 2000 quarter due to the leap year. We are especially pleased with the performance of our surgery center operations, which produced same-store volume growth of 4.4% over the 2000 quarter. We believe this reflects the early successes of our focused syndication efforts in our surgery centers. During the quarter, we also announced the pending divestiture of our occupational medicine operations, which closed this week, and of our Richmond, Virginia acute-care hospital, which we expect to close near the end of the month. The net proceeds from these transactions will be used to pay down back debt. We closed out the quarter with the announcement of a strategic partnership with Oracle Corporation to build the world’s first digital hospital, reinforcing our position as a leader in healthcare innovation.”

50. On April 26, 2001, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrushy and Owens stated:

Earnings per share, assuming dilution, were \$.19 for the 2001 Quarter, consistent with consensus Wall Street estimates. An increase of 12%, as compared to earnings per share, assuming dilution of \$.17 in the 2000 quarter.

\* \* \*

SCRUSHY: Now, as far as in-patient PPS -- we still remain well-positioned as a low-cost efficient provider. Our current cost -- as we mentioned in other presentations -- continue to be well below the \$9,600 mark. The implementation date is still to be determined, and hopefully all of that will fall into place this year. And, that’s the plan and we’re well-positioned for that to happen.

\* \* \*

SCRUSHY: Now, as far as future financial outlook. There are several things I’d like to bring up. We’re very comfortable with the 28-29% EBITDA margin for this year. We believe that we can achieve those margins through all the various efforts that we talked about here today. Through price increases, through increase in volume throughout all of our facilities. We think that the PPS program will play a major role once that comes in -- but, even without that, we feel very comfortable with the 28-29%.

As far as consensus estimate, it’s pretty much \$.81 a share is what everyone has, and we certainly feel comfortable with those numbers.

Now, the substantial EPS growth rate of 15% is in line with where we believe we are. It's in line with our internal budget, and the plans that we have to grow the company.

\* \* \*

We also feel very good about the debt reduction this year, in the range of \$250 million. We have a plan for that. We feel good about it. Of course, as you know, we always front-end load a little bit on the cap ex early in the year, and we'll work very hard throughout this year, to make sure we manage that extremely closely. It's all under the microscope where our management is lined up. Collections are looking strong, and we feel good that we will be able to achieve that number, if not something larger than that this year.

Actually, internally, we believe we can ... a little better than that. I think -- we feel very comfortable with the number of \$250.

We are also very comfortable with the cap ex number of \$300 to \$400 million. And, we'll talk about our cap ex expenditures for the Quarter, so you can see that's right in line with the \$300 to \$400 million.

51. On May 15, 2001, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending March 31, 2001 (the "1Q 2001 10-Q") signed by Scrushy and Owens. The 1Q 2001 10-Q reiterated the financial results reported in the April 26 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Second Quarter 2001**

52. On July 31, 2001, HealthSouth issued a press release over the PR Newswire entitled: "HEALTHSOUTH Reports Second Quarter Operating Earnings Per Share of \$.21, Up 24%." The press release falsely represented:

HEALTHSOUTH Corporation announced operating results for the quarter and six months ended June 30, 2001. For the quarter, HEALTHSOUTH's revenues were \$1.099 billion, an increase of 6% as compared to \$1.036 billion for the second quarter of 2000. Adjusting in both periods for the effect of the 2001 sale of the company's occupational medicine operations, revenues for the 2001 quarter would have been up 9% over revenues for the 2000 quarter. Income before unusual and non-recurring items for the 2001 quarter was \$83.1 million, an increase of 27% compared to net income of \$65.2 million in the 2000 quarter. The comparable

income per share (assuming dilution) was \$.21 for the 2001 quarter, beating consensus Wall Street estimates and representing an increase of 24% as compared to earnings per share (assuming dilution) of \$.17 in the 2000 quarter. For the quarter, the company's earnings before interest, taxes, depreciation and amortization (EBITDA) margin, excluding unusual and non-recurring items, was 28.1%, compared to 26.6% in the second quarter of 2000.

For the six months ended June 30, 2001, HEALTHSOUTH's revenues were \$2.189 billion, compared to \$2.058 billion for the same period in 2001. Income before unusual and non-recurring items for the 2001 period was \$158.4 million, compared to net income of \$130.5 million for the 2000 period. The comparable income per share (assuming dilution) for the 2001 period was \$.40, compared to earnings per share (assuming dilution) of \$.33 for the 2000 period.

\* \* \*

"Our second quarter results demonstrate the continued successful execution of our strategic plan," said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "In a quarter full of milestones, we achieved record quarterly revenues, continued the improvement in our EBITDA margin, and saw same-store volume and pricing increases in all lines of business, while completing the planned divestitures of our occupational medicine business and our Richmond medical center. In addition, our disciplined financial policies allowed us to reduce our indebtedness by \$152 million as compared to the end of the first quarter, while our accounts receivable days declined four days from the first quarter. We look forward to continuing our success in the remainder of 2001."

53. Later that day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call, Scrushy made additional misrepresentations to the investment community:

The comparable income per share, assuming dilution, was \$.21 for the 2001 quarter, beating consensus Wall Street estimates, and representing an increase of 24%, as compared to earnings per share of \$.17, end of 2000 Quarter.

\* \* \*

Our second quarter results do demonstrate the continued successful execution of our strategic plan. In a quarter-full milestone, we've achieved record quarterly revenues; continued improvements in our EBITDA margin; and, saw same-store volume and pricing increases in all lines of business, while completed a planned divestiture of our occupational medicine business and our Richmond Medical Center.

In addition, our disciplined financial policies allowed us to reduce our indebtedness by \$152 million, as compared to the end of the first quarter.

While our accounts receivable days declined 4 days from the first quarter, we look forward to continuing our success in the remaining part of the 2001 year.

\* \* \*

Same-store volume growth across all business lines; pricing increases across all business lines. Day sales outstanding are down 4 days in the quarter; debt -- pay-down debt is down approximately \$152 million in the quarter, an early retirement of the \$400 million secondary line of credit, which we eliminated that, because we did not need it and made no sense for us to continue to carry that. Strong cash-flow, as well as -- you know, about \$500 million in dry powder in our existing lines. So, there's really no need for us to maintain that, so we dropped it, and I think that was a good move, and that's going to save the company some money.

Second quarter operating EPS, last year, \$.17. This year, \$.21. 24% increase over the second quarter of last year, and that did exceed the consensus estimate by one penny.

\* \* \*

As far as the in-patient PPS review, we positioned ourselves as a low-cost efficient provider, and our current costs per Medicare discharge is well below the \$9,600. You know, we've been saying in the past that the implementation date would be determined, and we expect that January 1 -- well, the good news is ... The effective date for the start of PPS will be January 1, 2002. That's huge for us, and that's what we've been saying January 1 is where we want -- you know, we've aligned ourselves and prepared ourselves for a January 1 implementation date, and there have been a lot of questions out there. There has been a cloud over this now for 3 years. The cloud has lifted.

Our company is well-positioned to do extremely well under these new guidelines. We're very positive. We were happy with the initial information that they had sent out. It was sent out as we reviewed the initial plan and ran the analysis. We fit well with those guidelines.

There's been some changes, and I think most of those changes are going to be for the positive. But January 1 and we're excited about that. So, our cloud has been lifted, and that's good news, I think, for everyone in our business today.

\* \* \*

SCRUSHY: Financial outlook for the future. We're very comfortable with the 28-29% EBITDA margin for this year. We're very comfortable with the consensus EPS estimates for third quarter of \$.20 and \$.22 for the fourth quarter. We're very comfortable with the sustained EPS growth of 15%.

Also, debt reduction of \$250 million in this year. And, our cap ex, we had estimated would be in the range of \$300 to \$400 million, and certainly, we feel comfortable with that.

\* \* \*

And the strengthened company; we've overcome what we think was a bad decision Congress made with the Balanced Budget Act a couple years ago. We've all suffered through that. There was some difficult times in terms of pricing. But, those are behind us now.

54. On August 10, 2001, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending June 30, 2001 (the "2Q 2001 10-Q") signed by Scrusby and Owens. The 2Q 2001 10-Q reiterated the false financial results reported in the July 31 press release. It also falsely represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Third Quarter 2001**

55. On October 25, 2001, HealthSouth issued a press release over the PR Newswire entitled: "HEALTHSOUTH Reports Third Quarter Earnings Per Share of \$.20." The press release falsely stated:

HEALTHSOUTH Corporation announced operating results for the quarter and nine months ended September 30, 2001. For the quarter, HEALTHSOUTH's revenues were \$1.076 billion, an increase of 1.5% as compared to \$1.060 billion for the third quarter of 2000. Adjusting in both periods for the effect of the 2001 sale of the company's occupational medicine operations and its Richmond, Virginia, medical center, revenues for the 2001 quarter increased 5.2% over revenues for the 2000 quarter. Net income for the 2001 quarter was \$79.1 million, an increase of 11% compared to net income of \$71.0 million in the 2000 quarter. Earnings per share (assuming dilution) were \$.20 for the 2001 quarter, consistent with consensus Wall Street estimates and representing an increase of 11% as compared to earnings per share (assuming dilution) of \$.18 in the 2000 quarter. For the quarter, the company's earnings before interest, taxes, depreciation and amortization (EBITDA) margin was 27.7%, compared to 27.0% in the third quarter of 2000.

For the nine months ended September 30, 2001, HEALTHSOUTH's revenues were \$3.265 billion, compared to \$3.118 billion for the same period in 2000. Income before unusual and non-recurring items for the 2001 period (all of

which were incurred in the second quarter of 2001) was \$237.5 million, compared to net income of \$201.6 million for the 2000 period. The comparable income per share (assuming dilution) for the 2001 period was \$.60, a 15% increase compared to earnings per share (assuming dilution) of \$.52 for the 2000 period.

“We are very pleased that we again met Wall Street’s earnings expectations as we continued implementing our strategic plan,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “We saw same-store growth across all of our ambulatory services lines of business, as well as continued favorable pricing trends. In addition, despite the disruption in the capital markets, we successfully completed a private placement of \$600 million in five-year and ten-year senior notes in September. We also strengthened our management team with the promotion of Bill Owens to President and Chief Operating Officer and the consolidation of all of our ambulatory services into a single division, along with the other management changes we announced in August. We believe that these changes further strengthen our experienced management team and position us well as we move forward with our focus on providing exceptional service to the physicians, patients and payors that we serve.”

56. Later that day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrushy falsely represented:

SCRUSHY: Earnings per share, assuming dilution, were 20 cents for the 2001 quarter consistent with consensus Wall Street estimates and representing an increase of 11%, as compared to earnings per share, assuming dilution, of 18 cents in the 2000 quarter.

For the quarter the Company’s earnings before interest, taxes, depreciation and amortization margin was 27.7% compared to 27% in the third quarter of 2000.

\* \* \*

We’re very pleased that we met the Wall Street earnings expectations, and we continued to implementing our strategic plans. We saw same-store growth across all of our ambulatory service lines, in business, as well as continued favorable pricing trends.

\* \* \*

Financial outlook: as we go forward, we’re very comfortable with -- we believe -- our EBITDA margin moving up to the 28 to 29% range. We feel very comfortable that we will do that over the next couple of quarters.

We’re comfortable with the EPS estimate of 22 cents for the fourth quarter. Very comfortable with a sustained EPS growth of 15% and we will provide updated guidance, again, in early December to account for the earnings impact, the PPS, and the FAS 142, which we had a few questions about.



\* \* \*

We have a cap ex plan this year of about \$400 million. We're right at the \$300 million mark, so we're right on target. We don't know of any major -- we don't have any plans for anything outside of what we've planned for, for the last quarter of this year, so we feel that we will certainly be on target, if not under that \$400 million.

\* \* \*

And, so, this whole shift of PPS is very positive for us.

Our goal is to have our DSO's down to the low-70's, high-60's and, ideally, obviously, the mid-60's would be a great number -- to the high-60's. And in health care, that would be good.

As we move into a PPS system, we hope that that will have a positive impact in bringing our debt down, as well. We worked extremely hard to clean up old claims from acquisitions that we've made over the years and there's a lot of claims out there we had to work through. We've been moving to an electronic interface everywhere we can. We basically are communicating probably more electronically than any other health care company out there. We've done a great job with our EDI initiative. All of that is impacting our days.

57. On November 13, 2001, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending September 30, 2001 (the "3Q 2001 10-Q") signed by Scrushy and Smith. The 3Q 2001 10-Q reiterated the false financial results reported in the October 25 press release. It also falsely represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Fourth Quarter 2001 and Year End 2001**

58. On March 12, 2002, HealthSouth announced year-end and quarter results in a press release issued over the PR Newswire entitled: "HEALTHSOUTH Announces Record Revenues; Operating Earnings Per Share of \$.22, Up 16% for Fourth Quarter." In that press release, HealthSouth falsely represented:

HEALTHSOUTH Corporation announced operating results for the quarter and year ended December 31, 2001. For the quarter, HEALTHSOUTH's revenues were \$1.115 billion, an increase of 3.5% as compared to \$1.077 billion for the fourth

quarter of 2000 and an increase of 7.5% after adjusting in both periods for divestitures in 2001. Income before unusual and non-recurring items for the 2001 quarter was \$88.6 million, an increase of 15.2% compared to net income of \$76.9 million in the 2000 quarter. The comparable income per share (assuming dilution) was \$.22 for the 2001 quarter, consistent with consensus Wall Street estimates, an increase of 15.8% as compared to earnings per share (assuming dilution) of \$.19 in the 2000 quarter.

For the year ended December 31, 2001, HEALTHSOUTH's revenues were \$4.380 billion, compared to \$4.195 billion for 2000. Income before unusual and non-recurring items for 2001 was \$326.1 million, compared to net income of \$278.5 million for 2000. The comparable income per share (assuming dilution) for 2001 was \$.82, a 15.5% increase compared to net income per share (assuming dilution) of \$.71 for 2000.

“Our fourth quarter results reflect a strong finish to a very successful year,” said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “The fundamentals of our business showed continued improvement, as same-store volume growth ranged from 6.5% to 13% in our outpatient lines of business compared to the fourth quarter of 2000. Pricing trends were also strong on both a sequential quarter and year-over-year basis, contributing to an increase in our EBITDA margin to 28.2%. Looking ahead, our early experience under the new inpatient rehabilitation prospective payment system is confirming our expectations for the positive impact that PPS will have on our business.”

59. Later that day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrushy stated:

HealthSouth announced record revenues. Operating earnings per share of \$.22 was up 16% for the fourth quarter. Again, record quarterly revenues of \$1.115 billion, up 8% over fourth quarter. We continued EBITDA margin improvement of 28.2%, versus 27.9% in the fourth quarter of last year.

We continued with our policy of pricing trends. This has been -- this quarter we're the strongest same-store growth that we've ever had in our ambulatory line, at least in the last two years.

We had a net debt reduction of \$164 million. The PPS implementation, which is very important, is going extremely well, and the reimbursement is exactly as we had projected it would be.

Now, for 2001 year-end results, full-year earnings per share of \$.82 exceeded consensus earnings estimates by one penny, and that is up 15%, versus 2000; revenue growth of 7% over 2000.

\* \* \*

But the positive volume and pricing growth across all business lines in 2001, net debt reduction of \$283 million total for the year. So we met our commitments in that area, which we are very excited about. We feel that was very strong.

\* \* \*

Now let me just review the in-patient PPS situation with you. That went into effect January 1 of this year. We received notification of payment on over -- now, it's several 1,000 claims under the PPS. Our payment was identical to our expected payment. That validates the analysis that we had and the positive impact of the PPS implementation.

The projected contribution, again, at a minimum basis – we talked about on a very conservative basis – was \$.07, the EPS this year, and we believe the fully-implemented program, certainly, will exceed \$75 to \$100 million.

Now as far as the financial outlook, we're very comfortable with the 28 to 29 percent EBITDA margin for '02. Very comparable with the consensus EPS estimate of \$1.14 for 2002, and that represents 39 percent earnings growth from where we were. We're very comfortable with a sustained EPS growth of 15 percent or greater per year.

60. On March 27, 2002, HealthSouth filed with the SEC a Report on Form 10-K for the year ending December 31, 2001 (the "2001 Form 10-K"). Scrusby, Owens, and Smith signed the 2001 Form 10-K, which reiterated the financial results reported in the March 12 press release and stated:

#### Medicare Participation and Reimbursement

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services .... All of our inpatient facilities participate in the Medicare program.... All of our surgery centers and 121 of our diagnostic centers are certified (or awaiting certification) under the Medicare program. Our Medicare-certified facilities, inpatient and outpatient, undergo annual on-site Medicare certification surveys in order to maintain their certification status. Failure to comply with the program's conditions of participation may result in loss of program reimbursement or other governmental sanctions. ***We have developed our operational systems to attempt to assure compliance with the various standards and requirements of the Medicare program and have established ongoing quality assurance activities to monitor compliance.***

61. HealthSouth's 2001 Report to Shareholders contained a letter from Scrusby stating:

In addition to these promising developments, the year provided continued solid growth for HealthSouth – *a result achieved through hard work and a determined effort to increase stockholder value. In 2001, we set new records as we pushed our revenues well over \$4.3 billion and celebrated another year of fulfilling Wall Street expectations, maintaining our record as the Fortune 500 company with the second-largest streak for meeting or exceeding analysts' expectations.* We also increased earnings per share by 14 percent over 2000 and strengthened our balance sheet ratios through two senior note offerings that better diversified our debt maturities.

62. As represented in the 2001 Form 10-K:

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. Those reported amounts could differ, in some cases materially, if we made different estimates and judgments with respect to particular items in our financial statements. We make such estimates and judgments based on our historical experience and on assumptions that we believe are reasonable under the circumstances in an effort to ensure that our financial statements fairly reflect our financial condition and results of operations. We describe some of the most important policies that we follow in making such estimates and judgments below.

\* \* \*

#### Medicare Participation and Reimbursement

In order to participate in the Medicare program and receive Medicare reimbursement, each facility must comply with the applicable regulations of the United States Department of Health and Human Services .... All of our inpatient facilities participate in the Medicare program.... All of our surgery centers and 121 of our diagnostic centers are certified (or awaiting certification) under the Medicare program. Our Medicare-certified facilities, inpatient and outpatient, undergo annual on-site Medicare certification surveys in order to maintain their certification status. Failure to comply with the program's conditions of participation may result in loss of program reimbursement or other governmental sanctions. ***We have developed our operational systems to attempt to assure compliance with the various standards and requirements of the Medicare program and have established ongoing quality assurance activities to monitor compliance.***

63. HealthSouth's 2001 Annual Report contained the following financial data:

Statement of Income (in thousands, except for per share data)	2001	2000	1999	1998	1997
Revenue	\$4,380,477	\$4,195,115	\$4,072,107	\$4,006,074	\$3,123,176
Net Income	202,387	278,465	76,517	46,558	343,059
		*	*	*	
Net Income per common share	\$0.52	\$0.72	\$0.19	\$0.11	\$0.94
		*	*	*	
Statement of Income (in thousands)	2001	2000	1999	1998	1997
		*	*	*	
Total Assets	7,579,237	7,380,440	6,890,484	6,778,209	5,566,324
		*	*	*	
Retained Earnings	1,430,846	1,224,950	949,828	879,309	834,385
Stockholder Equity	3,796,924	3,526,454	3,206,362	3,423,004	3,290,623

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for First Quarter 2002**

64. In a press release issued over the PR Newswire on May 2, 2002, HealthSouth announced 42% growth in the first quarter EPS. In that press release HealthSouth announced that for the first quarter, HealthSouth's revenues were \$1.130 billion, an increase of 3.6%, net income was \$107.7 million, an increase of 43%, earnings per share were \$.27 for the 2002 quarter, consistent with consensus Wall Street estimates, an increase of 42%, EBITDA and margin was 29.1%, compared to 27.3% in the first quarter of 2001.

“We showed strong operational performance in the first quarter of 2002,” said Richard M. Scrusby, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. “Our first wave of inpatient rehabilitation facilities moved into the new inpatient rehabilitation prospective payment system beginning January 1, and just as we had projected, PPS had a positive impact on our bottom line. We have spent years preparing for this change, lowering our costs and increasing our efficiencies, and our initial PPS payments have continued to come in on target with our preliminary estimates. In addition, we saw strong same-store volume growth in all of our ambulatory lines and in our inpatient rehabilitation facilities. We are especially pleased to report the seventh consecutive quarter of increases in same-store volume in our surgery centers. Given these positive trends, we are actively pursuing additional strategic growth and development opportunities across our product lines. After a very successful 2001, the first quarter has positioned us well to move forward to a new level in 2002.”

65. That same day, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call Scrusby stated:

[E]arnings per share, assuming dilution, were \$.27 for the 2002 quarter, consistent with the Wall Street estimates, an increase of 42%, as compared to earnings per share of \$.19 in the 2001 quarter.

\* \* \*

We had very strong operational performance in the first quarter of this year. Our first wave of in-patient rehabilitation facilities moved into the new in-patient rehabilitation Prospective Payment System which began January 1, and just as we had projected, PPS had a positive impact on our bottom line. We’ve spent years preparing for this change, lowering our costs, and increasing our efficiencies.

Our initial PPS payments have continued with our preliminary estimates. In addition, we saw strong same-store growth in all of our ambulatory lines and in our in-patient rehabilitation facilities.

\* \* \*

We are especially pleased to report the seventh consecutive quarter of increases in same-store volume and our surgery centers. Given these positive trends, we’re actively pursuing additional strategic growth and development opportunities across our product lines.

After a very successful 2001 the first quarter has positioned us well, to move forward with a new level in 2002.

\* \* \*

Again, \$.27 EPS, we met the consensus estimate, up 42% over the first quarter of 2001.

\* \* \*

People just have to make the decision whether they want to own it or sell it. And, right now, at today's price, it's an outstanding buy. If you look at anything else out there -- you know, we're coming with an EBITDA margin almost 30%, the kind of growth we've got, trading at where we are -- you ought to own this stock.

66. On May 10, 2002, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending March 31, 2002 (the "1Q 2002 10-Q") signed by Scrusby and Smith. The 1Q 2002 10-Q reiterated the financial results reported in the May 2 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented." Furthermore the 1Q 2002 10-Q stated:

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. Those reported amounts could differ, in some cases materially, if we made different estimates and judgments with respect to particular items in our financial statements. We make such estimates and judgments based on our historical experience and on assumptions that we believe are reasonable under the circumstances in an effort to ensure that our financial statements fairly reflect our financial condition and results of operations. We describe some of the most important policies that we follow in making such estimates and judgments below.

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Second Quarter 2002**

67. On August 7, 2002 HealthSouth announced second quarter operating results over the PR Newswire entitled: "HEALTHSOUTH Reports Second Quarter Operating EPS Up 33% To \$0.28." The news release stated:

HEALTHSOUTH Corporation announced operating results for the quarter and six months ended June 30, 2002. For the second quarter, HEALTHSOUTH's revenues were \$1.164 billion, an increase of 5.9% as compared to \$1.099 billion for the second

quarter of 2001 and an increase of 8.6% after adjusting for divestitures in 2001. Operating earnings for the 2002 quarter were \$113.7 million, an increase of 36.8% compared to operating earnings of \$83.1 million in the 2001 quarter. Operating earnings per share (assuming dilution) were \$0.28 for the 2002 quarter, consistent with consensus Wall Street estimates, an increase of 33.3% as compared to operating earnings per share (assuming dilution) of \$0.21 in the 2001 quarter. For the quarter, the Company's earnings before interest, taxes, depreciation and amortization (EBITDA) margin, excluding unusual and non-recurring items, was 29.8%, compared to 28.1% in the second quarter of 2001.

For the six months ended June 30, 2002, HEALTHSOUTH's revenues were \$2.293 billion, compared to \$2.189 billion for the 2001 period. Operating earnings for the 2002 period were \$221.4 million, an increase of 39.8% compared to operating earnings of \$158.4 million for the 2001 period. The comparable operating earnings per share (assuming dilution) for the 2002 period were \$0.55, compared to operating earnings per share (assuming dilution) of \$0.40 for the 2001 period.

Operating earnings exclude the effects of certain items that are included in net income, including unusual and non-recurring items and changes in accounting principles. Including the effects of these items, net income was \$57.5 million or \$0.14 per diluted share versus a net loss of \$19.9 million or (\$0.05) per diluted share for the 2001 quarter. For the six months ended June 30, 2002, net income was \$82.1 million or \$0.20 per diluted share compared to \$55.4 million or \$0.14 per diluted share in the 2001 period. A reconciliation of operating earnings to net income as determined under generally accepted accounting principles is provided in the accompanying financial information.

Management believes that operating earnings and operating earnings per share excluding such unusual and non-recurring items and non-cash impairment charges provide a clearer picture of the Company's operational performance than net income and earnings per share standing alone. Unusual and non-recurring items in the second quarter totaled approximately \$56.2 million, net of income taxes. These items included a loss of approximately \$52.8 million on the previously announced disposition of five nursing homes and a loss of \$3.4 million related to the early extinguishment of debt.

"The second quarter showed strength across all product lines with each of our businesses demonstrating continued positive volume and pricing trends," said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "We were especially pleased with the performance of our inpatient rehabilitation facilities as they generated an 11% increase in revenue. This clearly demonstrates the success we are having under the new Prospective Payment System."

Scrushy added, "Additionally, we completed the final stage of our refinancing plan with the successful completion of a \$1 billion note offering and a \$1.25 billion revolving credit facility. This financing provides us with ample liquidity to meet the



2003 maturity of our convertible debentures. Subsequent to quarter-end, we have repurchased approximately \$220 million of our outstanding debt securities, and we still have availability of \$1.2 billion under our new credit facility. We have also used the recent weakness in our stock price to reactivate our share repurchase program and have been actively accumulating shares.”

At June 30, 2002, the Company’s balance sheet reflected total debt of \$3.480 billion and cash and cash equivalents of \$547 million, resulting in net debt of \$2.933 billion. Total debt and net debt at June 30, 2002 reflect the funding of \$207 million in expenditures during the quarter to acquire certain properties previously held under synthetic operating leases. Excluding the effect of funding such expenditures, net debt decreased \$55 million in the quarter in comparison to net debt at March 31, 2002. Accounts receivable days declined 2.5 days to 79 days from the first quarter of 2002.

Cash flow from operations totaled approximately \$235 million compared to \$159 million in the 2001 quarter. Capital spending was approximately \$137 million in the quarter, excluding the \$207 million expenditure to acquire the properties held under synthetic operating leases.

68. On August 7, 2002, HealthSouth held a conference call for analysts, money and portfolio managers, institutional investors and large shareholders. During the call and in follow-up conversations with analysts, Scrushy, Owens, Smith and McVay stated:

RICHARD SCRUSHY: Very strong second quarter results, \$.20 EPS, met consensus estimate, up 33% over second quarter of last year.

\* \* \*

SCRUSHY: As far as our recent financing activities, we did complete a \$1 billion public note offering and refinanced our bank credit facility. We eliminated any refinance risk that we had on the 2003 maturities. No significant maturities until 2007 now. Subsequent to quarter-end, we repurchased in excess of \$220 million in public debt at attractive prices. We reactivated our stock purchase plan and we were actively [indiscernible] the stock when it had its dip over the last quarter.

As far as corporate governance, the company will comply with all Congressional, SEC and New York Stock Exchange corporate accountability and listing standards. The company will sign SEC statements that certify the accuracy of our financial statements. And all of our executive loans have been paid now in full and [indiscernible] company.

\* \* \*

WESTON SMITH: We did enjoy some decrease in days sales outstanding in the quarter. As you remember, last quarter, we had two intermediaries who weren’t

prepared for PPS; did not have their systems in place. They did complete their systems' setup during this quarter. We had to go back and resubmit claims to those intermediaries, and we are seeing a number of those claims processed in addition to the current second quarter claims.

So in terms of the backlog that we have, we will continue to see a decrease in that area as a result of all the intermediaries now being up to speed in the PPS process.

COMPANY REPRESENTATIVE: And, Howard, in terms of the cap ex, our guidance that we recently updated has been -- for this year and next -- we expect cap ex to be in the 450 to 550 range. We're still good with that guidance.

\* \* \*

THE CALLER: Just a question that I have is just -- there has clearly been a crisis of confidence in the general market, but clearly in the shares of HealthSouth in recent months -- I'm just curious to hear, maybe, what the company is doing to address that. Clearly, there were signs of that with some of the things that you were just talking about. But could you go into more detail there and then just give us some thoughts on how active the Board is, in terms of driving that, as well. Thank you.

\* \* \*

RICHARD SCRUSHY: We will be glad to do that, Adam. I think we've been -- we were way out in front of the curve here.

We have an audit committee chair -- George Strong [ ], who has been on our Board for several years -- but -- George comes with an excellent financial background; he has been CFO of companies; spent 20 years working for a financial institution. And he's our Chairman of our Audit Committee, so we have a very strong audit committee with good leadership.

Our audit and compensation committee is made up solely of independent directors, so we are already there with that. That was in place, we already had established a business code of conduct and ethics. Brad H[ale] is our Chief Compliance Officer, and he reports directly to the Board on all of those issues and to a compensation committee, I mean a compliance committee, which is led by Joel Gordon [phonetic], who has also been a CEO of another company and has extensive experience in health care and understands it. Again, in an independent situation.

Also, I think it is important that Bill Owens and I, the President and Chief Operating Officer of our company and I are the only two members of the management team to serve on our Board. All the other Board members are independent.

I mentioned earlier that we have aggressively went back and made sure that all of our executive loans were repaid; That has been taken care of. It was a great idea at the time, and I still think it was a good idea. We obviously were able to create a lot of incentive for all of our folks to work very hard that were able to get shares through

that program but that has been taken care of. We're prepared to sign off on all the financial statements on August 14th.

I think everything is in place, Adam. We're where we need to be, and I appreciate your asking the question.

\* \* \*

WESTON SMITH: Well, again, we feel confident that the intermediaries are now in place to support processing PPS. With the new facilities -- with the additional facilities rolling in this quarter, the intermediaries had already been processing other PPS claims for other hospitals other systems. So any growing pains for that, I would think, would be done.

\* \* \*

TAD McVEIGH [sic]: In terms of the stock repurchase plan, our plan allows for the repurchase of up to 70 million shares. That plan is approved and in place until February of 2004. To date, of that 70 million share limitation, we have repurchased just under 48 million shares. So you can see we have got plenty of room there -- a 22 million cushion to continue to repurchase shares.

On the debt side, our strategy is take advantage of weak market conditions that may affect the spread on our bonds and where we can buy those bonds back under par, and it makes sense from an accretion standpoint and we have got ample liquidity to execute, we're going to do that. We have been active in repurchasing our bonds and I would expect we will continue to be active.

69. On August 14, 2002, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending June 30, 2002 (the "2Q 2002 10-Q") signed by Scrusby and Smith. The 2Q 2002 10-Q reiterated the financial results reported in the August 7 press release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented."

70. The 2Q 2002 10-Q stated:

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses. Those reported amounts could differ, in some cases materially, if we made different estimates and judgments with respect to particular items in our financial

statements. We make such estimates and judgments based on our historical experience and on assumptions that we believe are reasonable under the circumstances in an effort to ensure that our financial statements fairly reflect our financial condition and results of operations. We describe some of the most important policies that we follow in making such estimates and judgments below.

**False and/or Misleading Statements Re: HealthSouth's  
Financial and Operating Results for Third Quarter 2002**

71. On November 5, 2002, HealthSouth issued a press release, which announced its financial results for the third quarter of 2002. The press release stated:

For the nine months ended September 30, 2002, HEALTHSOUTH's revenues were \$3.387 billion, compared to \$3.265 billion for the 2001 period. Net income for the 2002 period was \$135.7 million, compared to net income of \$134.5 million for the 2001 period. Earnings per share (assuming dilution) were \$0.34 for the 2002 period, compared to \$0.34 for the 2001 period. Operating earnings for the 2002 period were \$259.7 million, compared to operating earnings of \$237.5 million for the 2001 period. Operating earnings per share (assuming dilution) were \$0.65 for the 2002 period, compared to \$0.60 for the 2001 period.

\* \* \*

“The third quarter was a challenging one, and we are glad to have it behind us,” said Richard M. Scrushy, Chairman of the Board of HEALTHSOUTH. “However, in the midst of all the difficulties, there were positive things happening. While our outpatient rehabilitation business showed a 17% decrease in revenue and a decline in volumes, we saw higher revenues in each of our other lines of business, including a 12% increase in inpatient rehabilitation revenue over the third quarter of 2001. We also saw same-store volume growth in our inpatient rehabilitation, diagnostic and surgery center businesses, including a 10% same-store increase in inpatient rehabilitation discharges. In addition, we added 52 new physician partners in our surgery centers during the quarter, resulting in our ninth consecutive quarter of same-store growth in that division.”

William T. Owens, President and Chief Executive Officer of HEALTHSOUTH, said, “Our revenue decline in the third quarter was driven by a decrease in reimbursement in our outpatient rehabilitation business of approximately \$23 million as compared to the second quarter, primarily related to the impact of Medicare Program Transmittal 1753 and its policies regarding the use of the group therapy billing code, and a decline in volumes in our outpatient rehabilitation business that resulted in approximately a \$34 million decrease in revenue. This decline in volumes related to several factors. First, we closed or consolidated outpatient facilities in some markets to eliminate duplication and enhance efficiency, so we operated fewer facilities during the quarter. In addition, our number of referrals and visits per referral were both down. Finally, the demands on

management resources in the quarter, combined with confusion among our therapists on scheduling and staffing requirements under the new Medicare policy, negatively affected our ability to restore lost volumes during the quarter. All of these factors contributed to a decline of about two patient visits per outpatient facility per day as compared to the second quarter of 2002. In addition, we saw increases of approximately \$39 million in operating unit expenses as compared to the second quarter of 2002, primarily attributable to field training for therapists in the new policies, increased recruiting and labor costs, higher insurance premiums and new marketing initiatives, and an approximately \$12 million increase in corporate general and administrative expenses from the second quarter. This increase in corporate-level expenses resulted primarily from increased legal, accounting and other professional fees related both to pending litigation and the proposed tax-free separation of our surgery center division and corporate-level marketing initiatives aimed at restoring patient volumes.”

Owens added, “[w]e are in the midst of our 2003 budget process, and we are intensely focused on both corporate and field expenses as well as on efforts to rebuild our outpatient volumes. We will also be evaluating some of our facilities for any necessary impairment charges under FASB Statement No. 142, and we expect the results of that evaluation to be complete in the fourth quarter. While the overall results of the third quarter were below what we had expected due to the impact of the factors we have described, it is important to note that we had an \$8.4 million sequential-quarter increase in revenues in our inpatient rehabilitation operations due to our successful response to the inpatient rehabilitation prospective payment system and strong same-store growth, despite the impact of Transmittal 1753 on outpatient services provided in our inpatient division. We also repurchased over \$440 million in public debt, including approximately \$214 million of our \$567.7 million in convertible subordinated debentures that mature in April 2003. Outside of those debentures, we have no significant debt maturities until 2005, and we had over \$1 billion in availability under our revolving credit facility at the end of the quarter. We have ample liquidity to meet our foreseeable needs at this time.”

At September 30, 2002, the Company’s balance sheet reflected total debt of \$3.212 billion and cash and cash equivalents of \$390.4 million, resulting in net debt of \$2.822 billion, a decline of \$111.3 million from June 30, 2002. Accounts receivable days increased 7.5 days, to 86.5 days, from the second quarter of 2002, primarily as a result of decreased revenues in the third quarter.

Cash flow from operations totaled approximately \$141 million, compared to \$170 million in the 2001 quarter. Capital spending was approximately \$75.0 million in the quarter.

72. On November 5, 2002, a conference call for analysts, money and portfolio managers, institutional investors and large shareholders was held by HealthSouth. During the call and in follow-up conversations with analysts, Scrusby stated:

RICHARD SCRUSHY: I would like to begin by stating the third Quarter was a challenging quarter for the company. The introduction of Transmittal 1753 certainly had an impact on the company. We had the negative press, a lot of bad press on the company, which created some problems for us in terms of referrals. So, we took a hit in that particular area.

The revenue increased by about 3percent, that is excluding divestitures, versus third Quarter of last year. The impact really where we were hurt the most was in the out-patient area: we had a 14% reduction in volume, resulting in about a 17% reduction in revenue decline. This of course, was due to lower reimbursement, the Transmittal 1753 impact. That shows up in the pricing and Bill Owens will talk about that in a moment, which is about an 11percent reduction in pricing.

So, you had 14 percent reduction in volume, driving a 17 percent reduction in revenue in that particular area. But there is a lot of good news that we are going to talk about, as well, in other divisions. We will walk through that in a moment and go through all the statistics.

As we had a lower revenue number, we had an increase in our AR days. But, if we are able to keep those revenues flat, we would have shown only a very slight increase -- we had about an \$18.5 million increase in AR. So, our reduction -- if we hadn't had -- without the reduction in revenue, we would have had about an 80.5 days in AR, but with the reduction it actually drove it up to 86.5.

\* \* \*

WILLIAM OWENS: Going product line by product line and talking about the issues that we have faced there. In out patient rehab is very well publicized the challenges that we faced in out-patient rehab. Transmittal 1753 resulted in a \$23 million revenue hit, just simply from pricing, with a drop from the previous quarter of \$100 per visit, down to \$89 per visit.

73. On November 14, 2002, HealthSouth filed with the SEC a Report on Form 10-Q for the quarter ending September 30, 2002 (the "3Q 2002 10-Q") signed by Scrushy and Owens. The 3Q 2002 10-Q reiterated the financial results reported in the November 5 Press Release. It also represented that the "consolidated financial statements reflect all adjustments ... necessary for a fair presentation of the results for the interim period and the comparable period presented." In the 3Q 2002 10-Q, defendants acknowledged that HealthSouth's results of operations had been "significantly affected" by the Company's compliance with CMS Transmittal 1753, which they continued falsely to claim was a "new" or "change[d]" Government policy:

When compared to the second quarter of 2002, we saw a decrease in reimbursement of approximately \$23,000,000 in our outpatient rehabilitation business, primarily attributable to the impact of Transmittal 1753, and an additional \$34,000,000 decrease in revenues in our outpatient rehabilitation business attributable to a decline in patient volumes. We also saw an increase of about \$39,000,000 in operating unit expenses as compared to the second quarter, primarily attributable to field training for therapists in the new Medicare policy, increased recruiting and labor costs, higher insurance premiums and new market initiatives aimed at restoring patient volumes.

### **False and/or Misleading Statements Re: HealthSouth's Financial and Operating Results for Fourth Quarter 2002 and Year End 2002**

74. On March 3, 2003, HealthSouth issued a press release (the "March 3 Press Release") reporting that the Company had lost \$405,800,000 for the fourth quarter of 2002 and \$202,400,000 for the year. The March 3 Press Release stated:

HEALTHSOUTH Corporation (NYSE:HRC) announced operating results for the quarter and year ended December 31, 2002. For the quarter, HEALTHSOUTH's revenues were \$923.5 million, a decrease of 17.2% as compared to \$1.115 billion for the fourth quarter of 2001. Operating revenues for the 2002 quarter were \$1.089 billion. Operating data exclude certain items included under generally accepted accounting principles, as more fully described below. For the 2002 quarter, the company incurred a net loss of (\$405.8) million, compared to net income for the 2001 quarter of \$67.9 million. Operating income for the 2002 quarter was \$18.6 million, compared to operating income of \$88.6 million for the 2001 quarter. The company incurred a net loss per share (assuming dilution) of (\$1.03) for the 2002 quarter, compared to earnings per share (assuming dilution) for the 2001 quarter of \$0.17. Operating earnings per share (assuming dilution) were \$0.05 for the 2002 quarter, compared to \$0.22 for the 2001 quarter.

For the year ended December 31, 2002, HEALTHSOUTH's revenues were \$4.311 billion, compared to \$4.380 billion for 2001. Operating revenues for 2002 were \$4.466 billion. The company incurred a net loss of (\$270.1) million for 2002, compared to net income for 2001 of \$202.4 million. Operating income for 2002 was \$267.3 million, compared to operating income of \$326.1 million for 2001. For the year, the company incurred a net loss per share (assuming dilution) of (\$0.68), compared to earnings per share (assuming dilution) of \$0.51 for 2001. Operating earnings per share (assuming dilution) for 2002 were \$0.67, compared to \$0.82 for 2001.

Operating revenues, operating income and operating earnings per share exclude the effects of certain items that are included in revenues and net income, including unusual items of gains or loss, the effects of changes in accounting principles, the effects of changes in estimates, and restructuring and similar charges. Management believes that operating revenues, operating income and operating earnings per share

excluding such items and charges provide a clearer picture of HEALTHSOUTH's operational performance than revenues, net income and earnings per share standing alone. A reconciliation of operating revenues, operating income and operating earnings per share to revenues, net income and earnings per share as determined under generally accepted accounting principles is provided in the accompanying financial information, and a description of the items excluded from revenues and net income to calculate operating revenues and operating income in the fourth quarter of 2002 is set forth below. For the fourth quarter of 2002, the following items and charges were excluded from revenues and net income to calculate operating revenues, operating income and operating earnings per share:

- **Restructuring and Other Charges:** The company incurred restructuring and other charges aggregating approximately \$445.0 million pretax, or \$305.1 million net of taxes. Many of the components of these charges were non-cash in nature. The cash portion of the charges was approximately \$58.9 million (\$36.8 million net of taxes). Included in this category are:
  - Restructuring charges of approximately \$255.5 million (\$175.7 million net of taxes) relating to the company's decision to close, consolidate or sell approximately 220 facilities, primarily outpatient rehabilitation facilities. This decision was made primarily in response to the impact of decreased Medicare reimbursement for outpatient rehabilitation services, and the facilities involved were determined to be consistent under performers, to represent duplicative capacity or no longer to be strategically useful to the company. The restructuring charges include employee severance expense and continuing lease obligations on closed facilities.
  - Asset impairment charges under the requirements of Statement of Financial Accounting Standards No. 144 of approximately \$55.6 million (\$34.1 million net of taxes). The impairment charges result from a comparison of the fair value of affected long-lived assets to the carrying value of such assets, and primarily relate to the adverse impact of decreases in Medicare reimbursement for outpatient rehabilitation services.
  - Goodwill impairment charges under the requirements of Statement of Financial Accounting Standards No. 142 of approximately \$80.5 million (\$62.5 million net of taxes). The impairment charges result from a comparison of the implied fair value of the goodwill associated with various reporting units containing facilities acquired in various past transactions with the current fair value of those units in accordance with SFAS No. 142. Again, the impairment is primarily related to diminished expected future cash flows primarily relating to the adverse impact of decreases in Medicare reimbursement for outpatient rehabilitation services. HEALTHSOUTH is awaiting a final report from an independent appraisal firm to complete the detailed calculations required by SFAS No. 142; thus, the goodwill impairment charge reflected in this announcement is preliminary in nature and subject to change upon receipt of the final appraisal report and



completion of such calculations. Any adjustment to management's preliminary estimate will be reflected in the audited financial statements to be included in the company's Annual Report on Form 10-K for the year ended December 31, 2002.

- Expenses of approximately \$6.1 million (\$3.7 million net of taxes) relating to the settlement of certain litigation relating to a contract dispute over a terminated surgery center acquisition and to a potential tax liability incurred by an entity the company sold to a third party.
- Adjustments aggregating approximately \$17.1 million (\$10.5 million net of taxes) relating to final post-closing settlements in connection with the sale of four rehabilitation hospitals to a third party and to the sale of certain technology assets to Source Medical Solutions, Inc.
- Losses aggregating approximately \$17.3 million (\$10.6 million net of taxes) representing the company's share of the losses of certain unconsolidated entities accounted for on the equity method.
- Unrealized losses on investment aggregating approximately \$9.6 million (\$5.9 million net of taxes) relating to unconsolidated entities in which the company has an interest accounted for on the cost method. Under generally accepted accounting principles, the company is required to report unrealized losses on such investments, but is not permitted to report unrealized gains or to offset such unrealized gains against unrealized losses.
- A loss of approximately \$3.4 million (\$2.1 million net of taxes) on the sale of the company's interest in a surgery center. In exchange for accepting a lower price for the sale of its interest, the company obtained relief from certain restrictive covenants relating to the surgery center and resolved a dispute over amounts owed by the surgery center to the company.
- Other Unusual Charges: In addition to the amounts described above as "Restructuring and Other Charges," during the fourth quarter the company incurred certain additional unusual charges, the effects of which are reflected in other line items on the company's income statement. These items aggregated approximately \$194.8 million (\$119.3 net of taxes). The cash portion of such charges was approximately \$175.8 million (\$107.7 million net of taxes). Those items include the following:
  - The company's results of operations include the effects of a change in estimate relating to the valuation of accounts receivable and bad debt expense as a result of a detailed analysis of the collectibility of accounts receivable. During the fourth quarter, the company's enhanced focus on collection of accounts receivable resulted in a cash collection rate that was significantly higher than the company's previous experience. In the course of the intensified focus on collections, however, the company reviewed its estimates

of historical reserves for contractual allowances and bad debt and determined that its estimates regarding the collectibility of some older accounts receivable should be revised. The results of this change in estimate are reflected as a reduction of approximately \$100.0 million (\$61.3 million net of taxes) in revenues and an increase of approximately \$10.0 million (\$6.1 million net of taxes) in bad debt reserves.

- The company's fourth quarter results reflect a change in estimate relating to open cost report settlements for the company's inpatient operations. The cost report settlements relate primarily to fiscal years ending December 31, 2001 and earlier. That change in estimate is reflected as a reduction of approximately \$65.8 million (\$40.3 net of taxes) in revenues. During 2002, the inpatient rehabilitation facilities transitioned to the new Medicare prospective payment system.
- The company accrued a reserve of approximately \$19.0 million (\$11.6 million net of taxes) reflecting estimated future obligations relating to certain unfunded contractual retirement benefits. This accrual is reflected as an increase in operating expenses. The reserve will be reduced in future periods as the related benefits are paid.

In addition to the foregoing, the company incurred significant expenses in the fourth quarter relating to legal, consulting and audit fees incurred in connection with the proposed tax-free separation of the company's surgery center operations and legal, consulting and other professional fees relating to litigation, internal and external investigations and related matters. These expenses are reflected in operating expenses for the quarter and are not excluded in calculating operating income and operating earnings per share, but management believes that they are not representative of operating expenses that are expected to be incurred going forward.

"The fourth quarter was another very challenging one for us, but we believe that it represents a bottom from which we expect to see growth in 2003," said Richard M. Scrushy, Chairman of the Board and Chief Executive Officer of HEALTHSOUTH. "Our quarterly operating revenues decreased 2% year over year, and were essentially flat on a sequential-quarter basis, primarily as a result of decreases in outpatient rehabilitation revenues and continued weak volumes in outpatient rehabilitation as we continue to deal with the effects of Medicare Program Transmittal 1753. However, we saw some positive trends in other lines of business, as inpatient rehabilitation revenues increased 12% and surgery center revenues increased 5% over the fourth quarter of 2001. In addition, we saw year-over-year same-store volume growth in our inpatient rehabilitation facilities, surgery centers and medical centers, including our tenth consecutive quarter of same-store growth in surgery volumes. In addition, volumes were off only slightly from the third quarter in our outpatient rehabilitation and diagnostic operations, and part of that reduction was due to the closure or consolidation of some facilities in those lines of business during the quarter. We believe that this confirms that we have reached a baseline from which we can resume positive trends in those lines."

Scrushy continued, “We have responded to these challenges by initiating a plan to close, consolidate or sell a number of locations, primarily outpatient rehabilitation facilities, that are duplicative, that are no longer strategic for us or that are consistent under performers. Some of those facilities were closed, consolidated or sold in the fourth quarter, and we are continuing to implement the plan in the first quarter of 2003. All of the costs we expect to incur with respect to the closure plan are reflected in the fourth quarter restructuring charge. We have also reduced our workforce, and we are closely monitoring other expenditures. During January 2003, we began seeing the results of our efforts, as our revenues and volumes exceeded budget in all of our business lines. Based on the trends we have seen thus far in the first quarter, we remain comfortable with our EPS guidance of \$0.13 for the first quarter and \$0.55 for 2003, and we reiterate our expectation that capital expenditures will not exceed \$400 million for the year.”

Scrushy concluded, “We believe that the fourth quarter represents a bottom from which we can grow and produce positive results. The last half of 2002 was a difficult chapter in HEALTHSOUTH’s history, but we believe we are positioned to put it behind us and move forward again in 2003.”



APPENDIX 3

DEFENDANTS' INSIDER TRADING

Insider	Date	Price	Shares Sold	Proceeds
A. Beam	11/04/97	\$27.590	100,000	\$2,759,000
		Totals:	100,000	\$2,759,000
J. Bennett	11/21/97	\$26.500	5,000	\$132,500
	11/21/97	\$26.560	15,700	\$416,992
	11/21/97	\$26.690	17,200	\$459,068
	11/21/97	\$26.190	23,200	\$607,608
	11/24/97	\$26.250	12,500	\$328,125
	11/24/97	\$26.500	1,600	\$42,400
	11/25/97	\$26.560	5,000	\$132,800
	11/25/97	\$26.190	25,000	\$654,750
	11/25/97	\$26.380	29,500	\$778,210
	11/25/97	\$26.440	5,000	\$132,200
	11/26/97	\$26.500	6,000	\$159,000
	11/28/97	\$26.720	40,000	\$1,068,800
	12/01/97	\$26.500	1,250	\$33,125
	12/03/97	\$26.380	12,950	\$341,621
		Totals:	199,900	\$5,287,199
D. Brown	11/06/97	\$27.130	5,000	\$135,650
	11/06/97	\$26.940	37,000	\$996,780
	11/06/97	\$27.190	25,810	\$701,774
	11/06/97	\$27.000	2,000	\$54,000
	11/19/97	\$26.250	11,000	\$288,750
	11/20/97	\$26.630	10,000	\$266,300
	11/20/97	\$26.380	3,500	\$92,330
	11/21/97	\$26.630	15,500	\$412,765
	12/03/97	\$26.380	18,000	\$474,840
	12/05/97	\$26.500	27,000	\$715,500
	12/22/97	\$27.000	25,000	\$675,000
		Totals:	179,810	\$4,813,689

Insider	Date	Price	Shares Sold	Proceeds
B. Hale	08/02/01	\$17.900	15,000	\$268,500
	12/26/01	\$14.010	17,200	\$240,972
	12/27/01	\$14.150	10,000	\$141,500
	Totals:		42,200	\$650,972
T. Carman	11/06/97	\$26.460	105,000	\$2,778,300
	11/10/97	\$26.060	4,000	\$104,240
	11/10/97	\$26.000	11,200	\$291,200
	11/11/97	\$26.060	25,100	\$654,106
	11/11/97	\$26.000	24,900	\$647,400
	11/12/97	\$26.500	7,000	\$185,500
	11/12/97	\$26.630	2,500	\$66,575
	11/13/97	\$26.560	5,000	\$132,800
	11/13/97	\$26.500	5,000	\$132,500
	11/20/97	\$26.630	7,300	\$194,399
	11/20/97	\$26.500	3,000	\$79,500
	12/18/00	\$14.177	30,000	\$425,310
	12/28/00	\$16.843	30,000	\$505,290
	08/21/01	\$17.633	100,000	\$1,763,300
	08/21/01	\$17.633	100,000	\$1,763,300
05/02/02	\$15.093	25,000	\$377,325	
	Totals:		485,000	\$10,101,045
R. Celeste	11/13/97	\$26.130	10,000	\$261,300
	12/15/97	\$27.000	20,000	\$540,000
	12/16/97	\$27.500	20,000	\$550,000
	12/17/97	\$27.380	10,000	\$273,800
	Totals:		60,000	\$1,625,100
C. Newhall	04/25/00	\$8.000	1,508,781	\$12,070,248
	12/18/01	\$14.233	70,000	\$996,310
	12/19/01	\$14.130	75,000	\$1,059,750
	12/20/01	\$14.050	1,200	\$16,860
	12/24/01	\$13.986	3,300	\$46,154
	12/24/01	\$13.980	400	\$5,592
	12/26/01	\$13.986	5,000	\$69,930
	12/27/01	\$14.030	10,100	\$141,703
	Totals:		1,673,781	\$14,406,547

Insider	Date	Price	Shares Sold	Proceeds
P. Foster	11/20/97	\$26.500	6,100	\$161,650
	11/20/97	\$26.380	5,100	\$134,538
	08/10/01	\$16.980	90,000	\$1,528,200
	08/10/01	\$16.980	50,000	\$849,000
	08/10/01	\$16.980	60,000	\$1,018,800
	08/30/01	\$17.859	51,000	\$910,809
	08/31/01	\$17.936	62,425	\$1,119,624
	01/02/01	\$15.750	56,712	\$893,214
	Totals:		381,337	\$6,615,835
L. House	01/02/98	\$26.260	300,000	\$7,878,000
	01/02/98	\$27.150	100,000	\$2,715,000
	07/20/98	\$30.000	5,363	\$160,890
	07/20/98	\$30.000	25,000	\$750,000
	07/20/98	\$30.000	2,633	\$78,990
	07/20/98	\$30.000	50,000	\$1,500,000
	Totals:		482,996	\$13,082,880
M. Martin	11/06/97	\$27.000	125,000	\$3,375,000
	Totals:		125,000	\$3,375,000
W. Owens	09/29/97	\$26.630	2,500	\$66,575
	09/29/97	\$26.500	20,000	\$530,000
	09/30/97	\$26.630	2,500	\$66,575
	09/30/97	\$27.000	2,500	\$67,500
	09/30/97	\$26.500	2,500	\$66,250
	12/23/97	\$27.000	25,000	\$675,000
	12/29/97	\$26.380	25,000	\$659,500
	12/29/97	\$26.130	100,000	\$2,613,000
	12/30/97	\$26.370	46,000	\$1,213,020
	Totals:		226,000	\$5,957,420
R. Scrusby	11/06/97	\$27.000	4,000,000	\$108,000,000
	05/14/02	\$14.050	2,275,360	\$31,968,808
	05/14/02	\$14.050	3,000,000	\$42,150,000
	07/31/02	\$10.060	2,506,770	\$25,218,106
	Totals:		11,782,130	\$207,336,914

Insider	Date	Price	Shares Sold	Proceeds
G. Strong	02/13/02	\$12.260	7,000	\$85,820
	02/14/02	\$12.260	16,000	\$196,160
	02/14/02	\$12.260	14,300	\$175,318
	02/14/02	\$12.280	2,100	\$25,788
	02/14/02	\$12.270	445	\$5,460
	02/15/02	\$11.900	6,680	\$79,492
	06/07/02	\$13.785	13,680	\$188,580
	06/07/02	\$13.785	12,815	\$176,656
	06/07/02	\$13.785	12,815	\$176,656
	06/07/02	\$13.785	12,815	\$176,656
	06/11/02	\$14.280	17,216	\$245,844
		Totals:		115,866
A. Tanner	11/18/97	\$25.940	4,000	\$103,760
	11/18/97	\$25.940	4,000	\$103,760
	11/18/97	\$26.130	25,000	\$653,250
	11/18/97	\$25.940	4,000	\$103,760
	11/20/97	\$26.560	6,000	\$159,360
	11/20/97	\$26.500	19,000	\$503,500
	11/20/97	\$26.630	23,700	\$631,131
	11/21/97	\$26.500	8,300	\$219,950
	11/21/97	\$26.690	3,000	\$80,070
	11/21/97	\$26.560	55,000	\$1,460,800
	11/21/97	\$26.750	10,000	\$267,500
	11/24/97	\$26.250	12,500	\$328,125
	11/24/97	\$26.500	1,600	\$42,400
	11/25/97	\$26.380	29,500	\$778,210
	11/25/97	\$25.190	26,000	\$654,940
	11/25/97	\$26.560	5,000	\$132,800
	11/25/97	\$26.440	5,000	\$132,200
	11/26/97	\$26.500	6,000	\$159,000
11/28/97	\$26.720	29,500	\$788,240	
12/01/97	\$26.500	1,250	\$33,125	
	Totals:		278,350	\$7,335,881
R. Thomson	11/12/97	\$26.130	25,000	\$653,250
	11/13/97	\$26.500	17,000	\$450,500
	11/13/97	\$26.560	8,000	\$212,480



Insider	Date	Price	Shares Sold	Proceeds
	11/18/97	\$26.130	35,000	\$914,550
	11/20/97	\$26.380	3,500	\$92,330
	11/20/97	\$26.630	20,000	\$532,600
	11/20/97	\$26.440	5,000	\$132,200
	11/21/97	\$26.630	15,000	\$399,450
	08/27/01	\$17.900	10,000	\$179,000
	08/28/01	\$18.000	10,000	\$180,000
	09/04/01	\$18.292	110,000	\$2,012,098
	09/07/01	\$18.200	5,000	\$91,000
	Totals:		263,500	\$5,849,458
P. Watkins	11/18/97	\$26.000	25,000	\$650,000
	11/20/97	\$26.630	15,000	\$399,450
	11/21/97	\$26.630	10,000	\$266,300
	01/02/98	\$27.150	50,000	\$1,357,500
	01/02/98	\$27.150	30,000	\$814,500
	01/02/98	\$27.150	30,000	\$814,500
	04/13/99	\$10.310	20,000	\$206,200
	06/25/01	\$14.710	5,000	\$73,550
	06/25/01	\$14.870	5,000	\$74,350
	08/01/01	\$17.245	10,000	\$172,450
	08/16/01	\$17.000	10,000	\$170,000
	Totals:		210,000	\$4,998,800
W. Smith	08/13/01	\$17.573	25,000	\$439,313
	08/13/01	\$17.573	6,250	\$109,831
	08/13/01	\$17.573	2,750	\$48,325
	08/13/01	\$17.573	21,400	\$376,060
	08/15/01	\$17.184	9,300	\$159,815
	08/16/01	\$16.987	20,000	\$339,744
	08/16/01	\$16.987	7,950	\$135,048
	Totals:		92,650	\$1,608,136
C. Sage Givens	12/22/97	\$27.122	30,000	\$813,660
	12/14/00	\$13.188	15,000	\$197,813
	12/14/00	\$13.250	5,000	\$66,250
	12/14/00	\$13.000	5,000	\$65,000
	12/14/00	\$13.125	5,000	\$65,625
	12/14/00	\$13.250	5,000	\$66,250
	12/14/00	\$13.375	5,000	\$66,875

Insider	Date	Price	Shares Sold	Proceeds
	12/14/00	\$13.375	10,000	\$133,750
	08/01/01	\$17.563	140,000	\$2,458,820
	08/02/01	\$17.850	5,000	\$89,250
	08/02/01	\$17.994	10,000	\$179,940
	08/03/01	\$17.500	5,000	\$87,500
		Totals:	240,000	\$4,290,733
M. McVay	08/01/01	\$17.318	50,000	\$865,910
		Totals:	50,000	\$865,910
S. Jones	08/13/01	\$17.326	5,000	\$86,629
	08/13/01	\$17.326	12,500	\$216,571
	08/13/01	\$17.326	10,000	\$173,257
	08/13/01	\$17.326	1,250	\$21,657
		Totals:	28,750	\$498,114
W. Horton	08/27/01	\$17.790	60,000	\$1,067,400
	08/27/01	\$17.790	50,000	\$889,500
	08/27/01	\$17.350	15,000	\$260,250
		Totals:	125,000	\$2,217,150
<b>Grand Totals:</b>			17,142,270	\$305,208,213



## APPENDIX 4

### 20A CONTEMPORANEOUS TRADES

<b>SUMMARY</b>									
<b>Plaintiff</b>	<b>Date</b>	<b>Shares</b>	<b>Price</b>	<b>Cost</b>	<b>Defendant</b>	<b>Date</b>	<b>Shares</b>	<b>Price</b>	<b>Proceeds</b>
Pittman	11/11/97	300	\$25.50	\$7,650	Carman	11/10/97	4,000	\$26.06	\$104,240
					Carman	11/10/97	11,200	\$26.00	\$291,200
					Carman	11/11/97	25,100	\$26.06	\$654,106
					Carman	11/11/97	24,900	\$26.00	\$647,400
McQueen	7/20/98	2,400	\$30.167	\$72,150	House	7/20/98	5,363	\$30.00	\$160,890
					House	7/20/98	25,000	\$30.00	\$750,000
					House	7/20/98	2,633	\$30.00	\$78,990
					House	7/20/98	50,000	\$30.00	\$1,500,000
Oracle Partners	5/3/02	50,000	\$15.00	\$750,000	Carman	5/2/02	25,000	\$ 15.093	\$377,325
<b>Total:</b>		52,700		\$829,800			173,196		\$4,564,151







## APPENDIX 6

### Summary of False Statements by UBS

Date	Analyst/ Recommendation	Additional False Statements
5/18/99*	Capek Strong Buy	<p>HRC: INITIATING COVERAGE WITH STRONG BUY ...</p> <p>Summary: We have initiated coverage of HRC with a Strong Buy. In our view, current valuation ... combined with HRC's scale, service menu, track record, balance sheet, and free cash flow help distinguish it as one of the better risk/reward profile investments in health care....</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC scores four out of four in our Investment Mantra. Our investment framework for all health care services centers on four criteria: (1) organic growth, (2) balance sheet integrity, (3) franchise value, and (4) business model. HRC scores high marks (if not the highest) across all four categories.</li> <li>• Powerful [sic] cash flow and organic growth engine. HRC has been in acquisition mode for the past few years. Given its market position and ability to deliver 8-10% organic top-line growth, we expect HRC to harvest cash, prudently allocate capital ... and deliver 15% annual EPS growth.... For 1999, we expect HRC to generate \$0.57 per share (\$250 million) in free cash.</li> </ul> <p style="text-align: center;">* * *</p> <p>Analysis: Investment Thesis Our investment thesis on HRC centers on strong organic growth, supported by service breadth, a sound cost structure, proven operating acquisition track record, and strong cash flow and balance sheet.... In addition, we highlight the following points in support of our investment argument:</p> <p>* HRC's Business Model Remains Well Intact. Despite HRC's share price performance and near-term pricing issues, HRC has continued to deliver top line growth and also sustain its cost structure. We argue HRC's leadership positioning in many of its markets and its sizable quality asset base (and ensuing insurance/payer contracts) have been overlooked. HRC's critical mass of assets is rooted in secular growth areas of health care (rehabilitation and outpatient services).</p> <p>* HRC's Scale and Scope Provide A Real Competitive</p>



		<p>Advantage. HRC's asset base has taken nearly 10 years to develop through solid organic growth and strategic acquisition. Based on availability of assets and access to capital, this base is neither quickly or easily duplicated.</p> <p style="text-align: center;">* * *</p> <p>* Medicare Reimbursement – HCR is neither a hospital nor a long term care provider. Still, it is often categorized as each when it comes to Medicare reimbursement worries. HRC continues to grow its non-government business and maintain an operating cost structure that should enable it to weather any structural changes to Medicare. Moreover, HRC is not directly exposed to long term care prospective payment (PPS). For hospital-based outpatient PPS (expected for April 2000 at the earliest), HRC's exposure should be limited to its four acute care hospitals and its outpatient rehab and surgery business. We note that HRC's outpatient rehab and surgery business derives about 10% of net revenue from Medicare and these businesses are already essentially operating under fee screens, which limits HRC's exposure to any potential changes in co-payment levels. In short, relative to hospital and other providers, HRC should well-manage through outpatient PPS. Moreover, given current share price levels and investor expectations, the worst-case operating scenario appears to be somewhat well-reflected in today's valuation.</p> <p>* Investigatory Activity in the Sector – Since the early 1990's, the health care service sectors have been to [sic] focus of an investigatory “call to arms” by the Attorney General and the Office of the Inspector General (OIG). HRC has not been the subject or focus of any investigations. We argue this risk is somewhat undiversifiable across health care. Still, by examining where the government has enjoyed success in proving fraud and abuse, investors can limit this systemic risk. HRC screens well in this regard. HRC continues to limit its exposure to Medicare, actually save the government money, maintain high-quality well capitalized assets and professionals, and operate one of the more comprehensive employee awareness and fraud and abuse compliance programs in health care.</p> <p>... Stock price weakness related to reimbursement concerns and hospital/long term care sector volatility should be viewed as buying opportunities for HRC.</p>
6/4/99	Capek Strong Buy	<p>[Projecting 1999 EPS of \$1.11, 2000 EPS of \$1.30.]  REITERATING STRONG BUY, DISPELLING SOME NEAR  TERM MARKET CONCERNS  Summary:</p>

	<p>We wish to focus investor attention on HRC's operating trends, underscore our investment thesis, and dispel a bit of what we perceive to be market misperception. Operating results continue to trend favorably, and we remain focused on the sequential earnings progression and momentum we foresee in 2H99 and into 2000. Our concerns with respect to government reimbursement issues are minimal; this view is based on HRC's non-government reimbursed business development and comprehensive asset base, as well as on the company's low cost structure and specific type of Medicare business in which it participates.... We believe investors should aggressively build positions now. Our 12-month price objective is \$20.</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC is one of the best positioned health care service providers, in our view, with a unique asset concentration and business model focused on rehabilitation and outpatient services. Given minor business mix issues and broader health care operating volatility and reimbursement concerns, we believe investors have overlooked HRC's market positioning, operating strength, and cash flow generation potential.</li> <li>• We focus investor attention on projected 2H99 and early 2000 earnings results. We believe this EPS progression and potential for upside momentum should be both the catalyst for stock price performance and the evidence needed to allay investors' near term business concerns.</li> <li>• We recommend aggressive purchase of the shares of HRC today, based on the company's cash flow generation, solid business model, and relatively strong organic growth trends.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• Investor Expectations for Growth Appear to be Muted. We believe current valuation should provide investors with limited downside exposure. In fact, after discounting our 1999 proxy for after tax cash flow at HRC's weighted average cost of capital (WACC), which assumes a zero growth state in perpetuity, we arrive at roughly 65% of current equity value. In other words, only 35% of today's share price reflects the present value of future growth opportunity, in our estimation. We believe this should allow for upside stock price potential based solely on HRC's ability to meet current earnings expectations....</li> </ul> <p>Analysis: INVESTMENT THESIS:</p>
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		<p>Our investment thesis on HRC centers on strong organic growth, supported by service breadth, a sound cost structure, proven operating acquisition track records, and strong cash flow and balance sheet. HRC's asset base has taken nearly 10 years to develop through solid organic growth and strategic acquisition. Based on availability of assets and access to capital, we believe this base is neither quickly or easily duplicable. In our view, HRC owns the model in rehabilitation and outpatient services. Despite conservative expectations of essentially flat year-over-year earnings growth, we focus our expectations for the sequential earnings ramp-up and the potential for better than expected results in 2H99. HEALTHSOUTH scores well across our investment mantra, possessing (1) organic growth, (2) balance sheet integrity, (3) franchise value, and (4) a viable business model.</p> <p>Although HRC's near-term pricing and business mix issues (along with broader health care sector jitters) could continue to fuel near-term trading volatility, we recommend purchase of HRC's shares for investors with time horizons of greater than six months. In addition, we highlight the following points in support of our investment argument:</p> <p>Powerful cash flow and organic growth engine. HRC has been in acquisition mode for the past few years. Given its market position and ability to deliver 8-10% organic top-line growth, we expect HRC to harvest cash, prudently allocated capital (including share buy-backs), and deliver 15% annual EPS growth. For 1999, we expect HRC to generate \$0.58 per share (\$250 million) in free cash. This roughly a 4% cash yield.</p> <p style="text-align: center;">* * *</p> <p>Based on the improvement in the managed care business and pricing cycle, as well as on HRC dominant asset base, we expect 1998's pricing trends to be short-term, with price stability (and perhaps some of the business lost from attrition) returning in late 1999 and 2000. This, combined with a favorable 2H99 earnings progression should provide the catalyst for stock price performance, we believe.</p> <p>Perceived Medicare reimbursement risk. HRC is neither a hospital nor a long term care provider. Still, it is often categorized as either when it comes to Medicare reimbursement worries. HRC continues to grow its non-government business and maintain an operating cost structure that should limit its exposure to any Medicare reimbursement changes. HRC is not exposed to long term care prospective payment (PPS). For</p>
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		<p>hospital-based outpatient PPS (expected for April 2000 at the earliest), HRC's exposure should be limited to its four acute care hospitals. We note that HRC's outpatient rehab and surgery business derives about 10% of net revenue from Medicare and these businesses are already essentially operating under fee screens. In short, relative to hospitals and other providers, HRC should well-manage through outpatient PPS. Moreover, given current share price levels and investor expectations, we believe the worst-case operating scenario is somewhat well reflected.</p> <p>Finally, in response to questions in the marketplace, we as a research team would like to clarify our position on HRC stock. There seems to be some confusion regarding Geoff Harris' current opinion on HRC relative to his published research opinion at his former employer. (We believe this confusion stems from an event in late 1998 when a lowering of Mr. Harris' estimates surprised the company and created a tremendous flow of incoming phone calls. Mr. Harris has apologized to the company for not concurrently informing them of his change in forecast.) Since starting employment with Warburg Dillon Read, Mr. Harris, in addition to assuming the role of global head of health care research, has narrowed his coverage to the managed care universe, and no longer covers health care service providers. Howard Capek, upon starting employment with WDR in May, covers the specialty and non-hospital health care service providers, which includes outpatient and rehabilitation service providers. Mr. Capek reinstated coverage on HEALTHSOUTH with a Strong Buy rating on May 18, 1999, and Mr. Harris, along with the entire healthcare research team, supports his recommendation. Please see our 18 page research report dated May 18, 1999, for company details and Mr. Capek's current outlook for the company. All questions regarding HEALTHSOUTH should be addressed to Mr. Capek, who has been covering HEALTHSOUTH since 1994.</p>
2/11/00*	Capek Strong Buy	<p>We are reinstating coverage on the leading U.S. rehabilitation and outpatient provider. Despite operating pressures, HEALTHSOUTH has maintained its business model and financial integrity. We believe the current valuation offers a unique long-term buying opportunity.</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• <b>Scale and structural integrity.</b> It is difficult to find an asset based comparable to HEALTHSOUTH's, despite its business downturn. This should support core business growth and other potential opportunities.</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Timing is everything.</b> Stabilizing industry trends, combined with HEALTHSOUTH's operating measures and fiscal prudence, should allow for sequential momentum and marked year-over-year improvement in the second half of 2000. Such a scenario recently benefited the hospital sector, and should hold promise for valuation of HRC shares, which are trading at 4.8 times our 2000 EV/EBITDA forecast.</li> <li>• <b>Cash is king.</b> HEALTHSOUTH repurchased roughly 36 million shares and preserved its capital structure in 1999. We believe it can generate \$220 million in free cash flow in 2000. Cash collection improvement should drive investor confidence in cash flow forecasts.</li> </ul> <p>Executive Summary</p> <p>We are reinstating coverage on HEALTHSOUTH Corporation with a Strong Buy rating. HEALTHSOUTH is the largest integrated rehabilitation and outpatient service provider in the United States. Despite (mainly industrywide) issues and trends that have depressed earnings and contributed to operating volatility, we believe the company has smartly maintained its value-added business model and investment-grade balance sheet. Moreover, during this period of operating volatility (which began in late 1998 and accelerated in mid 1999), we believe investors have overly discounted organic growth and cash flow potential from an intact asset and service platform that has taken roughly 10 years to create.</p> <p><b>Our eyes are on DSOs and cash collections</b></p> <p>On the topic of cash flow, we believe the most discouraging trend that has impacted the stock for the past seven quarters is a lengthening of account receivables. The cash tied up in working capital has similarly been the most negative contributor to cash flow. To this end, we believe <i>improvement</i> in days of sales outstanding, or DSOs (which stood at 100 days at the end of the third quarter), will be the biggest catalyst for stock price performance, regardless of any range of 2000 forecasts for EBITDA or operating cash flow. We estimate that each one-day change in DSO equates to roughly \$10 million in cash flow.</p> <p>Our 1999 EPS estimate is \$0.83, versus reported EPS of \$1.09 in 1998. (Our fourth quarter estimate is \$0.15, versus \$0.27 a year ago, and it should be the company's most difficult comparison.) Our 2000 EPS estimate is \$0.66, based on our net revenue and EBITDA forecasts of \$4.11 billion and \$1.09</p>
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	<p>billion, respectively. Our 2001 EPS estimate is \$0.77, based on our net revenue and EBITDA forecasts of \$4.31 billion and \$1.17 billion, respectively.</p> <p><b>We expect sequential operating momentum and year-over-year improvement in second half 2000.</b></p> <p>We believe investors should build positions now, in anticipation of operating improvements and in light of relative valuations and near-term catalysts that should limit downside exposure. HEALTHSOUTH has continued to invest in its businesses, to improve its operating structure, and to maintain its balance sheet (buying in shares and reducing debt) during a business downturn. By the second half of the year, operating comparisons should more readily demonstrate year-over-year improvements and sequential operating momentum – a scenario the broader hospital sector is currently benefiting from, and one that we believe should benefit HEALTHSOUTH in the second half of 2000.</p> <p>Investment Thesis</p> <p><b>Improving asset efficiency and a stabilized cost structure drives cash flow.</b></p> <p>Our investment thesis on HEALTHSOUTH centers on the company’s relatively solid organic growth, supported by its scale, comprehensive service breadth, sound cost structure, and strong cash flow and balance sheet. In our view, this platform should drive improvement in asset efficiency (organic top-line growth with relatively little new investment) <i>and</i> operating margin (improved collections, purchasing leverage, and recapture of market share). Although pricing and utilization issues should continue to fuel near-term volatility, we believe this is well reflected in current valuations and our lower than consensus forecast. In addition, share repurchases, debt paydown, relative hospital sector valuations, and improved collections could provide near-term catalysts for the shares. We reiterate our Strong Buy rating and have a 12-month price objective of \$11.</p> <p><b>HEALTHSOUTH is weathering a storm largely induced by broader healthcare industry trends.</b></p> <p>In our view, operating pressure has been mainly driven by broader managed care and hospital sector trends (commercial pricing cycles and Medicare hospital outpatient prospective</p>
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	<p>payment system or PPS uncertainty). For HEALTHSOUTH, these trends have helped induce managed care pricing pressure in inpatient <i>and</i> outpatient rehabilitation, adverse mix shift, volume growth slowdowns in outpatient rehabilitation and surgery, extended receivables, and labor and wage rate pressures. We expect that sector trend improvement (which has already begun from both the commercial and Medicare perspective) – combined with HEALTHSOUTH’s service platform, restructuring and site consolidation, collections focus, and fiscal discipline – should state a second half 2000 rebound in earnings and growth.</p> <p>Operating Highlights</p> <ul style="list-style-type: none"> <li>• <b>Asset base and scale equals growth.</b> HEALTHSOUTH’s \$7.4 billion invested capital base reflects roughly 2,000 facilities, purpose-built over the past 16 years for rehabilitation and outpatient services. Having heavily invested in acquisition and internal development for the past three years, the current business downturn has enabled the company to retrench and restructure operations. As its business cycles stabilize, HEALTHSOUTH should emerge to internally fund its growth <i>and</i> harvest cash. In our view, this scale also strongly positions the company to develop opportunities in areas such as healthcare online, purchasing, cancer care and disease management, in addition to the secular growth in its core business and not reflected in current expectations.</li> <li>• <b>A cash flow engine.</b> We expect HEALTHSOUTH to generate operating cash flow of \$640 million and free cash flow of \$220 million in 2000 (a 9.8% yield on current share price). Imbedded in our forecast is modest top-line growth (4%) and operating margin of 26.5% (down from 30% in 1999). Given the point at which we believe the company is relative to broader industry cycles, we view our forecast as conservative. Asset efficiency improvements (incremental revenue or improved collections) could drive better than expected cash flow and, in our view, will be the key to establishing investors’ belief in any cash flow forecast.</li> <li>• <b>Cash collection is key.</b> We estimate that average DSOs for the sector have increased by 25% since the first quarter of 1998. HEALTHSOUTH experienced a similar trend, and generally maintains a higher DSO level than hospitals, mostly because of a higher percentage of outpatient and private pay mix. Over the past nine months, the company’s collection efforts have focused on leveraging electronic submissions</li> </ul>
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	<p>(including the recent alliance with Healtheon/WebMD) and pushing commercial collections (and new contracting) to the local level. Local-level accountability should begin to yield DSO improvement in the fourth quarter of 1999, while broader electronic initiatives should ramp up and bear meaningful improvement by the second quarter of 2000. We estimate that each one-day improvement in DSOs frees up roughly \$10 million in working capital (cash).</p> <ul style="list-style-type: none"> <li>• <b>Restructuring business lines.</b> HEALTHSOUTH has restructured its outpatient services under one management line, split by region down to the local level, rather than by individual services (i.e., rehab, surgery, diagnostics, occ-med). In our view, the organizational restructuring can generate cross-utilization and foster greater local-level accountability, potentially driving better than expected revenue and margins by late 2000. At some point, this structure should also allow the company to better assess noncore or outlier assets that could be sold to local-level operators (hospitals).</li> <li>• <b>Inpatient rehabilitation PPS is manageable.</b> Long an area of uncertainty for the sector, Medicare's shift to a PPS for inpatient rehabilitation is less onerous than originally believed. The PPS (based on an episode or case) should begin its three-year phase-in this October, with rates scheduled to be published in March. Using our estimates for the industry's average cost per case (\$12,500) and for HEALTHSOUTH's (\$10,100), we believe that rates based on 98% of the average industry cost should, barring execution risk, allow HEALTHSOUTH operating flexibility and even an opportunity to leverage cost structure and relatively strong volume into earnings.</li> </ul> <p>Valuation: Limited Downside, Meaningful Upside</p> <p>The shares of HRC are trading at \$5.00 per share, which implies a multiple of 4.8 times our 2000 EV/EBITDA forecast. This compares with a broader hospital sector average group valuation multiple of 7.2 times our 2000 EV/EBITDA forecast. We argue that this 33% discount to the peer group valuation is unwarranted, given HEALTHSOUTH's asset base and delivery model, cash flow potential, and relative payor mix profile. Until cash collections improve and operating margins stabilize, such a discount should persist. We believe that these benchmarks are close at hand. Moreover, we believe that improving industry trends in commercial pricing and the broader hospital outlook for outpatient PPS could provide stability for HEALTHSOUTH's business in the second half of</p>
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		<p>2000. In our view, such a development, combined with nearer-term potential catalysts of receivables collection improvements, share repurchases, and cost-savings or revenue growth opportunities that capitalize on HEALTHSOUTH's asset base, should drive stock price appreciation.</p> <p><b>Near-term catalysts could drive modest multiple expansion</b></p> <p>Our Strong Buy rating is based on these potential near-term catalysts, which, as real measures of operating progress, should limit downside (execution) risk and drive early multiple expansion. HEALTHSOUTH's current risk/reward profile, in our view, is favorable, both on an absolute basis and relative to the comparable hospital peer group. Our 12-month price objective of \$11 implies an EV/EBITDA multiple valuation of 6.8 times our 2000 forecast, still a discount to the peer group average.</p>
2/16/00*	Capek Stong Buy	<p>Summary:</p> <p>Yesterday, HEALTHSOUTH's chairman and CEO, Richard Scrushy, provided an in depth overview into the company's long-term growth prospects and near-term benchmarks. Management confirmed our expectations for improved collection trends in the fourth quarter, and solid cash flow and operating stability. The presentation and break-out session also provided insight into recent outpatient business line restructuring and longer-term asset efficiency initiatives centered around purchasing, electronic claims/corrections, and web-based incremental volume growth. We reiterate our Strong Buy rating ....</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• Richard Scrushy's presentation and question and answer sessions focused on the sizable asset base that the company has developed over the past 15 years, and leverage opportunities that such a base provides.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• Nearer-term the company's recently announced initiative with and equity investments in MedcenterDirect.com should yield improved purchasing compliance and savings. Such developments are incremental to our current forecasts, and in our view, could help drive valuation, once confidence is restored in pricing, utilization and collection trends.</li> </ul>

3/7/00*	Capek Strong Buy	<p>HRC: ENCOURAGING 4Q RESULTS, RAISING ESTIMATES, REITERATE STRONG BUY</p> <p>Summary:</p> <p>HRC reported encouraging 4Q99 results .... Strong sequential volume trends drove quarterly revenues ahead of our expectations, while operating margins were in line with our expectations. Strong 6-day improvement in the A/R collections cycle (excluding charges) helped free up about \$60 million in cash flow, which we believe went toward buying back stock. Share buyback activity was stronger than expected and combined with the favorable utilization trends, allowed for the upside to our forecast. Reflecting the 4Q99 results and ongoing sequential momentum, we are raising our 2000 EPS estimate to \$0.70 from \$0.66 and our 2001 estimate to \$0.82 from \$0.77. We reiterate our Strong Buy rating ....</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC reported 4Q99 and fill-year operating results .... Net revenue growth was stronger than expected and operating margins were in line with our forecast....</li> <li>• Sequential comparisons help support our view that 4Q99 results represent a turning point for the company. Based on the stronger sequential volume trend, stabilizing operating margin, reduced share base, and strong balance sheet position, we have raised our 2000 and 2001 EPS forecasts.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• We estimate that A/R collections improved by 6 days from 3Q99, with days in sales outstanding (DSOs) reaching 94 days, before the expected write-down. This marks the first DSO improvement in seven quarters and points to the company's business re-alignment and local-level accountability initiatives taken over the past six months. This DSO trend should continue to improve by 6-10 days in 2000, aided by management efforts and electronic initiatives just beginning to ramp up.</li> </ul> <p style="text-align: center;">* * *</p> <p>EBITDA margins [of 25.8% posted in the quarter] should improve sequentially, toward the 27% [level], ... aided by stabilized pricing, collection improvements, purchasing and electronic patient data and billing initiatives, and strong organic volume trends.</p>
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		<p style="text-align: center;">* * *</p> <p>The company recorded net charges of \$204 million in 4Q99, in line with a previously disclosed range (actually about \$25 million short of the high-end of the range). Of this charge, \$140 million was related to A/R writeoffs, \$121 million to asset impairment/site consolidation charges, and the remaining \$69 million to Y2K and consolidation expenses, and equipment and investment write-downs; all of this netted against \$117 million tax benefit and \$10 million passed onto minority joint venture partners.</p>
4/26/00*	Capek Strong Buy	<p>HRC: ENCOURAGING 1Q RESULTS, RAISING ESTIMATES, REITERATE STRONG BUY</p> <p>Summary: HRC reported 1Q00 results that were \$0.01 ahead of our and consensus EPS estimates. Strong sequential volume and revenue gains combined with better-than-expected operating margins to drive EPS results.... All of this should help set the stage for EPS momentum in 2H00 and helps form the basis of our Strong Buy thesis. We have carried 1Q00 results through the full year and raised our 2000 EPS estimate to \$0.71 from \$0.70 and our 2001 estimate to \$0.83 from \$0.82....</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC reported 1Q00 EPS of \$0.17, versus \$0.26 a year ago and the \$0.16 posted in 4Q99. These earnings results were \$3.6 million (\$0.01 per share) ahead of our forecast. Net revenue was \$13 million ahead of our expectation and driven by stable pricing and stronger volume gains. These, combined with ongoing management initiatives, helped drive operating margins that were 30 basis points better than our forecast.</li> <li>• In our view, sequential comparisons reinforce our view that the company is in the early stages of an operating turnaround, one that should yield accelerating momentum throughout the year. We believe there is upside to our 2000 estimates, similar in magnitude to today's results, based on stronger sequential volumes, stabilized pricing and operating margin, reduced share base, strong balance sheet, and increasing contributions from cost-cutting, restructuring and collections programs.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• Operating income EBITDA for the quarter reached \$270 million, up 5% sequentially and \$7 million ahead of our forecast. The strong volume gains helped bolster margins, as</li> </ul>

		<p>did cost-savings and collections/recontracting initiatives that allowed for CG&amp;A and bad debt expense betterment. The EBITDA margin of 26.4% posted in the quarter should improve sequentially, toward the 27% level.</p> <ul style="list-style-type: none"> <li>• We believe the shares of HRC remain undervalued relative to peer group comparisons and the company’s own cash flow generation potential over the next few years. The shares are trading at 5.5x our 2000 EBITDA forecast, versus a (hospital) peer group average of 7.4x. We expect ongoing DSO improvement and sequential revenue, margin and EPS gains to drive investor interest. A transition to 2001 valuation and the company’s meeting (slightly beating) near-term operating expectations should drive share price appreciation and our \$11 price objective. Our price objective implies 6.6x 2000 and 6.2x 2001 EBITDA valuation.</li> </ul> <p style="text-align: center;">* * *</p> <p>Margin expansion opportunity toward yearend The company is engaging in a number of cost-saving initiatives that should provide margin expansion opportunity in 2H00 and 2001, including e-commerce and supplies procurement initiatives that could save the company (annualized) \$50-\$100 million over the course of the next year.</p>
1/11/01*	Capek Strong Buy	<p><b>HRC: OPERATING STRENGTH AND SECTOR MOMENTUM; RAISING PRICE TARGET</b></p> <p>Summary: We’ve raised our 12-month price objective on HRC (our top pick for 2001) to \$24 from \$15. We expect renewed operating strength (volume and pricing) .... Normal operating momentum and potential benefits from inpatient rehab PPS lend upward bias to 2002 EPS, and perhaps late 2001. We find it hard to find another marketshare, cash flow, balance sheet, and earnings profile as attractive as that of HRC’s. Our EPS estimates remain \$0.71 for 2000 and \$0.83 for 2001.</p> <p>Highlights: • We’ve raised our 12-month price objective on HRC .... As we look to the full year 2001, we expect business strength, the company’s return to “predictable operator” status, peer group leadership, and potential upside to EPS estimates in late 2001 and 2002 to drive multiple expansion.</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• 4Q00 results should provide evidence of commercial pricing</li> </ul>

		<p>stability in the outpatient rehabilitation and outpatient surgery segments (combined roughly 43% of HRC's net sales). On this stable backdrop, we expect volume to continue sequentially improving, returning to 4-6% growth by 2H01.</p> <ul style="list-style-type: none"> <li>• The inpatient rehabilitation business, in our view, hold [sic] meaningful upside opportunity, as HRC focuses on increasing occupancy rates (78% today, up to perhaps 85% by early 2002) and implementing Medicare's rehabilitation PPS. We estimate these initiatives separately can add \$0.10 and \$0.16 in annualized EPS, respectively. This upside potential (realizable in part in 2002) is yet reflected in expectations.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• Finally, the already solid balance sheet and cash flow picture could be potentially enhanced by one-off asset sales (to which the company has alluded). We expect HRC could sell a portion of its inpatient hospitals (which we estimate generate \$280 million in revenue and \$55 million in EBITDA). Assuming HRC can get a 10 multiple of EBITDA and sells \$15-20 million in EBITDA, this would be \$150-200 million in gross proceeds.</li> <li>• In summary, we find it is hard to find as compelling a growth and return profile as that of HRC's. We believe near-term sequential and year-over-year operating momentum will maintain stock price momentum, and the potential upside for 2002 will bridge the transition to a 2002 EBITDA multiple valuation by late 3Q01.</li> </ul> <p style="text-align: center;">* * *</p> <p><b>Medicare PPS</b>  In our view, based on published final Medicare inpatient rehab PPS rates, HRC's existing cost per Medicare discharge, its acuity mix of patients (in line with industry averages), and the historic operating focus HRC has maintained in this business, we believe the shift to a PPS represents a margin opportunity. The company indicates that its average cost per discharge for Medicare inpatient [sic] rehabilitation is below \$9,600. This compares to industry average published case rates that should be in the \$10,800 to \$11,500 range. Using the \$11,100 Medicare rate yields a potential pick-up per discharge to HRC of \$1,400. We believe HRC's cost structure is predicated on its size, scale, centralized overhead function, acquired asset integration, and its higher overall occupancy levels. We do not believe this model is easily duplicable.</p>
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		<p>We estimate that HRC currently has 70,000 Medicare discharges per year. Given the \$1,400 per discharge in potential pick-up, HRC could add \$98 million of incremental annualized pre-tax profit, once it is fully operating under the PPS (which likely won't be until May 2002). After-tax, HRC could realize an additional \$62 million in net income (\$0.16 in EPS) on an annualized basis. Based on our expectation that the inpatient rehabilitation PPS start-date gets pushed back until July 2001, we believe HRC can start realizing some of this profitability in 1Q02. Based on our estimate that 60% of its facilities roll onto PPS January 1, 2002 and the remaining 40% on June 1 2002, for the full year 2002, we believe the company can pick up \$0.10 to \$0.12 in incremental EPS.</p>
2/6/01*	Capek Strong Buy	<p>HRC: HIGHLIGHTS FROM THE HEALTHCARE SERVICES CONFERENCE</p> <p>Summary: Yesterday at the UBS Healthcare Services Conference, HealthSouth (HRC) Chairman and CEO Richard Scruschy, outlined the company's business prospects and the strong opportunities for growth. We remain confident in our 2000 and 2001 estimates of \$0.71 and \$0.83, respectively and view utilization and pricing increases as potential upside to our numbers.</p> <p>Highlights: We maintain our Strong Buy rating on HRC for this sector-leader with strong year-over-year operating momentum.</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• HRC remains one of our top picks as we feel the growth and returns profile remains extremely compelling.</li> </ul>
2/20/01*	Capek Strong Buy	<p>[Projecting 2000 EPS of \$0.71, 2001 EPS of \$0.83.] HRC: REITERATE STRONG BUY IN LIGHT OF MISLEADING NEGATIVE NEWS</p> <p>Summary: A February 16 Bloomberg article highlights a \$312 million jury award against HRC for a patient's injuries and death in a nursing home in 1997. In our view, the perhaps sensationalized headline overlooks the facts that HRC will appeal the award amount, has business insurance to cover such action, did not operate the facility at the time of the death, does not operate it now, and does not have nursing homes as part of its business model. We believe the unfortunate death, subsequent jury award, and final settlement will not impact HRC's operations or financials. We would use any stock price weakness caused</p>

		<p>by this news item as a buying opportunity and reiterate our \$24 12-month price objective.</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• We would use any stock price weakness caused by this news item as a buying opportunity. We find it hard to find as compelling a growth and return profile as that of HRC's in either healthcare services or the broader market. We believe near-term sequential and year-over-year operating momentum will maintain stock price momentum, and the potential upside for 2002 will bridge a smooth transition to 2002 EBITDA forecast valuations by late 3Q01.</li> <li>• HRC shares are currently trading at 8.2x our 2001 EBITDA forecast, compared to a peer group (hospital) forward valuation of 10x. Our price objective implies a multiple of 10.8x. Given HRC's business and growth profile, we believe a slight premium to group valuation is justifiable. We expect the shares can trade to \$20 by mid-year (an implied 2001E EBITDA multiple in line with the peer group) and test our \$24 price objective by late 2001 (based on 2002 forecasts).</li> </ul> <p>Analysis: Our investment thesis centers on the restored growth and profitability in HRC's core business (the turnaround is complete). We believe HRC has emerging [sic] from the trough in its operating cycle a wiser, more focused operator. As investors increasingly view HRC as a predictable operator in an attractive niche, supported by attractive balance sheet, case flows, cost structure, we believe they will give the company credit this positioning. HRC's market cap is close to \$5 billion, far from peak valuations in early 1998, but again large enough and liquid enough to attract large mid-cap and small large-cap interest, in our view. The company, in our view, is experiencing greater trading and earnings volatility. We also believe healthcare providers generally offer investors safe-haven from broader market (especially technology sector) volatility, with solid pricing and utilization and predictable earnings. We believe HRC should benefit from such positioning. Finally, for the first time in several years, we can identify upside earnings potential over the next 18 months. On this backdrop, we recommend purchase of the shares.</p>
3/7/01*	Capek Strong Buy	<p>HRC: GREAT 4Q; BUY AMIDST SHARE VOLATILITY AND CAP-EX MISPERCEPTION</p> <p>Summary: HRC reported strong, in line 4Q00 EPS of \$0.19, up 24% from</p>

	<p>4Q99. Better than expected revenue growth and operating margin gains (netted against higher interest expense and share count) paced results.... We reiterate our Strong Buy rating and \$24 price target.</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC reported 4Q00 EPS of 0.19, up 24% from \$0.16 in 4Q99 and in line with expectations. Full-year 2000 EPS were \$0.71, versus \$0.84 in 1999. We are maintaining our 2001 EPS estimate of \$0.83 (consensus is \$0.81) and introducing a \$0.95 estimate for 2002.</li> <li>• 4Q results mark the 6th quarter of sequential and 2nd quarter of year-over-year revenue, volume, EBITDA and net income growth, the 2nd quarter of modest positive pricing, and the 1st quarter of positive year-over-year EBITDA margin comparisons. The operating turn-around, in our view, is complete, and we'd view HRC as a self-funding, 6-8% top line, 15% or more) EPS growth story.</li> <li>• Net revenue for 4Q00 increased by 7.6% to \$1.08 billion, ahead of our \$1.07 billion forecast. Positive unit growth across all four business segments, along with nice pricing improvements in two of the four segments drove growth. We expect mid-to-high single digit revenue growth (after divestitures) for 2001.</li> <li>• 4Q00 operating income (EBITDA) margin was 27.9%, 60 bps ahead of our forecast, and up 90 bps from 3Q00 and 190 bps from 4Q99. Margins benefited from accelerating volume, pricing, and stable operating costs. We expect margins to continue improving through the 28% level in 2001</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• We expect cap-ex for 2001 to return to the \$400 million level. Moreover, we view the “extra” 4Q00 spending as opportunistic (breaking ground on 9 rehab hospitals, not coincidental to the governments publishing of the rehab PPS rates that should provide HRC with margin opportunity in 2002), carrying project returns of 18-25% (versus the 7.5% savings from debt reduction).</li> </ul> <p style="text-align: center;">* * *</p> <p>Analysis:  Net revenue in the quarter reached \$1.08 billion, an increase of 7.6% over 4Q99 results and \$10 million ahead of our forecast.</p>
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		<p>Positive unit growth across all four business segments, along with pricing improvements in three (although mainly outpatient rehab and surgery) of the four segments drove growth. Better than expected unit growth and pricing increases in HRC's outpatient rehabilitation segment and strong utilization in its diagnostic business drove the upside to our forecasts. Accelerating sequential volume gains and low-to-mid single digit pricing should drive results for 2001. Net of announced asset divestitures we still expect visible 5-7% revenue growth to maintain investor interest through the year.</p> <p style="text-align: center;">* * *</p> <p>Operating income or EBITDA for the quarter reached \$300 million, \$9 million ahead of our forecast and reflecting a 27.9% margin. Direct operating expenses improved to 65.9% of net sales, better by 120 basis points sequentially (and 40 basis points relative to our forecast) and 240 bps better from 4Q99. In addition to HRC's ability to manage salary/wage increases, we believe better pricing and the benefits from the business line re-alignment and electronic patient data and billing rollout continue to help margins.</p> <p style="text-align: center;">* * *</p> <p>Investment Thesis:</p> <p>Our investment thesis on HRC centers on the restored growth and profitability in HRC's core business (the turnaround is complete).... [W]e expect improving year over year EPS visibility, tangible returns on cap-ex of the past 18 months, and potential upside to late 2001 and 2002 EPS forecasts to bolster share price performance....</p> <p>1- The inpatient rehabilitation business, in our view, holds meaningful upside opportunity, as HRC focuses on increasing occupancy rates....</p> <p>2- Medicare's PPS rates for inpatient rehabilitation have been finalized. The methodology and average rates are in line with expectations, and in our estimation, represents a margin opportunity for HRC....</p> <p>3- The already solid balance sheet and cash flow picture could be potentially enhanced by one-off asset sales (a few already announced).... On a relative margin basis, each of these non-core sales will be "accretive" to existing operating margins.</p>
4/27/01*	Capek	HRC: FINE 1Q RESULTS; THE BEST IS YET TO COME

	<p>Strong Buy</p>	<p>Summary:  HRC reported solid 1Q01 EPS of \$0.19 up 12% from 1Q00 and in line with forecasts. Revenue growth of 7% was paced by an average 3-4% same-store volume gain across all businesses and a 3-6% pricing trend that should continue bolstering results through the rest of 2001. Modest operating margin gains and ongoing capital base efficiency helped drive 15% net income growth. Preliminary balance sheet and cash flow data were also encouraging.... We are maintaining our respective 2001 and 2002 EPS estimates of \$0.83 and \$0.95, and reiterate our Strong Buy ....</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC posted 1Q01 EPS of \$0.19, up 11.6% from the \$0.17 generated in 1Q00.... We are encouraged by the strong income statement and preliminary cash flow and balance sheet trends delivered by HRC and maintain our 2001 EPS estimate of \$0.83 (consensus estimate is \$0.81) and our 2002 estimate of \$0.95.</li> <li>• Net revenue for the quarter was in line with our \$1.09 billion forecast and 7% growth expectation. Volume and pricing contribution varied slightly from our expectation by business segment.</li> </ul> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• 1Q01 operating (EBITDA) margin was 27.3%, up 90 basis points from a year ago, but shy of our forecast by 50 bps, in our view, reflecting some seasonality and the H-CAP rollout. We continue to forecast a 28% EBITDA margin for the year, based on ongoing pricing and volume trends and infrastructure leverage.</li> <li>• Preliminary balance sheet and cash flow data were also encouraging.</li> </ul> <p style="text-align: center;">* * *</p> <p>Summary and Outlook  By most every measure, HRC met or surpassed expectations. Same-store volume growth is reaching consistency, pricing remains strong (we argue in an early phase of a cycle), operating margins are benefiting from top line trends and a cost-focus that has always been an HRC trademark, and the capital base continues to rationalize (gain efficiency) through divestitures and organic growth development. Our investment</p>
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		thesis on HRC centers on this restored growth and profitability on the income statement, and renewed structural strength in the balance sheet and cash flow statement. Improvements within these three financial ledgers should drive ROIC acceleration and mid-teens earnings growth for several years.
5/22/01*	Capek Strong Buy	Early this morning HRC announced it has settled a lawsuit with the Dept of Justice (DOJ) for \$7.9 million. The suit had alleged misallocation of costs (accounting treatment of property, plant and equipment or PP&E, not patient care, quality of care, or fraudulent billing issues) on Medicare cost reports from 1992 - 1997. As part of the settlement, HRC will enter into a corporate integrity agreement with the OIG, building on its existing solid corporate compliance program. Given the nature and magnitude of the alleged infractions (the settlement amounts of 0.1% of Medicare revenue generated by the firm during the time frame), we believe HRC's cooperation and settlement has been in the company's best interest. We reiterate our Strong Buy rating and 12-month price target of \$24.
8/2/01*	Capek Strong Buy	<p>HRC: STRONG 2Q, ALL PIECES COMING TOGETHER; REITERATE STRONG BUY</p> <p>Summary: HRC reported very strong and encouraging 2Q results, with operating EPS of \$0.21, up 25% from 2Q00 and \$0.01 better than our and Street expectations. The quarter highlighted continued solid revenue trends (pricing and volume growth) and better-than-expected operating margin gains, while the balance sheet and cash flow engine continued to catch up to the income statement, In our view, this development will continue through year-end, and help narrow the discount-to-peer group valuation at which the shares trade. By 2002, we expect inpatient rehab opportunity (arising from pending changes in Medicare reimbursement) to drive renewed EPS momentum and further differentiate HRC. We are maintaining our respective Street-high \$0.83 and \$0.95 EPS estimates for 2001 and 2002, respectively. Our 12-month price target is \$24.</p> <p>Highlights: HRC posted 2Q01 EPS of \$0.21, up 25% from \$0.17 in 2Q00. Results were \$0.01 ahead of our (and Street) forecast. We are maintaining our 2001 EPS estimate of \$0.83 (borrowing \$0.01 from 4Q) and our 2002 estimate of \$0.95.</p> <p style="text-align: center;">* * *</p> <p>• 2Q EBITDA margin was 28.1%, up 150 bps from 2Q00,</p>

	<p>80bps sequentially and 20 bps ahead of our forecast. In our view, consistent volume/pricing trends, less relative wage pressure, strong collections, and productivity programs (H-CAP) are driving margins, which should remain trending into the 28-29% range.</p> <p style="text-align: center;">*   *   *</p> <p>We expect business strength (steady, strong volume and pricing growth), normal cap-ex levels, debt reduction, divestitures, and an upside bias to 2H01 and 2002 EPS to drive multiple expansion.</p> <p>Analysis:  Net revenue in the quarter reached \$ 1.099 billion, an increase of 6% over the \$1.036 billion posted in 2Q00.</p> <p style="text-align: center;">*   *   *</p> <p>Moreover, with the start of Medicare’s inpatient rehabilitation PPS (in January 2002), we believe HRC will be presented with a margin and census opportunity, which are not yet reflected in our forecasts. In our estimation, this represents an additional \$0.15-\$0.20 per share in annualized EPS that HRC can generate progressively in 2002 and 2003. With the final PPS rates and methodology due out by next week, we expect the company to be in a position to better represent its expectations by late 4Q01. Roughly 35% of HRC’s 121 inpatient rehabilitation hospitals (7,656 beds) are on a fiscal year end December 31, an additional 7% have a fiscal year end during 1Q, 40% (largely the old Horizon assets) in 2Q, and the remaining 18% in 3Q. We believe that the firm’s experience with PPS transition in its first 35% of assets during 1Q02 will largely determine if it opts to accept the full federal rate in the remaining facility.</p> <p style="text-align: center;">*   *   *</p> <p>Operating income or EBITDA for the quarter topped \$308 million, just ahead of our \$306 million forecast, and up 11.9% from 2Q00. Results reflect a 28.1% margin, up 150 bps from 2Q00, 80 bps sequentially and 20 bps ahead of our forecast. In our view, consistent volume/pricing trends, less relative wage pressure, strong collections, and productivity programs (H-CAP) are driving margins, which should remain trending into the 28-29% range.</p> <p style="text-align: center;">*   *   *</p> <p>Summary and Outlook</p>
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		<p>By most every measure, HRC again met or surpassed quarterly expectations. Same-store volume growth is consistent, pricing remains strong (we argue in an early phase of a cycle), operating margins are solid and benefiting from top line trends and a cost-focus that has always been an HRC trademark. Moreover ... HRC continues to improve upon the renewed structural strength of its balance sheet.</p>
10/29/01*	Capek Strong Buy	<p>HRC: OKAY 3Q, MAINTAIN STRONG BUY, WITH KEY 4Q AND EVENTS NEAR-TERM</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• We maintain our '01 EPS estimate of \$0.83 (adding \$0.01 to our new 4Q01 estimate of \$0.23) and our 2002 estimate of \$0.95. Near-term, pricing, utilization rebound and DSO reduction should pace results. For '02, we expect solid pricing, inpatient rehab occupancy gains and PPS opportunity to drive results and \$0.10 or more pick-up to EPS.</li> </ul>
12/12/01*	Capek Strong Buy	<p>HealthSouth: Bumping Up EPS Estimates, Reiterate Strong Buy</p> <p>Summary: HRC provided upwardly revised guidance for 2002 EPS .... To reflect PPS and SFAS, we've raised our '02 EPS estimate to \$1.15 from \$0.95 and offer a preliminary '03 forecast of \$1.35. We ... believe this news bodes well for share price momentum.</p>
1/22/02*	Capek Strong Buy	<p>Late on January 18, HRC announced it was notified that the Department of Justice has partly enjoined a whistle blower lawsuit against HRC, alleging that some physical therapy practices (mainly the use of teams of therapists and aides) violate Medicare regulations. HRC believes the allegations are without merit. Furthermore, we note that the practices in question are industry standard and covered by state-level regulation. We would view weakness in HRC shares on any related weakness from this news, which (sensationalism aside) we view as financially and operationally non-material, as a buying opportunity. We believe this lawsuit will be an open issue for some time, and although it could detract from sentiment, should not affect operations or results. We maintain our Strong Buy rating and \$24 12-month price target.</p> <p style="text-align: center;">* * *</p> <p>[W]e believe the current DOJ enjoined portion of the lawsuit is without merit.</p> <ul style="list-style-type: none"> <li>• HRC's outpatient physical therapy Medicare revenue totals roughly \$50 million per year (less than 1% of HRC's total</li> </ul>

		annual revenue). Revenue attributed to extenders is a fraction of this \$50 million revenue stream.
2/5/02*	Capek Strong Buy	<p>HRC: Highlights from the Healthcare Services Conference</p> <p>Summary:</p> <p>Yesterday, HRC's Chairman &amp; CEO Richard Scrusy gave an upbeat luncheon presentation at the UBS Warburg Global Healthcare Services Conference. Although he reiterated much of our existing growth outlook for the company, there are a few positive points to highlight regarding 4Q01 cash flow and year end momentum, 2002 inpatient rehab PPS experience, and the overall free cash flow picture. In addition, the company laid out its views regarding a recently announced DOJ investigation. We remain confident in both our 2001 and 2002 EPS estimates of \$0.83 and \$1.15 and reiterate our Strong Buy rating and \$24 price target.</p> <p>Highlights:</p> <p style="text-align: center;">* * *</p> <ul style="list-style-type: none"> <li>• For 2002, the company said it was comfortable with free cash flow forecasts (excluding any contribution from asset sales) of \$250-\$300 million, a solid number which will enable the company to continue to pay down debt and maintain strategic investment spending.</li> <li>• With respect to Medicare's inpatient rehab PPS, HRC stressed that results were tracking exactly in line with their expectation, which underscores management's comfort in saying that PPS will be AT LEAST \$0.07 additive to forecasts.</li> </ul>
3/13/02*	Capek Strong Buy	<p>HEALTHSOUTH: SOLID 4Q WITH BRIGHTER DAYS AHEAD</p> <p>Summary:</p> <p>HRC reported 4Q operating EPS of \$0.22, in line with Consensus .... Strong same store volume growth and solid pricing drove operating results as EBITDA margin expanded 31 bps yoy. HRC continues to highgrade its portfolio.... We reiterate our Strong Buy rating and 12-month price objective of \$24.</p> <p>Highlights:</p> <ul style="list-style-type: none"> <li>• HRC posted 4Q01 EPS of \$0.22, up 13.5% from \$0.19 in 4Q00.... We maintain our 2002 and 2003 EPS estimates of \$1.15 and \$1.35 as greater asset efficiency drives results.</li> </ul>

		<ul style="list-style-type: none"> <li>• Quarterly net revenue of \$1.115 billion was ahead of our forecast and up 3.5% over 4Q00....</li> <li>• Same-store revenue gains were driven by strong volume (outpatient rehab same-store volume was up 6% well ahead of the 1% growth seen over the past quarters) and solid pricing increases. We expect pricing momentum to carry continue in 2002 (supported by recently renegotiated contracts during the 1Q02) whilst volume growth remains strong.</li> <li>• 4Q EBITDA margin was 28.2%, up 31 bps from 4Q00 and 49 bps sequentially, despite a strong salesforce ramp. In our view, consistent volume/pricing trends and non-core asset divestitures are driving margins, which should remain in the 28-29% range in 2002.</li> <li>• All preliminary results from inpatient rehab PPS (which was implemented 1/1/02) have been better than anticipated. For the first two months of 2002, Medicare discharges at facilities converted to PPS are up an unprecedented 8% while reimbursement has been inline. Given the strong discharge trend, HRC should ramp occupancy to the 80% range (from the current mid-70% level) sooner than anticipated, driving margin and earnings growth.</li> </ul>
5/3/02*	Capek Strong Buy	<p>HRC: Same-Store Growth Highlights 1Q Results</p> <p>Summary</p> <ul style="list-style-type: none"> <li>• HRC reported 1Q operating EPS of \$0.27, inline with our forecast and Consensus. Adjusting for divestitures, revenue was up 9% from a year ago, led by strong same store growth numbers from outpatient rehab (volume), surgery (volume) and inpatient rehab(volume and price).</li> <li>• Cash flow from operations was a solid \$175 million and should accelerate as the remainder of the inpatient rehab facilities migrate to PPS, helping to drive significant margin expansion through 2002.</li> </ul> <p>Action</p> <ul style="list-style-type: none"> <li>• We reiterate our Strong Buy rating and \$24 12-month price target as 1Q results were generally inline with our forecasts. We attribute the stock's lackluster performance yesterday to concerns about 1Q capex (\$187 million) and view this weakness as a buying opportunity as we remain confident that management will prudently stick to their 2002 capex forecast of \$400-\$500 million and post stellar results in the coming</li> </ul>

	<p>quarters.</p> <p>Valuation</p> <ul style="list-style-type: none"> <li>• HRC shares are trading at 6.5x our '02 EBITDA forecast, versus the peer group average of 9.2x. Given fundamentals (pricing gains, volume growth, increased utilization, and PPS opportunity), we believe that this discount will narrow as HRC posts compelling operating results. Our 12-month price target of \$24 implies an EBITDA multiple of 8.5x our '03 estimate (or PE multiple of 18 times our '03 forecast).</li> </ul> <p>Additional Information</p> <p>Net revenue in the quarter reached \$1.13 billion, an increase of 9% over the year ago period after adjusting for asset divestitures. Strong same-store volume growth and solid pricing gains in the major business segments drove the revenue trend. We believe current volume trends will continue or improve through 2002 and are particularly pleased with the pricing increases on newly signed contracts which should be drive pricing up 4%-5%.</p> <p>By business line, inpatient rehabilitation (42% of new revenue) total discharges increased 4.9% from a year ago, aided by the strength of the first quarter under PPS. Revenue per patient was up 6.8% from a year ago, again reflecting the PPS transition. We believe the early PPS results are favorable and should produce at least the \$0.07 EPS contribution that we originally forecasted.</p> <p>Outpatient rehabilitation (21% of net sales) visits reached 2.37 million in the quarter. This was up 7.9% from 1Q01, while same-store volume was up 7.9% as well. Revenue per visit in the 1Q increased to \$99 per visit, up from \$96 a year ago. Net revenue for this business unit was \$235 million, up 11% from the \$211 million a year ago. We continue to believe low-to-mid single digit volume growth, supported by surgery case growth, will be sustained through 2002.</p> <p>Surgery center (23% of net sales) cases reached 227,785 in 1Q02, up 3.6% from a year ago. Adjusting for facility closures, same-store cases were up about 6.5% as HRC added 111 new physician partnerships in the quarter, up from 93 in the 4Q01. New revenue per case was flat at \$1,117 versus the year ago period. Overall, net surgery segment revenue was \$254 million, up from \$245 million a year ago despite having 11 fewer facilities. HRC's initiatives to increase physician partnerships are producing solid results as evidenced by the increased same store case volume, results that should only continue to improve through 2002.</p>
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		<p style="text-align: center;">* * *</p> <p>EBITDA for the quarter was \$328 million, reflecting a 29.1% margin, up 180 bps from a year ago, and slightly below our forecast with higher operating expenses accounting for the difference. Direct operating expenses improved to 65.2% of net sales, down 232 bps from 1Q01 (driven mainly by PPS). Bad debt expense (2.2% of net revenue) was inline with out forecast. Below the operating line, net interest expense of \$47 million was slightly below our forecast as the company paid down \$8 million in debt from the end of 4Q01 and we anticipate accelerated debt reduction in the coming quarters.</p> <p style="text-align: center;">* * *</p> <p>As well documented, the DOJ has partly enjoined an existing lawsuit (a qui tam or whistle blower lawsuit filed by a former employee) alleging that HRC has violated Medicare billing regulations for use of “extenders” in outpatient therapy centers (concurrent therapy). We believe the size of the billings in question (less than \$20 million of HRC’s total revenue of \$4.4 billion) and the commentary from CMS on its final rule for SNF PPS (July 31, 2001), which stated that concurrent therapy does have a place in the care options, mitigates this risk.</p>
7/18/02*	Capek Strong Buy	<p>HRC: Announces small asset sale &amp; related non-cash charge</p> <p>Summary:</p> <ul style="list-style-type: none"> <li>• HRC announced that it has (in June) sold five skilled nursing facilities (SNFs) in Massachusetts to a private nursing home operator. Reflecting the sale (we estimate \$10 mm in cash), HRC will take a non-cash charge (estimated between \$60-80mm) on SNFs. Such a charge is in addition to the non-cash charge we expected in 2Q02 to reflect SFAS 142 (about \$70-120mm). HRC reports 2Q02 operating results on August 7, which we expect to be in line.</li> </ul> <p>Action:</p> <ul style="list-style-type: none"> <li>• In our view, this news is slightly positive because it generates some cash, eliminates negative margin assets from HRC’s 1,900-facility base, and clarifies expectations (in a broad market already scrutinizing all corporate accounting actions). Annualized, the sale is under \$0.01 accretive. We reiterate our Strong Buy rating and comfort with our \$1.15 '02 and \$1.35 '03 EPS estimates.</li> <li>• We do not believe recent HRC share weakness stems from these non-cash charges. Rather, we believe weakness reflects a combination of negative sentiment on management, poor fiscal</li> </ul>

		<p>(cap-ex) discipline, and lackluster ROIC on a backdrop of broad market and healthcare section selling pressure. We expect 2Q operating results to mark the start of stronger combined income statement and cash flow results (ongoing solid pricing and volume trends in outpatient segments, new profitability in inpatient rehab, thanks to Medicare PPS, and capex/working capital/DSO), a few quarters of which should bolster the share price.</p> <p>Valuation:</p> <ul style="list-style-type: none"> <li>• Shares are trading at a P/E multiple of 7.5x our '02 (6.5x our '03) EPS forecasts. We believe such valuation levels (50%-plus discount to most any relevant measure, including HRC's secular EPS growth rate of 15%, the S&amp;P 50 forward P/E, and the broad hospital/provider based peer group forward P/E average of 20x '02 (17.5x '03) EPS forecasts. We expect cash flow, improving business returns and an upside bias to 2H02 EPS forecasts to drive a more rational valuation, in line with the aforementioned measures. As such, we expect the stock can retrace the mid-teens share price levels later in this year and achieve our 12-month target price of \$24 (17.7x our '03 EPS forecast) by mid-2003.</li> </ul>
8/8/02*	Capek Strong Buy	<ul style="list-style-type: none"> <li>• HRC reported 2Q operating EPS of \$0.28, up 33% from a year ago and in line with our forecast and Consensus.</li> <li>• The company posted solid, 6% net sales growth .... EBIT was up 30% (a 23% margin, it was up 20% ex-FAS142) demonstrating HRC's operating leverage.</li> </ul> <p>Action</p> <ul style="list-style-type: none"> <li>• Business gains and balance sheet changes bode very well for 3Q, potentially setting up a better-than-expected BPS and cash flow story.</li> </ul> <p style="text-align: center;">*   *   *</p> <p>Additional Information</p> <p>Net revenue in the quarter reached \$1.16 billion, an increase of 9% over the year ago period after adjusting for asset divestitures.... We believe current volume trends will continue/improve in the 2H02 ....</p> <p style="text-align: center;">*   *   *</p> <p>EBITDA for the quarter was \$347 million, reflecting a 29.8% margin, up 175 bps from a year ago and 40 bps ahead of our forecast with lower than anticipated direct operating expense accounting for the difference....</p>

		<p>... Operating cash flow was a healthy \$235 million, up 43% from a year ago while free cash flow (excluding the purchase of the synthetic leases) was up 40% to \$95 million. HRC exited the quarter with \$525 million on the balance sheet....</p> <p><b>Outlook</b> We believe 2Q operating results mark the start of stronger combined income statement and cash flow results ... which should bolster the share price over the coming quarters.</p>
8/27/02*	Capek Buy	<p>HRC: Mixed news; lowering EPS estimates and rating to Buy</p> <p><b>Summary</b></p> <ul style="list-style-type: none"> <li>• HRC made several announcements his morning, the combination of which should have a mixed-to-negative effect on investors and the stock. Negatively, HRC said it has received a directive from CMS changing the way Medicare will reimburse for outpatient group (two or more patient) therapies. The potential negative impact, in our view, increases when we include commercial insurer rates that are based on Medicare fee schedules. HRC estimates a \$175mm annualized reduction in pre-tax income (\$0.27 in EPS) from this change.</li> <li>• On the positive side, the firm announced preliminary plans to spin/split out its outpatient surgery (\$1b in sales, \$265mm in EBITDA) unit.</li> </ul> <p style="text-align: center;">* * *</p> <p><b>CMS Changes the Rules</b> According to HRC's press release, the Centers for Medicare and Medicaid Services (CMS) has issued a directive to Medicare Part B carriers (entities that pay healthcare providers on behalf of Medicare) that requires them to reimburse providers under "group therapy" rates for any therapy delivered to two or more patients concurrently, regardless of difference in activity/therapy for each patient. This directive would lower net reimbursement to providers that historically have typically been reimbursed individually for each patient's therapy. Exacerbating the exercise of quantifying the downside from this change is the fact that commercial insurance rates are often based on Medicare outpatient fee schedules and coding policies. For now, given the moving parts, we will take HRC's assessment at face value.</p> <p>As has been well documented, the Department of Justice (DOJ) has party enjoined an existing lawsuit (a qui tam or whistle blower lawsuit filed by a former employee) alleging that HRC</p>

		<p>has violated Medicare billing regulations for use of “extenders” in outpatient therapy centers (also called concurrent therapy). With CMS’s directive, we expect the qui tam lawsuit to be moot.</p> <p>What has not changed, in our view, however, is the conflicting commentary from CMS on its final rule for skilled nursing facility (SNF) PPs (July 31, 2001) and inpatient treatment guidelines, which stated that concurrent therapy does have a place in the care options, significantly clouds the issue on concurrent therapy in the outpatient setting. We expect HRC and the industry to explore clarification on and ask for further justification of such rule action by CMS.</p>
9/23/03*	Capek Buy	<p>Healthsouth: Heavy and Mixed News Flow; Maintain Buy Rating</p> <ul style="list-style-type: none"> <li>• Amidst a swirl of “what if’s,” business retooling, business separation, and investigations and reviews (that have to weigh on management focus), we maintain our 2002 EPS estimate of \$1.00 and our 2003 estimate of \$1.08 (\$0.87 ex-surgery business). We also offer sensitivity to our forecasts, on a quarterly basis: every 10bps of operating expense (higher SG&amp;A, bad debt, etc.) lowers net income by \$6.6mm (\$0.015 per share), every \$10 million in sales represents \$0.005 in EPS, and a \$300mm in debt/equity buyback is \$0.01 in EPS pick-up. Net, net, given a number of moving parts, we believe current EPS estimates are within 5% of “worst case.”</li> </ul> <p style="text-align: center;">* * *</p> <p><b>Valuation</b></p> <ul style="list-style-type: none"> <li>• In our view, the balance sheet, cash flow (we estimate \$730mm in operating cash flow and \$220mm of free cash flow for 2003 pre-surgery center spinout), credit capacity and earnings support an \$8 valuation of HRC (the remaining company, post surgery center spinout), based on 10x our 2003 EPS estimate (six times our 2003 EBITDA estimate).</li> </ul>
11/6/02*	Capek Buy	<ul style="list-style-type: none"> <li>• [HRC’s] remaining business segments showed resilience paced by 12% growth in inpatient rehab hospital revenue (45% of total) and 5% growth in surgery center revenue). Despite higher DSOs, relatively healthy operating cash flow of \$141mm and credit line capacity allowed the firm to repurchase \$440mm of its debt (including \$214mm convertible sub debt due April 2003) and \$30 million in stock and end the quarter with \$390mm in cash.</li> </ul> <p><b>Action</b></p>

		<ul style="list-style-type: none"> <li>• We maintain our Buy rating on HRC shares .... For 2002, our EPS estimate is \$0.78, down from \$1.00 and for 2003, our (trough) EPS estimate is \$0.59, down from \$1.08. We believe 3Q earnings can be used as a floor for operating trends (more than likely extending through 4Q), while cash flow, debt/equity repurchases, any insight into the SEC or DOJ billing investigation could provide catalysts to drive the stock slightly higher (at the very least allow it to rebase itself) by year-end.</li> </ul> <p><b>Valuation</b></p> <ul style="list-style-type: none"> <li>• In our view, the balance sheet, cash flow (we estimate \$558mm of operating cash flow and \$140mm of free cash flow for 2003), credit capacity and earnings support an \$8 valuation of HRC, based on 13.6x our 2003 EPS estimate (6x our \$1b '03 EBITDA estimate, adjusted for minority interest)....</li> </ul> <p><b>A Change of Plans</b></p> <ul style="list-style-type: none"> <li>• In mid-October, HRC announced that it had suspended plans to pursue a tax-free separation of its surgery center division. HRC management says this decision was reached, in part on investor/lender commentary.</li> <li>• By shelving the spinout, we believe HRC removes uncertainty of potential balance sheet and liquidity constraints in 2003 (which may have arisen when HRC would have had to compensate bond (covenant) holders to allow the spinout).</li> </ul>
1/7/03*	Capek Buy	<ul style="list-style-type: none"> <li>• We maintain our Buy rating and \$8 price target ...</li> </ul> <p style="text-align: center;">* * *</p> <p>...HRC also announced ... its plan to reduce corporate, general and administrative (CG&amp;A) expenses by 18% in 2003 ....</p> <p style="text-align: center;">* * *</p> <p>...We expect the firm to be able to reduce net debt by \$220mm and exit the year with \$250mm in cash on the balance sheet.</p>
3/14/03*	Capek Buy 2	<ul style="list-style-type: none"> <li>• Charges and asset consolidation aside, HRC generated mixed-to-positive volume growth in 4Q, paced by 5.7% and 2.9% same-store gains in its respective inpatient rehab and outpatient surgery segments, which offset flat diagnostic procedures and a marked reduction in outpatient rehab visits.</li> <li>• We expect that the site consolidations, cost-cutting programs, management bonus and salary concessions, and impaired asset (including A/R) charges should portend fiscal discipline and more prudent capital allocation and needs in 2003.</li> </ul>

		<p><b>Action</b></p> <ul style="list-style-type: none"> <li>• We maintain our Buy 2 rating on HRC shares and 12-month price target of \$8. Our 2003 EPS estimate remains \$0.55, and we're starting an '04 estimate of \$0.60 (up 8% on 3.5% sales growth).</li> <li>• In our view, 4Q02 was an important low-water mark for HRC. On the backdrop of modest (3-5%) expected growth in 70% of HRC's business (inpatient rehab and outpatient surgery), 1Q03 margin should benefit from recent cost-cutting, site closures, and accelerated charges. By 2H03, we expect outpatient rehab and diagnostics to stabilize. In the interim, the sequential ramp in 1Q03 estimated EPS (\$0.13 up from \$0.05) should establish base-line business confidence.</li> </ul>
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\* Report includes notation that report is being issued by a subsidiary of UBS AG.

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## APPENDIX 7

### Summary of False Statements by Citi/Salomon

<b>Date</b>	<b>Analyst/ Recommendation</b>	<b>Comments</b>
7/22/97	Hoehn, Cavanaugh Buy	<p>Company is a growing force in health care. Second-Quarter Results on Target; Top-Line Growth Remains Strong.</p> <p>HealthSouth recently reported second-quarter earnings of \$0.23 per share, which was in line with our estimate and a 28% increase from last year.</p> <p>The company reported strong top-line growth of 15% year over year, driven by increased patient volume in all segments, while operating margins improved to 35.0% from 31.8% last year.</p> <p>We maintain our EPS estimates of \$0.93 for 1997 and \$1.15 for 1998.</p> <p>The revenue gain in the quarter was particularly impressive and represented a significant acceleration from the 13% gain of the first quarter.</p> <p>The company is expanding rapidly and aggressively through acquisitions and internal growth.</p>
11/3/97	Gutierrez Buy (1-M)	<p>HRC posted record 3Q97 results: EPS increased 26% to \$0.24, revenues increased 15% to \$748 million; and HRC's EBITDA margin jumped 240 basis points to 32.8%. Strong same-center trends across all of HRC's divisions, as well as a stable pricing environment &amp; HRC's continued focus on cost cutting generated the gains.</p> <p>We strongly recommend purchase of the shares – which are at a significant discount to their growth rate and our price target of \$35.</p> <p>The report projected five year EPS growth of 25%, 1997 EPS of \$0.93 and 1998 EPS of \$1.15.</p> <p>Perhaps more significantly, we are confident that HRC will continue to see strong same-center trends in the low double digit range due to the significant number of new contracts that HRC</p>



Date	Analyst/ Recommendation	Comments
		<p>has won this year.</p> <p>In short, HRC's growth prospects abound, <i>its fundamentals are rock-solid</i>, and its valuation is attractive.... Furthermore, given the experience of HRC management team and <i>their sterling track record of posting 45 quarters of uninterrupted earnings growth, we feel the shares deserve a premium valuation</i>. We strongly recommend purchase of the shares.</p>
12/10/97	Harris, Gutierrez Buy (1-M)	<p>HEALTHSOUTH's internal and acquisition related growth opportunities abound. We expect HEALTHSOUTH to post EBITDA growth of 25% in the upcoming year.</p> <p>In short, we see no slowdown in sight for HealthSouth, which has recorded more than 13 years of strong earnings growth.</p> <p>The report projected five year 25% EPS growth, with 1997 EPS of \$0.93, 1998 EPS of \$1.15 and 1999 EPS of \$1.40.</p> <p>HealthSouth's track record of consistent earnings growth has generated approximately \$9.7 billion in shareholder value over the past six years... Strong internal growth stemming from HealthSouth's healthy same-center trends and continued tight cost controls drove the gains.</p> <p>HEALTHSOUTH has saved the Medicare program approximately \$150 million and will generate an additional \$1.5 billion more in the upcoming five years. Unlike many rehabilitative care operators that cost the Medicare program millions of dollars a year by running up costs to the maximum amount allowed under the TEFRA program, <i>HEALTHSOUTH has saved the Medicare program \$150 million by reducing its cost structure to the minimum amount possible</i>. By substantially reducing a rehabilitation patient's cost per discharge and cost per day, HEALTHSOUTH has an operating structure that is the industry leader in cost efficiency.</p> <p>In short, we believe HealthSouth's growth prospects abound; its fundamentals are rock-solid; and its valuation is attractive.</p> <p>HEALTHSOUTH's success at reducing costs and generating strong clinical outcomes is in part due to its internal compliance programs.</p>

Date	Analyst/ Recommendation	Comments
		<p><b><i>HEALTHSOUTH has long had in place an extensive internal control system to monitor legal, accounting, and accounts payable functions.</i></b> HEALTHSOUTH's internal audit department, which is dedicated to eliminating any accounting or operational irregularities, augments the more common external audit programs HEALTHSOUTH has, as executed annually by Ernst and Young and Strategic Management Systems, Inc. <b><i>We underscore the importance of HEALTHSOUTH's compliance programs to give credence to our belief that, unlike other health care services operators which have been plagued by federal investigations related to their reimbursement and operating procedures, HEALTHSOUTH has long been in good standing at the nation's health care agencies.</i></b></p> <p>Given HEALTHSOUTH's low cost structure, the company believes that its profit margins on rehabilitative care services would be higher under a prospective payment system than they are under the current cost-based reimbursement system.</p> <p>As HEALTHSOUTH channels its payor contracts through the ASC facilities, we expect their same-center trends to grow in the mid- to high-single digit range. ... [W]e view the [ASC] acquisition positively, as it will bolster the company's same center trends ... [W]e expect [HRC's] outpatient surgery division to continue to grow 10%-15% on an overall basis owing to same-center volume gains.</p> <p>Our 1998 revenue estimate is approximately \$3.8 billion. We expect that the recently acquired Horizon facilitates will generate approximately \$480 million of the increase over 1997 estimated revenues of approximately \$3 billion. The remainder of the increase will come from internally generated revenue growth of an estimated 11%. For 1999, we expect revenues to reach about \$4.3 billion. Again, we assume that HEALTHSOUTH's internal growth (which we define as encompassing same-site revenue gains plus revenues related to HEALTHSOUTH's internal development program) will contribute 9%-11% of the total 13.4% gain, with acquisition-related growth contributing anywhere between 2% and 4% of the gain.</p> <p>We would note, however, that a switch to a prospective pay</p>

Date	Analyst/ Recommendation	Comments
		<p>system for inpatient rehabilitative services (which is in effect a reduction in Medicare reimbursement rates) would positively affect HEALTHSOUTH's inpatient rehabilitative division.</p> <p><b><i>We strongly recommend purchase of HEALTHSOUTH's shares.</i></b> The five factors influencing our recommendation are HEALTHSOUTH's robust acquisition related and internal growth opportunities, its strong operating fundamentals, its superior track record of earnings growth, its financial strength, and the shares' attractive valuation.</p> <p>Next, we would note that HEALTHSOUTH's track record of consistent earnings growth make the shares an attractive investment.</p> <p>HEALTHSOUTH's earnings of \$0.24 on October 30, 1997 marked the company's 45th consecutive quarter of strong earnings growth that met or exceeded analysts' expectations. Given the volatile nature of the health care services arena, which is characterized by frequent regulatory and reimbursement changes, we think HEALTHSOUTH's track record is particularly impressive. In short, it gives us confidence that HEALTHSOUTH can successfully endure whatever future changes surface in the health care services arena.</p>
1/23/98	Harris 1-M (Buy)	<p>HRC is off 14% from its 1998 high of \$27+7/16 on speculation as far-fetched as the stories that the company is planning to buy Medpartners or that HRC might miss analysts' fourth quarter estimates.</p> <p>None of this speculation is true. The consensus estimate for the fourth quarter is \$0.25.</p> <p>As we have said in the past, we remain confident in HEALTHSOUTH'S earnings growth potential and in all of our estimates. Currently, the share's are trading at 21x and 17x our 1998 and 1999 estimates, respectively. This represents a steep discount to the company's growth rate of between 20%-25%, and to our price target of \$35. We view the shares weakness as a buying opportunity and reiterate HRS as our top pick for the year. 1M</p>
2/25/98	Harris	HRC has met or exceeded Street est for 46 consecutive

Date	Analyst/ Recommendation	Comments
	1-M (Buy)	<p>quarters.</p> <p>Revenues for 4Q97 were \$854.3 MM, up 26% over 4Q96 and \$3.0 billion for 1997, up 17%.</p> <p>Revenue growth fueled by strong internal growth.</p> <p>Project 1998 EPS of \$1.15 and 1999 EPS of \$1.40.</p> <p>Strong same-store growth was reported for 4Q97.</p>
6/25/98	Harris 1-M (Buy)	<p>Based on a recent conversation with management, we are strongly reiterating our BUY rating and \$35 12 month price target on the shares of HEALTHSOUTH Corporation. In contrast to weakening volume trends at some of the acute care hospital providers, HRC's patient volumes have remained strong in 2Q98. Continued strong patient trends continue to give us confidence in the company's ability to meet our near-term EPS expectations. On the reimbursement front, HRC recently received positive news. It appears that Medicare rates for outpatient orthopedic surgery procedures will increase in 1999. This is in sharp contrast to declines expected for ophthalmic and GI outpatient surgery procedures. Thus, we believe that HRC is well positioned from a near-term as well as longer term standpoint as it relates to reimbursement trends. Finally, the integration of recent acquisitions continue to proceed smoothly and we expect that National Surgery Center (NASDAQ: NSCI:\$29 1/8) to close as planned sometime in 3Q98.</p> <p>In summary, HRC continues to experience strong fundamental trends that we believe have not been fairly reflected in the stock price performance this year. Accordingly, we strongly reiterate our BUY rating and price target [of \$35]. We will have more details followings the company's 2Q EPS release in late July/early August. Projecting 1998 EPS of \$1.16 and 1999 EPS of \$1.40.</p>
10/07/98	Harris	<p>"Conservatively" projecting 1998 EPS of \$1.09, 1999 EPS of \$1.09, and 2000 EPS of \$1.25, and a target price of \$16.00.</p> <p>Not included in our estimate is an anticipated \$100 million one-time charge related to the write-off of the Company's home care</p>

Date	Analyst/ Recommendation	Comments
		<p>business required in the Horizon transaction.</p> <p>[W]e continue to believe that the company is fundamentally strong, with positive operating cash flows from operations and a strong balance sheet.</p> <p>[HRC's] management team has demonstrated its excellence by delivering 48 consecutive quarters of meeting or exceeding consensus estimates; accordingly, we believe that this same team will quickly adjust to the changing environment and once again deliver strong results.</p>
10/27/98	Harris 1-M (Buy)	<p>HRC reported 3Q98 EPS from continuing operations of \$0.28, slightly ahead of our recently revised estimate for the quarter of \$0.27. Thus, EPS from continuing operations before non-recurring expenses rose 17%.</p> <p>Projecting 1998 EPS of \$1.10, 1999 EPS of \$1.09 and 2000 EPS of \$1.25.</p> <p>In summary, HRC's results reflect continued robust volume growth overall.</p> <p>Going forward, we expect modest EBITDA declines due to managed care pricing pressures and the impact of the Balanced Budget Act as discussed in previous call notes and as already reflected in our EPS estimates.</p> <p>All things considered, this was a good quarter for HEALTHSOUTH. Going forward, we expect managed care pricing pressures to have a modest impact on EBITDA margins and on same-store growth. However, these issues are already reflected in our EPS estimates and are more than discounted in the company's share price.</p>
3/5/99	Harris 1-M (Buy)	<p>HRC reported 4Q98 EPS of \$0.27....</p> <p>The results exclude the impact of a one-time charge taken in the fourth quarter.</p> <p>The charge on an after-tax basis was in-line with previous guidance of \$310 million.</p>

Date	Analyst/ Recommendation	Comments
		Projecting 1999 EPS of \$1.09, 2000 EPS of \$1.25, and a \$20.00 target price.
4/19/99*	Lawson, Santangelo 1-H (Buy)	<p>SUMMARY – HEALTHSOUTH – Health Care Services</p> <ul style="list-style-type: none"> <li>- Initiating coverage with a 1H (Buy, High Risk) rating and a \$19 price target.</li> <li>- Expect solid 1Q99 earnings report showing strong patient volumes and pricing trends well within expectations.</li> <li>- Believe stock is being somewhat discounted because of misperception of association with long-term care industry.</li> <li>- Moderating Medicare debate and solid March-quarter results should boost valuation.</li> </ul> <p>HEALTHSOUTH is in the enviable position of having the largest portfolio of assets in the outpatient services market. We look for the company to be able to generate close to 10% same-facility top-line growth over the next 3-5 years in its outpatient services business, driven primarily by volume.</p> <p>STRONG BALANCE SHEET AND CASH FLOW FUNDAMENTALS: At year-end 1998, HEALTHSOUTH had a debt-to-capital ratio of 45%, among the most conservative in the healthcare services industry. Additionally, the company generated over \$600 million in cashflow from operations in 1998. While the market may be disappointed with the company's earnings performance of late, the severed discount that is being applied to the company's stock, we believe, is usually reserved for companies with disappointing earnings combined with trouble balance sheet and cash flow fundamentals. As such, we believe that HEALTHSOUTH stock is being improperly valued by the market.</p>
4/28/99	Lawson, Santangelo 1-H (Buy)	<p>Projecting 1999 EPS of \$1.11, 2000 EPS of \$1.25, and a price target of \$19.</p> <p>Revenues increased 13% to \$1.03 billion, in line with our forecast.</p> <p>EBITDA margin increased 30 basis points year over year (33.1% versus 32.8%); as the company took cost controls to new heights.</p> <p>Management indicated that pricing in the current quarter was</p>

Date	Analyst/ Recommendation	Comments
		<p>down 2% sequentially from 4Q98, reflecting expected price erosion from 1998 managed care contracting (commercial/managed care represents almost 60% of the company's total revenues). Pricing in 4Q98 was down approximately 2% sequentially from 3Q98, which means in aggregate pricing is down approximately 4% from the mid-1998 levels.</p> <p>Additionally, the provision for doubtful accounts declined as a percentage of revenues to 1.9% from 2.4% in the year-ago quarter. The drop off in bad debts is primarily attributable to the company's decision in 4Q98 to exit the homecare business which typically has a higher percentage of bad debts.</p> <p>Cost remains the most critical issue for managed care companies and is the primary reason HEALTHSOUTH experienced a disappointing 1998 recontracting period.</p>
8/4/99*	Lawson 1-H (Buy)	<p>HealthSouth reported 2Q99 EPS of \$0.27.</p> <p>Volume increases remained strong, with the company's outpatient surgery center division showing exceptionally strong same-facility volume growth of 9%.</p> <p>Projecting 1999 EPS of \$1.10, 2000 EPS of \$1.25, with a target price of \$19.</p> <p>Since we are now half way through the year, we believe the second half earnings are fairly predictable; besides, we are not forecasting any significant increase in earnings levels in the second half of the year. Since these EPS and EBITDA levels seem easily achievable, we are surprised at how low the valuation of the shares is. Even assuming little or no growth in 2000 (which we do not believe is the case), the company appears significantly undervalued.</p> <p>The company discussed accounts receivable trends, stating that A/R days would increase slightly for the quarter. Reasons given included "game-playing" by HMOs such as losing and refusing payment.</p> <p>Management noted that it is pleased with the positive direction taken by the Health Care Financing Administration (HFCA) with</p>

Date	Analyst/ Recommendation	Comments
		regard to the future Prospective Payment System (PPS) for inpatient rehabilitation hospitals.
11/4/99	Lawson 3-H (Neutral)	<p>Projecting 1999 EPS of \$0.87, 2000 EPS of \$0.75, and a \$10 price target.</p> <p>[I]t is worth noting that the company was highly profitable and generated \$67 million in net income in the quarter.</p> <p>The company did take a \$117 million pre-tax write-off of receivables in the quarter (\$71 million after tax). HRC explained that these were considerably aged receivables largely produced by facilities that the company has ceased operating; most were facilities that the company had acquired over the years. <b><i>The company stated emphatically that the receivables that were written off were not generated by its core businesses and that we should not view the write-off as indicative of a “revenue recognition” issue.</i></b> We tend to concur. Days sales outstanding have increased markedly to 1999 (to almost 100 currently); we don’t believe that this is a HealthSouth problem; we believe that it is an industry problem. Top management at HRC has taken the reigns on this issue and we believe that progress will be made with regard to collections over the next several quarters.</p>
11/24/99	Lawson 3-H (Neutral)	<p>In the current difficult environment, HEALTHSOUTH’s balance sheet is a significant asset.</p> <p>Projecting 1997 EPS of \$0.87 and 2000 EPS of \$0.75.</p> <p>3Q99 Earnings Pre-Announcement Revisited: HEALTHSOUTH announced on September 9 that it expected its operating margins for the third and fourth quarters of 1999 to be 27-29%, compared with the 30%+ levels that the company has historically experienced. The company attributed this reduction in margin expectations to changes in volume and payor mix in its inpatient segment, lower-than-expected same-facility volume growth in its outpatient rehabilitation business, continuing issues with managed care reimbursement, the effects of changes in government reimbursement policies, seasonal variations in its surgery center operations, and current and anticipated increases in costs, among other factors. The company indicated that, based on current information, it expected cash flow (EBITDA) for 1999 to be approximately \$1.2 billion. The company elaborated:</p>



Date	Analyst/ Recommendation	Comments
		<ul style="list-style-type: none"> <li data-bbox="626 342 1437 558">In its inpatient rehabilitation business, HEALTHSOUTH has seen an upward shift in the percentage of revenues derived from Medicare resulting from a decrease in private pay occupancy. As the payor mix changes in its inpatient facilities, its average pricing goes down because Medicare only reimburses the company for costs.</li> </ul> <p data-bbox="626 594 1437 699">Capital Expenditure Plan. HEALTHSOUTH is undertaking a plan to invest up to \$1 billion in capital expenditures and related items over the next three to five years.</p> <p data-bbox="626 737 1437 1062">HEALTHSOUTH also explained that <i>favorable developments in the likely structure of the Medicare prospective payment system (PPS) for inpatient rehabilitation may alleviate some of the valuation concerns relating to the impact of keeping the inpatient and outpatient businesses together</i>. Since that announcement, favorable language with regard to inpatient rehabilitation PPS has indeed been added to pending congressional legislation, and we believe it will become law in the near term.</p> <p data-bbox="626 1100 1437 1283">The company took a \$117 million pretax write-off of receivables in the quarter.... The company stated emphatically that the receivables that were written off were not generated by its core businesses and that we should not view the write-off as indicative of a “revenue recognition” issue.</p> <p data-bbox="626 1320 1437 1394">We now expect HEALTHSOUTH to earn \$0.17 per share in fourth quarter 1999, \$0.87 for the full year, and \$0.75 in 2000.</p>
3/8/00	Lawson 3-H (Neutral)	<p data-bbox="626 1430 1437 1535">HRC recorded impairment charges and receivables write-offs and management has indicated it expects no more receivable write-offs in the future.</p> <p data-bbox="927 1541 1130 1562">* * *</p> <p data-bbox="626 1608 1437 1713">The company experienced relatively strong volume growth in its outpatient rehabilitation division and its inpatient rehabilitation hospital division.</p>
4/20/00	Lawson 3-H (Neutral)	<p data-bbox="626 1751 1437 1856">*We recently visited management and had a constructive meeting during which management indicated its renewed confidence in earnings prospects for 2000.</p>

Date	Analyst/ Recommendation	Comments
		<p>*Mgmt. shared its plans with regard to technology and the internet which could create value and reduce labor and costs at HRC.</p> <p>*Further, management indicated that it plans to be more communicative with the Street than has been the case over the last several quarters.</p> <p>*We view all of the above as positive sentiment indicators for the stock.</p> <p>- We have fine-tuned our HRC earnings model and have adjusted our 1Q00 EPS estimates to \$0.16 from \$0.17. Our sense is that patient volumes in 1Q00 were strong and that the company has a very real chance of exceeding our revised EPS estimate. Our EPS estimate for the full year 2000 is now \$0.70 (down from \$0.75). Again, with strong volumes and strict cost controls, we believe that the company has the chance to slightly exceed our revised estimates. Our revised 2001 EPS estimates is \$0.82 (down from \$0.85).</p> <p>--Shares of HEALTHSOUTH (HRC) have appreciated some 43% over the last two weeks and daily trading volume has exceeded historical averages.</p> <p>--We recently visited management and had a constructive meeting during which management indicated its renewed confidence in earnings prospects for 2000. This renewed confidence is partly the result of a comprehensive review of operations, a restructuring of the company's management set-up (2 primary divisions: inpatient and outpatient), a highly detailed facility-by-facility budget renew and early indications from January volume and pricing trends.</p> <p>--The company has also instituted a program to manage and control costs which encompasses employee productivity, billing and collections, and electronic procurement and payment processes. The company expects that it could see results from these initiatives as soon as 2Q00.</p> <p>--Management expects to see slow, steady improvement in sequential quarter EBDITA and EPS throughout 2000.</p>

Date	Analyst/ Recommendation	Comments
		<p>--Additionally, management shared some of its plans with regard to technology and internet investments which could create value in their own right but also reduce labor and costs at HRC. In fact, one such company, Medcenterdirect.com, recently filed a registration statement with the SEC for an initial public offering (IPO). Medcenterdirect.com is involved in e-procurement for the health services industry.</p> <p>HRC, for the first time in 3 quarters, will hold a quarterly conference call to discuss earnings on Tuesday, April 25. We think it will be an excellent start to “rehabbing” the company’s image on Wall Street (pardon the pun).</p> <p>HRC reports 1Q00 EPS on Tuesday, April 25. We are confident that the company will meet or exceed consensus estimate of \$0.16.</p>
4/25/00 – 4/26/00	Lawson 3-H (Neutral)	<p>--HEALTHSOUTH reported 1Q00 EPS of \$0.17 versus \$0.26 in the year-ago quarter, and a penny ahead of street consensus expectations.</p> <p>--EBITDA margin was 26.4%, an improvement from 4Q99 of 25.8% but down from 33.1% a year ago.</p> <p>--Volumes in four out of five of the company’s business lines increased from 4Q99; surgery center volumes decreased almost 1%, however.</p> <p>The company’s balance sheet remains one of its strongest assets and remains conservatively leveraged at less than 50% debt to capital.</p> <p>We are maintaining our EPS estimates for 2000 and 2001 and continue to rate the shares 3H. We are encouraged by 1Q00 results but maintain our 3H rating as we await further tangible evidence that the pricing cycle for HRC has firmed.</p> <p>Managed Care: We continue to believe that HRC expects to see some isolated payer pressures, but that on a whole the trend will not be negative. In fact, the company noted that it has noted some positive pricing momentum in recent negotiations and is hopeful that this will begin to show in the numbers in coming quarters.</p>

Date	Analyst/ Recommendation	Comments
		<p>Days sales outstanding decreased two days since the beginning of the year 81.5 days reflecting the success of efforts to work closer with managed care payers to improve the collection cycle.</p> <p>HealthSouth management is confident that the company is poised to take advantage of the implementation of inpatient PPS for its rehabilitation hospitals ... [u]nder the current cost-based system HRC has successfully brought its costs down.</p> <p>[T]he company estimates that PPS translates into significant profit potential for the company from Medicare. Currently management estimates that it will recognize an approximate \$100 million annualized net benefit from PPS.</p> <p>For now, we are maintaining our EPS estimates for the full year 2000 of \$0.70. With strong volumes and strict cost controls, we believe that the company has the chance to slightly exceed this estimate. Our 2001 EPS estimate is \$0.82.</p>
7/19/00*	Lawson 1-H (Buy)	<p>HRC:2000 Highlights Include Profitability and Collections Improvement</p> <p>SUMMARY</p> <ul style="list-style-type: none"> <li>' HEALTHSOUTH reported 2Q00 EPS of \$0.17 versus \$0.27 in the year-ago quarter, in line with our estimate and the consensus estimate.</li> <li>' Total revenues increased 1.5% on a sequential quarter basis in 2Q00 to \$1.04 billion from \$1.02 billion in 1Q00.</li> <li>' EBITDA margin improved to 26.6% from 25.8% in 4Q99.</li> <li>' Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 10.1x and 8.8x our 2000 and 2001 EPS estimates, respectively, and 5.8x our 2000 EBITDA estimate. Given our growing confidence in the company's stabilization and earnings prospects, we believe the shares are significantly undervalued.</li> <li>' RECEIVABLES: Days sales outstanding (DSOs) decreased a full day in 2Q00, and are now down to 80.4 days compared to 81.4 days at the end of March 2000 and 82.6 days at the end of</li> </ul>

Date	Analyst/ Recommendation	Comments
		<p>December 1999. HRC has set a goal of reducing DSOs by as much as 10 days year over year in 2000. The company has a goal of reducing that to 75 by the end of 2000. Each one-day reduction in DSOs is equal to \$10 million in cash for the company.</p> <p>' We believe it is of note that, while the company did take a \$200 million-plus pretax write-off of receivables in the last half of 1999, it believes that a significant percentage of those receivables that were written off will ultimately prove collectible. This could provide the company with a potentially significant source of cash.</p>
7/26/00*	Lawson 1-H (Buy)	<p>SUMMARY</p> <p>' We believe that some of the recent weakness in shares of HRC is because the company stated on its 2Q00 earnings conference call a week ago that it would file its 10-Q on Tuesday, the 25th, and did not do so.</p> <p>' The company filed its second quarter 10-Q after the close of trading on Wednesday.</p> <p>' We did not detect anything alarming or unexpected in the 10-Q filing (but provide some details of what was in the filing below).</p> <p>' We maintain our 1H rating on the shares, which trade at the lowest multiple of earnings and EBITDA of any healthcare provider company that we follow: 7.7x our 2000 EPS estimate and 5.2x our 2000 EBITDA estimate.</p> <p>OPINION</p> <p>' Cash flow from operations in the 2Q00 was \$210.5 million versus \$139.8 million in the same period a year ago, an increase of 50.6%. This also compares to \$77.1 million in the March 2000 quarter. HRC generated positive net working capital of \$12.6 million in the 2Q00 versus negative net working capital of \$134.6 million in the 2Q99.</p> <p>' The company has noted that it anticipates a lower level of overall capital spending in the second half of 2000. In fact,</p>

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		<p>the company's targeted capital spending on combined maintenance and internal and external development capex is roughly \$450 million for 2000. HRC has already expended approximately \$350 million, implying that the company will likely spend only about another \$100 million in the second half of the year. With significant positive cash flow from operations expected in the second half (a bit greater than what we saw in the first half), we expect the company to be able to retire in excess of \$100 million in debt in the second half of the year.</p> <p>' The cash balance of \$170.9 million at the end of the 2Q00 was at its highest level in over five years.</p> <p>' In our opinion, HRC is not facing any sort of SOLVENCY issue. We have fielded numerous calls as to this issue. HRC does have a number of short-term LIQUIDITY needs that management believes it can resolve through reasonable means. At the very least, the company has on hand \$170 million in cash, is generating significant cash flow from operations and can pare back capital expenditures. We do not believe this will be necessary, but believe it is worth pointing out.</p> <p>' A point worth noting in the revenue area as revealed in the 10-Q is that HRC generated only 29.4% of its revenues from Medicare in 2Q00 versus 34.1% from Medicare in the year-ago quarter.</p>
10/17/00*	Lawson 1-H (Buy)	<p>Projecting 2000 EPS of \$0.70, 2001 EPS of \$0.80, and a target price of \$12.</p> <p>HRC: PROSPECTS UNDER PPS LOOKING BETTER</p> <p>The BBA-relief bill working its way through the House and Senate contains several provisions that we believe will be very favorable to HEALTHSOUTH.</p> <p>First, under the current reimbursement methodology, HRC will not be subject to a sub-par Medicare rate increase for fiscal 2001. The company will see its per discharge cost limit increase equal to market basket.</p> <p>Second, and more important for the long-run, specific provisions</p>

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		<p>related to the implementation of a Medicare prospective payment system for rehabilitation hospitals, should prove highly favorable to HRC, and, ironically, the government.</p> <p>HRC, we believe will find itself in the winner category when PPS is implemented due to its lower cost structure than its competition.</p>
10/31/00*	Lawson 1-H (Buy)	<p>' HEALTHSOUTH reported 3Q00 EPS of \$0.18 versus \$0.16 in the year-ago quarter, in line with our estimate and the consensus estimate.</p> <p>' Revenues in 3Q00 increased 6.8% year over year to \$1.06 billion, slightly higher than our estimate.</p> <p>' EBITDA margin improved to 27.0% from 26.6% in 2Q00 and vs. 27.4% a year ago.</p> <p>' Volumes and pricing for the most part were solid and the company reduced debt in the quarter. Additionally, DSOs declined by 1.5 days to 78 days.</p> <p>' Our revised price target is \$15: targets an 8.0x multiple on est. 2001 EBITDA.</p> <p>--We note the particularity strong performance of the inpatient rehabilitation hospitals on the same-facility basis. Improved volume and performance in this segment of the company's business can only help the company's prospects under the pending Medicare inpatient rehabilitation hospital prospective payment system. The rehab hospital business has a high degree of fixed costs. To the extent that volume increases, cost per day/discharge per patient tends to decrease. The whole key to success under a PPS is to have lower costs than the payment rate. To the extent that HRC continues to increase utilization in its rehab hospitals, it should also be lowering its already relatively lower cost per discharge in the rehab hospital business. We view this as a very encouraging sign that should help profitability now, under the current Medicare reimbursement system, and under the pending Medicare PPS.... We do not foresee similar operational or financial problems for HRC as the rehab hospital PPS is implemented.</p> <p>The company stated that capital expenditures during the quarter were in the range of \$70-\$75 million. Capital expenditures in 2Q00 were \$98.4 million. We think the company is on tract to spend about \$450 million on capital</p>

Date	Analyst/ Recommendation	Comments
		<p>expenditures in 2000.</p> <p>--We raised our rating on shares of HRC to 1H from 3H back at the end of June on the following basis:</p> <p>-- We believe pricing and volume erosion have subsided at HRC and that the company will begin to shortly generate moderate top-line growth.</p> <p>-- HRC is focused on expansion of its surgery center business which is less susceptible to top-line and margin pressure.</p> <p>--HRC has an aggressive A/R collection plan in place that should reduce DSOs significantly throughout 2000, alleviating a significant investor concern.</p> <p>--New financial management is highly “operationally” focused versus previous financial management which was “deal” oriented.</p>
1/10/01*	Lawson 1-H (Buy)	<p>HRC: Healthsouth Update; Raising Price Target to \$21.</p> <p>' At only 8x our 2001 EBITDA estimates, shares of HRC remain among the cheapest in the healthcare service provider sector. We maintain our 1H rating and have increased our price target to \$21, targeting about 9.5x our 2002 EBITDA estimate.</p> <p>--Expect volume growth of 3-5% across all business lines.</p> <p>--Substantial capital expenditures and facility upgrades is behind the company.</p> <p>--HRC says it is moving from rapid growth by acquisition to steady, sustainable growth from operations.</p> <p>-- Each day of DSO improvement nets HRC approximately \$11 million in cash.</p> <p>--Surgery center initiative: opportunity to bring in new surgeons to drive case volumes. HRC has goal of adding 1,000 new surgical partners by end of 2Q01. HRC is operating at 50% capacity today (so there is plenty of room for new</p>



Date	Analyst/ Recommendation	Comments
		<p>surgeons). Incremental volume is high margin (40%+).</p> <p>--If those 1,000 new surgical partners perform 1 case per day at an average price of \$1,100 per case, with 40% EBITDA margin, HRC would generate \$271 million of incremental revenue, \$111 million of incremental EBITDA, and \$66 million of incremental pre-tax income (HRC ownership of 60%; physicians would own 40%). Potential EPS impact is \$0.10 (on base of \$0.80 forecast for 2001).</p> <p>--Inpatient rehabilitation Medicare' prospective payment system (PPS): HCFA sample database reflects overall average PPS rate of \$11,509 per discharge, HRC's average cost per discharge. is \$9,600. HRC has approximately 70,000 annual Medicare discharges.</p> <p>--Company believes it can generate incremental profit of \$1,400 on each discharge, translating into \$98 million of pre-tax earnings. If utilization increases 10%, HRC would add another \$50 million of pre-tax income. Potential additional EPS of \$0.22 (on base of \$0.80 forecast for 2001).</p> <p>--We plan to meet with HRC management late next week and will provide a thorough update following our meeting.</p>
1/22/01*	Lawson 1-H (Buy)	<p><b>SUMMARY</b></p> <p>' We met with HRC management late last week and came away highly enthused about business trends and the general outlook for earnings growth in 2001.</p> <p>' A number of new initiatives appear to be going well, and, we believe, offer potential upside to consensus earnings in 2001.</p> <p>Projecting 2000 EPS of \$0.70, 2001 EPS of \$0.80, and a \$21 price target.</p> <p><b>OPINION</b></p> <p>--We met with HRC management late last week and came away highly enthused about business trends and the general outlook for earnings growth in 2001. A few highlights include: HRC stopped accepting price cuts in 4Q99; in 2000, 35% of managed care contracts had pricing increases, 65% were stable; expect volume growth of 3-5% across all business</p>

Date	Analyst/ Recommendation	Comments
		<p>lines; substantial capital expenditures and facility upgrades is behind the company; HRC is moving from rapid growth by acquisition to steady, sustainable growth from operations.</p> <p>--A number of new initiatives appear to be going well, and, we believe, offer potential upside to consensus earnings in 2001.</p> <p>--In our opinion, the sooner rehab PPS begins, the better off HRC is, however, our earnings estimates include no benefit whatsoever for HRC from the new payment system.</p>
3/6/01*	Lawson 1-H (Buy)	<p><b>SUMMARY</b></p> <ul style="list-style-type: none"> <li>' HRC reported 4Q00 EPS of \$0.19 versus \$0.16 in the year ago quarter, in line with the consensus estimate and a penny above our estimate.</li> <li>' Revenues in 4Q00 increased 7.6% year over year, slightly higher than our estimate.</li> <li>' EBITDA margin improved substantially to 27.9% from 27.0% in 3Q00 and 26.6% in 2Q00 and vs. 25.8% a year ago.</li> <li>' Volumes and pricing were solid in all business lines.</li> <li>' While the company reduced debt slightly in 4Q00, capex were higher than expected but are being invested in high return rehab hospital and other projects.</li> <li>' Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 17.2x and 14.7x our 2001 and 2002 EPS est., respectively and 7.2x our 2001 EBITDA estimate.</li> <li>' Our price target remains \$21: targets a 9.0x multiple on est. 2002 EBITDA.</li> </ul> <p><b>OPINION</b></p> <ul style="list-style-type: none"> <li>--HRC reported 4Q00 EPS of \$0.19 versus \$0.16 in the year ago quarter (+19%), in line with the consensus estimate.</li> <li>--Total revenue increased 7.6% on a year over year basis to \$1.077 billion, slightly ahead of our forecast of \$1.072 billion.</li> <li>--Revenue mix: the inpatient division represented 41% of revenues, outpatient rehab was 23% of revenues, surgery centers comprised 22% of revenues, the diagnostic division was 7% of revenues and the company's acute care hospitals accounted for 7% of revenues. This revenue mix is consistent with recent quarterly trends. We expect some changes in the next two quarters as the company has announced the divestiture of one of its five acute care hospitals.</li> </ul>

Date	Analyst/ Recommendation	Comments
		<p>--Facility operating expenses as a percentage of revenues decreased to 65.9% versus 68.3%. In the year-ago quarter and from 67.1%. In 3Q00, 67.6% In 2000 and 67.9% In 1Q00. Corporate, general and administrative costs as a percentage of revenues were 3.8% versus recent trend of just over 3.5%. Excluding the \$5 million option exchange program expense noted above, this line item would have represented only 3.3% of revenues and would have declined on a sequential quarter basis (in raw dollars). Provision for doubtful accounts was 2.4% of revenues, in line with recent quarterly trends.</p> <p>--There has been substantial debate in the investment community about capex levels at HRC. This debate seems to center around balancing the need for the company to reduce debt vs. spending cash on development. Quite frankly, we do not understand the market's fascination with this issue. If HRC were in a bind financially with regard to its balance sheet or if it were still showing signs of substantial operating difficulties, we would agree that the company should probably focus solely on debt reduction while it gets its house in order. However, we believe that HRC has, for the most part, fully recovered from the operational difficulties of the late 1990s and 2000, and we see no signs of financial stress on the balance sheet. The company has EBITDA-to-interest coverage of just over 5.0x, among the healthiest in the healthcare services universe, and, clearly, the operational trends outlined above indicate that the company is doing quite well in that regard.</p> <p>--We raised our rating on shares of HRC to 1H from 3H back at the end of June 2000 on the following basis:</p> <ul style="list-style-type: none"> <li>--We believe that pricing and volume erosion have subsided at HRC and that the company would begin to generate moderate top-line growth – which it certainly has.</li> <li>--HRC is focused on expansion of its surgery center business which we believe is less susceptible to top-line and margin pressure and has higher overall profit margins.</li> <li>--HRC has an aggressive A/R collection plan in place that should reduce DSOs significantly over the next several years.</li> <li>--Focus by management on “operations” instead of deals.</li> <li>--We continue to strongly believe that the transition to a Medicare prospective payment system for rehab hospitals will provide significant upside in revenues and margins and profits</li> </ul>

Date	Analyst/ Recommendation	Comments
		<p>to HRC.</p> <p>--Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 17.2x and 14.7x our 2001 and 2002 EPS est., respectively, and 7.2x our 2001 EBITDA estimate.</p> <p>--We strongly reiterate our Buy (1H) rating on the shares.</p>
4/2/01*	Lawson 1-H (Buy)	<p>SUMMARY</p> <p>' Despite the elevated capital expenditures in 4Q00, the company generated material free cash flow in the quarter (which was used to reduce debt).</p> <p>' We believe that the pressure the shares came under in the aftermath of the 4Q00 earnings report was unwarranted and that the share continue to be among the most compelling in the healthcare provider universe. Currently, shares of HRC are trading at only 6.9x our 2001 EBITDA estimate.</p> <p>OPINION</p> <p>--HRC generated \$305.8 million in operating cash flow in 4Q00.</p> <p>--During 4Q00, HRC used cash of \$266.4 million in investing activities: \$227.9 million for purchase of PP&amp;E, \$58 million in additions to intangible assets.</p> <p>--Free cash flow for 4Q00 totaled \$39.4 million.</p> <p>--For the full year 2000, HRC generated operating cash flow of \$796.8 million and used \$757.3 million in investing activities.</p>
4/26/01*	Lawson I-H (Buy)	<p>SUMMARY</p> <p>' HRC reported 1Q01 EPS of \$0.19 versus \$0.17 in the year ago quarter, in line with the consensus estimate.</p> <p>' Revenue in 1Q01 increased 6.8% year over year.</p> <p>' EBITDA margin improved to 27.3% from 26.4% a year ago.</p> <p>' Volume and pricing were solid in all business lines, with exceptionally strong same-facility surgery center volume.</p> <p>' Capex came in at \$100 million, in line with guidance and expectations.</p> <p>' Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 17.1x and 14.4x our 2001 and 2002 EPS estimates, respectively and only 7.1x our 2001 EBITDA estimate.</p> <p>' Our price target remains \$21; targets a 9.0 multiple on 2002 estimated EBITDA.</p> <p>Projecting 2001 EPS of \$0.80, 2002 EPS of \$0.95</p>

Date	Analyst/ Recommendation	Comments
		<p>OPINION</p> <p>--EBITDA margin improved to 27.3% from 26.4% in 1Q00. The company noted that it granted slightly “above average” raises to staff and executives at the beginning of the year following several years of below average wage increases but that the impact has been fully loaded in the first quarter.</p> <p>--Facility operating expenses as a percentage of revenues was 67.5% vs. 67.9 a year ago. Corporate, general and administrative (CG&amp;A) costs as a percentage of revenues were 3.0% vs. 3.3% a year ago. This item decreased significantly from 4Q00 levels (which was 3.8%) due to the inclusion of a \$5 million option exchange program expense in the 4Q00 that did not recur in 1Q01. Provision for doubtful accounts was 2.2% of revenues, in line with recent quarterly trends.</p> <p>--The company reiterated its goal of reducing debt with operating cash flow by about \$250 million in 2001. Additionally, the company expects to receive proceeds of about \$300 million from asset divestitures during the year, all of which would be used to repay debt.</p> <p>--HRC management noted that it is hopeful and has reason to believe that the pending Medicare prospective payment system (PPS) for rehab hospitals will be implemented in October of this year. We expect the payment system change, whenever it is implemented, will have a positive impact on HRC’s revenues and profits.</p> <p>--Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 17.1x and 14.4x our 2001 and 2002 EPS estimates, respectively, and only 7.1x our 2001 EBITDA estimate.</p> <p>--Our price target remains \$21; targets a 9.0 multiple on 2002 estimated EBITDA.</p>
5/15/01*	Lawson 1-H (Buy)	<p>Projecting 2001 EPS of \$0.80, 2002 EPS of \$0.95 and a target price of \$21.</p> <p>Over the last 12 months, HRC has generated \$800 million in operating cash flow, and we expect that the company will generate a similar amount in 2001.</p>
5/22/01	Lawson 1-H (Buy)	<p>SUMMARY</p> <p>' HRC announced that it entered into a settlement with the government for \$7.9 million pertaining to a number of cost</p>

Date	Analyst/ Recommendation	Comments
		<p>report billing issues.</p> <ul style="list-style-type: none"> <li>' The billing issues have to do with a handful of sale leaseback transactions that date back a number of years as well as for the company's accounting for the write-off of some abandoned software costs associated with a 1995 acquisition.</li> <li>' The issues are not related to patient billing issues and will have absolutely no impact on the company's billing behavior going forward. In other words, there will be no revenue or profit impact going forward.</li> <li>' The dollar amount is largely insignificant.</li> <li>' We simply do not view this as a "big deal" or one that will or should have any financial or operating impact on HRC.</li> <li>' We are traveling with HRC management today and have discussed the issue at length and are very comfortable with the situation.</li> </ul>
7/31/01*	Lawson 1-M (Buy)	<p>HRC: 2Q01: JUST WHAT THE STREET ORDERED</p> <p>SUMMARY</p> <ul style="list-style-type: none"> <li>' HRC reported 2Q01 EPS of \$0.21 versus \$0.17 in the year ago quarter, a penny better than the consensus estimate.</li> <li>' Revenue in 2Q01 increased 6.0% year over year; excluding the sale of HRC's occupational health division, revenues advanced a healthy 9%.</li> <li>' EBITDA margin improved significantly to 28.1% from 26.6% a year ago.</li> <li>' HRC reduced debt by \$152 million during the quarter.</li> <li>' Raising our 2001 EPS estimate to \$0.81 from \$0.80. HRC trades at 21.1x and 18x our 2001 and 2002 EPS estimates, respectively and only 7.9x and 7.3x our 2001 and 2002 EBITDA estimates, respectively, a discount to other healthcare service companies. Assuming that shares of HRC can trade to a discounted 8.5x multiple of 2002 EBITDA, we maintain our price target of \$21.</li> </ul> <p>OPINION</p> <p>HIGHLIGHT ISSUES:</p>

Date	Analyst/ Recommendation	Comments
		<p>BALANCE SHEET/CASH FLOW/CAPEX: HRC finally delivered what the Street really wanted to see – a quarter where debt was reduced (at least in part with operating cash flow), capex were well within expectations, and DSOs declined.</p> <p>Debt declined by \$152 million in the quarter. The company noted that it received cash proceeds from the divestiture of its occupational health division and a hospital in Richmond, VA of about \$100 million, all of which was used to reduce debt. The remaining \$52 million of reduced indebtedness was achieved by using cash flow from operations. Also, the company’s cash balance was up by about \$10 million at quarter end. We expect at least another \$100 million or so of debt reduction during the second half of 2001 (our model indicates it should be a bit more, actually).</p> <p>Operating cash flow was between \$145 and \$160 million (the company is still waiting on an audited number) and capex were reportedly about \$91 million in the quarter.</p> <p>HRC noted that the 4 day improvement in DSOs on a consecutive quarter basis resulted from a 2 day improvement in overall collections and 2 days resulting from the Richmond hospital divestiture. The 4 day decline means that HRC’s DSOs are running about 76, not at all out of line with other large healthcare services companies (as they once were).</p> <p>VOLUME AND PRICING:</p> <p>With the exception of outpatient rehab, same-facility volumes were very strong. In the case of outpatient rehab, where the company saw just under a 1% increase in outpatient visits, the company noted that it has walked away from underpriced business and will continue to do so. The good news is that price per visit is up more than 3% to \$95. Outpatient surgery and diagnostics saw increases in volume of 7.2% and 9.4% respectively.</p> <p>EBITDA MARGIN:</p> <p>EBITDA margin increased a strong 150 basis points year over year. There are a couple of things to note here. First, facility operating expenses (where labor is contained) declined to 65.8% of revenues from 67.6% a year ago. We believe a bit of this</p>

Date	Analyst/ Recommendation	Comments
		<p>improvement is related to the sale of the occupational health business, although that only happened in late April, so a full quarter effect is not included. Also, and we have noted this many times before as a contrast to the acute care hospital business, HRC is in the fortunate position of operating many of the types of facilities that nurses are gravitating to not away from. Also, a major constituent of its employee base is physical therapists, which are not in short supply (as nurses are). While HRC does compete for nurses in its rehab hospitals, in particular, staffing is not nearly the issue at HRC as it is with acute care hospitals.</p> <p>Another point to note on EBITDA margin is that corporate, general and administrative costs (CG&amp;A) increased substantially on both a year over year and sequential quarter basis. This is due in large part to a non-cash charge for an option exchange program HRC instituted in 1999. In 1999, HRC allowed certain non-executive employees to exchange existing options for lower-priced options. The options were re-issued at \$13.31. At the time, no expense needed to be recorded to reflect this action. Since that time, FASB has issued a new interpretation that requires companies to record this as an expense to the extent that the stock price rises above the issue price of the options. In the case of the 2Q01 this amounted to almost a \$6 million expense. This eroded EBITDA margin by 60 basis points and EPS by a full penny! This will continue to be a quarterly issue (the expense is pegged to the closing price of the stock on the last day of the quarter therefore is difficult to predict). Management indicated that its underlying true CG&amp;A expense is between \$37 and \$38 million. We think this is an issue worth noting as it indicates that HRC's profitability and earnings growth was actually a bit more than it appears.</p> <p><b>DETAILS OF THE QUARTER:</b></p> <ul style="list-style-type: none"> <li>- HRC reported 2Q01 EPS of \$0.21 versus \$0.17 in the year ago quarter (+25%), a penny above the consensus estimate.</li> <li>- Total revenue increased 6.0% on a year over year basis; excluding the now-divested occupational health business in both the 2Q01 and the year ago quarter, revenues actually increased a very healthy 9%.</li> <li>- A note on rehab PPS: Just today, HCFA/CMS published for</li> </ul>



Date	Analyst/ Recommendation	Comments
		<p>public inspection the PPS regs which it now says will be implemented on January 1, 2002. The regs will be published in the Federal Register on August 7 (next Tuesday). If one wants to see them before then, one has to either go to Washington and get them or get someone to make a copy and send them! We do not expect that any significant changes were made to the rules that would adversely affect the provider community. We very strongly expect the payment system change will have a positive impact on HRC's revenues and profits. The company's facilities will phase onto the new PPS system throughout the year owing to differing cost report year ends.</p> <p>– Shares of HRC trade at a significant discount to other healthcare service companies. HRC trades at 21.1x and 18x our 2001 and 2002 EPS estimates, respectively and only 7.9x and 7.3x our 2001 and 2002 EBITDA estimates, respectively. Assuming that shares of HRC can trade to a still discounted 8.5x multiple of 2002 EBITDA, we maintain our price target of \$21 (implying 24% upside).</p>
8/7/01*	Lawson 1-M (Buy)	<p>Projecting 2001 EPS of \$0.81, 2002 EPS of \$0.95.</p> <p>– We continue to believe that Healthsouth, the largest operator of freestanding rehabilitation hospitals in the U.S. will financially benefit from the pending reimbursement changes. We continue to rate shares of HRC 1M and maintain our price target of \$21.</p>
8/8/01*	Lawson 1-M (Buy)	<p>HRC: GARBAGE IN = GARBAGE OUT; GOV'T DATA NOT USEFUL</p> <p>SUMMARY</p> <p>' Sometimes (most times) government data is a bit difficult to utilize, especially when it comes to investment decisions. The way that the government presents data is not always useful or logical, and depending on it too much can be problematic.</p> <p>' The data that was published yesterday pertaining to the impact of the Medicare rehab PPS was just such an example; in the end, we believe that for investment purposes, the information is useless.</p> <p>' We explain in excruciating detail below why, but suffice it to</p>

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		<p>say that, at first blush, it appears as though HRC would indeed see a slight drop in payments under PPS. However, the underlying calculation renders the government's impact analysis virtually useless for investors (or anyone else for that matter).</p> <p>OPINION</p> <p>– Based upon the average payment rate expected under the new system (\$11,838 per case), we continue to expect HRC to benefit. How much? We just don't know. Depending on a number of things, it could be as much as \$0.15 per share when fully implemented, but we just don't know for sure, so factor in nothing to our earnings model.</p> <p>– The key focus here should be that there really should be no material adverse impact from the implementation – and given the current valuation of the stock, we certainly do not believe that investors are being asked to pay for any upside from PPS whatsoever.</p>
10/25/01*	Lawson 1-M (Buy)	<p>SUMMARY</p> <p>' Revenue in 3Q01 increased 5.2% year over year (adjusting for sale of HRC's occupational health division and an acute care hospital).</p> <p>' EBITDA margin improved 70 basis points to 27.7% in 3Q01 vs. 3Q00.</p> <p>BALANCE SHEET/CASH FLOW/CAPEX: Debt was essentially flat on a sequential quarter basis. The company appears to have generally offset capital expenditures of a little north of \$100 million with about the same level of operating cash flow.</p> <p>EBITDA margin increased a 70 basis points year over year. There are a couple of things to note here. First, facility operating expenses (where labor is contained) declined to 66.4% of revenues from 67.1% a year ago. We believe a bit of this improvement is related to the sale of the occupational health business. Also, and we have noted this many times before as a contrast to the acute care hospital business, HRC is in the fortunate position of operating many types of facilities that</p>

Date	Analyst/ Recommendation	Comments
		<p>nurses are gravitating to, not away from. Also, a major constituent of its employee base is physical therapists, which are not in short supply (as nurses are). While HRC does compete for nurses in its rehab hospitals, in particular, staffing is not nearly the issue at HRC as it is with acute care hospitals.</p> <p>' HEALTHSOUTH reported 3Q01EPS of \$0.20 vs. our estimate of \$0.21 and the consensus estimate of \$0.20 and vs. \$0.18 in the year-ago quarter.</p> <p>' Revenues increased only 1.5% year over year but if one adjusts for the sale of HRC's occupational health business and its Richmond, VA medical center during 2Q01, revenues increased 5.2%. Revs were \$1.075 billion, exactly in line with our forecast.</p> <p>Another point to note on EBITDA margin is that corporate, general and administrative costs (CG&amp;A) decreased on a sequential quarter basis.</p> <p>OPINION</p> <p>– CG&amp;A expense was \$38.96 million in the quarter (3.6% of revenues) – down sequentially from 2Q01 when it was \$43 million (3.9% of revenues). This line item has been intermittently impacted by a non-cash expense associated with a stock option exchange program dating back to 1999. In 1999, HRC allowed certain non-executive employees to exchange existing options for lower-priced options. The options were re-issued at \$13.31. At the time, no expense needed to be recorded to reflect this action. Since that time, FASB has issued a new interpretation that requires companies to record this as an expense to the extent that the stock price rises above the issue price of the options. The expense goes up when the stock goes up (as measured by stock price on last day of quarter). In 2Q01, this expense was nearly \$6 million because the stock price had appreciated significantly. The stock was not so strong in 3Q01, so this expense was considerably less than it was in 2Q01, hence the lesser cost on a sequential quarter basis.</p>
12/12/01*	Lawson 1-M (Buy)	' HRC released its earnings objectives for the year ending December 31, 2002.

Date	Analyst/ Recommendation	Comments
		<p>' The new guidance takes into account the expected effects of the new prospective payment system (PPS) for inpatient rehabilitation facilities which is expected to add approximately \$0.07 to HRC's 2002 EPS.</p> <p>The company also expects SFAS No. 142 (elimination of goodwill amortization) to add back \$0.13 (approximately \$50 million) to 2002 EPS.</p> <p>We are raising our 2002 EBITDA estimate to \$1,350 million (from \$1,325 million) and our EPS estimate to \$1.10 (from \$0.95).</p>
1/22/02*	Lawson 1-M (Buy)	<p>' HRC announced that the U.S. DOJ has joined a qui tam lawsuit claiming the company's outpatient therapy (PT) violated Medicare regulations. The Company has not received the formal complaint.</p> <p>' The crux of the suit has to do with the use of extendors in providing outpatient PT. HRC has a licensed therapist overseeing aides, as this is industry practice, however there are no formal federal guidelines, and only 1CPT code. Only a few states do not use extendors, and HRC is compliant in these states.</p> <p>' Medicare investigations can never be framed in a positive light. While we do not yet know the time period the suit covers, timeframes tend to be multi year. Three mitigating factors for the stock are (1) the percentage of revenue derived from Medicare for HRC's outpatient PT is only 1% of revenue, and (2) initial feedback of claims for inpatient rehab PPS are in line with expectations (3) the stock is cheap, trading at only 6.2 times our 2002 EBITDA estimate.</p> <p>OPINION</p> <p>After the close on Friday, HRC announced that the U.S. Dep't. of Justice has joined a qui tam suit alleging that the Company's outpatient PT business violated Medicare regulations, with a focus on HRC's use of extendors, for which there is no federal standard, but some state standards restricting this practice. CMS acknowledges that the general industry practice is that a licensed therapist oversees aides in its administration of PT. HRC is compliant in states that prohibit the use of extendors. Further, there is only one CPT code used for Medicare billing, so unlike hospital company Medicare billing investigations, the issue of</p>

Date	Analyst/ Recommendation	Comments
		<p>upcoding to obtain higher reimbursement does not apply. HRC derives approximately 22% of revenue from outpatient PT, and 29% of revenue from Medicare, so overall, the exposure is only 1% of revenue.</p>
3/12/02*	Lawson 1-M (Buy)	<p>HRC: TRANSITION YEAR OVER; LOOKING FOR STRONG 2002. The report, based on HRC[’s] reported 4Q01 EPS of \$0.22 vs. \$0.19 in the year ago quarter noted that HRC trades at a very significant discount to other healthcare service companies, by our analysis. Salomon therefore maintained its price tgt of \$21 (implying 65%+ upside).</p> <p><b>BALANCE SHEET/CASH FLOW/CAPEX:</b>  --Debt was reduced by about \$140 million on a sequential quarter basis and about \$240 million for the year. The company generated about \$220-\$225 million in operating cash flow during the quarter and had capital expenditures of about \$152 million, for free cash flow generation of about \$65 million. The company was able to reduce debt during the quarter at a level greater than free cash flow from operations due to the divestiture of a number of diagnostic facilities in the UK and a few “non-strategic” rehab hospitals (generated cash proceeds of about \$100 million).</p> <p><b>PPS and 2002 GUIDANCE:</b>  --Management indicated that all things are going very smoothly under the new Medicare PPS for inpatient rehabilitation hospitals. The company said that it is getting payments under the new system that are right in line with what it had estimated prior to implementation and that it has seen no surprises. In fact, the company is seeing an increase in Medicare patient volume which should show up in 1Q02 numbers. Management stated that is it comfortable with current Street consensus estimates for 2002 earnings.  --Pricing was up slightly in all of the company’s operating divisions, and the company expressed confidence that it is successfully renegotiating all of its contracts at same or better pricing.  --Capital expenditures during the quarter were \$152 million, a little north of expectations as capex were expected to be between \$300-\$400 million for the full year and they came in around \$435-\$440 million. In particular management stated that it is seeing many significant opportunities on the inpatient rehab hospital development front and want to take advantage of those</p>

Date	Analyst/ Recommendation	Comments
		opportunities.
5/2/02*	Lawson, Bici 1-M (Buy)	<p>SUMMARY</p> <ul style="list-style-type: none"> <li>' HRC reported 1Q02 EPS of \$0.27, up 23% adjusting for SFAS 142 and in line with its favorable Dec. 2001 pre-announcement.</li> <li>' Inpatient rehabilitation revenues (42% of total) were up 12% yr/yr. on 5% volume growth (4% is same-center), and 7% pricing growth. Management indicated that hospitals with higher cost structures are referring higher acuity inpatient rehab patients to HRC facilities.</li> <li>' Approximately \$50 million of the \$187 million in cap ex was spent in the inpatient rehab division, building seven new hospitals, and expanding five existing facilities. Cap ex exceeded cash flow from operations of \$175 million.</li> <li>' DSOs climbed four days to 81, three days of the increase was from slower payments from a fiscal intermediary.</li> <li>' We are maintaining our \$1.12 and \$1.30 EPS estimates and \$21 price target. Valuation is attractive, at 5.5 times our 2003 EBITDA estimate.</li> </ul> <p>OPINION</p> <p>FIRST QUARTER 2002 HIGHLIGHTS</p> <p>PRICING APPEARS TO BE STRENGTHENING</p> <p>Overall, pricing increased in three out of five divisions, declined in diagnostic imaging (due to lower revenue per scan procedures), and was flat in the surgery center division. There were 12 favorably priced managed care contracts renegotiated during the quarter, representing 15.4 million lives.</p> <p>INVESTMENT THESIS</p> <p>We believe the company has made the transition from an acquisition-focused story to growth through internal organic means. The focus on operations should lead to stronger cash flows, to pay down debt and improved financial performance.</p>

Date	Analyst/ Recommendation	Comments
		We would also expect improvements in accounts receivables collection with lower capital expenditures.
5/12/02*	Lawson 1-M (Buy)	<p>Capital expenditures were \$184 million in 1Q02 versus \$95.5 million in the year-ago quarter. Management noted that “Because of the favorable results we have seen in the early transition to inpatient rehabilitation PPS, we have incurred additional capital expenditures in the first quarter of 2002 in connection with expansion activities at some of our facilities and accelerated development activities.</p> <p>– HRC notes that over the next 12 months it expects to spend approximately \$150 million to \$200 million on maintenance and expansion of existing facilities and approximately \$300 million to \$350 million on development activities (total of \$450 million to \$550 million). In HRC’s 10-K for 2001 (filed in late March 2001), the company stated that it expected to spend approximately \$100 million to \$150 million on maintenance and expansion of existing facilities and approximately \$250 million to \$350 million on development activities (total of \$350 million to \$500 million), so the company has guided its capex for the year up by about \$50 million.</p> <p>– DSOs at the end of 1Q02 were 81.5 compared to 77.6 days at the end of December 2001. The company attributes this increase primarily to delays by some of its Medicare fiscal intermediaries in implementing systems for processing inpatient rehabilitation PPS payments.</p>
6/11/02*	Lawson 1-M (Buy)	<p>SUMMARY</p> <p>' We are revising our price target to \$19 from \$21, now targeting a 7.5x multiple.</p> <p>OPINION</p> <p>– We continue to believe that HRC will do well under the new Medicare prospective payment system (PPS) for rehabilitation hospitals which continues to phase in over the course of 2002. Given this belief and that the stock trades at only 6.5x our 2003 EBITDA estimate and 10.8x our 2003 EPS estimate, we continue to rate the shares a Buy.</p>

Date	Analyst/ Recommendation	Comments
7/18/02*	Lawson 1-M (Buy)	<p>' Shares of HRC have come under renewed pressure the last few days after having fallen sharply late last week on market chatter about a number of unsubstantiated issues.</p> <p>' The issues were about alleged accounting improprieties, auditor reluctance to sign off on 2Q02 financials, surgery center doctor defections, and concerns that certain knee surgery procedures were unnecessary, among other things.</p> <p>' There do not appear to be any “new” issues that have surfaced this week.</p> <p>' We believe most of the rampant speculation from last week was unfounded – keeping in mind that one can never know unequivocally in this day and age that any company is “in the clear” and we wouldn’t propose to say that about any company – and that the sharp sell-off in the shares was unwarranted (shares of HRC are down almost 40% since mid-May and were off 21% last week alone).</p> <p>– That having been said, we believe that HRC’s share price is being undermined largely as a result of having repeatedly missed making good on promises to the Street about such things as DSO reduction, capital expenditure restraint and free cash flow generation. While margins have improved, pricing and volume have improved substantially, the initial transition to Medicare prospective pay (PPS) has gone smoothly, and the company has successfully re-engineered its balance sheet, these significant accomplishments have been overshadowed by the goals the company has not met.</p> <p>– Despite the noteworthy accomplishments of the HRC management team over the last few years it is the handful of goals that haven’t been met that plague the stock. Case in point is DSOs. HRC’s DSOs average in the high 70s to near 80. This is down from north of 100 just 2 years ago (admittedly after a mammoth write-off). We do not believe that is so terrible for this company to have DSOs in the 70s and we also understand that DSOs, for a number of reasons, will bounce around quarter to quarter. The problem is that some two years ago the company promised that DSOs would be south of 70 and provided an overview of what that would mean for cash flow and EPS. Investors latched onto such promises and the associated EPS</p>



Date	Analyst/ Recommendation	Comments
		<p>impact and invested in the stock. Well, the DSOs began a downward trend for about 2 quarters and have since marched steadily upward (for one reason or another).</p> <p>– The same can be said for free cash flow. Here and there the company has reported positive free cash flow but not consistently and not to the extent that the Street would like to see. This goes hand in hand with failure to reduce debt levels. We understand, and, in fact, sometimes sympathize, with management’s contention that it is seeing many opportunities to make capital investments (i.e., rehab hospitals in the wake of PPS, etc.). Management contends that to forego such investments would be a mistake in the long run. We do not necessarily believe that HRC is so overburdened with debt that it needs to put every penny of cash it generates toward debt reduction. Far from it. Debt-to-EBITDA is only 2.2x, only slightly higher than other large healthcare services providers. However, we do believe that many of the investors that bought the stock over the last 2 years did so under the assumption that free cash flow would increase and debt would decline.</p> <p>– We have been recommending shares of HRC for some time now based almost solely on our expectations that PPS would be favorable for the company. We have long held, despite lots of dissenting opinion, that PPS would be favorable.</p> <p>We felt that once the PPS cloud departed, many investors who had previously shied away from the stock would be inclined to have another look. In fact, PPS, at least at these early stages, seems to be going rather smoothly and we don’t expect any material bumps along the way.</p>
8/7/02*	Lawson 1-M (Buy)	<p>SUMMARY</p> <p>' HEALTHSOUTH reported 2Q02 EPS of \$0.28, in-line with the Street consensus estimate and a penny better than our estimate, and vs. \$0.24 (FASB 142 adjusted) in 2Q01 (+17%).</p> <p>' Revs increased 5.9% y-o-y but adjusting for divestitures during 2001, revs increased 8.6%. Revs were \$1.164 billion, slightly higher than our estimate. Importantly, inpatient rehab facility revenue increased 11% signaling the continued success in</p>

Date	Analyst/ Recommendation	Comments
		<p>the transition to rehab PPS.</p> <ul style="list-style-type: none"> <li>' EBITDA margin improved 170 basis points year over year to 29.8% in 2Q02.</li> <li>' Capex for the quarter totaled \$344 million but excluding \$207 mil expenditure for acquiring synthetic operating leases, capex totaled \$137 mil in 2Q02.</li> </ul> <p>OPINION</p> <ul style="list-style-type: none"> <li>– Cash flow from operations totaled \$235 million compared to \$159 million in the year-ago quarter.</li> <li>– Facility operating costs were 64.2% of revenues vs. 65.8% in 2Q01 (a 160 bps improvement).</li> <li>– The \$0.01 upside to our estimate came from higher revenue and lower than expected facility operating costs, but was somewhat offset a bit by higher net interest expense.</li> </ul> <p>We have pegged a 3-5 year earnings growth rate of 15% as the company focuses on growth through internal organic means.</p>
8/8/02*	Lawson 1-M (Buy)	<p>SUMMARY</p> <ul style="list-style-type: none"> <li>' HEALTHSOUTH reported 2Q02 EPS and \$0.28, up 17% adjusting for FASB 142, in-line with Street consensus, and a penny better than our estimate.</li> <li>' Pricing and volume gains were solid across all business lines.</li> <li>' Inpatient rehabilitation revenues (42% of total) were up 11% yr/yr., on 5.5% volume growth (5.2% same-facility), and 5.4% pricing growth as company continues to see positive impact from transition to PPS.</li> <li>' DSOs declined 2.5 days to 79 days from 1Q02. Capex totaled \$137 mil. in 2Q02 and HRC reaffirmed 2002 capex of \$450-\$550 mil. (ex synthetic leases).</li> <li>' HRC generated \$235 mil of operating cash flow in 2Q02.</li> <li>' Company reactivated share repurchase program and can</li> </ul>

Date	Analyst/ Recommendation	Comments
		<p data-bbox="625 306 1429 369">purchase up to an additional 22 million shares until February 2004.</p> <p data-bbox="625 411 1429 516">' We are slightly raising our EPS estimates to \$1.13 in 2002 and \$1.31 in 2003. We believe valuation remains attractive at 5.1x our 2003 EBITDA estimate.</p> <p data-bbox="625 548 756 579">OPINION</p> <p data-bbox="625 621 894 653">2Q02 HIGHLIGHTS</p> <p data-bbox="625 684 1268 716">PRICING CONTINUES TO SHOW STRENGTH</p> <p data-bbox="625 747 1429 1041">– Overall, pricing increased in four out of five divisions, with no increase in diagnostic imaging. While the company negotiates thousands of managed care contracts each quarter, the company noted that it renegotiated several national contracts at average pricing increases of 10%. Some specific contracts include: outpatient contracts in Illinois and Missouri for a 27% average increase, and a 12% contract rate increase for surgery centers in Colorado.</p> <p data-bbox="625 1083 1429 1188">– Outpatient rehab pricing was up 5.3%, diagnostic imaging pricing remained flat, and medical center pricing increased 1.6% year-over-year.</p> <p data-bbox="625 1220 1089 1251">VOLUME GROWTH WAS SOLID</p> <p data-bbox="625 1293 1429 1587">– Overall, volumes were solid. The strongest volume growth was in the outpatient rehab division, increasing 6.7% overall and up 6.5% on a same-facility basis. Inpatient rehab volumes strengthened to 5.5% and were up 5.2% on a same-center basis. Diagnostic imaging scans increased 5.6% yr./yr., on a same-center basis. Same-center surgery volumes were solid, at 4.8% while overall surgery volume increased only 1.3% due to divestiture of some marginal facilities.</p> <p data-bbox="625 1619 1429 1797">- Inpatient rehab PPS appears favorable, as evidenced by the strong pricing and volume, which to-date is now based on 42% of HEALTHSOUTH's facilities adopting PPS (35% in 1Q02 and 7% in 2Q02). The percentage of facilities adopting PPS over the balance of the year is as follows: 3Q2002-41%; 4Q2002-16%.</p>

Date	Analyst/ Recommendation	Comments
		<p>PROFITABILITY IMPROVED</p> <p>- EBITDA margin expanded 170 basis points to 29.8% yr./yr., on lower facility operating expense (improved 160 basis points), and lower CG&amp;A expense as a percentage of revenue which improved 20 bps to 3/7%.</p> <p>- The company generated \$235 million in cash flow from operations, and capex totaled \$137 million (excluding \$207 million expenditure to acquire synthetic operating leases). The company reaffirmed its capex guidance of \$450-\$550 million which leaves approximately \$180 million in capex spending for the remainder of the year (assuming the midpoint of the guidance).</p> <p>RAISING EPS ESTIMATES</p> <p>- We are slightly raising our 2002 EPS estimate to \$1.13, to reflect the penny upside from the quarter and we have slightly raised our 2003 EPS estimate to \$1.31.</p> <p>We have pegged a 3-5 year earnings growth rate of 15% as the company focuses on growth through internal organic means. We use hospital stocks as the main comparables for HEALTHSOUTH. Like hospitals, our preferred method of valuation for HRC is enterprise value to EBITDA and we typically derive our price target from this valuation metric. In recent years, HRC has traded at a discount to the hospital group, with multiples ranging from 6.0x to 8.0x forward EBITDA. Our target price of \$19 assumes HRC can trade at roughly the midpoint of that range.</p>
8/14/02*	Lawson 1-M (Buy)	<p>OPINION</p> <p>- Cash flow from operations was \$234.9 million for the three months ended June 2002 versus \$148.4 million in the same quarter of 2001. The significant increase in cash flow from operations versus a year ago was that in the 2Q01 there was a nearly \$90 million decrease in accounts payable and accrued expenses versus only an \$18 million decrease in 2Q02. Change in accounts receivable resulted in \$27.8 million cash outflow in the 2Q02 versus a \$9 million use in the year-ago quarter.</p>

Date	Analyst/ Recommendation	Comments
		<p>– Capital expenditures were \$385 million in 2Q02 versus \$91 million in the year-ago quarter. Management noted that “Because of the favorable results we have seen in the early transition to inpatient rehabilitation PPS, we have incurred additional capital expenditures in the first half of 2002 in connection with expansion activities at some of our facilities and accelerated development activities.” Also included in this amount is \$207 million in connection with the purchase of various facilities and properties previously held under synthetic leases – a one-time expenditure.</p> <p style="text-align: center;">* * *</p> <p>We have pegged a 3-5 year earnings growth rate of 15% as the company focuses on growth through internal organic means. We use hospital stock as the main comparables for HEALTHSOUTH. Like hospitals, our preferred method of valuation for HRC is enterprise value to EBITDA and we typically derive our price target from this valuation metric. In recent years, HRC has traded at a discount to the hospital group, with multiples ranging from 6.0x to 8.0x forward EBITDA. Our target price of \$19 assumes HRC can trade at roughly the midpoint of that range.</p>

\* These reports include a notation that SSB is a member of CitiGroup, Inc.

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**Appendices 8 – 12**  
are oversized & will be mailed overnight delivery.



## APPENDIX 13

### Facts Relating to Steve Schlatter

1. From July 1995 to December 2001, Steve Schlatter was a physical therapist and head administrator of a HealthSouth rehabilitation clinic located in Indiana. In that capacity, Schlatter supervised eight other employees, including three physical and one occupational therapist.

2. In the Spring of 2001, Schlatter and other employees at the HealthSouth facility read an article in the April 13, 2001 edition of *Eli's Rehab Report* concerning outpatient group therapy miscoding, and also spoke to other physical therapists within HealthSouth, including one physical therapist whose billing practices had been audited. Those communications confirmed the Government's policy on coding for outpatient individual and group physical therapy. Concerned about the appropriateness of HealthSouth's billing practices, on April 23, 2001, Schlatter e-mailed his supervisor Bill Schmidt ("Schmidt") at HealthSouth's regional office in Indiana and Jon A. Santini ("Santini"), a HealthSouth technical support executive based in Ohio, seeking clarification of the appropriate billing practices. Schlatter also raised the matter with Vicki Sherman ("Sherman"), a HealthSouth Regional Clinical Director based in Ohio, who was visiting the facility. Schlatter noted in the e-mail that the Government "pays much less" for a group therapy session. Schlatter and his co-workers were extremely concerned about this issue because treating two or more individuals concurrently was "the rule more than the exception" at HealthSouth, and yet the HCAP billing program utilized at HealthSouth did not even permit group billing under CPT Code 97150.

3. Receiving no response from his prior e-mails, Schlatter sent follow-up e-mails to his supervisor, Schmidt, and other supervisors, seeking "Corporate input" on the matter. In an April 26, 2001 e-mail to Schmidt, Walt Jimenez ("Jimenez"), Schmidt's supervisor, and Sherman, Schlatter stated that, "I certainly understand the huge financial implications, but am not willing to jeopardize my license." That same day, David McMullan ("McMullan"), a HCAP Support Services Manager based in



HealthSouth's headquarters, confirmed in an e-mail to Santini, that the HCAP billing system "does not support Group PT/OT," *i.e.*, permit entry of a group billing code. McMullan further noted that, if the interpretation was accurate, "you could consider 75-80% of HS patients treated in group," and that doing so would have "significant impacts financially to the clinic" and to HealthSouth.

4. On April 30, 2001, Schlatter sent a follow-up e-mail to Jimenez and Schmidt when he still had not received an acceptable response. In that e-mail message, entitled "HCAP-HCFA Group Therapy," Schlatter elaborated upon his reasons for believing the Company was committing what he found to be "Medicare billing fraud":

As you know from last weeks e-mails I have expressed a concern re: this issue. I am still concerned.... I base my concerns not only on the Eli Rehab Report article dated 4-13-01, but I also have talked to another Indiana P.T. who had an independent compliance audit done for his practice.... [T]he auditor that visited my friend agreed with what is reported in the Eli report. ***I am not trying to create trouble and certainly do not understand the financial ramifications of this, but one must also consider the financial issues of a Medicare billing fraud claim. In Orlando we repeatedly hear "do the right thing" and listen to the compliance attorneys['] presentations. I will feel much more comfortable when someone is able to actually produce this policy.*** Your response to this will be appreciated.

5. Dissatisfied with the lack of response from his HealthSouth superiors, Schlatter contacted the American Physical Therapy Association ("APTA") for its interpretation on group therapy billing. That organization confirmed that the practices being employed by HealthSouth were improper. On May 2, 2001, Schlatter forwarded this information to Schmidt. In that e-mail, Schlatter stated that he had been told by APTA "that the group therapy code should be used whenever treating two or more patients at the same time ... a HCFA guideline dating back to 1996."

6. Still unable to obtain a response, on May 10, 2001, Schlatter sent an e-mail entitled "Stonewalled on group therapy" to Schmidt, Jimenez, and Jimenez's superior, Floyd Stahl ("Stahl"):

As most of you know I have been repeatedly expressing my concerns re: group therapy billing dating back to 4-23-01. I know and realize that this is a very controversial issue and is open to many different interpretations. What concerns me is that many people and organizations (HCFA & APTA) state that when treating two or more people at the same time you must bill as group therapy. I have the HCFA

transmittal, a tape recorded message from Elizabeth O'Brien from the APTA Dept. of Governmental Affairs, and a copy of the HCFA Federal Register all backing up this interpretation. I have been advised that HS has a policy on this, but all efforts on my part to obtain a copy of this have been unsuccessful. ***As you should know there is no way for us to bill for group therapy in the HCAP system even if we wanted to. The fact that we are being asked to continue billing with this system, knowing that some people may interpret this as billing fraud causes me significant concern.***

7. On May 17, 2001, Schlatter sent Schmidt a schedule summarizing 30 of the communications Schlatter had had with his superiors, colleagues, or APTA questioning the appropriateness of HealthSouth's billing practices. In his accompanying e-mail message to Schmidt, Schlatter stated:

Enclosed please find my documented communication efforts trying to resolve the "group therapy" issue. I know management has become irritated that I continue to pursue this, but I feel my clinicians and myself need to be assured that we are "doing the right thing." We are the one with a license, career, and profession to protect and I do not feel my requests have been at all unreasonable.

8. The knowledge of HealthSouth's top management is shown by a May 17, 2001 e-mail from Mike McCracken to Santini, McMullan and Schlatter which stated that the group therapy issue was "being worked on at a high level in HealthSouth":

From what I understand, HCAP does not allow the therapist to bill group therapy. Information received recently from APTA indicates that group therapy should be billed for 2 or more individuals receiving therapy.... ***This is being worked on at a high level in HealthSouth***, but it sounds like you know as much as I do right now.

9. On May 31, 2001, Schmidt sent an e-mail to his superiors, Stahl and Jimenez, recommending that HealthSouth address the over-billing issue:

I appreciate your recognition of the issue ... regarding how HCAP does (or does not) address group therapy charges. While we seem to have reached consensus conceptually on this matter, I think we still need to look at this matter on a global level as there has never been clear resolution provided by anyone at the corporate level.

This recommendation was ignored too, and HealthSouth continued to stonewall and systematically overbill the Government on group therapy sessions.



## APPENDIX 14

### **Facts Based on the Testimony of Martin Cohen Before the House Committee on Energy and Commerce, October 16, 2003**

1. Martin Cohen testified before the House Committee on Energy and Commerce on October 16, 2003. Cohen is a Senior Managing Director with FTI Consulting, Inc. (“FTI”), focusing on financial restructuring of troubled companies.

2. In mid-September 2002, FTI was hired by Fulbright & Jaworski (“Fulbright”) to conduct an analysis of the impact of Transmittal 1753 on the revenues of HealthSouth. Fulbright had been engaged by the Board of Directors of HealthSouth to examine a number of issues. Fulbright hired FTI to examine the impact of Transmittal 1753 on HealthSouth’s outpatient rehabilitation revenues, and to assess the reasonableness of HealthSouth’s assertion that the reduction in revenue could, on an annual basis, approximate \$175 million.

3. After being retained by Fulbright, Cohen led a team of FTI employees in analyzing the potential impact of Transmittal 1753 on HealthSouth’s outpatient rehabilitation revenues. FTI collected detailed coding and billing information from HealthSouth’s billing files for a limited number of health care facilities for a two-week period during the months of May and June, 2002. FTI then created a billing model based upon various assumptions as to how Medicare outpatient rehabilitation coding guidelines should be applied in the field. FTI further assessed the potential impact of Transmittal 1753 on commercial and workers’ compensation insurance revenues. Applying the data provided by HealthSouth to the billing model developed by FTI, Cohen next applied those conclusions to HealthSouth’s outpatient rehabilitation patient population for the first six months of 2002. Using this methodology, FTI came up with a series of estimates of the potential impact of Transmittal 1753 on HealthSouth’s revenues.

4. FTI presented a draft report to Fulbright on November 5, 2002, which preliminarily indicated that the potential annualized impact of Transmittal 1753 on HealthSouth's outpatient rehabilitation revenues from Medicare, commercial and workers' compensation could range from a low of \$101 million to a high of \$227 million. The range of impact was largely dependent on the fact that it was unclear how the commercial and workers' compensation insurers would respond to the Medicare changes, either through a change in billing practices or subsequent reduction in rates. However, during the course of drafting the report, FTI staff listened to the HealthSouth third quarter investor call held on November 5, 2002, and noted significant discrepancies between management's representations as to the impact of Transmittal 1753 on third quarter financial results and FTI's preliminary findings.

5. Concerned that HealthSouth management's representations during the third quarter investor call, if correct, could indicate a problem with FTI's draft analysis, FTI immediately notified Fulbright of the discrepancies. Further, on November 6, 2002, Cohen wrote to defendant Owens, then HealthSouth's President and Chief Executive Officer, and requested that HealthSouth provide FTI with certain specific financial information that could be used to check the discrepancies between FTI's draft findings and the statements made during the earnings announcement. Neither Owens, nor anyone else from HealthSouth, ever responded to Cohen's November 6, 2002 request for further information and FTI never finalized its report.



**APPENDIX 15**

**BBA PROVISIONS**

<b>BBA Provision</b>	<b>BBA Section</b>	<b>Application to HealthSouth – HealthSouth Segment; Foster’s Testimony about Provision’s Impact; and writeoffs</b>	<b>Source of BBA Provision</b>	<b>Effective Dates</b>
Reduced hospital capital payment for rehabilitation hospitals by 15%	Sec. 4412, 111 Stat. 404  House Bill Sec. 10512; Conf. Rep. Page 364	rehab hospitals  “This is a harsh, immediate cut that hits PPS exempt facilities hard.” Foster Testimony, at 15.	President’s February 1997 budget	FY 1998 through 2002
No Medicare update for PPS-exempt hospitals	Sec. 4411(a), 111 Stat. 403  House Bill Sec. 10511; Conf. Rep. Page 363	rehab hospitals  Reduced update has adverse impact; Foster prefers alternative. Foster Testimony, at 13.	President’s February 1997 budget	FY 1998
Cap on “TEFRA limit” and reduced bonus payments for PPS-exempt hospital	Sec. 4414-5, 111 Stat. 405-6  House Bill Sec. 10513; Conf. Rep. Page 364	rehab hospitals  Opposes “arbitrary floors and ceilings on TEFRA limits,” and that “TEFRA hospitals would be expected to bear more of a risk and none of reward for efficiency.” Foster Testimony, at 13-14.	PPAC March 1997; President’s April 1997 position	10/1/97
no formula-driven overpayments (“FDO”) for outpatient departments	Sec. 4521, 111 Stat. 444  House Bill Sec. 10411; Conf. Rep. Page 402	rehab hospitals	President’s February 1997 budget	10/1/97
cap Part B outpatient rehabilitation at \$1,500	Sec. 4641(d), 111 Stat. 457  House Bill Sec. 10412; Conf. Rep. Page 409-410	home health \$100 million writeoff		FY 1999

<b>BBA Provision</b>	<b>BBA Section</b>	<b>Application to HealthSouth – HealthSouth Segment; Foster’s Testimony about Provision’s Impact; and writeoffs</b>	<b>Source of BBA Provision</b>	<b>Effective Dates</b>
can cut most Part B up to 15% each year	Sec. 4316, 111 Stat. 391  House Bill Sec. 10401; Conf. Rep. Page 374-79	home health \$100 million writeoff  \$100 million home health writeoff		8/5/97
PPS for SNF for new SNFs, rates look-back to FY95 SNFs per diem system	Sec. 4432, 111 Stat. 414-6  House Bill Sec. 10401; Conf. Rep. Page 374-379	“How will the need for high cost ancillary services such as rehabilitation therapies, which varies greatly among SNF patients, be fairly addressed?” Foster Testimony, at 18.	President’s February 1997 budget	immediate for new SNFs
rates for outpatient therapy: ’98, minus 10%	Sec. 4541a(2), 111 Stat. 455  House Bill Sec. 10421; Conf. Rep. Page 409-410			in 1998
new (rehab) providers – eliminated exemptions	Sec. 4416, 111 Stat. 409  House Bill Sec. 10518; Conf. Rep. Page 369	rehabilitation hospitals  “it will be hard for these new providers to receive adequate reimbursement ....” Foster Testimony, at 16.	PPAC March 1997	10/1/97
payments and targets for new rehabilitation providers	Sec. 4416, 111 Stat. 407  House Bill Sec. 10515; Conf. Rep. Page 366	rehabilitation hospitals  Defendant Foster opposes floors and ceilings on TEFRA limits as “arbitrary.” Foster Testimony, at 13.	President’s April 1997 position	10/1/97



<b>BBA Provision</b>	<b>BBA Section</b>	<b>Application to HealthSouth – HealthSouth Segment; Foster’s Testimony about Provision’s Impact; and writeoffs</b>	<b>Source of BBA Provision</b>	<b>Effective Dates</b>
home health IPS – “new” (lower) national per-beneficiary limits on rates	Sec. 4602(c), 111 Stat. 467 & HCFA policy  House Bill Sec. 10712; Conf. Rep. Page 430	home health \$100 million writeoff  \$100 million home health writeoff	President’s February 1997 budget	10/1/97
rate reduction for oxygen equipment	Sec. 4552, 111 Stat. 459  House Bill Sec. 10612; Conf. Rep. Page 414	\$310 million writeoff		1998
update freeze for durable medical equipment	Sec. 4551, 111 Stat 457  House Bill Sec. 10611; Conf. Rep. Page 411	\$310 million writeoff		1998

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DECLARATION OF SERVICE BY ELECTRONIC MAIL

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101.

2. That on January 8, 2004, declarant will cause the APPENDICES TO JOINT AMENDED CONSOLIDATED COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS to be electronically served on the parties listed on the attached Service List.

3. That there is a regular communication by e-mail between the place of origin and the places so addressed.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 7th day of January, 2004, at San Diego, California.

  
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