

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

Commission File Number 001-10315

HealthSouth Corporation

(Exact name of Registrant as specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

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

35243
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-Accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes No

The registrant had 89,770,417 shares of common stock outstanding, net of treasury shares, as of July 22, 2016.

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NOTE TO READERS

As used in this report, the terms “HealthSouth,” “we,” “us,” “our,” and the “Company” refer to HealthSouth Corporation and its consolidated subsidiaries, unless otherwise stated or indicated by context. This drafting style is suggested by the Securities and Exchange Commission and is not meant to imply that HealthSouth Corporation, the publicly traded parent company, owns or operates any specific asset, business, or property. The hospitals, operations, and businesses described in this filing are primarily owned and operated by subsidiaries of the parent company. In addition, we use the term “HealthSouth Corporation” to refer to HealthSouth Corporation alone wherever a distinction between HealthSouth Corporation and its subsidiaries is required or aids in the understanding of this filing.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to, among other things, future events, changes to Medicare reimbursement and other healthcare laws and regulations from time to time, our business strategy, our dividend and stock repurchase strategies, our financial plans, our growth plans, our future financial performance, our projected business results, or our projected capital expenditures. In some cases, the reader can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “targets,” “potential,” or “continue” or the negative of these terms or other comparable terminology. Such forward-looking statements are necessarily estimates based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Any forward-looking statement is based on information current as of the date of this report and speaks only as of the date on which such statement is made. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. While it is impossible to identify all such factors, factors that could cause actual results to differ, such as decreases in revenues or increases in costs or charges, materially from those estimated by us include, but are not limited to, the following:

- each of the factors discussed in Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for the year ended December 31, 2015, as well as uncertainties and factors discussed in Part II, Item 1A, *Risk Factors*, and elsewhere in this Form 10-Q, in our other filings from time to time with the SEC, or in materials incorporated therein by reference;
- changes in the rules and regulations of the healthcare industry at either or both of the federal and state levels, including those contemplated now and in the future as part of national healthcare reform and deficit reduction such as the reinstatement of the “75% Rule” or the introduction of site neutral payments with skilled nursing facilities for certain conditions, and related increases in the costs of complying with such changes;
- reductions or delays in, or suspension of, reimbursement for our services by governmental or private payors, including our ability to obtain and retain favorable arrangements with third-party payors;

- delays in the administrative appeals process associated with denied Medicare reimbursement claims, including from various Medicare audit programs, and our exposure to the related delay or reduction in the receipt of the reimbursement amounts for services previously provided;
- the ongoing evolution of the healthcare delivery system, including alternative payment models and value-based purchasing initiatives;
- our ability to comply with extensive and changing healthcare regulations as well as the increased costs of regulatory compliance and compliance monitoring in the healthcare industry, including the costs of investigating and defending asserted claims, whether meritorious or not;
- our ability to attract and retain nurses, therapists, and other healthcare professionals in a highly competitive environment with often severe staffing shortages and the impact on our labor expenses from potential union activity and staffing recruitment and retention;
- competitive pressures in the healthcare industry and our response to those pressures;
- changes in our payor mix or the acuity of our patients;
- our ability to successfully complete and integrate de novo developments, acquisitions, investments, and joint ventures consistent with our growth strategy, including realization of anticipated revenues, cost savings, and productivity improvements arising from the related operations;
- any adverse outcome of various lawsuits, claims, and legal or regulatory proceedings, including the ongoing investigations initiated by the U.S. Department of Health and Human Services, Office of the Inspector General;
- increased costs of defending and insuring against alleged professional liability and other claims and the ability to predict the costs related to such claims;
- potential incidents affecting the proper operation, availability, or security of our information systems;
- new or changing quality reporting requirements impacting operational costs or our Medicare reimbursement;
- the price of our common stock as it affects our willingness and ability to repurchase shares and the financial and accounting effects of any repurchases;
- our ability and willingness to continue to declare and pay dividends on our common stock;
- our ability to successfully integrate Encompass Home Health and Hospice, the inpatient rehabilitation hospitals acquired from Reliant Hospital Partners, LLC, and the home health agency operations of CareSouth Health System, Inc., including the realization of anticipated benefits from those acquisitions and avoidance of unanticipated difficulties, costs, or liabilities that could arise from the acquisitions or integrations;
- our ability to maintain proper local, state and federal licensing where we and our subsidiaries do business;
- our ability to attract and retain key management personnel, including as a part of executive management succession planning; and
- general conditions in the economy and capital markets, including any instability or uncertainty related to governmental impasse over approval of the United States federal budget, an increase to the debt ceiling, or an international sovereign debt crisis.

The cautionary statements referred to in this section also should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward-looking statements, even though our situation may change in the future. Furthermore, we cannot guarantee future results, events, levels of activity, performance, or achievements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In Millions)			
Net operating revenues	\$ 920.7	\$ 764.4	\$ 1,830.5	\$ 1,505.0
Less: Provision for doubtful accounts	(15.4)	(10.9)	(31.9)	(22.5)
Net operating revenues less provision for doubtful accounts	905.3	753.5	1,798.6	1,482.5
Operating expenses:				
Salaries and benefits	486.1	401.8	972.2	786.9
Other operating expenses	121.5	104.2	240.7	207.4
Occupancy costs	17.9	12.5	35.9	24.6
Supplies	34.4	31.7	69.4	63.1
General and administrative expenses	34.4	32.1	66.3	66.7
Depreciation and amortization	42.9	32.7	85.3	64.6
Government, class action, and related settlements	—	—	—	8.0
Professional fees—accounting, tax, and legal	1.7	0.1	1.9	2.3
Total operating expenses	738.9	615.1	1,471.7	1,223.6
Loss on early extinguishment of debt	2.4	18.8	4.8	20.0
Interest expense and amortization of debt discounts and fees	43.4	30.9	88.0	62.7
Other income	(0.7)	(3.0)	(1.3)	(3.5)
Equity in net income of nonconsolidated affiliates	(2.4)	(2.3)	(4.8)	(3.9)
Income from continuing operations before income tax expense	123.7	94.0	240.2	183.6
Provision for income tax expense	42.4	32.2	82.1	62.5
Income from continuing operations	81.3	61.8	158.1	121.1
Loss from discontinued operations, net of tax	(0.1)	(1.6)	(0.2)	(1.9)
Net income	81.2	60.2	157.9	119.2
Less: Net income attributable to noncontrolling interests	(18.6)	(17.3)	(37.3)	(33.8)
Net income attributable to HealthSouth	62.6	42.9	120.6	85.4
Less: Convertible perpetual preferred stock dividends	—	—	—	(1.6)
Net income attributable to HealthSouth common shareholders	\$ 62.6	\$ 42.9	\$ 120.6	\$ 83.8

(Continued)

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
(In Millions, Except Per Share Data)				
Weighted average common shares outstanding:				
Basic	89.3	89.8	89.4	88.4
Diluted	99.4	101.5	99.4	101.3
Earnings per common share:				
Basic earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	\$ 0.70	\$ 0.49	\$ 1.34	\$ 0.96
Discontinued operations	—	(0.02)	—	(0.02)
Net income	\$ 0.70	\$ 0.47	\$ 1.34	\$ 0.94
Diluted earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	\$ 0.65	\$ 0.47	\$ 1.26	\$ 0.91
Discontinued operations	—	(0.02)	—	(0.02)
Net income	\$ 0.65	\$ 0.45	\$ 1.26	\$ 0.89
Cash dividends per common share	\$ 0.23	\$ 0.21	\$ 0.46	\$ 0.42
Amounts attributable to HealthSouth common shareholders:				
Income from continuing operations	\$ 62.7	\$ 44.5	\$ 120.8	\$ 87.3
Loss from discontinued operations, net of tax	(0.1)	(1.6)	(0.2)	(1.9)
Net income attributable to HealthSouth	\$ 62.6	\$ 42.9	\$ 120.6	\$ 85.4

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

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

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
(In Millions)				
COMPREHENSIVE INCOME				
Net income	\$ 81.2	\$ 60.2	\$ 157.9	\$ 119.2
Other comprehensive income, net of tax:				
Net change in unrealized gain on available-for-sale securities:				
Unrealized net holding gain arising during the period	0.4	0.8	0.6	0.9
Reclassifications to net income	—	(0.6)	—	(0.6)
Other comprehensive income before income taxes	0.4	0.2	0.6	0.3
Provision for income tax expense related to other comprehensive income items	(0.2)	(0.1)	(0.3)	(0.1)
Other comprehensive income, net of tax	0.2	0.1	0.3	0.2
Comprehensive income	81.4	60.3	158.2	119.4
Comprehensive income attributable to noncontrolling interests	(18.6)	(17.3)	(37.3)	(33.8)
Comprehensive income attributable to HealthSouth	\$ 62.8	\$ 43.0	\$ 120.9	\$ 85.6

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

HealthSouth Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2016	December 31, 2015
(In Millions)		
Assets		
Current assets:		
Cash and cash equivalents	\$ 70.3	\$ 61.6
Accounts receivable, net of allowance for doubtful accounts of \$48.9 in 2016; \$39.3 in 2015	420.6	410.5
Other current assets	168.6	126.6
Total current assets	659.5	598.7
Property and equipment, net	1,336.9	1,310.1
Goodwill	1,899.7	1,890.1
Intangible assets, net	414.2	419.4
Deferred income tax assets	115.5	190.8
Other long-term assets	206.8	197.0
Total assets ⁽¹⁾	\$ 4,632.6	\$ 4,606.1
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 36.5	\$ 36.8
Accounts payable	67.1	61.6
Accrued expenses and other current liabilities	355.5	328.0
Total current liabilities	459.1	426.4
Long-term debt, net of current portion	3,050.0	3,134.7
Other long-term liabilities	154.1	144.6
	3,663.2	3,705.7
Commitments and contingencies		
Redeemable noncontrolling interests	120.0	121.1
Shareholders' equity:		
HealthSouth shareholders' equity	672.7	611.4
Noncontrolling interests	176.7	167.9
Total shareholders' equity	849.4	779.3
Total liabilities ⁽¹⁾ and shareholders' equity	\$ 4,632.6	\$ 4,606.1

⁽¹⁾ Our consolidated assets as of June 30, 2016 include total assets of variable interest entities of \$255.3 million, which cannot be used by us to settle the obligations of other entities. Our consolidated liabilities as of June 30, 2016 include total liabilities of the variable interest entities of \$54.6 million. See Note 3, *Variable Interest Entities*.

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

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

Six Months Ended June 30, 2016

(In Millions)

HealthSouth Common Shareholders									
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total	
Balance at beginning of period	90.1	\$ 1.1	\$ 2,834.9	\$ (1,696.0)	\$ (1.2)	\$ (527.4)	\$ 167.9	\$ 779.3	
Net income	—	—	—	120.6	—	—	29.8	150.4	
Receipt of treasury stock	(0.4)	—	—	—	—	(9.9)	—	(9.9)	
Dividends declared on common stock	—	—	(41.7)	—	—	—	—	(41.7)	
Stock-based compensation	—	—	11.5	—	—	—	—	11.5	
Stock options exercised	0.2	—	5.4	—	—	(4.7)	—	0.7	
Distributions declared	—	—	—	—	—	—	(29.9)	(29.9)	
Capital contributions from consolidated affiliates	—	—	—	—	—	—	7.6	7.6	
Fair value adjustments to redeemable noncontrolling interests, net of tax	—	—	2.8	—	—	—	—	2.8	
Repurchases of common stock in open market	(0.7)	—	—	—	—	(24.1)	—	(24.1)	
Other	0.6	—	1.7	—	0.3	(0.6)	1.3	2.7	
Balance at end of period	89.8	\$ 1.1	\$ 2,814.6	\$ (1,575.4)	\$ (0.9)	\$ (566.7)	\$ 176.7	\$ 849.4	

Six Months Ended June 30, 2015

(In Millions)

HealthSouth Common Shareholders									
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total	
Balance at beginning of period	87.8	\$ 1.0	\$ 2,810.5	\$ (1,879.1)	\$ (0.5)	\$ (458.7)	\$ 146.3	\$ 619.5	
Net income	—	—	—	85.4	—	—	27.4	112.8	
Conversion of preferred stock	3.3	—	93.2	—	—	—	—	93.2	
Receipt of treasury stock	(0.5)	—	—	—	—	(16.6)	—	(16.6)	
Dividends declared on common stock	—	—	(38.0)	—	—	—	—	(38.0)	
Dividends declared on convertible perpetual preferred stock	—	—	(1.6)	—	—	—	—	(1.6)	
Stock-based compensation	—	—	14.9	—	—	—	—	14.9	
Stock options exercised	0.2	—	5.6	—	—	(3.6)	—	2.0	
Distributions declared	—	—	—	—	—	—	(23.4)	(23.4)	
Capital contributions from consolidated affiliates	—	—	—	—	—	—	8.6	8.6	
Fair value adjustments to redeemable noncontrolling interests, net of tax	—	—	(6.8)	—	—	—	—	(6.8)	
Other	0.7	0.1	0.6	(0.2)	0.2	(0.5)	(0.1)	0.1	
Balance at end of period	91.5	\$ 1.1	\$ 2,878.4	\$ (1,793.9)	\$ (0.3)	\$ (479.4)	\$ 158.8	\$ 764.7	

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

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

	Six Months Ended June 30,	
	2016	2015
(In Millions)		
Cash flows from operating activities:		
Net income	\$ 157.9	\$ 119.2
Loss from discontinued operations, net of tax	0.2	1.9
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	31.9	22.5
Depreciation and amortization	85.3	64.6
Loss on early extinguishment of debt	4.8	20.0
Equity in net income of nonconsolidated affiliates	(4.8)	(3.9)
Distributions from nonconsolidated affiliates	3.0	3.7
Stock-based compensation	13.1	15.6
Deferred tax expense	73.2	55.6
Other	6.9	11.0
Change in assets and liabilities, net of acquisitions—		
Accounts receivable	(59.5)	(62.1)
Other assets	(4.3)	(6.5)
Accounts payable	1.2	1.7
Accrued payroll	9.3	(23.6)
Other liabilities	(1.9)	(10.7)
Premium received on bond issuance	—	8.0
Premium paid on redemption of bonds	(3.9)	(11.8)
Net cash used in operating activities of discontinued operations	(0.5)	(0.3)
Total adjustments	153.8	83.8
Net cash provided by operating activities	311.9	204.9

(Continued)

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

	Six Months Ended June 30,	
	2016	2015
(In Millions)		
Cash flows from investing activities:		
Purchases of property and equipment	(71.4)	(46.3)
Capitalized software costs	(15.2)	(15.2)
Acquisitions of businesses, net of cash acquired	(9.4)	(77.7)
Net change in restricted cash	(11.5)	13.1
Other	2.0	(0.6)
Net cash used in investing activities	(105.5)	(126.7)
Cash flows from financing activities:		
Proceeds from bond issuance	—	700.0
Principal payments on debt, including pre-payments	(112.8)	(546.1)
Borrowings on revolving credit facility	165.0	270.0
Payments on revolving credit facility	(145.0)	(442.0)
Debt amendment and issuance costs	—	(13.9)
Repurchases of common stock, including fees and expenses	(24.1)	—
Dividends paid on common stock	(41.9)	(37.1)
Dividends paid on convertible perpetual preferred stock	—	(3.1)
Distributions paid to noncontrolling interests of consolidated affiliates	(33.6)	(26.2)
Other	(5.3)	(1.0)
Net cash used in financing activities	(197.7)	(99.4)
Increase (decrease) in cash and cash equivalents	8.7	(21.2)
Cash and cash equivalents at beginning of period	61.6	66.7
Cash and cash equivalents at end of period	\$ 70.3	\$ 45.5

Supplemental schedule of noncash financing activity:

Conversion of preferred stock to common stock	\$	—	\$	93.2
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The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

HealthSouth Corporation, incorporated in Delaware in 1984, including its subsidiaries, is one of the nation’s largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through its network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies.

The accompanying unaudited condensed consolidated financial statements of HealthSouth Corporation and Subsidiaries should be read in conjunction with the consolidated financial statements and accompanying notes filed with the United States Securities and Exchange Commission in HealthSouth’s Annual Report on Form 10-K filed on February 24, 2016 (the “2015 Form 10-K”). The unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the SEC applicable to interim financial information. Certain information and note disclosures included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been omitted in these interim statements, as allowed by such SEC rules and regulations. The condensed consolidated balance sheet as of December 31, 2015 has been derived from audited financial statements, but it does not include all disclosures required by GAAP. However, we believe the disclosures are adequate to make the information presented not misleading.

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

See also Note 12 , *Segment Reporting* .

Variable Interest Entities —

Effective January 1, 2016, in connection with our adoption of ASU 2015-02, we updated our evaluation of all jointly held legal entities to determine whether they are now variable interest entities (“VIEs”) under the new guidance. Any entity considered a VIE is evaluated to determine which party is the primary beneficiary and thus should consolidate the VIE. This analysis is complex, involves uncertainties, and requires significant judgment on various matters. In order to determine if we are the primary beneficiary of a VIE, we must determine what activities most significantly impact the economic performance of the entity, whether we have the power to direct those activities, and if our obligation to absorb losses or receive benefits from the VIE could potentially be significant to the VIE.

Net Operating Revenues —

We derived consolidated *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	74.7%	74.5%	75.1%	74.7%
Medicare Advantage	8.1%	7.7%	7.9%	8.0%
Managed care	10.0%	10.1%	9.8%	10.0%
Medicaid	3.2%	3.1%	3.3%	2.9%
Other third-party payors	1.4%	1.8%	1.4%	1.6%
Workers’ compensation	0.7%	0.9%	0.8%	0.9%
Patients	0.5%	0.6%	0.5%	0.6%
Other income	1.4%	1.3%	1.2%	1.3%
Total	100.0%	100.0%	100.0%	100.0%

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Inpatient Rehabilitation Revenues

Our inpatient rehabilitation segment derived its *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	73.1%	72.7%	73.3%	73.1%
Medicare Advantage	7.8%	7.8%	7.7%	8.1%
Managed care	11.5%	11.4%	11.2%	11.3%
Medicaid	2.9%	2.6%	3.0%	2.3%
Other third-party payors	1.7%	2.1%	1.7%	1.9%
Workers' compensation	0.8%	1.1%	1.0%	1.1%
Patients	0.6%	0.7%	0.6%	0.7%
Other income	1.6%	1.6%	1.5%	1.5%
Total	100.0%	100.0%	100.0%	100.0%

Home Health and Hospice Revenues

Our home health and hospice segment derived its *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	82.3%	83.9%	82.9%	83.8%
Medicare Advantage	9.0%	7.2%	8.9%	7.3%
Managed care	3.7%	2.9%	3.2%	3.0%
Medicaid	4.8%	5.8%	4.8%	5.7%
Other third-party payors	—%	0.1%	—%	0.1%
Patients	0.1%	0.1%	0.1%	0.1%
Other income	0.1%	—%	0.1%	—%
Total	100.0%	100.0%	100.0%	100.0%

See Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying the 2015 Form 10-K for our policies related to *Net operating revenues*, *Accounts receivable*, and our *Allowance for doubtful accounts*.

Recent Accounting Pronouncements —

In February 2015, the FASB issued ASU 2015-02, “Consolidations (Topic 810) - Amendments to the Consolidation Analysis,” which provides guidance on evaluating whether a reporting entity should consolidate certain legal entities. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are VIEs. Under this analysis, limited partnerships and other similar entities will be considered a VIE unless the limited partners hold substantive kick-out rights or participating rights. Further, the amendments eliminate the presumption that a general partner should consolidate a limited partnership under the voting interest model, as well as affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships. This standard was effective for annual periods beginning after December 15, 2015 and interim periods within those annual periods. We elected to adopt this guidance using the modified retrospective approach. Our adoption of this guidance resulted in certain limited partnership-like entities that were previously consolidated as voting interest entities to now be consolidated as VIEs, for

HealthSouth Corporation and Subsidiaries
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which additional disclosures are required. Our adoption of ASU 2015-02 did not have a material impact on our financial position, results of operations, or cash flows. See Note 3, *Variable Interest Entities*.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” in order to increase transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the new standard, lessees will recognize a right-of-use asset and a corresponding lease liability for all leases other than leases that meet the definition of a short-term lease. The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in an expense pattern similar to current capital leases. Classification will be based on criteria that are similar to those applied in current lease accounting. This standard will be effective for HealthSouth for the annual reporting period beginning after December 15, 2018. Early adoption is permitted. We continue to review the requirements of this standard and any potential impact it may have on our financial position, results of operations, or cash flows.

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting (Topic 718),” to simplify various aspects of share-based payment accounting and presentation. The new standard requires entities to record all of the tax effects related to share-based payments at settlement (or expiration) through the income statement. This will require us to reclassify tax benefits in excess of compensation cost (“windfalls”) and tax deficiencies (“shortfalls”) to the extent of previous windfalls from *Capital in excess of par value* to *Provision for income tax expense*. This change is required to be applied prospectively to all excess tax benefits and tax deficiencies resulting from settlements after the date of adoption of the ASU. The standard eliminates the requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis, with a cumulative-effect adjustment to opening retained earnings. In addition, all income tax-related cash flows resulting from share-based payments are required to be reported as operating activities on the statement of cash flows as opposed to the current presentation as an inflow from financing activities and an outflow from operating activities. Either prospective or retrospective transition of this provision is permitted. Finally, the standard clarifies that all cash payments made to taxing authorities on the employees’ behalf for withheld shares should be presented as financing activities on the statement of cash flows. This change will be applied retrospectively. For HealthSouth, this guidance is effective for annual reporting periods beginning after December 15, 2016 and interim periods within that reporting period. Early adoption is permitted, with any adjustments reflected as of the beginning of the fiscal year of adoption. We continue to review the requirements of this standard and any potential impact it may have on our financial position, results of operations, or cash flows.

2. Business Combinations

Inpatient Rehabilitation

In February 2016, we acquired 50% of the inpatient rehabilitation hospital at CHI St. Vincent Hot Springs (“Hot Springs”), a 20 -bed inpatient rehabilitation hospital in Hot Springs, Arkansas, through a joint venture with St. Vincent Community Health Services, Inc. The acquisition, which was funded through a contribution to the consolidated joint venture, was not material to our financial position, results of operations, or cash flows. The Hot Springs transaction was made to enhance our position and ability to provide inpatient rehabilitative services to patients in Hot Springs and its surrounding areas. As a result of this transaction, *Goodwill* increased by \$1.8 million, none of which is deductible for federal income tax purposes. The goodwill reflects our expectations of our ability to gain access to and penetrate the acquired hospital’s historical patient base and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in this market.

We accounted for this transaction under the acquisition method of accounting and reported the results of operations of the acquired hospital from its respective date of acquisition. Assets acquired and liabilities assumed, if any, were recorded at their estimated fair values as of the respective acquisition date. The fair value of the identifiable intangible asset was based on valuations using the income approach. The income approach is based on management’s estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill.

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The fair value of the assets acquired at the acquisition date were as follows (in millions):

Property and equipment	\$ 5.1
Identifiable intangible asset:	
Trade name (useful life of 20 years)	0.2
Goodwill	1.8
Total assets acquired	\$ 7.1

Information regarding the net cash paid for all inpatient rehabilitation acquisitions during each period presented is as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Fair value of assets acquired	\$ —	\$ 62.8	\$ 5.3	\$ 62.8
Goodwill	—	0.7	1.8	0.7
Fair value of liabilities assumed	—	(2.7)	—	(2.7)
Fair value of noncontrolling interest owned by joint venture partner	—	(4.2)	(7.1)	(4.2)
Net cash paid for acquisition	\$ —	\$ 56.6	\$ —	\$ 56.6

Home Health and Hospice

On May 1, 2016, we acquired Home Health Agency of Georgia, LLC (“Camellia”), a home health and hospice provider with two home health locations and two hospice locations in the Greater Atlanta area. The acquisition, which was funded using cash on hand, was not material to our financial position, results of operations, or cash flows. As a result of this transaction, *Goodwill* increased by \$8.1 million, all of which is deductible for federal income tax purposes. The Camellia acquisition was made to enhance our position and ability to provide post-acute healthcare services to patients in the applicable geographic area. The goodwill reflects our expectations of our ability to utilize Camellia’s mobile workforce and established relationships within the community and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in this market.

We accounted for this transaction under the acquisition method of accounting and reported the results of operations of Camellia from the date of acquisition. Assets acquired and liabilities assumed were recorded at their estimated fair values as of the acquisition date. The fair values of identifiable intangible assets were based on valuations using the cost and income approaches. The cost approach is based on amounts that would be required to replace the asset (i.e., replacement cost). The income approach is based on management’s estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill.

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The fair value of the assets acquired and liabilities assumed at the acquisition date were as follows (in millions):

Identifiable intangible asset:	
Noncompete agreements (useful lives of 5 years)	\$ 0.1
Certificate of need (useful life of 10 years)	1.0
Licenses (useful lives of 10 years)	0.3
Goodwill	8.1
Total assets acquired	9.5
Total liabilities assumed	(0.1)
Net assets acquired	<u>\$ 9.4</u>

Information regarding the net cash paid for home health and hospice acquisitions during each period presented is as follows (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Fair value of assets acquired	\$ 1.4	\$ 7.1	\$ 1.4	\$ 8.4
Goodwill	8.1	6.8	8.1	12.8
Fair value of liabilities assumed	(0.1)	(0.1)	(0.1)	(0.1)
Net cash paid for acquisitions	<u>\$ 9.4</u>	<u>\$ 13.8</u>	<u>\$ 9.4</u>	<u>\$ 21.1</u>

Pro Forma Results of Operations

The following table summarizes the results of operations of Hot Springs and Camellia from their respective dates of acquisition included in our consolidated results of operations and the unaudited pro forma results of operations of the combined entity had the date of the acquisitions been January 1, 2015 (in millions):

	<u>Net Operating Revenues</u>		<u>Net Income Attributable to HealthSouth</u>	
	<u>\$</u>	<u></u>	<u>\$</u>	<u></u>
Acquired entities only: Actual from acquisition date to June 30, 2016	\$	3.0	\$	(0.8)
Combined entity: Supplemental pro forma from 04/01/2016-06/30/2016		921.2		62.6
Combined entity: Supplemental pro forma from 04/01/2015-06/30/2015		766.9		43.0
Combined entity: Supplemental pro forma from 01/01/2016-06/30/2016		1,833.0		120.7
Combined entity: Supplemental pro forma from 01/01/2015-06/30/2015		1,510.1		85.8

See Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K for information regarding acquisitions completed in 2015.

3. Variable Interest Entities

As of June 30, 2016, we consolidated ten limited partnership-like entities that are VIEs and of which we are the primary beneficiary. All ten of these entities were also consolidated as of December 31, 2015. Our ownership percentages in these entities range from 6.8% to 99.5%. Through partnership and management agreements with or governing each of these entities, we manage all of these entities and handle all day-to-day operating decisions. Accordingly, we have the decision making power over the activities that most significantly impact the economic performance of our VIEs and an obligation to absorb losses or receive benefits from the VIE that could potentially be significant to the VIE. These decisions and significant

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activities include, but are not limited to, marketing efforts, oversight of patient admissions, medical training, nurse and therapist scheduling, provision of healthcare services, billing, collections and creation and maintenance of medical records. The terms of the agreements governing each of our VIEs prohibit us from using the assets of each VIE to satisfy the obligations of other entities.

The carrying amounts and classifications of the consolidated VIEs' assets and liabilities, which are included in our consolidated balance sheet, are as follows (in millions):

		June 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$	1.5
Accounts receivable, net of allowance for doubtful accounts		31.4
Other current assets		6.7
Total current assets		39.6
Property and equipment, net		132.6
Goodwill		73.5
Intangible assets, net		8.6
Other long-term assets		1.0
Total assets	\$	255.3
Liabilities		
Current liabilities:		
Current portion of long-term debt	\$	1.4
Accounts payable		8.5
Accrued expenses and other current liabilities		14.1
Total current liabilities		24.0
Long-term debt, net of current portion		30.6
Total liabilities	\$	54.6

4. Investments in and Advances to Nonconsolidated Affiliates

As of June 30, 2016 and December 31, 2015, we had \$13.6 million and \$11.7 million, respectively, of investments in and advances to nonconsolidated affiliates included in *Other long-term assets* in our condensed consolidated balance sheets. Investments in and advances to nonconsolidated affiliates represent our investments in seven partially owned subsidiaries, of which six are general or limited partnerships, limited liability companies, or joint ventures in which HealthSouth or one of its subsidiaries is a general or limited partner, managing member, member, or venturer, as applicable. We do not control these affiliates but have the ability to exercise significant influence over the operating and financial policies of certain of these affiliates. Our ownership percentages in these affiliates range from approximately 1% to 60%. We account for these investments using the cost and equity methods of accounting.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net operating revenues	\$ 10.9	\$ 8.9	\$ 22.1	\$ 17.1
Operating expenses	(5.8)	(3.8)	(12.1)	(7.7)
Income from continuing operations, net of tax	5.0	4.8	10.0	8.7
Net income	5.0	4.8	10.0	8.7

5. Long-term Debt

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

	June 30, 2016	December 31, 2015
Credit Agreement—		
Advances under revolving credit facility	\$ 150.0	\$ 130.0
Term loan facilities	432.3	443.3
Bonds payable—		
7.75% Senior Notes due 2022	75.3	174.3
5.125% Senior Notes due 2023	294.9	294.6
5.75% Senior Notes due 2024	1,192.9	1,192.6
5.75% Senior Notes due 2025	343.6	343.4
2.00% Convertible Senior Subordinated Notes due 2043	270.7	265.9
Other notes payable	43.3	39.2
Capital lease obligations	283.5	288.2
	3,086.5	3,171.5
Less: Current portion	(36.5)	(36.8)
Long-term debt, net of current portion	\$ 3,050.0	\$ 3,134.7

The following chart shows scheduled principal payments due on long-term debt for the next five years and thereafter (in millions):

	Face Amount	Net Amount
July 1 through December 31, 2016	\$ 18.2	\$ 18.2
2017	36.8	36.8
2018	37.2	37.2
2019	40.1	40.0
2020	834.2	783.5
2021	10.7	10.7
Thereafter	2,179.4	2,160.1
Total	\$ 3,156.6	\$ 3,086.5

On February 23, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of \$50 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022 (the “2022 Notes”). On March 24, 2016, we

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completed this redemption using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of the 2022 Notes, this optional redemption was made at a price of 103.875% , which resulted in a total cash outlay of approximately \$52 million . As a result of this redemption, we recorded a \$2.4 million *Loss on early extinguishment of debt* in the first quarter of 2016.

On April 6, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of an additional \$50 million of the outstanding principal amount of the 2022 Notes. On May 6, 2016, we completed this redemption using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of the 2022 Notes, this optional redemption was also made at a price of 103.875% , which resulted in a total cash outlay of approximately \$52 million . As a result of this redemption, we recorded a \$2.4 million *Loss on early extinguishment of debt* in the second quarter of 2016.

On July 28, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of the remaining outstanding principal balance of \$76.0 million of the 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption will be made at a price of 102.583% , which will result in a total cash outlay of approximately \$78 million when the transaction closes on September 15, 2016 . We plan to use cash on hand and capacity under our revolving credit facility to fund the redemption. As a result of this redemption, we expect to record an approximate \$3 million *Loss on early extinguishment of debt* in the third quarter of 2016.

In February 2016, we entered into a development/lease agreement with CR HQ, LLC (the “Developer”) to construct our new corporate headquarters in Birmingham, Alabama. Under the terms of this agreement, the Developer is responsible for all costs of constructing the new facility ‘shell’ which will then be leased to us for an initial term of 15 years with four , five -year renewal options. The lease is expected to commence in the first half of 2018. We are responsible for the costs associated with improvements to the interior of the building. Due to the nature and extent of the tenant improvements we will be making to the new corporate headquarters and certain provisions of the development/lease agreement, we are deemed to be the accounting owner of the new corporate headquarters during the construction period. Construction commenced in the second quarter of 2016. Accordingly, we increased *Property and equipment, net* by \$5.8 million , based on the construction costs incurred to date by the Developer, and recorded a corresponding noncurrent financing obligation liability of \$5.8 million in *Long-term debt, net of current portion* within our condensed consolidated balance sheet as of June 30, 2016. The total financing obligation associated with the Developer’s costs to construct the new corporate headquarters is estimated at \$56 million . The amounts recorded for construction costs and the corresponding liability are non-cash activities for purposes of our condensed consolidated statement of cash flows.

For additional information regarding our indebtedness, see Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

6. Redeemable Noncontrolling Interests

The following is a summary of the activity related to our *Redeemable noncontrolling interests* during the six months ended June 30, 2016 and 2015 (in millions):

	Six Months Ended June 30,	
	2016	2015
Balance at beginning of period	\$ 121.1	\$ 84.7
Net income attributable to noncontrolling interests	7.5	6.4
Distributions declared	(4.3)	(4.0)
Change in fair value	(4.3)	11.4
Balance at end of period	<u>\$ 120.0</u>	<u>\$ 98.5</u>

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The following table reconciles the net income attributable to nonredeemable *Noncontrolling interests*, as recorded in the shareholders' equity section of the condensed consolidated balance sheets, and the net income attributable to *Redeemable noncontrolling interests*, as recorded in the mezzanine section of the condensed consolidated balance sheets, to the *Net income attributable to noncontrolling interests* presented in the condensed consolidated statements of operations for the three and six months ended June 30, 2016 and 2015 (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income attributable to nonredeemable noncontrolling interests	\$ 15.0	\$ 13.8	\$ 29.8	\$ 27.4
Net income attributable to redeemable noncontrolling interests	3.6	3.5	7.5	6.4
Net income attributable to noncontrolling interests	\$ 18.6	\$ 17.3	\$ 37.3	\$ 33.8

7. Fair Value Measurements

Our financial assets and liabilities that are measured at fair value on a recurring basis are as follows (in millions):

<u>As of June 30, 2016</u>	Fair Value	Fair Value Measurements at Reporting Date Using				Valuation Technique ⁽¹⁾
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Other current assets:						
Current portion of restricted marketable securities	\$ 27.4	\$ —	\$ 27.4	\$ —		M
Other long-term assets:						
Restricted marketable securities	29.9	—	29.9	—		M
Redeemable noncontrolling interests	120.0	—	—	120.0		I
<u>As of December 31, 2015</u>						
Other current assets:						
Current portion of restricted marketable securities	\$ 16.1	\$ —	\$ 16.1	\$ —		M
Other long-term assets:						
Restricted marketable securities	40.1	—	40.1	—		M
Redeemable noncontrolling interests	121.1	—	—	121.1		I

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

The fair values of our financial assets and liabilities are determined as follows:

- *Restricted marketable securities* - The fair values of our available-for-sale restricted marketable securities are determined based on quoted market prices in active markets or quoted prices, dealer quotations, or alternative pricing sources supported by observable inputs in markets that are not considered to be active.
- *Redeemable noncontrolling interests* - The fair value of the *Redeemable noncontrolling interest* related to our home health segment is determined using the product of a twelve-month specified performance measure and a specified median market price multiple based on a basket of public health companies. To determine the fair value of the *Redeemable noncontrolling interests* in our joint venture hospitals, we use the applicable hospitals'

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projected operating results and cash flows discounted using a rate that reflects market participant assumptions for the applicable facilities. The projected operating results use management's best estimates of economic and market conditions over the forecasted periods including assumptions for pricing and volume, operating expenses, and capital expenditures. See also Note 6, *Redeemable Noncontrolling Interests*.

In addition to assets and liabilities recorded at fair value on a recurring basis, we are also required to record assets and liabilities at fair value on a nonrecurring basis. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges or similar adjustments made to the carrying value of the applicable assets. During the three and six months ended June 30, 2016 and June 30, 2015, we did not record any gains or losses related to our nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis as part of our continuing operations.

As discussed in Note 1, *Summary of Significant Accounting Policies*, "Fair Value Measurements," to the consolidated financial statements accompanying the 2015 Form 10-K, the carrying value equals fair value for our financial instruments that are not included in the table below and are classified as current in our condensed consolidated balance sheets. The carrying amounts and estimated fair values for all of our other financial instruments are presented in the following table (in millions):

	As of June 30, 2016		As of December 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term debt:				
Advances under revolving credit facility	\$ 150.0	\$ 150.0	\$ 130.0	\$ 130.0
Term loan facilities	432.3	433.8	443.3	445.0
7.75% Senior Notes due 2022	75.3	79.3	174.3	183.7
5.125% Senior Notes due 2023	294.9	297.8	294.6	288.0
5.75% Senior Notes due 2024	1,192.9	1,215.8	1,192.6	1,146.0
5.75% Senior Notes due 2025	343.6	350.0	343.4	332.5
2.00% Convertible Senior Subordinated Notes due 2043	270.7	372.4	265.9	345.0
Other notes payable	43.3	43.3	39.2	39.2
Financial commitments:				
Letters of credit	—	35.0	—	34.2

Fair values for our long-term debt and financial commitments are determined using inputs, including quoted prices in nonactive markets, that are observable either directly or indirectly, or *Level 2* inputs within the fair value hierarchy. See Note 1, *Summary of Significant Accounting Policies*, "Fair Value Measurements," to the consolidated financial statements accompanying the 2015 Form 10-K.

8. Share-Based Payments

In February and May 2016, we issued a total of 0.8 million restricted stock awards to members of our management team and our board of directors. Approximately 0.2 million of these awards contain only a service condition, while the remainder contain both a service and a performance or market condition. For the awards that include a performance or market condition, the number of shares that will ultimately be granted to employees may vary based on the Company's performance during the applicable two-year performance measurement period. Additionally, in February 2016, we granted 0.1 million stock options to members of our management team. The fair value of these awards and options was determined using the policies described in Note 1, *Summary of Significant Accounting Policies*, and Note 13, *Share-Based Payments*, to the consolidated financial statements accompanying the 2015 Form 10-K.

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9. Income Taxes

Our *Provision for income tax expense* of \$42.4 million and \$82.1 million for the three and six months ended June 30, 2016 , respectively, primarily resulted from the application of our estimated effective blended federal and state income tax rate. Our *Provision for income tax expense* of \$32.2 million and \$62.5 million for the three and six months ended June 30, 2015 , respectively, primarily resulted from the application of our estimated effective blended federal and state income tax rate.

The \$115.5 million of net deferred tax assets included in the accompanying condensed consolidated balance sheet as of June 30, 2016 reflects management’s assessment it is more likely than not we will be able to generate sufficient future taxable income to utilize those deferred tax assets based on our current estimates and assumptions. As of June 30, 2016 , we maintained a valuation allowance of \$27.6 million due to uncertainties regarding our ability to utilize a portion of our state net operating losses (“NOLs”) and other credits before they expire. The amount of the valuation allowance has been determined for each tax jurisdiction based on the weight of all available evidence including management’s estimates of taxable income for each jurisdiction in which we operate over the periods in which the related deferred tax assets will be recoverable. It is possible we may be required to increase or decrease our valuation allowance at some future time if our forecast of future earnings varies from actual results on a consolidated basis or in the applicable state tax jurisdictions, or if the timing of future tax deductions differs from our expectations.

We have significant federal and state NOLs that expire in various amounts at varying times through 2031. Our reported federal NOL of \$25.1 million (approximately \$72 million on a gross basis) as of June 30, 2016 excludes \$15.5 million related to operating loss carryforwards resulting from excess tax benefits related to share-based awards, the tax benefits of which, when recognized, will be accounted for as a credit to *Capital in excess of par value* when they reduce taxes payable. At June 30, 2016 , we had unused federal tax credit carryforwards of \$15.8 million . These credit carryforwards expire in various amounts at various times through 2036.

Total remaining gross unrecognized tax benefits were \$2.8 million and \$2.9 million as of June 30, 2016 and December 31, 2015 , respectively, all of which would affect our effective tax rate if recognized. A reconciliation of the beginning and ending liability for unrecognized tax benefits is as follows (in millions):

	Gross Unrecognized Income Tax Benefits	
Balance at December 31, 2015	\$	2.9
Gross amount of increases in unrecognized tax benefits related to prior periods		0.3
Gross amount of decreases in unrecognized tax benefits related to prior periods		(0.4)
Gross amount of increases in unrecognized tax benefits related to current periods		0.1
Gross amount of decreases in unrecognized tax benefits related to current periods		(0.1)
Balance at June 30, 2016	\$	2.8

Our continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. Interest recorded as part of our income tax provision during the three and six months ended June 30, 2016 and 2015 was not material. Accrued interest income related to income taxes as of June 30, 2016 and December 31, 2015 was not material.

In December 2014, we signed an agreement with the IRS to begin participating in their Compliance Assurance Process, a program in which we and the IRS endeavor to agree on the treatment of significant tax positions prior to the filing of our federal income tax return. We signed a new agreement in December 2015 for the 2016 tax year. As a result of these agreements, the IRS surveyed our 2013, 2012, and 2011 federal income tax returns and will examine our 2015 and 2016 returns when filed. Our 2014 federal income tax return has been filed, and the IRS has not indicated its intent to examine or survey this return. We have settled federal income tax examinations with the IRS for all tax years through 2012. Our state income tax

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returns are also periodically examined by various regulatory taxing authorities. We are currently under audit by six states for tax years ranging from 2007 through 2014.

For the tax years that remain open under the applicable statutes of limitation, amounts related to unrecognized tax benefits have been considered by management in its estimate of our potential net recovery of prior years' income taxes. Based on discussions with taxing authorities, we anticipate \$0.4 million to \$2.6 million of our unrecognized tax benefits may be released within the next 12 months.

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10. Earnings per Common Share

The following table sets forth the computation of basic and diluted earnings per common share (in millions, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic:				
<i>Numerator:</i>				
Income from continuing operations	\$ 81.3	\$ 61.8	\$ 158.1	\$ 121.1
Less: Net income attributable to noncontrolling interests included in continuing operations	(18.6)	(17.3)	(37.3)	(33.8)
Less: Income allocated to participating securities	(0.2)	(0.3)	(0.4)	(0.6)
Less: Convertible perpetual preferred stock dividends	—	—	—	(1.6)
Income from continuing operations attributable to HealthSouth common shareholders	62.5	44.2	120.4	85.1
Loss from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.1)	(1.6)	(0.2)	(1.9)
Net income attributable to HealthSouth common shareholders	<u>\$ 62.4</u>	<u>\$ 42.6</u>	<u>\$ 120.2</u>	<u>\$ 83.2</u>
<i>Denominator:</i>				
Basic weighted average common shares outstanding	<u>89.3</u>	<u>89.8</u>	<u>89.4</u>	<u>88.4</u>
<i>Basic earnings per share attributable to HealthSouth common shareholders:</i>				
Continuing operations	\$ 0.70	\$ 0.49	\$ 1.34	\$ 0.96
Discontinued operations	—	(0.02)	—	(0.02)
Net income	<u>\$ 0.70</u>	<u>\$ 0.47</u>	<u>\$ 1.34</u>	<u>\$ 0.94</u>
Diluted:				
<i>Numerator:</i>				
Income from continuing operations	\$ 81.3	\$ 61.8	\$ 158.1	\$ 121.1
Less: Net income attributable to noncontrolling interests included in continuing operations	(18.6)	(17.3)	(37.3)	(33.8)
Add: Interest on convertible debt, net of tax	2.4	2.3	4.8	4.6
Income from continuing operations attributable to HealthSouth common shareholders	65.1	46.8	125.6	91.9
Loss from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.1)	(1.6)	(0.2)	(1.9)
Net income attributable to HealthSouth common shareholders	<u>\$ 65.0</u>	<u>\$ 45.2</u>	<u>\$ 125.4</u>	<u>\$ 90.0</u>
<i>Denominator:</i>				
Diluted weighted average common shares outstanding	<u>99.4</u>	<u>101.5</u>	<u>99.4</u>	<u>101.3</u>
<i>Diluted earnings per share attributable to HealthSouth common shareholders:</i>				
Continuing operations	\$ 0.65	\$ 0.47	\$ 1.26	\$ 0.91
Discontinued operations	—	(0.02)	—	(0.02)
Net income	<u>\$ 0.65</u>	<u>\$ 0.45</u>	<u>\$ 1.26</u>	<u>\$ 0.89</u>

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The following table sets forth the reconciliation between basic weighted average common shares outstanding and diluted weighted average common shares outstanding (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic weighted average common shares outstanding	89.3	89.8	89.4	88.4
Convertible perpetual preferred stock	—	0.8	—	2.0
Convertible senior subordinated notes	8.5	8.2	8.5	8.2
Restricted stock awards, dilutive stock options, restricted stock units, and common stock warrants	1.6	2.7	1.5	2.7
Diluted weighted average common shares outstanding	99.4	101.5	99.4	101.3

In October 2015, February 2016, and May 2016, our board of directors declared cash dividends of \$0.23 per share that were paid in January 2016, April 2016, and July 2016, respectively. On July 21, 2016, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of \$0.24 per share, payable on October 17, 2016 to stockholders of record on October 3, 2016. As of June 30, 2016 and December 31, 2015, accrued common stock dividends of \$21.3 million were included in *Accrued expenses and other current liabilities* in our condensed consolidated balance sheets. Future dividend payments are subject to declaration by our board of directors.

On April 22, 2015, we delivered notice of the exercise of our rights to force conversion of all outstanding shares of our *Convertible perpetual preferred stock* (par value of \$0.10 per share and liquidation preference of \$1,000 per share) pursuant to the underlying certificate of designations. The effective date of the conversion was April 23, 2015. On that date, each share of preferred stock automatically converted into 33.9905 shares of our common stock (par value of \$0.01 per share). We completed the forced conversion by issuing and delivering in the aggregate 3,271,415 shares of our common stock to the registered holders of the 96,245 shares of the preferred stock outstanding and paying cash in lieu of fractional shares due to those holders.

The indenture underlying our convertible notes includes antidilutive protection that requires adjustments to the number of shares of common stock issuable upon conversion and the exercise price for common stock upon the occurrence of certain events, including payment of cash dividends on our common stock after a *de minimis* threshold. At issuance, the convertible notes had a conversion price of \$39.65 per share, which was equal to an initial conversion rate of 25.2194 shares per \$1,000 principal amount of the convertible notes. The payment of dividends on our common stock has triggered and will continue to trigger, from time to time, the antidilutive adjustment provisions of the convertible notes. The current conversion price of the convertible notes is \$37.59 per share, and the conversion rate is 26.6011 for each \$1,000 principal amount of the convertible notes.

See Note 8, *Long-term Debt*, Note 10, *Convertible Perpetual Preferred Stock*, and Note 16, *Earnings per Common Share*, to the consolidated financial statements accompanying the 2015 Form 10-K for additional information related to our convertible notes, common stock, common stock warrants, and convertible perpetual preferred stock.

11. Contingencies and Other Commitments

We operate in a highly regulated and litigious industry. As a result, various lawsuits, claims, and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. The resolution of any such lawsuits, claims, or legal and regulatory proceedings could materially and adversely affect our financial position, results of operations, and cash flows in a given period.

Nichols Litigation—

We have been named as a defendant in a lawsuit filed March 28, 2003 by several individual stockholders in the Circuit Court of Jefferson County, Alabama, captioned *Nichols v. HealthSouth Corp.* The plaintiffs allege that we, some of our former officers, and our former investment bank engaged in a scheme to overstate and misrepresent our earnings and financial position. The plaintiffs are seeking compensatory and punitive damages. This case was stayed in the Circuit Court on August 8, 2005.

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The plaintiffs filed an amended complaint on November 9, 2010 to which we responded with a motion to dismiss filed on December 22, 2010. During a hearing on February 24, 2012, plaintiffs' counsel indicated his intent to dismiss certain claims against us. Instead, on March 9, 2012, the plaintiffs amended their complaint to include additional securities fraud claims against HealthSouth and add several former officers to the lawsuit. On September 12, 2012, the plaintiffs further amended their complaint to request certification as a class action. One of those named officers has repeatedly attempted to remove the case to federal district court, most recently on December 11, 2012. We filed our latest motion to remand the case back to state court on January 10, 2013. On September 27, 2013, the federal court remanded the case back to state court. On November 25, 2014, the plaintiffs filed another amended complaint to assert new allegations relating to the time period of 1997 to 2002. On December 10, 2014, we filed a motion to dismiss on the grounds the plaintiffs lack standing because their claims are derivative in nature, and the claims are time-barred by the statute of limitations. On May 26, 2016, the court granted our motion to dismiss. The plaintiffs appealed the dismissal of the case to the Supreme Court of Alabama on June 28, 2016. The supreme court has not yet scheduled a hearing on the appeal.

We intend to vigorously defend ourselves in this case. Based on the stage of litigation, review of the current facts and circumstances as we understand them, the nature of the underlying claim, the results of the proceedings to date, and the nature and scope of the defense we continue to mount, we do not believe an adverse judgment or settlement is probable in this matter, and it is also not possible to estimate the amount of loss, if any, or range of possible loss that might result from an adverse judgment or settlement of this case.

Other Litigation—

One of our hospital subsidiaries was named as a defendant in a lawsuit filed August 12, 2013 by an individual in the Circuit Court of Etowah County, Alabama, captioned *Honts v. HealthSouth Rehabilitation Hospital of Gadsden, LLC*. The plaintiff alleged that her mother, who died more than three months after being discharged from our hospital, received an unprescribed opiate medication at the hospital. We deny the patient received any such medication, accounted for all the opiates at the hospital and argued the plaintiff established no causal liability between the actions of our staff and her mother's death. The plaintiff sought recovery for punitive damages. On May 18, 2016, the jury in this case returned a verdict in favor of the plaintiff for \$20.0 million. On June 17, 2016, we filed a renewed motion for judgment as a matter of law or, in the alternative, a motion for new trial or, in the further alternative, a motion seeking reduction of the damages awarded (collectively, the "post-judgment motions"). Those post-judgment motions remain pending before the trial court. We intend to vigorously defend ourselves in this case through those motions and by appeal, if necessary. Although we continue to believe in the merit of our defenses and counterarguments, we have recorded a liability of \$21.0 million (including \$1.0 million in fees and expenses) in *Accrued expenses and other liabilities* in our condensed consolidated balance sheet as of June 30, 2016 with a corresponding receivable of \$ 15.0 million in *Other current assets* for the portion of the liability we would expect to be covered through our excess insurance coverages, resulting in a net charge of an additional \$5.7 million to *Other operating expenses* in our condensed consolidated statements of operations for the three and six months ended June 30, 2016. The \$6.0 million portion of this liability would be a covered claim through our captive insurance subsidiary, HCS, Ltd. As a result of the verdict, we posted a bond in the amount of the judgment pending resolution of our post-judgment motions, and if necessary, any appeals.

Governmental Inquiries and Investigations—

On June 24, 2011, we received a document subpoena addressed to HealthSouth Hospital of Houston, a long-term acute care hospital ("LTCH") we closed in August 2011, and issued from the Dallas, Texas office of the HHS-OIG. The subpoena stated it was in connection with an investigation of possible false or otherwise improper claims submitted to Medicare and Medicaid and requested documents and materials relating to patient admissions, length of stay, and discharge matters at this closed LTCH. We furnished the documents requested and have heard nothing from the HHS-OIG since December 2012.

On March 4, 2013, we received document subpoenas from an office of the HHS-OIG addressed to four of our hospitals. Those subpoenas also requested complete copies of medical records for 100 patients treated at each of those hospitals between September 2008 and June 2012. The investigation is being conducted by the United States Department of Justice (the "DOJ"). On April 24, 2014, we received document subpoenas relating to an additional seven of our hospitals. The new subpoenas reference substantially similar investigation subject matter as the original subpoenas and request materials from the period January 2008 through December 2013. Two of the four hospitals addressed in the original set of subpoenas have received supplemental subpoenas to cover this new time period. The most recent subpoenas do not include requests for specific

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patient files. However, in February 2015, the DOJ requested the voluntary production of the medical records of an additional 70 patients, some of whom were treated in hospitals not subject to the subpoenas, and we provided these records.

All of the subpoenas are in connection with an investigation of alleged improper or fraudulent claims submitted to Medicare and Medicaid and request documents and materials relating to practices, procedures, protocols and policies, of certain pre- and post-admissions activities at these hospitals including, among other things, marketing functions, pre-admission screening, post-admission physician evaluations, patient assessment instruments, individualized patient plans of care, and compliance with the Medicare 60% rule. Under the Medicare rule commonly referred to as the “60% rule,” an inpatient rehabilitation hospital must treat 60% or more of its patients from at least one of a specified list of medical conditions in order to be reimbursed at the inpatient rehabilitation hospital payment rates, rather than at the lower acute care hospital payment rates.

We are cooperating fully with the DOJ in connection with these subpoenas and are currently unable to predict the timing or outcome of the related investigations.

Other Matters—

The False Claims Act, 18 U.S.C. § 287, allows private citizens, called “relators,” to institute civil proceedings alleging violations of the False Claims Act. These *qui tam* cases are generally sealed by the court at the time of filing. The only parties typically privy to the information contained in the complaint are the relator, the federal government, and the presiding court. It is possible that *qui tam* lawsuits have been filed against us and that those suits remain under seal or that we are unaware of such filings or prevented by existing law, court order, or agreement with the government from discussing or disclosing the filing of such suits. We may be subject to liability under one or more undisclosed *qui tam* cases brought pursuant to the False Claims Act.

It is our obligation as a participant in Medicare and other federal healthcare programs to routinely conduct audits and reviews of the accuracy of our billing systems and other regulatory compliance matters. As a result of these reviews, we have made, and will continue to make, disclosures to the HHS-OIG and the United States Centers for Medicare and Medicaid Services relating to amounts we suspect represent over-payments from these programs, whether due to inaccurate billing or otherwise. Some of these disclosures have resulted in, or may result in, HealthSouth refunding amounts to Medicare or other federal healthcare programs.

12. Segment Reporting

Our internal financial reporting and management structure is focused on the major types of services provided by HealthSouth. We manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. These reportable operating segments are consistent with information used by our chief executive officer, who is our chief operating decision maker, to assess performance and allocate resources. The following is a brief description of our reportable segments:

- *Inpatient Rehabilitation* - Our national network of inpatient rehabilitation hospitals stretches across 29 states and Puerto Rico, with a concentration of hospitals in the eastern half of the United States and Texas. As of June 30, 2016, we operate 121 inpatient rehabilitation hospitals, including one hospital that operates as a joint venture which we account for using the equity method of accounting. In addition, we manage four inpatient rehabilitation units through management contracts. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. Our inpatient rehabilitation hospitals provide a higher level of rehabilitative care to patients who are recovering from conditions such as stroke and other neurological disorders, cardiac and pulmonary conditions, brain and spinal cord injuries, complex orthopedic conditions, and amputations.
- *Home Health and Hospice* - As of June 30, 2016, we provide home health and hospice services in 218 locations across 24 states. Two of these agencies operate as joint ventures which we account for using the equity method of accounting. Our home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational, and speech therapy, medical social work, and home health aide services. We also provide specialized home care services in Texas and Kansas for pediatric patients with severe medical conditions. Our hospice services primarily

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include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual support.

The accounting policies of our reportable segments are the same as those described in Note 1, *Basis of Presentation*, "Variable Interest Entities," to these condensed consolidated financial statements and Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying the 2015 Form 10-K. All revenues for our services are generated through external customers. See Note 1, *Basis of Presentation*, "Net Operating Revenues," for the payor composition of our revenues. No corporate overhead is allocated to either of our reportable segments. Our chief operating decision maker evaluates the performance of our segments and allocates resources to them based on adjusted earnings before interest, taxes, depreciation, and amortization ("Segment Adjusted EBITDA").

Selected financial information for our reportable segments is as follows (in millions):

	Inpatient Rehabilitation				Home Health and Hospice			
	Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015	2016	2015	2016	2015
Net operating revenues	\$ 752.6	\$ 645.3	\$ 1,501.8	\$ 1,275.6	\$ 168.1	\$ 119.1	\$ 328.7	\$ 229.4
Less: Provision for doubtful accounts	(14.5)	(10.2)	(30.1)	(21.2)	(0.9)	(0.7)	(1.8)	(1.3)
Net operating revenues less provision for doubtful accounts	738.1	635.1	1,471.7	1,254.4	167.2	118.4	326.9	228.1
Operating expenses:								
Inpatient rehabilitation:								
Salaries and benefits	366.1	317.6	736.0	624.0	—	—	—	—
Other operating expenses	106.8	93.5	211.6	188.7	—	—	—	—
Supplies	31.8	29.9	64.2	59.7	—	—	—	—
Occupancy costs	15.4	10.7	31.0	21.1	—	—	—	—
Home health and hospice:								
Cost of services sold (excluding depreciation and amortization)	—	—	—	—	81.6	56.7	160.0	110.1
Support and overhead costs	—	—	—	—	58.0	41.0	115.0	79.1
	520.1	451.7	1,042.8	893.5	139.6	97.7	275.0	189.2
Other income	(0.7)	(0.4)	(1.3)	(0.9)	—	—	—	—
Equity in net income of nonconsolidated affiliates	(2.2)	(2.3)	(4.4)	(3.9)	(0.2)	—	(0.4)	—
Noncontrolling interests	16.8	15.6	33.6	30.8	1.8	1.7	3.7	3.0
Segment Adjusted EBITDA	\$ 204.1	\$ 170.5	\$ 401.0	\$ 334.9	\$ 26.0	\$ 19.0	\$ 48.6	\$ 35.9
Capital expenditures	\$ 47.4	\$ 33.1	\$ 86.1	\$ 59.4	\$ 1.9	\$ 1.9	\$ 2.4	\$ 2.2

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	<u>Inpatient Rehabilitation</u>	<u>Home Health and Hospice</u>	<u>HealthSouth Consolidated</u>
As of June 30, 2016			
Total assets	\$ 3,612.4	\$ 1,091.5	\$ 4,632.6
Investments in and advances to nonconsolidated affiliates	10.8	2.8	13.6
As of December 31, 2015			
Total assets	\$ 3,589.0	\$ 1,088.4	\$ 4,606.1
Investments in and advances to nonconsolidated affiliates	9.3	2.4	11.7

Segment reconciliations (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
	Total segment Adjusted EBITDA	\$ 230.1	\$ 189.5	\$ 449.6
General and administrative expenses	(34.4)	(32.1)	(66.3)	(66.7)
Depreciation and amortization	(42.9)	(32.7)	(85.3)	(64.6)
(Loss) gain on disposal or impairment of assets	(0.2)	(0.8)	(0.4)	0.7
Government, class action, and related settlements	—	—	—	(8.0)
Professional fees - accounting, tax, and legal	(1.7)	(0.1)	(1.9)	(2.3)
Loss on early extinguishment of debt	(2.4)	(18.8)	(4.8)	(20.0)
Interest expense and amortization of debt discounts and fees	(43.4)	(30.9)	(88.0)	(62.7)
Net income attributable to noncontrolling interests	18.6	17.3	37.3	33.8
Gain related to SCA equity interest	—	2.6	—	2.6
Income from continuing operations before income tax expense	<u>\$ 123.7</u>	<u>\$ 94.0</u>	<u>\$ 240.2</u>	<u>\$ 183.6</u>

	<u>June 30, 2016</u>	<u>December 31, 2015</u>
Total assets for reportable segments	\$ 4,703.9	\$ 4,677.4
Reclassification of deferred income tax liabilities to net deferred income tax assets	(71.3)	(71.3)
Total consolidated assets	<u>\$ 4,632.6</u>	<u>\$ 4,606.1</u>

Additional detail regarding the revenues of our operating segments by service line follows (in millions):

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2015</u>	<u>2016</u>	<u>2015</u>
Inpatient rehabilitation:				
Inpatient	\$ 721.2	\$ 618.7	\$ 1,440.5	\$ 1,225.3
Outpatient and other	31.4	26.6	61.3	50.3
Total inpatient rehabilitation	<u>752.6</u>	<u>645.3</u>	<u>1,501.8</u>	<u>1,275.6</u>
Home health and hospice:				
Home health	157.1	111.5	308.0	215.4
Hospice	11.0	7.6	20.7	14.0
Total home health and hospice	<u>168.1</u>	<u>119.1</u>	<u>328.7</u>	<u>229.4</u>
Total net operating revenues	<u>\$ 920.7</u>	<u>\$ 764.4</u>	<u>\$ 1,830.5</u>	<u>\$ 1,505.0</u>

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13. Condensed Consolidating Financial Information

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered." Each of the subsidiary guarantors is 100% owned by HealthSouth, and all guarantees are full and unconditional and joint and several, subject to certain customary conditions for release. HealthSouth's investments in its consolidated subsidiaries, as well as guarantor subsidiaries' investments in nonguarantor subsidiaries and nonguarantor subsidiaries' investments in guarantor subsidiaries, are presented under the equity method of accounting with the related investment presented within the line items *Intercompany receivable and investments in consolidated affiliates* and *Intercompany payable* in the accompanying condensed consolidating balance sheets.

The terms of our credit agreement allow us to declare and pay cash dividends on our common stock so long as: (1) we are not in default under our credit agreement and (2) our senior secured leverage ratio (as defined in our credit agreement) remains less than or equal to 1.75 x. The terms of our senior note indenture allow us to declare and pay cash dividends on our common stock so long as (1) we are not in default, (2) the consolidated coverage ratio (as defined in the indenture) exceeds 2 x or we are otherwise allowed under the indenture to incur debt, and (3) we have capacity under the indenture's restricted payments covenant to declare and pay dividends. See Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Periodically, certain wholly owned subsidiaries of HealthSouth make dividends or distributions of available cash and/or intercompany receivable balances to their parents. In addition, HealthSouth makes contributions to certain wholly owned subsidiaries. When made, these dividends, distributions, and contributions impact the *Intercompany receivable*, *Intercompany payable*, and *HealthSouth shareholders' equity* line items in the accompanying condensed consolidating balance sheet but have no impact on the consolidated financial statements of HealthSouth Corporation.

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Three Months Ended June 30, 2016

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net operating revenues	\$ 5.1	\$ 546.1	\$ 398.9	\$ (29.4)	\$ 920.7
Less: Provision for doubtful accounts	—	(10.6)	(4.8)	—	(15.4)
Net operating revenues less provision for doubtful accounts	5.1	535.5	394.1	(29.4)	905.3
Operating expenses:					
Salaries and benefits	11.0	248.7	231.0	(4.6)	486.1
Other operating expenses	6.9	76.7	49.4	(11.5)	121.5
Occupancy costs	0.9	22.4	7.9	(13.3)	17.9
Supplies	—	22.4	12.0	—	34.4
General and administrative expenses	31.2	—	3.2	—	34.4
Depreciation and amortization	2.4	25.9	14.6	—	42.9
Professional fees—accounting, tax, and legal	1.7	—	—	—	1.7
Total operating expenses	54.1	396.1	318.1	(29.4)	738.9
Loss on early extinguishment of debt	2.4	—	—	—	2.4
Interest expense and amortization of debt discounts and fees	36.6	5.7	6.0	(4.9)	43.4
Other income	(4.9)	(0.1)	(0.6)	4.9	(0.7)
Equity in net income of nonconsolidated affiliates	—	(2.2)	(0.2)	—	(2.4)
Equity in net income of consolidated affiliates	(88.7)	(10.4)	—	99.1	—
Management fees	(33.8)	25.9	7.9	—	—
Income from continuing operations before income tax (benefit) expense	39.4	120.5	62.9	(99.1)	123.7
Provision for income tax (benefit) expense	(23.3)	48.1	17.6	—	42.4
Income from continuing operations	62.7	72.4	45.3	(99.1)	81.3
Loss from discontinued operations, net of tax	(0.1)	—	—	—	(0.1)
Net income	62.6	72.4	45.3	(99.1)	81.2
Less: Net income attributable to noncontrolling interests	—	—	(18.6)	—	(18.6)
Net income attributable to HealthSouth	\$ 62.6	\$ 72.4	\$ 26.7	\$ (99.1)	\$ 62.6
Comprehensive income	\$ 62.8	\$ 72.4	\$ 45.3	\$ (99.1)	\$ 81.4
Comprehensive income attributable to HealthSouth	\$ 62.8	\$ 72.4	\$ 26.7	\$ (99.1)	\$ 62.8

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Condensed Consolidating Statement of Operations

Three Months Ended June 30, 2015

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net operating revenues	\$ 5.1	\$ 460.0	\$ 325.0	\$ (25.7)	\$ 764.4
Less: Provision for doubtful accounts	—	(8.1)	(2.8)	—	(10.9)
Net operating revenues less provision for doubtful accounts	5.1	451.9	322.2	(25.7)	753.5
Operating expenses:					
Salaries and benefits	12.2	212.1	181.7	(4.2)	401.8
Other operating expenses	6.7	67.0	40.7	(10.2)	104.2
Occupancy costs	1.0	15.8	7.0	(11.3)	12.5
Supplies	—	20.7	11.0	—	31.7
General and administrative expenses	31.5	—	0.6	—	32.1
Depreciation and amortization	2.4	19.4	10.9	—	32.7
Professional fees—accounting, tax, and legal	0.1	—	—	—	0.1
Total operating expenses	53.9	335.0	251.9	(25.7)	615.1
Loss on early extinguishment of debt	18.8	—	—	—	18.8
Interest expense and amortization of debt discounts and fees	28.4	2.1	2.9	(2.5)	30.9
Other income	(4.8)	(0.1)	(0.6)	2.5	(3.0)
Equity in net income of nonconsolidated affiliates	—	(2.3)	—	—	(2.3)
Equity in net income of consolidated affiliates	(81.7)	(8.8)	—	90.5	—
Management fees	(29.3)	21.8	7.5	—	—
Income from continuing operations before income tax (benefit) expense	19.8	104.2	60.5	(90.5)	94.0
Provision for income tax (benefit) expense	(24.7)	39.7	17.2	—	32.2
Income from continuing operations	44.5	64.5	43.3	(90.5)	61.8
Loss from discontinued operations, net of tax	(1.6)	—	—	—	(1.6)
Net income	42.9	64.5	43.3	(90.5)	60.2
Less: Net income attributable to noncontrolling interests	—	—	(17.3)	—	(17.3)
Net income attributable to HealthSouth	\$ 42.9	\$ 64.5	\$ 26.0	\$ (90.5)	\$ 42.9
Comprehensive income	\$ 43.0	\$ 64.5	\$ 43.3	\$ (90.5)	\$ 60.3
Comprehensive income attributable to HealthSouth	\$ 43.0	\$ 64.5	\$ 26.0	\$ (90.5)	\$ 43.0

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Condensed Consolidating Statement of Operations

Six Months Ended June 30, 2016

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net operating revenues	\$ 10.0	\$ 1,088.5	\$ 790.3	\$ (58.3)	\$ 1,830.5
Less: Provision for doubtful accounts	—	(22.4)	(9.5)	—	(31.9)
Net operating revenues less provision for doubtful accounts	10.0	1,066.1	780.8	(58.3)	1,798.6
Operating expenses:					
Salaries and benefits	22.3	500.0	459.1	(9.2)	972.2
Other operating expenses	12.5	152.6	98.1	(22.5)	240.7
Occupancy costs	1.8	44.8	15.9	(26.6)	35.9
Supplies	—	45.2	24.2	—	69.4
General and administrative expenses	64.3	—	2.0	—	66.3
Depreciation and amortization	4.8	51.8	28.7	—	85.3
Professional fees—accounting, tax, and legal	1.9	—	—	—	1.9
Total operating expenses	107.6	794.4	628.0	(58.3)	1,471.7
Loss on early extinguishment of debt	4.8	—	—	—	4.8
Interest expense and amortization of debt discounts and fees	75.4	10.9	11.4	(9.7)	88.0
Other income	(9.6)	(0.2)	(1.2)	9.7	(1.3)
Equity in net income of nonconsolidated affiliates	—	(4.4)	(0.4)	—	(4.8)
Equity in net income of consolidated affiliates	(174.4)	(19.9)	—	194.3	—
Management fees	(68.0)	51.7	16.3	—	—
Income from continuing operations before income tax (benefit) expense	74.2	233.6	126.7	(194.3)	240.2
Provision for income tax (benefit) expense	(46.6)	93.2	35.5	—	82.1
Income from continuing operations	120.8	140.4	91.2	(194.3)	158.1
Loss from discontinued operations, net of tax	(0.2)	—	—	—	(0.2)
Net income	120.6	140.4	91.2	(194.3)	157.9
Less: Net income attributable to noncontrolling interests	—	—	(37.3)	—	(37.3)
Net income attributable to HealthSouth	\$ 120.6	\$ 140.4	\$ 53.9	\$ (194.3)	\$ 120.6
Comprehensive income	\$ 120.9	\$ 140.4	\$ 91.2	\$ (194.3)	\$ 158.2
Comprehensive income attributable to HealthSouth	\$ 120.9	\$ 140.4	\$ 53.9	\$ (194.3)	\$ 120.9

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Statement of Operations

Six Months Ended June 30, 2015

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net operating revenues	\$ 10.4	\$ 907.7	\$ 637.3	\$ (50.4)	\$ 1,505.0
Less: Provision for doubtful accounts	—	(17.0)	(5.5)	—	(22.5)
Net operating revenues less provision for doubtful accounts	10.4	890.7	631.8	(50.4)	1,482.5
Operating expenses:					
Salaries and benefits	20.3	418.2	356.7	(8.3)	786.9
Other operating expenses	16.2	128.7	83.1	(20.6)	207.4
Occupancy costs	2.1	30.4	13.6	(21.5)	24.6
Supplies	—	41.1	22.0	—	63.1
General and administrative expenses	65.8	—	0.9	—	66.7
Depreciation and amortization	4.7	38.3	21.6	—	64.6
Government, class action, and related settlements	8.0	—	—	—	8.0
Professional fees—accounting, tax, and legal	2.3	—	—	—	2.3
Total operating expenses	119.4	656.7	497.9	(50.4)	1,223.6
Loss on early extinguishment of debt	20.0	—	—	—	20.0
Interest expense and amortization of debt discounts and fees	57.6	4.4	5.6	(4.9)	62.7
Other income	(7.1)	(0.1)	(1.2)	4.9	(3.5)
Equity in net income of nonconsolidated affiliates	—	(3.9)	—	—	(3.9)
Equity in net income of consolidated affiliates	(160.1)	(17.4)	—	177.5	—
Management fees	(57.8)	43.1	14.7	—	—
Income from continuing operations before income tax (benefit) expense	38.4	207.9	114.8	(177.5)	183.6
Provision for income tax (benefit) expense	(48.9)	79.1	32.3	—	62.5
Income from continuing operations	87.3	128.8	82.5	(177.5)	121.1
Loss from discontinued operations, net of tax	(1.9)	—	—	—	(1.9)
Net income	85.4	128.8	82.5	(177.5)	119.2
Less: Net income attributable to noncontrolling interests	—	—	(33.8)	—	(33.8)
Net income attributable to HealthSouth	\$ 85.4	\$ 128.8	\$ 48.7	\$ (177.5)	\$ 85.4
Comprehensive income	\$ 85.6	\$ 128.8	\$ 82.5	\$ (177.5)	\$ 119.4
Comprehensive income attributable to HealthSouth	\$ 85.6	\$ 128.8	\$ 48.7	\$ (177.5)	\$ 85.6

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Balance Sheet

As of June 30, 2016

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
	(In Millions)				
Assets					
Current assets:					
Cash and cash equivalents	\$ 56.5	\$ 2.4	\$ 11.4	\$ —	\$ 70.3
Accounts receivable, net	—	262.0	158.6	—	420.6
Other current assets	67.3	23.1	138.2	(60.0)	168.6
Total current assets	123.8	287.5	308.2	(60.0)	659.5
Property and equipment, net	21.1	987.8	328.0	—	1,336.9
Goodwill	—	860.6	1,039.1	—	1,899.7
Intangible assets, net	15.2	119.0	280.0	—	414.2
Deferred income tax assets	99.5	64.1	—	(48.1)	115.5
Other long-term assets	49.2	88.6	69.0	—	206.8
Intercompany notes receivable	537.3	—	—	(537.3)	—
Intercompany receivable and investments in consolidated affiliates	2,809.9	13.8	—	(2,823.7)	—
Total assets	\$ 3,656.0	\$ 2,421.4	\$ 2,024.3	\$ (3,469.1)	\$ 4,632.6
Liabilities and Shareholders' Equity					
Current liabilities:					
Current portion of long-term debt	\$ 40.0	\$ 6.3	\$ 7.7	\$ (17.5)	\$ 36.5
Accounts payable	5.6	39.7	21.8	—	67.1
Accrued expenses and other current liabilities	153.7	92.7	151.6	(42.5)	355.5
Total current liabilities	199.3	138.7	181.1	(60.0)	459.1
Long-term debt, net of current portion	2,743.2	252.4	54.4	—	3,050.0
Intercompany notes payable	—	—	537.3	(537.3)	—
Other long-term liabilities	40.8	14.6	146.5	(47.8)	154.1
Intercompany payable	—	—	176.3	(176.3)	—
	2,983.3	405.7	1,095.6	(821.4)	3,663.2
Commitments and contingencies					
Redeemable noncontrolling interests	—	—	120.0	—	120.0
Shareholders' equity:					
HealthSouth shareholders' equity	672.7	2,015.7	632.0	(2,647.7)	672.7
Noncontrolling interests	—	—	176.7	—	176.7
Total shareholders' equity	672.7	2,015.7	808.7	(2,647.7)	849.4
Total liabilities and shareholders' equity	\$ 3,656.0	\$ 2,421.4	\$ 2,024.3	\$ (3,469.1)	\$ 4,632.6

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Balance Sheet

As of December 31, 2015

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Assets					
Current assets:					
Cash and cash equivalents	\$ 41.2	\$ 1.2	\$ 19.2	\$ —	\$ 61.6
Accounts receivable, net	—	261.5	149.0	—	410.5
Other current assets	29.3	22.2	93.9	(18.8)	126.6
Total current assets	70.5	284.9	262.1	(18.8)	598.7
Property and equipment, net	14.5	988.4	307.2	—	1,310.1
Goodwill	—	860.7	1,029.4	—	1,890.1
Intangible assets, net	8.8	122.4	288.2	—	419.4
Deferred income tax assets	176.2	64.1	—	(49.5)	190.8
Other long-term assets	48.6	75.3	73.1	—	197.0
Intercompany notes receivable	546.6	—	—	(546.6)	—
Intercompany receivable and investments in consolidated affiliates	2,779.7	—	—	(2,779.7)	—
Total assets	\$ 3,644.9	\$ 2,395.8	\$ 1,960.0	\$ (3,394.6)	\$ 4,606.1
Liabilities and Shareholders' Equity					
Current liabilities:					
Current portion of long-term debt	\$ 40.0	\$ 6.8	\$ 7.5	\$ (17.5)	\$ 36.8
Accounts payable	5.8	35.4	20.4	—	61.6
Accrued expenses and other current liabilities	122.2	71.8	135.3	(1.3)	328.0
Total current liabilities	168.0	114.0	163.2	(18.8)	426.4
Long-term debt, net of current portion	2,821.9	255.6	57.2	—	3,134.7
Intercompany notes payable	—	—	546.6	(546.6)	—
Other long-term liabilities	43.6	12.3	137.8	(49.1)	144.6
Intercompany payable	—	156.7	157.5	(314.2)	—
	3,033.5	538.6	1,062.3	(928.7)	3,705.7
Commitments and contingencies					
Redeemable noncontrolling interests	—	—	121.1	—	121.1
Shareholders' equity:					
HealthSouth shareholders' equity	611.4	1,857.2	608.7	(2,465.9)	611.4
Noncontrolling interests	—	—	167.9	—	167.9
Total shareholders' equity	611.4	1,857.2	776.6	(2,465.9)	779.3
Total liabilities and shareholders' equity	\$ 3,644.9	\$ 2,395.8	\$ 1,960.0	\$ (3,394.6)	\$ 4,606.1

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Statement of Cash Flows

Six Months Ended June 30, 2016

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net cash provided by operating activities	\$ 31.5	\$ 182.5	\$ 97.9	\$ —	\$ 311.9
Cash flows from investing activities:					
Purchases of property and equipment	(5.4)	(35.3)	(30.7)	—	(71.4)
Capitalized software costs	(7.6)	(6.0)	(1.6)	—	(15.2)
Acquisitions of businesses, net of cash acquired	—	—	(9.4)	—	(9.4)
Net change in restricted cash	—	—	(11.5)	—	(11.5)
Funding of intercompany note receivable	(6.5)	—	—	6.5	—
Proceeds from repayment of intercompany note receivable	22.0	—	—	(22.0)	—
Other	(2.8)	(0.1)	4.9	—	2.0
Net cash used in investing activities	(0.3)	(41.4)	(48.3)	(15.5)	(105.5)
Cash flows from financing activities:					
Principal payments on debt, including pre-payments	(111.2)	(0.8)	(0.8)	—	(112.8)
Principal borrowings on intercompany note payable	—	—	6.5	(6.5)	—
Principal payments on intercompany note payable	—	—	(22.0)	22.0	—
Borrowings on revolving credit facility	165.0	—	—	—	165.0
Payments on revolving credit facility	(145.0)	—	—	—	(145.0)
Repurchases of common stock, including fees and expenses	(24.1)	—	—	—	(24.1)
Dividends paid on common stock	(41.9)	—	—	—	(41.9)
Distributions paid to noncontrolling interests of consolidated affiliates	—	—	(33.6)	—	(33.6)
Other	2.2	(2.9)	(4.6)	—	(5.3)
Change in intercompany advances	139.1	(136.2)	(2.9)	—	—
Net cash used in financing activities	(15.9)	(139.9)	(57.4)	15.5	(197.7)
Increase (decrease) in cash and cash equivalents	15.3	1.2	(7.8)	—	8.7
Cash and cash equivalents at beginning of period	41.2	1.2	19.2	—	61.6
Cash and cash equivalents at end of period	\$ 56.5	\$ 2.4	\$ 11.4	\$ —	\$ 70.3

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Statement of Cash Flows

Six Months Ended June 30, 2015

	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
(In Millions)					
Net cash (used in) provided by operating activities	\$ (13.5)	\$ 120.9	\$ 97.5	\$ —	\$ 204.9
Cash flows from investing activities:					
Purchases of property and equipment	(5.1)	(24.2)	(17.0)	—	(46.3)
Capitalized software costs	(13.9)	—	(1.3)	—	(15.2)
Acquisitions of businesses, net of cash acquired	(56.5)	—	(21.2)	—	(77.7)
Net change in restricted cash	—	—	13.1	—	13.1
Other	7.7	3.3	(5.6)	(6.0)	(0.6)
Net cash used in investing activities	(67.8)	(20.9)	(32.0)	(6.0)	(126.7)
Cash flows from financing activities:					
Proceeds from bond issuance	700.0	—	—	—	700.0
Principal payments on debt, including pre-payments	(545.0)	(0.8)	(0.3)	—	(546.1)
Borrowings on revolving credit facility	270.0	—	—	—	270.0
Payments on revolving credit facility	(442.0)	—	—	—	(442.0)
Debt amendment and issuance costs	(13.9)	—	—	—	(13.9)
Dividends paid on common stock	(37.1)	—	—	—	(37.1)
Dividends paid on convertible perpetual preferred stock	(3.1)	—	—	—	(3.1)
Distributions paid to noncontrolling interests of consolidated affiliates	—	—	(26.2)	—	(26.2)
Other	1.7	(0.8)	(7.9)	6.0	(1.0)
Change in intercompany advances	138.6	(98.6)	(40.0)	—	—
Net cash provided by (used in) financing activities	69.2	(100.2)	(74.4)	6.0	(99.4)
Decrease in cash and cash equivalents	(12.1)	(0.2)	(8.9)	—	(21.2)
Cash and cash equivalents at beginning of period	41.9	1.4	23.4	—	66.7
Cash and cash equivalents at end of period	\$ 29.8	\$ 1.2	\$ 14.5	\$ —	\$ 45.5

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") relates to HealthSouth Corporation and its subsidiaries and should be read in conjunction with our condensed consolidated financial statements included under Part I, Item 1, *Financial Statements (Unaudited)*, of this report and our audited consolidated financial statements for the year ended December 31, 2015 and *Management's Discussion and Analysis of Financial Condition and Results of Operations* which are included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the "2015 Form 10-K").

This MD&A is designed to provide the reader with information that will assist in understanding our condensed consolidated financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our condensed consolidated financial statements. See "Cautionary Statements Regarding Forward-Looking Statements" on page i of this report for a description of important factors that could cause actual results to differ from expected results. See also Item 1A, *Risk Factors*, of this report and to the 2015 Form 10-K.

Executive Overview

Our Business

We are one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based post-acute services in 34 states and Puerto Rico through our network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. As discussed in this Item, "Segment Results of Operations," we manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. For additional information about our business, see Item 1, *Business*, of the 2015 Form 10-K.

Inpatient Rehabilitation

We are the nation's largest owner and operator of inpatient rehabilitation hospitals in terms of patients treated and discharged, revenues, and number of hospitals. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. While our national network of inpatient hospitals stretches across 29 states and Puerto Rico, we are concentrated in the eastern half of the United States and Texas. As of June 30, 2016, we operate 121 inpatient rehabilitation hospitals, including one hospital that operates as a joint venture which we account for using the equity method of accounting. In addition to HealthSouth hospitals, we manage four inpatient rehabilitation units through management contracts. Our inpatient rehabilitation segment represented approximately 82% of our *Net operating revenues* for the three and six months ended June 30, 2016.

Home Health and Hospice

We are the nation's fourth largest provider of Medicare-certified skilled home health services. As of June 30, 2016, we provide home health and hospice services in 218 locations across 24 states. Two of these home health locations operate as joint ventures which we account for using the equity method of accounting. Our home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational, and speech therapy, medical social work, and home health aide services. We also provide specialized home care services in Texas and Kansas for pediatric patients with severe medical conditions. Our hospice services primarily include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual support. Our home health and hospice segment represented approximately 18% of our *Net operating revenues* for the three and six months ended June 30, 2016.

As of March 31, 2016, all of HealthSouth's 25 legacy agencies, with the exception of one closing, had been integrated into Encompass Home Health and Hospice ("Encompass"), which we acquired on December 31, 2014, with 12 of those locations relocated or merged into existing Encompass locations. In addition, Encompass operates one of HealthSouth's integrated agencies as two locations.

2016 Overview

Our 2016 strategy focuses on the following priorities:

- continuing to provide high-quality, cost-effective care to patients in our existing markets;
- achieving organic growth at our existing hospitals, home health agencies, and hospice agencies;

- expanding our services to more patients who require post-acute healthcare services by constructing and acquiring new hospitals in new markets and acquiring home health and hospice agencies in new markets;
- continuing our shareholder value-enhancing strategies such as common stock dividends and repurchases of our common stock; and
- positioning the Company for continued success in the evolving healthcare delivery system. This preparation includes continuing the installation of our electronic clinical information system in our hospitals which allows for interfaces with all major acute care electronic medical record systems and health information exchanges and participating in bundling projects and Accountable Care Organizations (“ACOs”).

During the three and six months ended June 30, 2016, *Net operating revenues* increased by 20.4% and 21.6% over the same periods of 2015 due primarily to our acquisitions of the operations of Reliant Hospital Partners, LLC and affiliated entities (“Reliant”) on October 1, 2015 and CareSouth Health System, Inc. (“CareSouth”) on November 2, 2015 (see Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K).

Within our inpatient rehabilitation segment, discharge growth of 13.6% coupled with a 2.6% increase in net patient revenue per discharge in the second quarter of 2016 generated 16.6% growth in net patient revenue from our hospitals compared to the second quarter of 2015. Discharge growth included a 1.9% increase in same-store discharges. During the six months ended June 30, 2016, discharge growth of 15.3% coupled with a 2.0% increase in net patient revenue per discharge generated 17.7% growth in net patient revenue from our hospitals compared to the six months ended June 30, 2015. Discharge growth for the six-month period included a 2.3% increase in same-store discharges. Our inpatient rehabilitation quality and outcome measures, as reported through the Uniform Data System for Medical Rehabilitation (the “UDS”), remained well above the average for hospitals included in the UDS database.

Within our home health and hospice segment, admission growth of 52.7% coupled with the impact of a 1.6% decrease in revenue per episode in the second quarter of 2016 generated 41.1% growth in home health and hospice revenue compared to the second quarter of 2015. Admission growth included a 11.1% increase in same-store admissions. During the six months ended June 30, 2016, admission growth of 54.4% coupled with the impact of a 1.9% decrease in revenue per episode generated 43.3% growth in home health and hospice revenue compared to the six months ended June 30, 2015. Admission growth for the six-month period included a 11.7% increase in same-store admissions. The quality of patient care star rating for our home health agencies continued to be well above the national average, as reported by the United States Centers for Medicare and Medicaid Services (“CMS”). In addition, 30-day readmission rates at our home health agencies continued to be well below the national average, as reported by Avalere Health and the Alliance for Home Health Quality and Innovation.

Our growth efforts thus far in 2016 have included the following:

- began operating the 27-bed inpatient rehabilitation hospital at CHI St. Vincent Hot Springs, a Catholic Health Initiatives’ hospital, in Hot Springs, Arkansas with our joint venture partner, St. Vincent Community Health Services, Inc, in February 2016. The joint venture completed construction of a new 40-bed hospital and began accepting patients on July 1, 2016;
- acquired, in May 2016, Home Health Agency of Georgia, LLC., a home health and hospice provider with two home health locations and two hospice locations in the Greater Atlanta area;
- began accepting patients at our new home health locations in Lee’s Summit, Missouri in February 2016 and New Port Richey, Florida in May 2016;
- continued our capacity expansions by adding 60 new beds to existing hospitals; and

- continued development of the following de novo hospitals:

Location	# of Beds	Actual / Expected	
		Construction Start Date	Expected Operational Date
Modesto, California	50	Q1 2015	Q4 2016
Pearland, Texas ⁽¹⁾	40	Q4 2016	Q4 2017
Shelby County, Alabama ⁽²⁾	34	First half of 2017	First half of 2018
Murrieta, California ⁽³⁾	50	First half of 2017	Second half of 2018

⁽¹⁾ In March 2016, we acquired land and began the design and permitting process to build an inpatient rehabilitation hospital.

⁽²⁾ In June 2016, we were awarded a certificate of need, acquired land, and began the design and permitting process to build an inpatient rehabilitation hospital.

⁽³⁾ In August 2014, we acquired land and began the design and permitting process to build an inpatient rehabilitation hospital.

In addition to our growth efforts, we took the following steps to further increase the strength and flexibility of our balance sheet.

- In March 2016, we redeemed \$50.0 million of the outstanding principal amount of our existing 7.75% Senior Notes due 2022 (the “2022 Notes”) using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of these notes, this optional redemption was made at a price of 103.875%, which resulted in a total cash outlay of approximately \$52 million.
- In May 2016, we redeemed an additional \$50.0 million of the outstanding principal amount of the 2022 Notes using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of these notes, this optional redemption was also made at a price of 103.875%, which resulted in a total cash outlay of approximately \$52 million.

For additional information regarding these actions, see Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and the “Liquidity and Capital Resources” section of this Item.

We also continued our shareholder value-enhancing strategies by repurchasing 0.6 million shares of our common stock in the open market for approximately \$22 million during the first and second quarters of 2016. In addition, we continued paying a quarterly cash dividend of \$0.23 per share on our common stock in the first and second quarters of 2016. See the “Liquidity and Capital Resources” section of this Item.

Business Outlook

We believe our business outlook remains positive for two primary reasons. First, demographic trends, such as population aging, should increase long-term demand for facility-based and home-based post-acute services. While we treat patients of all ages, most of our patients are 65 and older, and the number of Medicare enrollees is expected to grow approximately 3% per year for the foreseeable future. We believe the demand for facility-based and home-based post-acute services will continue to increase as the U.S. population ages and life expectancies increase.

Second, we are an industry leader in the growing post-acute sector. As the nation’s largest owner and operator of inpatient rehabilitation hospitals, we believe we differentiate ourselves from our competitors based on our broad platform of clinical expertise, the quality of our clinical outcomes, the sustainability of best practices, and the application of rehabilitative technology. As the fourth largest provider of Medicare-certified skilled home health services, we believe we differentiate ourselves from our competitors by virtue of our scale and density in the markets we serve, the application of a highly integrated technology platform, our ability to manage a variety of care pathways, and a proven track record of consummating and integrating acquisitions.

We have invested considerable resources into clinical and management systems and protocols that have allowed us to consistently produce high-quality outcomes for our patients while continuing to contain cost growth. Our proprietary hospital

management reporting system aggregates data from each of our key business systems into a comprehensive reporting package used by the management teams in our hospitals, as well as executive management, and allows them to analyze data and trends and create custom reports on a timely basis. Our commitment to technology also includes the on-going implementation of our rehabilitation-specific electronic clinical information system. As of June 30, 2016, we had installed this system in 92 of our 121 hospitals. We believe this system will improve patient care and safety, enhance staff recruitment and retention, and set the stage for connectivity with other providers and health information exchanges. Our home health and hospice segment also uses information technology to enhance patient care and manage the business by utilizing Homecare HomebaseSM, a comprehensive information platform that allows home health providers to process clinical, compliance, and marketing information as well as analyze data and trends for management purposes using custom reports on a timely basis. This allows our home health segment to manage the entire patient work flow and provide valuable data for health systems, payors, and ACO partners. We are currently the preferred home health provider to one ACO serving approximately 20,000 patients and are exploring several other participation opportunities.

We believe these factors align with our strengths in, and focus on, post-acute services. In addition, we believe we can address the demand for facility-based and home-based post-acute services in markets where we currently do not have a presence by constructing or acquiring new hospitals and by acquiring home health and hospice agencies in that highly fragmented industry.

Longer-term, the nature and timing of the transformation of the current healthcare system to coordinated care delivery and payment models is uncertain and will likely remain so for some time, as the development of new delivery and payment systems will almost certainly require significant time and resources. Furthermore, many of the alternative approaches being explored may not work as intended. However, as outlined in the 2015 Form 10-K (see Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges—Changes to Our Operating Environment Resulting from Healthcare Reform"), our goal is to position the Company in a prudent manner to be responsive to industry shifts. We have invested in our core business and created an infrastructure that enables us to provide high-quality care on a cost-effective basis. We have been disciplined in creating a capital structure that is flexible with no significant debt maturities prior to 2020. Our balance sheet remains strong and includes a substantial portfolio of owned real estate. We have significant availability under our revolving credit facility, and we continue to generate strong cash flows from operations. Importantly, we have flexibility with how we choose to deploy our cash and create value for shareholders, including repayments of long-term debt, repurchases of our common stock, bed additions, de novos, acquisitions of inpatient rehabilitation hospitals, home health agencies, and hospice agencies, and common stock dividends. While our financial leverage increased as a result of the acquisitions discussed in Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K, we anticipate in the longer term reducing our financial leverage based on growth of Adjusted EBITDA and an allocation of a portion of our free cash flow to debt reduction.

For these and other reasons, we believe we will be able to adapt to changes in reimbursement, sustain our business model, and grow through acquisition and consolidation opportunities as they arise.

Key Challenges

The healthcare industry is facing many well-publicized regulatory and reimbursement challenges. The industry is also facing uncertainty associated with the efforts, primarily arising from initiatives included in the 2010 Healthcare Reform Laws (as defined in Item 1, *Business*, "Regulatory and Reimbursement Challenges" of the 2015 Form 10-K) to identify and implement workable coordinated care delivery models. Successful healthcare providers are those who provide high-quality, cost-effective care and have the ability to adjust to changes in the regulatory and operating environments. We believe we have the necessary capabilities — scale, infrastructure, balance sheet, and management — to adapt to changes and continue to succeed in a highly regulated industry, and we have a proven track record of doing so.

As we continue to execute our business plan, the following are some of the challenges we face.

- **Operating in a Highly Regulated Industry**. We are required to comply with extensive and complex laws and regulations at the federal, state, and local government levels. These rules and regulations have affected, or could in the future affect, our business activities by having an impact on the reimbursement we receive for services provided or the costs of compliance, mandating new documentation standards, requiring additional licensure or certification, regulating our relationships with physicians and other referral sources, regulating the use of our properties, and limiting our ability to enter new markets or add new capacity to existing hospitals and agencies. Ensuring continuous compliance with extensive laws and regulations is an operating requirement for all healthcare providers.

We have invested, and will continue to invest, substantial time, effort, and expense in implementing and maintaining training programs as well as internal controls and procedures designed to ensure regulatory compliance, and we are committed to continued adherence to these guidelines. More specifically, because Medicare comprises a significant portion of our *Net operating revenues*, it is particularly important for us to remain compliant with the laws and regulations governing the Medicare program and related matters including anti-kickback and anti-fraud requirements. If we were unable to remain compliant with these regulations, our financial position, results of operations, and cash flows could be materially, adversely impacted.

Concerns held by federal policymakers about the federal deficit and national debt levels could result in enactment of further federal spending reductions, further entitlement reform legislation affecting the Medicare program, or both, in 2016 and beyond. Additionally, many legislators in the United States House of Representatives and the United States Senate continue to express the policy objective of modifying or repealing the Patient Protection and Affordable Care Act (as subsequently amended, the “2010 Healthcare Reform Laws”). At this time, it is unclear what, if any, of the Medicare-related changes may ultimately be enacted and signed into law by the President, but it is possible that any reductions in Medicare spending will have a material impact on reimbursements for healthcare providers generally and post-acute providers specifically. We cannot predict what, if any, changes in Medicare spending or modifications to the healthcare laws and regulations will result from future budget and other legislative initiatives.

The Medicare Payment Advisory Commission (“MedPAC”) is an independent agency that advises Congress on issues affecting Medicare and makes payment policy recommendations to Congress and CMS for a variety of Medicare payment systems including, among others, the inpatient rehabilitation facility prospective payment system (the “IRF-PPS”), the home health prospective payment system (the “HH-PPS”) and the hospice prospective payment system (the “Hospice-PPS”). Congress and CMS are not obligated to adopt MedPAC recommendations, and, based on outcomes in previous years, there can be no assurance those recommendations will be adopted. However, MedPAC’s recommendations have, and may in the future, become the basis for subsequent legislative or regulatory action.

In March 2016, MedPAC released recommendations to eliminate the market basket update for each of the IRF-PPS, the HH-PPS, and the Hospice-PPS for 2017. In another recommendation affecting IRFs, MedPAC suggested increasing the IRF-PPS outlier payment pool. Under the IRF-PPS, CMS effectively withholds 3% of payments due to providers to fund an outlier pool used to pay for patient treatments that are extraordinarily costly. MedPAC recommended the outlier pool be increased above its current 3% level. Any change in the outlier payment pool up to 5% could be done by CMS without legislative action. If implemented, this change would reduce the base Medicare payment to all IRF providers and redistribute payment to IRFs receiving a higher proportion of outlier payments. The latest proposed rule for the IRF-PPS discussed below did not follow MedPAC’s recommendations to eliminate the market basket update or to increase the outlier pool.

On April 21, 2016, CMS released its notice of proposed rulemaking for fiscal year 2017 (the “2017 Rule”) for IRFs under the IRF-PPS. The proposed rule would implement a net 1.45% market basket increase effective for discharges between October 1, 2016 and September 30, 2017, calculated as follows:

Market basket update	2.7%
Healthcare reform reduction	75 basis points
Productivity adjustment	50 basis points

The proposed rule also includes other changes that impact our hospital-by-hospital base rate for Medicare reimbursement. Such changes include, but are not limited to, revisions to the wage index values, changes to designations between rural and urban facilities, and updates to the outlier fixed loss threshold. The proposed rule also continues the freeze to the update to the IRF-PPS facility-level rural adjustment factor, low-income patient factor, and teaching status adjustment factors. Based on our analysis which utilizes, among other things, the acuity of our patients over the 12-month period prior to the proposed rule’s release and incorporates other adjustments included in the proposed rule, we believe the 2017 Rule will result in a net increase to our Medicare payment rates of approximately 1.7% effective October 1, 2016, prior to the impact of sequestration.

Additionally, the proposed rule contains changes that could affect us in future years. For example, CMS proposed five additional quality reporting measures, the reporting of which may require additional time and expense and could affect reimbursement beginning October 1, 2017.

Reimbursement claims made by healthcare providers, including inpatient rehabilitation hospitals as well as home health and hospice agencies, are subject to audit from time to time by governmental payors and their agents, such as the Medicare Administrative Contractors (“MACs”), fiscal intermediaries and carriers, as well as the Office of Inspector General, CMS, and state Medicaid programs. Under programs designated as “widespread probes,” certain of our MACs have conducted pre-payment claim reviews of our billings and denied payment for certain diagnosis codes. The majority of the denials we have encountered in these probes derive from one MAC. In connection with recent probes, this MAC has made determinations regarding medical necessity which represent its uniquely restrictive interpretations of the CMS coverage rules. We have discussed our objections to those interpretations with both the MAC and CMS. We cannot predict what, if any, changes will result from those discussions. If the MAC continues to deny a significant number of claims for certain diagnosis codes, we may experience increases in the *Provision for doubtful accounts*, decreases in cash flow as a result of increasing accounts receivable, and/or a shift in the patients and conditions we treat, any of which could have an adverse effect on our financial position, results of operations, and liquidity.

On November 16, 2015, CMS issued its final rule establishing the Comprehensive Care for Joint Replacement (“CJR”) payment model. This mandatory model holds acute care hospitals accountable for the quality of care they deliver to Medicare fee-for-service beneficiaries for lower extremity joint replacements (i.e., knees and hips) from surgery through recovery. Through the five-year payment model, which began on April 1, 2016, healthcare providers in 67 geographic areas (“MSAs”) would continue to be paid under existing Medicare payment systems. However, the hospital where the joint replacement takes place would be held accountable for the quality and costs of care for the entire episode of care — from the time of the surgery through 90 days after discharge. Depending on the quality and cost performance during the entire episode, the hospital may receive an additional payment or be required to repay Medicare for a portion of the episode costs. As a result, the acute care hospitals would be incented to work with physicians and post-acute care providers to ensure beneficiaries receive the coordinated care they need in an efficient manner. We believe its impact would be positive for HealthSouth as it should favor high-quality, low-cost providers like us who have made significant commitments to information systems that enable and enhance connectivity. We also believe the rule further validates our movement into home health via the acquisition of Encompass. Currently, lower extremity joint replacement patients represent less than 8% of our total annual discharges due to our required compliance with the 60% rule. Given the 67 MSAs included in the CJR model, our patients potentially subject to this model represent approximately 2.1% of our annual Medicare discharges. The lower extremity joint replacement patients we do treat are generally higher acuity and bilateral or possess significant comorbidities. In these cases and in any risk-bearing bundling initiative, quality of outcomes is critical to achieving targeted financial results.

On July 25, 2016, CMS issued a proposed rule to establish a new mandatory payment bundling model for cardiac care and extend the existing bundled payment model for hip replacement to other hip surgeries. The program as proposed is generally similar to the CJR program described above, in that acute care hospitals would be at risk for patients’ quality of care and Medicare expenditures incurred during their hospital stay and 90 days thereafter. CMS proposes to establish additional hip fracture bundles in the 67 MSAs (HealthSouth is located in 27 of these MSAs) where the CJR program is being implemented, and CMS proposes 294 potential MSAs for the cardiac bundle, of which 98 would be applied as part of the final rule. CMS proposes to begin the program in July 2017, and hospitals will have a gradual phasing-in of risk beginning in April 2018. Of the 294 potential MSAs included in the proposed model for cardiac cases, our hospitals are included in approximately 60 MSAs. If all of these 60 MSAs are selected as part of the final 98 MSAs for mandatory cardiac bundle, our patients potentially subject to this model represent approximately 1.0% of our annual Medicare discharges. Our patients potentially subject to the expanded portion of the hip replacement model represent approximately 1.2% of our annual Medicare discharges incremental to the above CJR program. Our analysis of this proposed rule and its potential impact on HealthSouth is ongoing.

On June 27, 2016, CMS released its notice of proposed rulemaking for calendar year 2017 for home health agencies under the HH-PPS. CMS estimates the rule will reduce Medicare payments to home health agencies by approximately 1.0% in 2017. Specifically, while the proposed rule provides for a market basket update of 2.8%, that update is offset by a 2.3% rebasing adjustment reduction (the last year of a four-year phase-in), a productivity adjustment reduction of 50 basis points, an outlier fixed dollar loss adjustment of 0.1%, and a coding intensity reduction of 0.9% (the second year of a three-year phase-in). We believe the proposed 2017 rule will result in a net decrease to Encompass’ Medicare payment rates within a range of 3.0% to 4.0% effective for episodes ending in calendar year 2017. The net decrease to Encompass’ Medicare payment rates is primarily impacted by an approximate 1.0% case mix re-weighting and approximately 1.0% to 2.0% for the change in the outlier calculation methodology. Additionally, we believe the proposed 2017 rule could have an approximate \$1.5 million

negative impact on revenues in the fourth quarter of 2016 applicable to episodes that begin in 2016 and end in 2017.

On June 8, 2016, CMS implemented a new pre-claim review demonstration of home health services in five states for a period of three years. Encompass operates in three of these states (Florida, Texas, and Massachusetts), which represents approximately 50% of their Medicare claims. The pre-claim demonstration will begin in Florida no earlier than October 1, 2016, in Texas no earlier than December 1, 2016, and in Massachusetts no earlier than January 1, 2017. As a result of the pre-claim review demonstration, we expect an increase in Encompass' administrative costs beginning in the second half of 2016. Additionally, we may experience increases in the *Provision for doubtful accounts* and decreases in cash flow as a result of increasing accounts receivable, each of which could have an adverse effect on our financial position, results of operations, and liquidity.

See also Item 1, *Business*, "Sources of Revenues" and "Regulation," and Item 1A, *Risk Factors*, to the 2015 Form 10-K and Note 11, *Contingencies and Other Commitments*, "Governmental Inquiries and Investigations," to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

- Changes to Our Operating Environment Resulting from Healthcare Reform. Our challenges related to healthcare reform are discussed in Item 1, *Business*, "Sources of Revenues," Item 1A, *Risk Factors*, and Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, "Executive Overview—Key Challenges," to the 2015 Form 10-K. Many provisions within the 2010 Healthcare Reform Laws have impacted, or could in the future impact, our business. Most notably for us are the reductions to our hospitals' annual market basket updates, including productivity adjustments, mandated reductions to home health and hospice Medicare reimbursements, and future payment reforms such as ACOs and bundled payments.

The healthcare industry in general is facing uncertainty associated with the efforts, primarily arising from initiatives included in the 2010 Healthcare Reform Laws, to identify and implement workable coordinated care delivery models. In a coordinated care delivery model, hospitals, physicians, and other care providers work together to provide coordinated healthcare on a more efficient, patient-centered basis. These providers are then paid based on the overall value of the services they provide to a patient rather than the number of services they provide. While this is consistent with our goal and proven track record of being a high-quality, cost-effective provider, broad-based implementation of a new delivery model would represent a significant transformation for the healthcare industry. As the industry and its regulators explore this transformation, we are positioning the Company in preparation for whatever changes are ultimately made to the delivery system. We are currently participating in several coordinated care delivery model initiatives and are exploring ACO participation in several others. Eight of our IRFs began participating in Phase 2, the "at-risk" phase, of Model 3 of CMS' Bundled Payments for Care Improvement ("BPCI") initiative in 2015. We also have several IRFs that have signed participation agreements with acute care providers participating in Model 2 of the BPCI initiative. Ten of our home health agencies began participating in Phase 2 of Model 3 of the BPCI initiative in April 2014. In July 2015, 42 additional home health agencies began participating in Phase 2 of Model 3 of this initiative. In addition, we have partnered as the home health provider with Premier PHC™, an ACO serving approximately 20,000 Medicare patients.

Given the complexity and the number of changes in the 2010 Healthcare Reform Laws and other pending regulatory initiatives, we cannot predict their ultimate impact. In addition, the ultimate nature and timing of the transformation of the healthcare delivery system is uncertain, and will likely remain so for some time. We will continue to evaluate these laws and regulations and position the Company for this industry shift. Based on our track record, we believe we can adapt to these regulatory and industry changes. Further, we have engaged, and will continue to engage, actively in discussions with key legislators and regulators to attempt to ensure any healthcare laws or regulations adopted or amended promote our goal of high-quality, cost-effective care.

- Maintaining Strong Volume Growth. Various factors, including competition, increasing regulatory and administrative burdens, and changes in the healthcare delivery system, may impact our ability to maintain and grow our hospital, home health, and hospice volumes. In any particular market, we may encounter competition from local or national entities with longer operating histories or other competitive advantages, such as acute care hospitals who provide post-acute services similar to ours or other post-acute providers with relationships with referring acute care hospitals or physicians. Aggressive payment review practices by Medicare contractors, aggressive enforcement of regulatory policies by government agencies, and restrictive or burdensome rules, regulations or statutes governing admissions practices may lead us to not accept patients who would be appropriate for and would benefit from the services we provide. In addition, from time to time, we must get

regulatory approval to expand our services and locations in states with certificate of need laws. This approval may be withheld or take longer than expected. In the case of new-store volume growth, the addition of hospitals, home health agencies, and hospice agencies to our portfolio also may be difficult and take longer than expected.

- **Recruiting and Retaining High-Quality Personnel.** See Item 1A, *Risk Factors*, to the 2015 Form 10-K for a discussion of competition for staffing, shortages of qualified personnel, and other factors that may increase our labor costs. Recruiting and retaining qualified personnel for our inpatient hospitals and home health and hospice agencies remain a high priority for us. We attempt to maintain a comprehensive compensation and benefits package that allows us to remain competitive in this challenging staffing environment while remaining consistent with our goal of being a high-quality, cost-effective provider of post-acute services.

See also Item 1, *Business*, Item 1A, *Risk Factors*, and Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operations*, “Executive Overview—Key Challenges,” to the 2015 Form 10-K.

These key challenges notwithstanding, we believe we have a strong business model, a strong balance sheet, and a proven track record of achieving strong financial and operational results. We are attempting to position the Company to respond to changes in the healthcare delivery system, and believe we will be in a position to take advantage of any opportunities that arise as the industry moves to this new stage. We believe we are positioned to continue to grow, adapt to external events, and create value for our shareholders in 2016 and beyond.

Results of Operations

Payor Mix

We derived consolidated *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	74.7%	74.5%	75.1%	74.7%
Medicare Advantage	8.1%	7.7%	7.9%	8.0%
Managed care	10.0%	10.1%	9.8%	10.0%
Medicaid	3.2%	3.1%	3.3%	2.9%
Other third-party payors	1.4%	1.8%	1.4%	1.6%
Workers’ compensation	0.7%	0.9%	0.8%	0.9%
Patients	0.5%	0.6%	0.5%	0.6%
Other income	1.4%	1.3%	1.2%	1.3%
Total	100.0%	100.0%	100.0%	100.0%

For additional information regarding our payors, see the “Sources of Revenues” section of Item 1, *Business*, of the 2015 Form 10-K.

Our Results

For the three and six months ended June 30, 2016 and 2015, our consolidated results of operations were as follows:

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2016	2015	2016 vs. 2015	2016	2015	2016 vs. 2015
(In Millions, Except Percentage Change)						
Net operating revenues	\$ 920.7	\$ 764.4	20.4 %	\$ 1,830.5	\$ 1,505.0	21.6 %
Less: Provision for doubtful accounts	(15.4)	(10.9)	41.3 %	(31.9)	(22.5)	41.8 %
Net operating revenues less provision for doubtful accounts	905.3	753.5	20.1 %	1,798.6	1,482.5	21.3 %
Operating expenses:						
Salaries and benefits	486.1	401.8	21.0 %	972.2	786.9	23.5 %
Other operating expenses	121.5	104.2	16.6 %	240.7	207.4	16.1 %
Occupancy costs	17.9	12.5	43.2 %	35.9	24.6	45.9 %
Supplies	34.4	31.7	8.5 %	69.4	63.1	10.0 %
General and administrative expenses	34.4	32.1	7.2 %	66.3	66.7	(0.6)%
Depreciation and amortization	42.9	32.7	31.2 %	85.3	64.6	32.0 %
Government, class action, and related settlements	—	—	N/A	—	8.0	(100.0)%
Professional fees—accounting, tax, and legal	1.7	0.1	1,600.0 %	1.9	2.3	(17.4)%
Total operating expenses	738.9	615.1	20.1 %	1,471.7	1,223.6	20.3 %
Loss on early extinguishment of debt	2.4	18.8	(87.2)%	4.8	20.0	(76.0)%
Interest expense and amortization of debt discounts and fees	43.4	30.9	40.5 %	88.0	62.7	40.4 %
Other income	(0.7)	(3.0)	(76.7)%	(1.3)	(3.5)	(62.9)%
Equity in net income of nonconsolidated affiliates	(2.4)	(2.3)	4.3 %	(4.8)	(3.9)	23.1 %
Income from continuing operations before income tax expense	123.7	94.0	31.6 %	240.2	183.6	30.8 %
Provision for income tax expense	42.4	32.2	31.7 %	82.1	62.5	31.4 %
Income from continuing operations	81.3	61.8	31.6 %	158.1	121.1	30.6 %
Loss from discontinued operations, net of tax	(0.1)	(1.6)	(93.8)%	(0.2)	(1.9)	(89.5)%
Net income	81.2	60.2	34.9 %	157.9	119.2	32.5 %
Less: Net income attributable to noncontrolling interests	(18.6)	(17.3)	7.5 %	(37.3)	(33.8)	10.4 %
Net income attributable to HealthSouth	\$ 62.6	\$ 42.9	45.9 %	\$ 120.6	\$ 85.4	41.2 %

Provision for Doubtful Accounts and Operating Expenses as a % of Net Operating Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Provision for doubtful accounts	1.7%	1.4%	1.7%	1.5%
Operating expenses:				
Salaries and benefits	52.8%	52.6%	53.1%	52.3%
Other operating expenses	13.2%	13.6%	13.1%	13.8%
Occupancy costs	1.9%	1.6%	2.0%	1.6%
Supplies	3.7%	4.1%	3.8%	4.2%
General and administrative expenses	3.7%	4.2%	3.6%	4.4%
Depreciation and amortization	4.7%	4.3%	4.7%	4.3%
Government, class action, and related settlements	—%	—%	—%	0.5%
Professional fees—accounting, tax, and legal	0.2%	—%	0.1%	0.2%
Total operating expenses	80.3%	80.5%	80.4%	81.3%

In the discussion that follows, we use “same-store” comparisons to explain the changes in certain performance metrics and line items within our financial statements. We calculate same-store comparisons based on hospitals and agencies open throughout both the full current periods and prior periods presented. These comparisons include the financial results of market consolidation transactions in existing markets, as it is difficult to determine, with precision, the incremental impact of these transactions on our results of operations.

Net Operating Revenues

Our consolidated *Net operating revenues* increased by \$156.3 million , or 20.4% , in the second quarter of 2016 compared to the second quarter of 2015. This increase primarily resulted from strong volume growth in both of our operating segments and included the effect of our acquisitions of Reliant on October 1, 2015 and CareSouth on November 2, 2015. See additional discussion in the “Segment Results of Operations” section of this Item.

Provision for Doubtful Accounts

The change in our *Provision for doubtful accounts* in any given period primarily results from the fluctuations in pre-payment claims denials by MACs and continued substantial delays (exceeding four years) in the adjudication process at the administrative law judge hearing level. For additional information, see Item 1, *Business* , “Sources of Revenues—Medicare Reimbursement,” and Item 7, *Management’s Discussion and Analysis of Financial Condition and Results of Operations* , “Results of Operations—Our Results—Provision for Doubtful Accounts,” to the 2015 Form 10-K.

Salaries and Benefits

Salaries and benefits increased in the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily due to increased patient volumes, including an increase in the number of full-time equivalents as a result of our 2015 development activities, the acquisitions of Reliant and CareSouth, and increases in merit and benefit costs.

Salaries and benefits as a percent of *Net operating revenues* increased by 20 basis points and 80 basis points during the three and six months ended June 30, 2016 compared to the same periods of 2015, respectively, primarily as a result of merit and benefit cost increases, Medicare home health reimbursement rate cuts, and the ramping up of new hospitals in Franklin, Tennessee and Hot Springs, Arkansas. *Salaries and benefits* as a percent of *Net operating revenues* during the three and six months ended June 30, 2015 included an approximate \$5 million Supplemental Security Income (“SSI”) adjustment that negatively impacted revenue in the second quarter of 2015 (as discussed in this Item, “Segment Results of Operations—Inpatient Rehabilitation—Net Operating Revenues”).

Other Operating Expenses

Other operating expenses increased in the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily due to the acquisitions of Reliant and CareSouth and increased patient volumes at our hospitals. *Other operating*

expenses for the six months ended June 30, 2015 included the settlement of an employee sexual harassment matter that was not covered by insurance.

As a percent of *Net operating revenues*, *Other operating expenses* decreased during the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily due to our increasing revenues, primarily as a result of the acquisitions of Reliant and CareSouth. As a percent of *Net operating revenues*, *Other operating expenses* also decreased during the six months ended June 30, 2016 compared to the same period of 2015 due to the aforementioned settlement.

Occupancy Costs

Occupancy costs increased during the three and six months ended June 30, 2016 compared to the same periods of 2015 in terms of dollars and as a percent of *Net operating revenues* due to the acquisition of Reliant, which leased all of its hospitals.

Supplies

Supplies increased during the three and six months ended June 30, 2016 compared to the same periods of 2015 due primarily to increased patient volumes. *Supplies* decreased as a percent of *Net operating revenues* during the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily due to continued supply chain initiatives.

General and Administrative Expenses

General and administrative expenses decreased during the six months ended June 30, 2016 compared to the same period of 2015 due primarily to activity associated with stock-based compensation discussed in Note 14, *Employee Benefit Plans*, to the consolidated financial statements accompanying the 2015 Form 10-K, and transaction costs related to the acquisition of Reliant. *General and administrative expenses* decreased as a percent of *Net operating revenues* during the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily due to our increasing revenue, primarily as a result of the acquisitions of Reliant and CareSouth.

Depreciation and Amortization

Depreciation and amortization increased during the three and six months ended June 30, 2016 compared to the same periods of 2015 due to our capital expenditures and development activities throughout 2015 and 2016.

Government, Class Action, and Related Settlements

The loss included in *Government, Class Action, and Related Settlements* during the six months ended June 30, 2015 resulted from a settlement discussed in Note 17, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Professional Fees—Accounting, Tax, and Legal

Professional Fees—Accounting, Tax, and Legal in each period presented related primarily to legal and consulting fees for continued litigation and support matters discussed in Note 17, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Loss on Early Extinguishment of Debt

The *Loss on early extinguishment of debt* during the three and six months ended June 30, 2016 resulted from the redemptions of our 2022 Notes in March 2016 and May 2016.

In January 2015, we issued an additional \$400 million of our 5.75% Senior Notes due 2024 at a price of 102% of the principal amount and used \$250 million of the net proceeds to repay borrowings under our term loan facilities, with the remaining net proceeds used to repay borrowings under our revolving credit facility. As a result of the term loan prepayment, we recorded a \$1.2 million *Loss on early extinguishment of debt* in the first quarter of 2015.

In April 2015, we used the net proceeds from the offering of 5.125% Senior Notes due 2023 along with cash on hand to execute the redemption of our 8.125% Senior Notes due 2020. As a result of this redemption, we recorded an \$18.8 million *Loss on early extinguishment of debt* in the second quarter of 2015.

See Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)* and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K for additional information regarding these transactions.

Interest Expense and Amortization of Debt Discounts and Fees

The increase in *Interest expense and amortization of debt discounts and fees* during the three and six months ended June 30, 2016 compared to the same periods of 2015 resulted from an increase in average borrowings due to our use of debt to fund the acquisitions of Reliant and CareSouth. Our average cash interest rate remained relatively flat during the three and six months ended June 30, 2016 compared to the same periods of 2015. See Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Other Income

Other income for the three and six months ended June 30, 2015 included a \$2.0 million gain related to the increase in fair value of our option to purchase up to a 5% equity interest in Surgical Care Affiliates (“SCA”), our former surgery centers division, from April 1, 2015 (the date it became exercisable) to April 13, 2015 (the date we exercised the option). *Other income* for the three and six months ended June 30, 2015 also included a \$0.6 million realized gain from the sale of a portion of SCA common stock during the second quarter of 2015. See Note 12, *Fair Value Measurements*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Income from Continuing Operations Before Income Tax Expense

Our pre-tax income from continuing operations increased during the three and six months ended June 30, 2016 compared to the same periods of 2015 due to increased *Net operating revenues* as a result of our acquisitions of Reliant and CareSouth.

Provision for Income Tax Expense

Due to our federal and state net operating loss carryforwards (“NOLs”), we currently estimate our cash income tax expense to be approximately \$15 million to \$30 million, net of refunds, for 2016. These payments are expected to result from state income tax expense of subsidiaries which have separate state filing requirements, alternative minimum taxes, and federal income taxes based upon tax planning opportunities, the extent of the remaining federal NOL balance and the availability of other federal tax credits. For the three months ended June 30, 2016 and 2015, current income tax expense was \$4.0 million and \$3.4 million, respectively. For the six months ended June 30, 2016 and 2015, current income tax expense was \$9.0 million and \$6.9 million, respectively.

Our *Provision for income tax expense* in each period presented, primarily resulted from the application of our estimated effective blended federal and state income tax rate.

In certain state jurisdictions, we do not expect to generate sufficient income to use all of the available NOLs prior to their expiration. This determination is based on our evaluation of all available evidence in these jurisdictions including results of operations during the preceding three years, our forecast of future earnings, and prudent tax planning strategies. It is possible we may be required to increase or decrease our valuation allowance at some future time if our forecast of future earnings varies from actual results on a consolidated basis or in the applicable state tax jurisdiction, or if the timing of future tax deductions differs from our expectations.

We recognize the financial statement effects of uncertain tax positions when it is more likely than not, based on the technical merits, a position will be sustained upon examination by and resolution with the taxing authorities. Total remaining unrecognized tax benefits were \$2.8 million and \$2.9 million as of June 30, 2016 and December 31, 2015, respectively.

See Note 9, *Income Taxes*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and Note 15, *Income Taxes*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Net Income Attributable to Noncontrolling Interests

The increase in *Net Income Attributable to Noncontrolling Interests* during the three and six months ended June 30, 2016 compared to the same period of 2015 primarily resulted from increased profitability of our joint ventures.

Segment Results of Operations

Our internal financial reporting and management structure is focused on the major types of services provided by HealthSouth. We manage our operations using two operating segments which are also our reportable segments: (1) inpatient

rehabilitation and (2) home health and hospice. For additional information regarding our business segments, including a detailed description of the services we provide, financial data for each segment, and a reconciliation of total segment Adjusted EBITDA to income from continuing operations before income tax expense, see Note 12, *Segment Reporting*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

Inpatient Rehabilitation

Our inpatient rehabilitation segment derived its *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	73.1%	72.7%	73.3%	73.1%
Medicare Advantage	7.8%	7.8%	7.7%	8.1%
Managed care	11.5%	11.4%	11.2%	11.3%
Medicaid	2.9%	2.6%	3.0%	2.3%
Other third-party payors	1.7%	2.1%	1.7%	1.9%
Workers' compensation	0.8%	1.1%	1.0%	1.1%
Patients	0.6%	0.7%	0.6%	0.7%
Other income	1.6%	1.6%	1.5%	1.5%
Total	100.0%	100.0%	100.0%	100.0%

Additional information regarding our inpatient rehabilitation segment's operating results for the three and six months ended June 30, 2016 and 2015 is as follows:

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2016	2015	2016 vs. 2015	2016	2015	2016 vs. 2015
(In Millions, Except Percentage Change)						
Net operating revenues:						
Inpatient	\$ 721.2	\$ 618.7	16.6 %	\$ 1,440.5	\$ 1,225.3	17.6 %
Outpatient and other	31.4	26.6	18.0 %	61.3	50.3	21.9 %
Inpatient rehabilitation segment revenues	752.6	645.3	16.6 %	1,501.8	1,275.6	17.7 %
Less: Provision for doubtful accounts	(14.5)	(10.2)	42.2 %	(30.1)	(21.2)	42.0 %
Net operating revenues less provision for doubtful accounts	738.1	635.1	16.2 %	1,471.7	1,254.4	17.3 %
Operating expenses:						
Salaries and benefits	366.1	317.6	15.3 %	736.0	624.0	17.9 %
Other operating expenses	106.8	93.5	14.2 %	211.6	188.7	12.1 %
Supplies	31.8	29.9	6.4 %	64.2	59.7	7.5 %
Occupancy costs	15.4	10.7	43.9 %	31.0	21.1	46.9 %
Other income	(0.7)	(0.4)	75.0 %	(1.3)	(0.9)	44.4 %
Equity in net income of nonconsolidated affiliates	(2.2)	(2.3)	(4.3)%	(4.4)	(3.9)	12.8 %
Noncontrolling interests	16.8	15.6	7.7 %	33.6	30.8	9.1 %
Segment Adjusted EBITDA	\$ 204.1	\$ 170.5	19.7 %	\$ 401.0	\$ 334.9	19.7 %

(Actual Amounts)						
Discharges	41,365	36,408	13.6 %	82,463	71,524	15.3 %
Net patient revenue per discharge	\$ 17,435	\$ 16,994	2.6 %	\$ 17,468	\$ 17,131	2.0 %
Outpatient visits	164,761	144,914	13.7 %	327,410	276,267	18.5 %
Average length of stay (days)	12.6	13.0	(3.1)%	12.8	13.1	(2.3)%
Occupancy %	68.2%	70.4%	(3.1)%	68.8%	70.2%	(2.0)%
# of licensed beds	8,430	7,374	14.3 %	8,430	7,374	14.3 %
Full-time equivalents*	19,708	17,601	12.0 %	19,627	17,302	13.4 %
Employees per occupied bed	3.43	3.41	0.6 %	3.39	3.36	0.9 %

* Excludes approximately 420 full-time equivalents for the three and six months ended June 30, 2016 and approximately 400 full-time equivalents for the three and six months ended June 30, 2015 who are considered part of corporate overhead with their salaries and benefits included in *General and administrative expenses* in our consolidated statements of operations. Full-time equivalents included in the above table represent HealthSouth employees who participate in or support the operations of our hospitals and exclude an estimate of full-time equivalents related to contract labor.

We actively manage the productive portion of our *Salaries and benefits* utilizing certain metrics, including employees per occupied bed, or "EPOB." This metric is determined by dividing the number of full-time equivalents, including an estimate of full-time equivalents from the utilization of contract labor, by the number of occupied beds during each period. The number of occupied beds is determined by multiplying the number of licensed beds by our occupancy percentage.

Net Operating Revenues

Net operating revenues were 16.6% higher during the second quarter of 2016 compared to the same quarter of 2015. This increase included a 13.6% increase in patient discharges and a 2.6% increase in net patient revenue per discharge.

Discharge growth included a 1.9% increase in same-store discharges. Discharge growth from new stores resulted from our acquisitions of Reliant (October 2015) and Cardinal Hill Rehabilitation Hospital (May 2015), our joint venture with St. Vincent Community Health Services, Inc. in Hot Springs, Arkansas (February 2016), and one de novo hospital that opened in Franklin, Tennessee (December 2015). Growth in net patient revenue per discharge benefited by approximately 90 basis points from an approximate \$5 million SSI adjustment that negatively impacted revenue in the second quarter of 2015. CMS periodically retroactively updates SSI ratios that are used to determine adjustments to Medicare payment rates for low-income patients. In June 2015, CMS updated the ratios for fiscal year 2013, and we retroactively recorded adjustments to full-year 2013, full-year 2014, and year-to-date 2015.

Net operating revenues were 17.7% higher during the six months ended June 30, 2016 compared to the same period of 2015. This increase included a 15.3% increase in patient discharges and a 2.0% increase in net patient revenue per discharge. Discharge growth included a 2.3% increase in same-store discharges. Discharge growth and net patient revenue per discharge for the year-to-date period of 2016 were impacted by the same factors as discussed above for the second quarter of 2016. In addition, during the six months ended June 30, 2016, net patient revenue per discharge was impacted by the ramping up of new hospitals (Franklin, TN and Hot Springs, AR) which are required to treat a minimum of 30 patients for zero revenue as part of the Medicare certification process.

Outpatient revenues increased during the three and six months ended June 30, 2016 compared to the same periods of 2015 due to the acquisitions of Reliant and Cardinal Hill.

See Note 2, *Business Combinations*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report for information regarding our joint venture with St. Vincent Community Health Services, Inc. See Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K for information regarding Reliant and Cardinal Hill.

Adjusted EBITDA

The increase in Adjusted EBITDA during the second quarter of 2016 compared to the same quarter of 2015 primarily resulted from revenue growth, as discussed above. All operating expenses as a percent of net operating revenues were impacted in the second quarter of 2015 by the aforementioned SSI adjustment. *Salaries and benefits* in the second quarter of 2016 included the positive impact of \$2.4 million in rebates associated with a contractual periodic pharmacy benefit reconciliation for 2014 and 2015. Hospital operating expenses (*Other operating expenses*, *Supplies*, and *Occupancy costs*) as a percent of *Net operating revenues* improved in the second quarter of 2016 compared to the second quarter of 2015 primarily due to continued supply chain initiatives. This improvement in hospital operating expenses occurred in spite of an increase in *Occupancy costs* as a percent of *Net operating revenues* due to the acquisition of Reliant. Bad debt expense as a percent of *Net operating revenues* increased from 1.6% in the second quarter of 2015 to 1.9% in the second quarter of 2016 due to administrative payment delays at our largest MAC.

The increase in Adjusted EBITDA during the six months ended June 30, 2016 resulted from the same factors as discussed above for the second quarter of 2016. Adjusted EBITDA for the six months ended June 30, 2015 was negatively impacted by a settlement of an employee sexual harassment matter that was not covered by insurance.

Home Health and Hospice

Our home health and hospice segment derived its *Net operating revenues* from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Medicare	82.3%	83.9%	82.9%	83.8%
Medicare Advantage	9.0%	7.2%	8.9%	7.3%
Managed care	3.7%	2.9%	3.2%	3.0%
Medicaid	4.8%	5.8%	4.8%	5.7%
Other third-party payors	—%	0.1%	—%	0.1%
Patients	0.1%	0.1%	0.1%	0.1%
Other income	0.1%	—%	0.1%	—%
Total	100.0%	100.0%	100.0%	100.0%

Additional information regarding our home health and hospice segment's operating results for the three and six months ended June 30, 2016 and 2015 is as follows:

	Three Months Ended June 30,		Percentage Change	Six Months Ended June 30,		Percentage Change
	2016	2015	2016 vs. 2015	2016	2015	2016 vs. 2015
(In Millions, Except Percentage Change)						
Net operating revenues:						
Home health	\$ 157.1	\$ 111.5	40.9 %	\$ 308.0	\$ 215.4	43.0 %
Hospice	11.0	7.6	44.7 %	20.7	14.0	47.9 %
Home health and hospice segment revenues	168.1	119.1	41.1 %	328.7	229.4	43.3 %
Less: Provision for doubtful accounts	(0.9)	(0.7)	28.6 %	(1.8)	(1.3)	38.5 %
Net operating revenues less provision for doubtful accounts	167.2	118.4	41.2 %	326.9	228.1	43.3 %
Operating expenses:						
Cost of services sold (excluding depreciation and amortization)	81.6	56.7	43.9 %	160.0	110.1	45.3 %
Support and overhead costs	58.0	41.0	41.5 %	115.0	79.1	45.4 %
Equity in net income of nonconsolidated affiliates	(0.2)	—	N/A	(0.4)	—	N/A
Noncontrolling interests	1.8	1.7	5.9 %	3.7	3.0	23.3 %
Segment Adjusted EBITDA	\$ 26.0	\$ 19.0	36.8 %	\$ 48.6	\$ 35.9	35.4 %

(Actual Amounts)

Home health:						
Admissions	25,753	16,862	52.7 %	51,516	33,361	54.4 %
Recertifications	20,432	15,103	35.3 %	39,885	29,588	34.8 %
Episodes	45,774	31,817	43.9 %	89,618	61,329	46.1 %
Average revenue per episode	\$ 3,033	\$ 3,082	(1.6)%	\$ 3,034	\$ 3,092	(1.9)%
Episodic visits per episode	18.9	19.4	(2.6)%	19.0	19.5	(2.6)%
Total visits	967,968	675,095	43.4 %	1,905,772	1,306,094	45.9 %
Cost per visit	\$ 73	\$ 71	2.8 %	\$ 73	\$ 71	2.8 %
Hospice:						
Admissions	785	594	32.2 %	1,509	1,218	23.9 %
Patient days	71,277	49,272	44.7 %	134,709	90,170	49.4 %
Revenue per day	\$ 154	\$ 154	—%	\$ 154	\$ 155	(0.6)%

Net Operating Revenues

Home health and hospice revenue was 41.1% higher during the second quarter of 2016 compared to the same quarter of 2015. This increase included a 52.7% increase in admissions and was impacted by a 1.6% decrease in average revenue per episode. Admission growth included a 11.1% increase in same-store admissions. Admission growth from new stores resulted from the acquisition of CareSouth and Encompass' other acquisitions throughout 2015. Average revenue per episode was impacted by the Medicare home health reimbursement rate cuts that became effective January 1, 2016, a higher percentage of patients requiring therapy visits, and lower revenue per episode at CareSouth due to patient mix.

Home health and hospice revenue was 43.3% higher during the six months ended June 30, 2016 compared to the same period of 2015. This increase included a 54.4% increase in admissions and was impacted by a 1.9% decrease in average revenue per episode. Admission growth included a 11.7% increase in same-store admissions. Admission growth from new stores and average revenue per episode resulted from the same factors discussed above for the second quarter of 2016.

See Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K for information regarding CareSouth and Encompass' other acquisitions throughout 2015.

Adjusted EBITDA

The increase in Adjusted EBITDA during the three and six months ended June 30, 2016 compared to the same periods of 2015 primarily resulted from revenue growth. Adjusted EBITDA for the segment during the three and six months ended June 30, 2016 was impacted by lower average revenue per episode, higher cost per visit driven by an increased percentage of therapy patients, merit and benefit costs increases, and expenses related to the integration of CareSouth.

Liquidity and Capital Resources

Our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility.

The objectives of our capital structure strategy are to ensure we maintain adequate liquidity and flexibility. Pursuing and achieving those objectives allows us to support the execution of our operating and strategic plans and weather temporary disruptions in the capital markets and general business environment. Maintaining adequate liquidity is a function of our unrestricted *Cash and cash equivalents* and our available borrowing capacity. Maintaining flexibility in our capital structure is a function of, among other things, the amount of debt maturities in any given year, the options for debt prepayments without onerous penalties, and limiting restrictive terms and maintenance covenants in our debt agreements.

Consistent with these objectives, in March 2016, we redeemed \$50.0 million of the outstanding principal amount of our existing 2022 Notes using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of the 2022 Notes, this optional redemption was made at a price of 103.875%, which resulted in a total cash outlay of approximately \$52 million. As a result of this redemption, we recorded a \$2.4 million *Loss on early extinguishment of debt* in the first quarter of 2016.

On April 6, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of an additional \$50 million of the outstanding principal amount of our 2022 Notes. On May 6, 2016, we completed this redemption using cash on hand and capacity under our revolving credit facility. Pursuant to the terms of the 2022 Notes, this optional redemption was also made at a price of 103.875%, which resulted in a total cash outlay of approximately \$52 million. As a result of this redemption, we recorded a \$2.4 million *Loss on early extinguishment of debt* in the second quarter of 2016.

On July 28, 2016, we gave notice of, and made an irrevocable commitment for, the redemption of the remaining outstanding principal balance of \$76.0 million of the 2022 Notes. Pursuant to the terms of the 2022 Notes, this optional redemption will be made at a price of 102.583%, which will result in a total cash outlay of approximately \$78 million when the transaction closes on September 15, 2016. We plan to use cash on hand and capacity under our revolving credit facility to fund the redemption. As a result of this redemption, we expect to record an approximate \$3 million *Loss on early extinguishment of debt* in the third quarter of 2016.

We have been disciplined in creating a capital structure that is flexible with no significant debt maturities prior to 2020. Our balance sheet remains strong, and we have significant availability under our credit agreement. We continue to generate strong cash flows from operations, and we have significant flexibility with how we choose to invest our cash and return capital to shareholders. While our financial leverage increased as a result of the Reliant and CareSouth transactions, we anticipate in the longer term reducing our financial leverage based on growth of Adjusted EBITDA and an allocation of a portion of our free cash flow to debt reduction.

For additional information regarding our indebtedness, see Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Current Liquidity

As of June 30, 2016, we had \$70.3 million in *Cash and cash equivalents*. *Cash and cash equivalents* as of June 30, 2016 excluded \$57.4 million in restricted cash (included in *Other current assets*) and \$57.3 million of restricted marketable securities (\$27.4 million included in *Other current assets* and \$29.9 million included in *Other long-term assets*). Our restricted assets pertain primarily to obligations associated with our captive insurance company, as well as obligations we have under agreements with joint venture partners. See Note 3, *Cash and Marketable Securities*, to the consolidated financial statements accompanying the 2015 Form 10-K.

In addition to *Cash and cash equivalents*, as of June 30, 2016, we had approximately \$ 415 million available to us under our revolving credit facility. Our credit agreement governs the substantial majority of our senior secured borrowing capacity and contains a leverage ratio and an interest coverage ratio as financial covenants. Our leverage ratio is defined in our credit agreement as the ratio of consolidated total debt (less up to \$75 million of cash on hand) to Adjusted EBITDA for the trailing four quarters. In calculating the leverage ratio under our credit agreement, we are permitted to use pro forma Adjusted EBITDA, the calculation of which includes historical income statement items and pro forma adjustments resulting from (1) the dispositions and repayments or incurrence of debt and (2) the investments, acquisitions, mergers, amalgamations, consolidations and operational changes from acquisitions to the extent such items or effects are not yet reflected in our trailing four-quarter financial statements. Our interest coverage ratio is defined in our credit agreement as the ratio of Adjusted EBITDA to consolidated interest expense, excluding the amortization of financing fees, for the trailing four quarters. As of June 30, 2016, the maximum leverage ratio requirement per our credit agreement was 4.5x and the minimum interest coverage ratio requirement was 3.0x, and we were in compliance with these covenants. Based on Adjusted EBITDA for the trailing four quarters and the interest rate in effect under our credit agreement during the three-month period ended June 30, 2016, if we had drawn on the first day and maintained the maximum amount of outstanding draws under our revolving credit facility for that entire period, we would still be in compliance with the maximum leverage ratio and minimum interest coverage ratio requirements.

We do not face near-term refinancing risk, as the amounts outstanding under our credit agreement do not mature until 2020, and our bonds all mature in 2022 and beyond. See the “Contractual Obligations” section below for information related to our contractual obligations as of June 30, 2016.

We anticipate we will continue to generate strong cash flows from operations that, together with availability under our revolving credit facility, will allow us to invest in growth opportunities and continue to improve our existing business. We also will continue to consider additional shareholder value-enhancing strategies such as repurchases of our common stock and distribution of common stock dividends, including the potential growth of the quarterly cash dividend on our common stock, recognizing that these actions may increase our leverage ratio. See also the “Authorizations for Returning Capital to Stakeholders” section of this Item.

See Item 1A, *Risk Factors*, of the 2015 Form 10-K for a discussion of risks and uncertainties facing us.

Sources and Uses of Cash

The following table shows the cash flows provided by or used in operating, investing, and financing activities for the six months ended June 30, 2016 and 2015 (in millions):

	Six Months Ended June 30,	
	2016	2015
Net cash provided by operating activities	\$ 311.9	\$ 204.9
Net cash used in investing activities	(105.5)	(126.7)
Net cash used in financing activities	(197.7)	(99.4)
Increase (decrease) in cash and cash equivalents	\$ 8.7	\$ (21.2)

Operating activities. The increase in *Net cash provided by operating activities* for the six months ended June 30, 2016 compared to the same period of 2015 primarily resulted from revenue growth, as described above, and lower working capital primarily attributable to payroll-related liabilities.

Investing activities. The decrease in *Net cash used in investing activities* during the six months ended June 30, 2016 compared to the same period of 2015 primarily resulted from our 2015 development activities as described in Note 2, *Business Combinations*, to the consolidated financial statements accompanying the 2015 Form 10-K, offset by an increase in capital expenditures and a decrease in restricted cash.

Financing activities. The increase in *Net cash used in financing activities* during the six months ended June 30, 2016 compared to the same period of 2015 primarily resulted from the two \$50 million redemptions of the 2022 Notes in March 2016 and May 2016, as discussed above, and repurchases of our common stock. *Net cash provided by financing activities* during the six months ended June 30, 2015 included the public offering of our 5.125% Senior Notes due 2023 as discussed in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Contractual Obligations

Our consolidated contractual obligations as of June 30, 2016 are as follows (in millions):

	Total	July 1 through December 31, 2016	2017 - 2018	2019 - 2020	2021 and thereafter
Long-term debt obligations:					
Long-term debt, excluding revolving credit facility and capital lease obligations ^(a)	\$ 2,653.0	\$ 12.2	\$ 47.4	\$ 654.2	\$ 1,939.2
Revolving credit facility	150.0	—	—	150.0	—
Interest on long-term debt ^(b)	1,037.4	67.3	270.8	267.3	432.0
Capital lease obligations ^(c)	527.3	15.5	68.6	58.3	384.9
Operating lease obligations ^{(d)(e)}	411.7	30.7	109.8	84.7	186.5
Purchase obligations ^{(e)(f)}	95.8	15.3	49.9	23.7	6.9
Other long-term liabilities ^{(g)(h)}	3.6	0.1	0.4	0.4	2.7
Total	\$ 4,878.8	\$ 141.1	\$ 546.9	\$ 1,238.6	\$ 2,952.2

^(a) Included in long-term debt are amounts owed on our bonds payable and other notes payable. These borrowings are further explained in Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

^(b) Interest on our fixed rate debt is presented using the stated interest rate. Interest expense on our variable rate debt is estimated using the rate in effect as of June 30, 2016. Interest pertaining to our credit agreement and bonds is included to their respective ultimate maturity dates. Interest related to capital lease obligations is excluded from this line. Future minimum payments, which are accounted for as interest, related to sale/leaseback transactions involving real estate accounted for as financings are included in this line (see Note 5, *Property and Equipment*, and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K). Amounts exclude amortization of debt discounts, amortization of loan fees, or fees for lines of credit that would be included in interest expense in our consolidated statements of operations.

^(c) Amounts include interest portion of future minimum capital lease payments.

^(d) Our inpatient rehabilitation segment leases approximately 16% of its hospitals as well as other property and equipment under operating leases in the normal course of business. Our home health and hospice segment leases relatively small office spaces in the localities it serves, space for its corporate office, and other equipment under operating leases in the normal course of business. Some of our hospital leases contain escalation clauses based on changes in the Consumer Price Index while others have fixed escalation terms. The minimum lease payments do not include contingent rental expense. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. For more information, see Note 5, *Property and Equipment*, to the consolidated financial statements accompanying the 2015 Form 10-K.

^(e) Future operating lease obligations and purchase obligations are not recognized in our condensed consolidated balance sheet.

^(f) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on HealthSouth and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. Our purchase obligations primarily relate to software licensing and support.

^(g) Because their future cash outflows are uncertain, the following noncurrent liabilities are excluded from the table above: general liability, professional liability, and workers' compensation risks, noncurrent amounts related to third-party billing audits, and deferred income taxes. Also, as of June 30, 2016, we had \$2.8 million of total gross

unrecognized tax benefits. For more information, see Note 9, *Self-Insured Risks*, Note 15, *Income Taxes*, and Note 17, *Contingencies and Other Commitments*, to the consolidated financial statements accompanying the 2015 Form 10-K and Note 9, *Income Taxes*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

- (h) The table above does not include *Redeemable noncontrolling interests* of \$120.0 million because of the uncertainty surrounding the timing and amounts of any related cash outflows.

Our capital expenditures include costs associated with our hospital refresh program, de novo projects, capacity expansions, technology initiatives, and building and equipment upgrades and purchases. During the six months ended June 30, 2016, we made capital expenditures of approximately \$86.6 million for property and equipment and capitalized software. During 2016, we expect to spend approximately \$185 million to \$225 million for capital expenditures. Approximately \$95 million to \$105 million of this budgeted amount is considered nondiscretionary expenditures, which we may refer to in other filings as “maintenance” expenditures. Actual amounts spent will be dependent upon the timing of construction projects and acquisition opportunities for our home health and hospice business.

Authorizations for Returning Capital to Stakeholders

In October 2015, February 2016, and May 2016, our board of directors declared cash dividends of \$0.23 per share that were paid in January 2016, April 2016, and July 2016, respectively. On July 21, 2016, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of \$0.24 per share, payable on October 17, 2016 to stockholders of record on October 3, 2016. We expect quarterly dividends to be paid in January, April, July, and October. However, the actual declaration of any future cash dividends, and the setting of record and payment dates as well as the per share amounts, will be at the discretion of our board of directors after consideration of various factors, including our capital position and alternative uses of funds. Cash dividends are expected to be funded using cash flows from operations, cash on hand, and availability under our revolving credit facility.

The payment of cash dividends on our common stock triggers antidilution adjustments, except in instances when such adjustments are deemed *de minimis*, under our convertible notes. See Note 8, *Long-term Debt* to the consolidated financial statements accompanying the 2015 Form 10-K and Note 10, *Earnings per Common Share*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

On February 14, 2014, our board of directors approved an increase in our existing common stock repurchase authorization from \$200 million to \$250 million. As of June 30, 2016, approximately \$137 million remained under this authorization. The repurchase authorization does not require the repurchase of a specific number of shares, has an indefinite term, and is subject to termination at any time by our board of directors. Subject to certain terms and conditions, including a maximum price per share and compliance with federal and state securities and other laws, the repurchases may be made from time to time in open market transactions, privately negotiated transactions, or other transactions, including trades under a plan established in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended. During the first and second quarters of 2016, we repurchased 0.6 million shares of our common stock in the open market for approximately \$22 million under this repurchase authorization using cash on hand. Future repurchases under this authorization generally are expected to be funded using a combination of cash on hand and availability under our \$600 million revolving credit facility.

Adjusted EBITDA

Management believes Adjusted EBITDA as defined in our credit agreement is a measure of our ability to service our debt and our ability to make capital expenditures. We reconcile Adjusted EBITDA to *Net income* and to *Net cash provided by operating activities*.

We use Adjusted EBITDA on a consolidated basis as a liquidity measure. We believe this financial measure on a consolidated basis is important in analyzing our liquidity because it is the key component of certain material covenants contained within our credit agreement, which is discussed in more detail in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K. These covenants are material terms of the credit agreement. Noncompliance with these financial covenants under our credit agreement—our interest coverage ratio and our leverage ratio—could result in our lenders requiring us to immediately repay all amounts borrowed. If we anticipated a potential covenant violation, we would seek relief from our lenders, which would have some cost to us, and such relief might be on terms less favorable to us than those in our existing credit agreement. In addition, if we cannot satisfy these financial covenants, we would be prohibited under our credit agreement from engaging in certain activities, such as incurring additional indebtedness, paying common stock dividends, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted EBITDA is critical to our assessment of our liquidity.

In general terms, the credit agreement definition of Adjusted EBITDA, therein referred to as “Adjusted Consolidated EBITDA,” allows us to add back to consolidated *Net income* interest expense, income taxes, and depreciation and amortization and then add back to consolidated *Net income* (1) all unusual or nonrecurring items reducing consolidated *Net income* (of which only up to \$10 million in a year may be cash expenditures), (2) any losses from discontinued operations and closed locations, (3) costs and expenses, including legal fees and expert witness fees, incurred with respect to litigation associated with stockholder derivative litigation, and (4) share-based compensation expense. We also subtract from consolidated *Net income* all unusual or nonrecurring items to the extent they increase consolidated *Net income*.

Under the credit agreement, the Adjusted EBITDA calculation does not include net income attributable to noncontrolling interests and includes (1) gain or loss on disposal of assets, (2) professional fees unrelated to the stockholder derivative litigation, (3) unusual or nonrecurring cash expenditures in excess of \$10 million, and (4) pro forma adjustments resulting from debt transactions and development activities. Items falling within the credit agreement’s “unusual or nonrecurring” classification may occur in future periods, but these items and amounts recognized can vary significantly from period to period and may not directly relate to our ongoing operations. Accordingly, these items may not be indicative of our ongoing performance, so the Adjusted EBITDA calculation presented here includes adjustments for them.

Adjusted EBITDA is not a measure of financial performance under generally accepted accounting principles in the United States of America, and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted EBITDA should not be considered a substitute for *Net income* or cash flows from operating, investing, or financing activities. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. Revenues and expenses are measured in accordance with the policies and procedures described in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Our Adjusted EBITDA for the three and six months ended June 30, 2016 and 2015 was as follows (in millions):

Reconciliation of Net Income to Adjusted EBITDA

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$ 81.2	\$ 60.2	\$ 157.9	\$ 119.2
Loss from discontinued operations, net of tax, attributable to HealthSouth	0.1	1.6	0.2	1.9
Provision for income tax expense	42.4	32.2	82.1	62.5
Interest expense and amortization of debt discounts and fees	43.4	30.9	88.0	62.7
Professional fees—accounting, tax, and legal	1.7	0.1	1.9	2.3
Government, class action, and related settlements	—	—	—	8.0
Net noncash loss (gain) on disposal or impairment of assets	0.2	0.8	0.4	(0.7)
Depreciation and amortization	42.9	32.7	85.3	64.6
Loss on early extinguishment of debt	2.4	18.8	4.8	20.0
Stock-based compensation expense	8.6	6.2	13.1	15.6
Net income attributable to noncontrolling interests	(18.6)	(17.3)	(37.3)	(33.8)
Transaction costs	—	3.3	—	3.3
Adjusted EBITDA	\$ 204.3	\$ 169.5	\$ 396.4	\$ 325.6

Reconciliation of Net Cash Provided by Operating Activities to Adjusted EBITDA

	Six Months Ended June 30,	
	2016	2015
Net cash provided by operating activities	\$ 311.9	\$ 204.9
Provision for doubtful accounts	(31.9)	(22.5)
Professional fees—accounting, tax, and legal	1.9	2.3
Interest expense and amortization of debt discounts and fees	88.0	62.7
Equity in net income of nonconsolidated affiliates	4.8	3.9
Net income attributable to noncontrolling interests in continuing operations	(37.3)	(33.8)
Amortization of debt-related items	(6.8)	(6.3)
Distributions from nonconsolidated affiliates	(3.0)	(3.7)
Current portion of income tax expense	9.0	6.9
Change in assets and liabilities	55.2	101.2
Premium received on bond issuance	—	(8.0)
Premium paid on bond redemption	3.9	11.8
Transaction costs	—	3.3
Net cash used in operating activities of discontinued operations	0.5	0.3
Other	0.2	2.6
Adjusted EBITDA	\$ 396.4	\$ 325.6

Growth in Adjusted EBITDA in 2016 compared to 2015 resulted primarily from revenue growth in both segments due to the acquisitions of Reliant and CareSouth as well as our other 2015 development activities.

Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, see Note 1, *Basis of Presentation*, to our condensed consolidated financial statements included under Part I, Item 1, *Financial Statements (Unaudited)*, of this report.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary exposure to market risk is to changes in interest rates on our variable rate long-term debt. We use sensitivity analysis models to evaluate the impact of interest rate changes on our variable rate debt. As of June 30, 2016, our primary variable rate debt outstanding related to \$150.0 million in advances under our revolving credit facility and \$432.3 million outstanding under our term loan facilities. Assuming outstanding balances were to remain the same, a 1% increase in interest rates would result in an incremental negative cash flow of approximately \$5.2 million over the next 12 months, while a 1% decrease in interest rates would result in an incremental positive cash flow of approximately \$2.7 million over the next 12 months, assuming floating rate indices are floored at 0%.

See Note 5, *Long-term Debt*, and Note 7, *Fair Value Measurements*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report, for additional information regarding our long-term debt.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out by our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended. Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control Over Financial Reporting

There have been no changes in our Internal Control over Financial Reporting during the quarter ended June 30, 2016 that have a material effect on our Internal Control over Financial Reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information relating to certain legal proceedings in which we are involved is included in Note 11, *Contingencies and Other Commitments*, to the condensed consolidated financial statements contained in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and is incorporated herein by reference and should be read in conjunction with the related disclosure previously reported in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016 and our Annual Report on Form 10-K for the year ended December 31, 2015 (the “2015 Form 10-K”).

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part I, Item 1A, *Risk Factors*, of the 2015 Form 10-K. Certain information in those risk factors has been updated by the discussion in the “Executive Overview—Key Challenges” section of Part I, Item 2, *Management’s Discussion and Analysis of Financial Condition and Results of Operations*, of this report, which section is incorporated by reference herein.

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

Purchases of Equity Securities

The following table summarizes our repurchases of equity securities during the three months ended June 30, 2016 :

Period	Total Number of Shares (or Units) Purchased ⁽¹⁾	Average Price Paid per Share (or Unit) (\$)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs ⁽²⁾
April 1 through April 30, 2016	38,794	\$ 35.42	35,776	\$ 147,505,752
May 1 through May 31, 2016	145,447	39.83	145,447	141,712,702
June 1 through June 30, 2016	106,623	39.49	106,449	137,508,756
Total	290,864	39.12	287,672	

⁽¹⁾ Except as noted in the following sentence, the number of shares reported in this column includes the shares purchased under the plan or program as reported in the third column of this table and the shares tendered by employees as payments of the tax liabilities incident to the vesting of previously awarded shares of restricted stock and the exercise price and tax liability incident to the net settlement of an option exercise. In April, 1,112 shares were purchased pursuant to our Directors’ Deferred Stock Investment Plan. This plan is a nonqualified deferral plan allowing non-employee directors to make advance elections to defer a fixed percentage of their director fees. The plan administrator acquires the shares in the open market which are then held in a rabbi trust. The plan provides that dividends paid on the shares held for the accounts of the directors will be reinvested in shares of our common stock which will also be held in the trust. The directors’ rights to all shares in the trust are nonforfeitable, but the shares are only released to the directors after departure from our board.

⁽²⁾ On October 28, 2013, we announced our board of directors authorized the repurchase of up to \$200 million of our common stock. On February 14, 2014, our board of directors approved an increase in this common stock repurchase authorization from \$200 million to \$250 million. The repurchase authorization does not require the repurchase of a specific number of shares, has an indefinite term, and is subject to termination at any time by our board of directors. Subject to certain terms and conditions, including a maximum price per share and compliance with federal and state securities and other laws, the repurchases may be made from time to time in open market transactions, privately negotiated transactions, or other transactions, including trades under a plan established in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended.

Dividends

On October 15, 2013, we paid the first cash dividend, \$0.18 per share, on our common stock, and we paid the same per share dividend quarterly through July 15, 2014. On July 17, 2014, our board of directors approved an increase in our

quarterly dividend and declared a cash dividend of \$0.21 per share on our common stock that was paid on October 15, 2014, and we paid the same per share quarterly dividend through July 15, 2015. On July 16, 2015, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of \$0.23 per share that was paid on October 15, 2015, and we have paid the same per share quarterly dividend through July 15, 2016. On July 21, 2016, our board of directors approved an increase in our quarterly dividend and declared a cash dividend of \$0.24 per share, payable on October 17, 2016 to stockholders of record on October 3, 2016. We expect quarterly dividends to continue to be paid in January, April, July, and October. However, the actual declaration of any future cash dividends, and the setting of record and payment dates as well as the per share amounts, will be at the discretion of our board each quarter after consideration of various factors, including our capital position and alternative uses of funds.

The terms of our credit agreement allow us to declare and pay cash dividends on our common stock so long as: (1) we are not in default under our credit agreement and (2) our senior secured leverage ratio remains less than or equal to 1.75x. The terms of our senior note indenture allow us to declare and pay cash dividends on our common stock so long as (1) we are not in default, (2) the consolidated coverage ratio (as defined in the indenture) exceeds 2x or we are otherwise allowed under the indenture to incur debt, and (3) we have capacity under the indenture's restricted payments covenant to declare and pay dividends. We believe we currently have adequate capacity under these covenants to pursue the dividend strategy described in this report for the foreseeable future based on the capacity as of the date of this report and anticipated restricted payments. See Note 5, *Long-term Debt*, to the condensed consolidated financial statements included in Part I, Item 1, *Financial Statements (Unaudited)*, of this report and Note 8, *Long-term Debt*, to the consolidated financial statements accompanying the 2015 Form 10-K.

Item 6. Exhibits

See the Exhibit Index immediately following the signature page of this report.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

HEALTHSOUTH CORPORATION

By: _____ /s/ Douglas E. Coltharp
Douglas E. Coltharp
Executive Vice President and Chief Financial Officer

Date: July 29, 2016

EXHIBIT INDEX

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

No.	Description
3.1	Restated Certificate of Incorporation of HealthSouth Corporation, as filed in the Office of the Secretary of State of the State of Delaware on May 21, 1998 (incorporated by reference to HealthSouth's Annual Report on Form 10-K filed with the SEC on June 27, 2005).
3.2	Certificate of Amendment to the Restated Certificate of Incorporation of HealthSouth Corporation, as filed in the Office of the Secretary of State of the State of Delaware on October 25, 2006 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on October 31, 2006).
3.3	Amended and Restated Bylaws of HealthSouth Corporation, effective as of May 7, 2015 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on May 11, 2015).
3.4	Certificate of Designations of 6.50% Series A Convertible Perpetual Preferred Stock, as filed with the Secretary of State of the State of Delaware on March 7, 2006 (incorporated by reference to Exhibit 3.1 to HealthSouth's Current Report on Form 8-K filed on March 9, 2006).
10.1.1	HealthSouth Corporation 2016 Omnibus Performance Incentive Plan.+
10.1.2	Form of Non-Qualified Stock Option Agreement (2016 Omnibus Performance Incentive Plan).+
10.1.3	Form of Restricted Stock Agreement (2016 Omnibus Performance Incentive Plan).+
10.1.4	Form of Performance Share Unit Award (2016 Omnibus Performance Incentive Plan).+
10.1.5	Form of Restricted Stock Unit Award (2016 Omnibus Performance Incentive Plan).+
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Sections of the HealthSouth Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, formatted in XBRL (eXtensible Business Reporting Language), submitted in the following files:
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

+ Management contract or compensatory plan or arrangement.

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting a representative in the compensation group in the Human Resources department.

**HEALTHSOUTH CORPORATION
2016 OMNIBUS PERFORMANCE INCENTIVE PLAN**

**ARTICLE 1
PURPOSE**

1.1. General. The purpose of the HealthSouth Corporation 2016 Omnibus Performance Incentive Plan (the “*Plan*”) is to promote the success, and enhance the value, of HealthSouth Corporation (the “*Company*”) and its subsidiaries, by linking the personal interests of their employees, officers and directors to those of Company stockholders and by providing such persons with an incentive for outstanding performance. The Plan is further intended to provide flexibility to the Company by increasing its ability to motivate, attract, and retain the services of employees, officers and directors upon whose judgment, interest, and special effort the successful conduct of the Company’s operation is largely dependent. Accordingly, the Plan permits the grant of cash and equity incentive awards from time to time to selected employees, officers and directors.

**ARTICLE 2
EFFECTIVE DATE**

2.1. Effective Date. The Plan shall be effective as of May 9, 2016 (the “*Effective Date*”), subject to its approval by the stockholders of the Company. Unless terminated earlier by the Board, the Plan shall have a term of ten (10) years commencing upon the Effective Date; provided, however, termination of the Plan shall not cancel any Awards previously granted thereunder and provided further that the applicable provisions of the Plan shall remain in effect according to the terms of such Awards. If the Plan is approved and effective, the Company shall not grant or issue new equity awards under any other currently effective equity plan after the Effective Date.

**ARTICLE 3
DEFINITIONS**

3.1. Definitions. When a word or phrase appears in the Plan with the initial letter capitalized, and the word or phrase does not commence a sentence, the word or phrase shall generally be given the meaning ascribed to it in this Section or in Section 1.1 unless a clearly different meaning is required by the context. The following words and phrases shall have the following meanings:

(a) “*Award*” means any grant or award of Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Performance Shares, Performance Units, Dividend Equivalents, Other Stock-Based Award, Cash Award, or any other right or interest relating to Stock or cash, granted to a Participant under the Plan.

(b) “*Award Agreement*” means an agreement, contract, other instrument or document or other evidence approved by the Committee evidencing an Award. An Award Agreement may be in an electronic medium, may be solely evidenced by a notation on the Company’s books and records, and need not be signed by a representative of the Company or a Participant. An Award Agreement may be in the form of individual award agreements or certificates or a document describing the terms and provisions of an Award or series of Awards under the Plan.

(c) “*Board*” means the Board of Directors of the Company.

(d) “*Cash Award*” means any grant or award that confers the right to receive cash with the amount of such cash subject to achievement of one or more specified Performance Goals and subject to such other restrictions and conditions as may be established by the Committee.

(e) “**Cause**” means a conviction or no contest plea to a felony or moral turpitude crime or an act of dishonesty, moral turpitude, an intentional, negligent, or grossly negligent act detrimental to the best interests of the Company or a Subsidiary, failure to perform assigned duties, poor performance of assigned duties, breach of fiduciary duties to the Company, or violations of Company policies or code of conduct as in effect and amended from time to time, all as determined by the Committee; provided that, if a Participant is a participant in an executive severance plan adopted by the Company, then “Cause” for purposes of the Plan shall have the meaning set forth in such executive severance plan.

(f) “**Change in Control**” means any of the following events:

(i) the acquisition (other than from the Company) by any person, entity or “group” (within the meaning of Section 13(d)(3) or 14(d)(2) of the 1934 Act, but excluding, for this purpose, the Company or its subsidiaries, or any employee benefit plan of the Company or its subsidiaries which acquires beneficial ownership of voting securities of the Company) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the 1934 Act) of 30% or more of either the then-outstanding shares of Common Stock or the combined voting power of the Company’s then-outstanding voting securities entitled to vote generally in the election of Directors; or

(ii) during any period of up to 24 consecutive months, individuals who at the beginning of such period constituted the Board (together with any new directors whose election by the Board or whose nomination for election by the stockholders of the Company was approved by a vote of a majority of the directors of the Company then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease to constitute at least a majority of the Board; or

(iii) the Company is liquidated or dissolved or adopts a plan of liquidation or dissolution; or

(iv) the consummation of a merger or consolidation of the Company with or into another person or the merger of another person with or into the Company, or the sale of all or substantially all the assets of the Company (determined on a consolidated basis) to another person, other than a transaction following which (A) in the case of a merger or consolidation transaction, holders of securities that represented 100% of the combined voting power entitled to vote generally in the election of directors of the Company immediately prior to such transaction (or other securities into which such securities are converted as part of such merger or consolidation transaction) own directly or indirectly at least a majority of the combined voting power entitled to vote generally in the election of directors of the surviving person in such transaction immediately after such transaction and (B) in the case of a sale of assets, each transferee is owned by holders of securities that represented at least a majority of the combined voting power entitled to vote generally in the election of directors of the Company immediately prior to such sale.

(g) “**Code**” means the Internal Revenue Code of 1986, as amended from time to time.

(h) “**Committee**” means the Compensation Committee of the Board, or any successor thereto.

(i) “**Company**” means HealthSouth Corporation, a Delaware corporation, or any successor corporation.

(j) “**Covered Employee**” means a covered employee as defined in Code Section 162(m)(3) and authoritative guidance thereunder.

(k) “**Disability**” means, except as otherwise provided in an Award Agreement, a physical or mental condition which is expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months and which renders the Participant incapable of performing the work for which he is employed or similar work, as evidenced by eligibility for and actual receipt of benefits payable under a group disability plan or policy maintained by the Company or any of its Subsidiaries that is by its terms applicable to the Participant.

(l) “**Dividend Equivalent**” means a right granted to a Participant under Article 11.

(m) “**Effective Date**” has the meaning assigned such term in Section 2.1.

(n) “**Full Value Award**” means an Award other than in the form of an Option or SAR which is settled by the issuance of stock.

(o) “ **Fair Market Value** ” means (i) as of any given date, the closing price at which the shares of stock were traded (or if no transactions were reported on such date on the next preceding date on which transactions were reported) on the New York Stock Exchange on such date, or, if different, the principal exchange or automated quotation system on which such stock is traded, or (ii) should the Committee elect, the average selling price or volume-weighted average price (“ **VWAP** ”) on a given trading day or the VWAP over a series of pre-established trading days preceding or following such given date. If the shares are neither listed on the NYSE or another public exchange nor quoted on an inter-dealer quotation system or if the term is being applied to property other than stock, the amount determined by the Committee in its sole discretion to be the fair market value thereof.

(p) “ **Good Reason** ” shall mean, when used with reference to any Participant, any of the following actions or failures to act, but in each case only if it occurs while such Participant is employed by the Company and then only if it is not consented to by such Participant in writing:

(i) assignment of a position that is of a lesser rank than held by the Participant prior to the assignment and that results in a material adverse change in such Participant’s reporting position, duties or responsibilities or title or elected or appointed offices as in effect immediately prior to the effective date of such change;

(ii) a material reduction in such Participant’s total compensation from that in effect immediately prior to the Change in Control. For purposes of this clause (ii), “total compensation” shall mean the sum of base salary, target bonus opportunity and the opportunity to receive compensation in the form of equity in the Company. Notwithstanding the foregoing, a reduction will not be deemed to have occurred hereunder on account of (A) any change to a plan term other than ultimate target bonus opportunity or equity opportunity, (B) the actual payout of any bonus amount or equity amount, (C) any reduction resulting from changes in the market value of securities or other instruments paid or payable to the Participant, or (D) any reduction in the total compensation of a group of similarly situated Participants that includes such Participant; or

(iii) any change in a Participant’s status as a participant under any Change in Control compensation plan of the Company if such change in status occurs during the period beginning six (6) months prior to a Change in Control and ending twenty-four (24) months after a Change in Control; or

(iv) any change of more than fifty (50) miles in the location of the principal place of employment of such Participant immediately prior to the effective date of such change.

For purposes of this definition, none of the actions described in clauses (i) through (iv) above shall constitute “Good Reason” if taken for Cause. Additionally, none of the actions described in clauses (i) through (iv) above shall constitute “Good Reason” with respect to any Participant if remedied by the Company within thirty (30) days after receipt of written notice thereof given by such Participant (or, if the matter is not capable of remedy within thirty (30) days, then within a reasonable period of time following such thirty (30) day period, provided that the Company has commenced such remedy within said thirty (30) day period); provided that “Good Reason” shall cease to exist for any action described in clauses (i) through (iv) above on the sixtieth (60th) day following the later of the occurrence of such action or the Participant’s knowledge thereof, unless such Participant has given the Company written notice thereof prior to such date.

(q) “ **Grant Date** ” means the date specified by the Committee on which a grant of an Award shall become effective, which shall not be earlier than the date on which the Committee takes action with respect thereto.

(r) “ **Incentive Stock Option** ” means an Option that meets the requirements of Section 422 of the Code or any successor provision thereto.

(s) “ **Non-Employee Director** ” means a director of the Company who is not an employee of the Company or an affiliate.

(t) “ **Non-Qualified Stock Option** ” means an Option that is not intended to be an Incentive Stock Option.

(u) “ **Option** ” means a right granted to a Participant under Article 7 of the Plan to purchase Stock at a specified price during specified time periods. An Option under the Plan shall be a Non-Qualified Stock Option or an Incentive Stock Option.

(v) “ **Other Stock-Based Award** ” means a right, granted to a Participant under Article 13, which relates to or is valued by reference to Stock or other Awards relating to Stock.

(w) “ **Parent** ” means a corporation which owns or beneficially owns a majority of the outstanding voting stock or voting power of the Company.

(x) “ **Participant** ” means a person who, as an employee, officer or director of the Company or any Subsidiary, has been granted an Award under the Plan.

(y) “ **Performance Objectives** ” means the performance goals or objectives, if any, established pursuant to the Plan for Participants who have been granted Awards under the Plan. Performance Objectives may be described in terms of Company-wide objectives or objectives that are related to the performance of the individual Participant or the Subsidiary, division, region, department or function within the Company or Subsidiary in which the Participant is employed. Performance Objectives may be specified in absolute terms, in percentages, or in terms of growth from period to period or growth rates over time, as well as measured relative to an established or specially-created index of Company competitors or peers. Performance Objectives need not be based upon an increase or positive result under a business criterion and could include, for example, the maintenance of the status quo or the limitation of economic losses (measured, in each case, by reference to a specific business criterion). Performance Objectives may be based on any performance criteria, provided that any performance criteria applicable to a Qualified Performance-Based Award shall be limited to specified levels of or changes in the following metrics which may or may not, at the Committee’s discretion and as applicable, be calculated in accordance with generally accepted accounting principles in the United States: (1) earnings (including, but not limited to, earnings per share); (2) profit (including, but not limited to, net profit, gross profit, operating profit, economic profit, profit margins or other profit measures); (3) net or operating income; (4) revenue; (5) stock price or performance; (6) stockholder return; (7) return measures (including, but not limited to, return on assets, capital, equity or revenue); (8) EBITDA; (9) operating or EBITDA margins; (10) market share; (11) expenses (including, but not limited to, expense management, expense efficiency ratios or other expense measures); (12) business expansions or consolidation (including but not limited to, acquisitions and divestitures); (13) internal rate of return; (14) planning accuracy (as measured by comparing planned results to actual results); (15) year-over-year patient volume growth; (16) year-over-year changes in expense line items; (17) cash flow measures (including, but not limited to, free cash flow), (18) prevention of failures of internal controls or compliance, and (19) quality of care metrics (including, but not limited to, PEM Score, functional improvement measures, patient satisfaction and other metrics tracked by Medicare or Medicaid). Where applicable, those metrics may be measured on the basis of the consolidated Company, a Subsidiary, or a region or other subdivision of the business of the Company. Except in the case of a Qualified Performance-Based Award (unless and to the extent permitted under Code Section 162(m)), if the Committee determines that a change in the business, operations, corporate structure or capital structure of the Company, or the manner in which it conducts its business, or other events, circumstances or accounting entries that are unusual, nonrecurring or unrelated to the performance of the Participant render the Performance Objectives unsuitable (including, but not limited to, asset write-downs or impairment charges, litigation or claim judgments or settlements, changes in tax laws, material legislation changes, acquisitions and divestitures, accounting principles or other laws or provisions affecting reported results, unusual or infrequently occurring items as described in Accounting Standards Codification Topic 225-20 or Accounting Standards Update (ASU) 2015-01 (or any successor pronouncement thereto) and/or management’s discussion and analysis of financial condition and results of operations appearing in the Company’s annual report to stockholders for the applicable year, foreign exchange gains and losses, or any other identifiable event of a nonrecurring or extraordinary nature), the Committee may modify or adjust such Performance Objectives or the related minimum acceptable level of achievement, in whole or in part, as the Committee deems appropriate and equitable. Notwithstanding the foregoing, the calculation of the performance result for any metric may be subject to adjustment for such pre-established items or events if the Committee deems appropriate and equitable.

(z) “ **Performance Share** ” means a bookkeeping entry that records the equivalent of one share of Stock awarded pursuant to Article 9.

(aa) “ **Performance Unit** ” means a bookkeeping entry that records a unit equivalent to \$1.00 awarded pursuant to Article 9.

(bb) “ **Plan** ” means the HealthSouth Corporation 2016 Omnibus Performance Incentive Plan, as amended from time to time.

(cc) “ **Plan Year** ” means the twelve-month period beginning January 1 and ending December 31.

(dd) “ **Qualified Performance-Based Award** ” means an Award or portion of an Award that is intended to qualify for the Section 162(m) Exemption. The Committee shall designate any Qualified Performance-Based Award as such at the time of grant.

(ee) “ **Restricted Stock** ” means Stock granted to a Participant under Article 10 that is subject to certain restrictions and to risk of forfeiture.

(ff) “ **Restricted Stock Unit** ” or “ **RSU** ” means a bookkeeping entry that records a unit equivalent to one share of Stock awarded pursuant to Article 12.

(gg) “ **Retirement** ” means, except as otherwise provided in an Award Agreement, the voluntary termination of employment by a Participant after attaining (a) age 65 or (b) in the event that the Participant has been employed by the Company for ten (10) or more years on the date of such termination, age 60.

(hh) “ **Section 162(m) Exemption** ” means the exemption from the limitation on deductibility imposed by Section 162(m) of the Code that is set forth in Section 162(m)(4)(C) of the Code or any successor provision thereto.

(ii) “ **Specified Employee** ” means a specified employee as defined in Code Section 409A or authoritative guidance thereunder.

(jj) “ **Stock** ” means the \$.01 par value Common Stock of the Company, and such other securities of the Company as may be substituted for Stock pursuant to Article 16.

(kk) “ **Stock Appreciation Right** ” or “ **SAR** ” means a right granted to a Participant under Article 8 to receive a payment equal to the difference between the Fair Market Value of a share of Stock as of the date of exercise of the SAR over the grant price of the SAR, all as determined pursuant to Article 8.

(ll) “ **Subsidiary** ” means a corporation or other entity in which the Company has a direct or indirect ownership or other equity interest.

(mm) “ **1933 Act** ” means the Securities Act of 1933, as amended from time to time.

(nn) “ **1934 Act** ” means the Securities Exchange Act of 1934, as amended from time to time.

ARTICLE 4 ADMINISTRATION

4.1. Committee. The Plan shall be administered by the Compensation Committee of the Board or, at the discretion of the Board from time to time, by the Board. The Committee shall consist of three or more members of the Board. It is intended that the directors appointed to serve on the Committee shall be “non-employee directors” (within the meaning of Rule 16b-3 promulgated under the 1934 Act) and “outside directors” (within the meaning of Code Section 162(m) and the regulations thereunder) to the extent that Rule 16b-3 and, if necessary for relief from the limitation under Code Section 162(m) and such relief is sought by the Company, Code Section 162(m), respectively, are applicable. However, the mere fact that a Committee member shall fail to qualify under either of the foregoing requirements shall not invalidate any Award made by the Committee which Award is otherwise validly made under the Plan. During any time that the Board is acting as administrator of the Plan, it shall have all the powers of the Committee hereunder, and any reference herein to the Committee (other than in this Section 4.1) shall include the Board.

4.2. Authority of Committee. The Committee has the exclusive power, authority and discretion to:

- (a) Designate Participants;
- (b) Determine the type or types of Awards to be granted to each Participant;

(c) Determine the number of Awards to be granted and the number of shares of Stock to which an Award will relate;

(d) Determine the terms and conditions of any Award granted under the Plan, including but not limited to, the exercise price, grant price, or purchase price, any restrictions or limitations on the Award (including forfeiture provisions), any schedule or provisions for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers of vesting or forfeiture provisions, based in each case on such considerations as the Committee in its sole discretion determines;

(e) Determine whether, to what extent, and under what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered;

(f) Prescribe the form of each Award Agreement, which need not be identical for each Participant and which may be in the form of a document evidencing multiple Awards to one or more Participants;

(g) Decide all other matters that must be determined in connection with an Award;

(h) Establish, adopt or revise any rules and regulations as it may deem necessary or advisable to administer the Plan;

(i) Make all other decisions, determinations and interpretations that may be required or authorized under the Plan or as the Committee deems necessary or advisable to administer the Plan;

(j) Amend the Plan or any Award Agreement as provided herein; and

(k) Adopt such modification, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of non-U.S. jurisdictions in which the Company or a Subsidiary may operate, in order to assure the viability of the benefits of Awards granted to Participants located in such other jurisdictions and to meet the objectives of the Plan.

Notwithstanding the above, the Board or the Committee may, by resolution, delegate to officers, employees or directors of the Company or any of its Subsidiaries the authority to determine individuals to be recipients of Awards under the Plan, as well as the authority to determine the number of Shares of Stock to be subject to such Awards and the terms of such Awards; provided however, that such delegation of duties and responsibilities may not be made with respect to the grant of Awards to individuals (a) who are subject to Section 16(a) of the 1934 Act at the Grant Date, or (b) who, as of the Grant Date, are reasonably anticipated to become Covered Employees during the term of the Award. The acts of such delegates shall be treated hereunder as acts of the Committee and such delegates shall report regularly to the Board and the Committee regarding the delegated duties and responsibilities and any Awards so granted.

4.3. Decisions Binding. The Committee's interpretation of the Plan, any Awards granted under the Plan, any Award Agreement and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties.

4.4. Award Agreements. Each Stock-based Award shall be evidenced by an Award Agreement. Each Award Agreement shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

ARTICLE 5 SHARES SUBJECT TO THE PLAN

5.1. Number of Shares. Subject to adjustment as provided in Sections 5.3(a) and 17.1, the aggregate number of shares of Stock reserved and available for Awards under the Plan on or after May 9, 2016 shall be fourteen million (14,000,000) shares. The total number of shares that may be granted as Incentive Stock Options is one million (1,000,000) shares.

5.2. Reduction Ratio. For purposes of Section 5.1, each share of Stock subject to an Award, other than an Option or SAR, shall reduce the number of shares of Stock available for Awards by 2.65 shares (the "*Fungibility Ratio*"). The number of

shares of Stock available for Awards shall be reduced by one (1) share for each Option or SAR. If the exercise of the Option or SAR with respect to a share of Stock cancels an associated or tandem SAR or Option, respectively, with respect to such share, the associated or tandem Option and SAR shall, in the aggregate, reduce the available count by one share only. Awards that can be settled only in cash shall not reduce the number of shares of Stock available for issuance under the Plan.

5.3. Share Counting.

(a) The following (as modified by the Fungibility Ratio) shall not reduce, or may be added back to, the number of authorized shares of Stock available for issuance under the Plan:

(1) Common Stock reserved for issuance upon exercise or settlement, as applicable, of Awards granted under the Plan to the extent the Awards expire or are forfeited, canceled or surrendered;

(2) Restricted Stock granted under the Plan, to the extent such Restricted Stock is forfeited under Section 16.8 or is otherwise surrendered to the Company before the restricted period expires;

(3) Awards, to the extent the payment is actually made in cash;

(4) Shares reserved for issuance upon grant of Performance Share or Performance Unit or Other Stock-Based Award, to the extent the number of reserved shares exceeds the number of shares actually issued upon determination of the satisfaction of the related Performance Objectives;

(5) Shares reserved for issuance upon grant of RSUs, to the extent the number of reserved shares exceeds the number of shares actually issued upon settlement of RSUs; and

(6) Shares withheld by, or otherwise remitted to, the Company to satisfy a Participant's tax withholding obligations upon the lapse of restrictions on Full Value Awards granted under the Plan or upon any other payment or issuance of shares under the Plan not prohibited under Section 5.3(b)(2) below.

(b) The following shares of Stock shall not become available for issuance under the Plan:

(1) Shares withheld by, or otherwise remitted to, the Company as full or partial payment of the exercise price of an Option granted under the Plan;

(2) Shares withheld by, or otherwise remitted to, the Company to satisfy a Participant's tax withholding obligations upon the lapse of restrictions on the exercise of Options or SARs granted under the Plan;

(3) Shares not issued upon the settlement of a SAR that settles in shares of Stock;

(4) Shares remaining available for issuance (and not associated with previous grants or awards) under any prior plan of the Company after the Effective Date; and

(5) Shares reacquired by the Company in the open market or otherwise using cash proceeds from the exercise of Options or, after the Effective Date, options under any prior plan.

(c) Substitute Awards granted pursuant to Section 16.10 of the Plan shall not count against the shares of Stock otherwise available for issuance under the Plan under Section 5.1.

(d) Shares reserved for issuance in connection with grants or awards under any prior plan of the Company outstanding as of the Effective Date may be added to the number of authorized shares of Stock available for issuance under the Plan, to the extent such shares would have been added back pursuant to this Section 5.3 had such grants or awards been made under the Plan.

(e) Shares available under a stockholder approved plan of an entity which is acquired by, or merged with and into, the Company (as such shares are appropriately adjusted to reflect the financial effect of the transaction in accordance with relevant legal requirements), shall (subject to applicable stock exchange requirements) be available for

the granting of Awards hereunder, and shall not count against the shares of Stock otherwise available for issuance under Section 5.1.

5.4. Annual Award Limits. The following limits (each an “ *Annual Award Limit* ”, and collectively, “ *Annual Award Limits* ”) shall, subject to adjustment as provided in Section 17.1, apply to grants of Awards under the Plan:

(a) Options: The maximum aggregate number of shares of Stock subject to Options which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(b) SARs: The maximum aggregate number of shares of Stock subject to SARs which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(c) Performance Shares: For Awards of Performance Shares that are intended to be Qualified Performance-Based Awards, the maximum aggregate number of shares of Stock subject to Awards of Performance Shares which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(d) Performance Units: The maximum aggregate amount that may be granted to any one Participant in any period consisting of two consecutive Plan Years shall be \$10,000,000 of associated bookkeeping entry value. If, after an amount has been earned with respect to a Cash Award, the delivery of such amount is deferred, any additional amount attributable to earnings during the deferral period shall be disregarded for purposes of this limitation.

(e) Cash Awards: For Cash Awards that are intended to be Qualified Performance-Based Awards, the maximum aggregate amount that may be granted to any one Participant in any period consisting of two consecutive Plan Years shall be \$10,000,000. If, after an amount has been earned with respect to a Cash Award, the delivery of such amount is deferred, any additional amount attributable to earnings during the deferral period shall be disregarded for purposes of this limitation.

(f) Restricted Stock: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Restricted Stock which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000.

(g) Restricted Stock Units: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Restricted Stock Units which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000 and the associated bookkeeping entry value shall not exceed Fair Market Value (determined on the date of grant) of such number of shares.

(h) Other Stock-Based Awards: The maximum aggregate number of shares of Stock that are intended to be Qualified Performance-Based Awards of Other Stock-Based Awards which may be granted in any period consisting of two consecutive Plan Years to any one Participant shall be 1,000,000 shares or the Fair Market Value of such number of shares (determined on the date of grant).

5.5. Stock Distributed. Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock, Stock held in treasury, or Stock purchased on the open market.

5.6. Minimum Vesting Requirements. Except with respect to Full Value Awards accounting for not greater than 5% of the aggregate number of shares of Stock reserved and available for Awards under Section 5.1 or as otherwise provided in Section 16.6, Full-Value Awards granted under the Plan to an employee shall either (i) be subject to a minimum vesting period of three years (which may include graduated vesting within such three-year period) or one year if the vesting is based on Performance Objectives, or (ii) be granted solely in lieu of cash compensation.

ARTICLE 6 ELIGIBILITY

6.1. General. Awards may be granted only to individuals who are employees, officers or directors of the Company or employees or officers of a Parent or Subsidiary.

ARTICLE 7
STOCK OPTIONS

7.1. General. The Committee is authorized to grant Options to Participants on the following terms and conditions:

(f) Exercise Price. The exercise price per share of Stock at which an Option is granted shall be determined by the Committee, provided that the exercise price for any Option (other than an Option issued as a substitute Award pursuant to Section 16.10) shall not be less than the Fair Market Value as of the Grant Date. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding Options may not be amended to reduce the exercise price or to cancel or replace outstanding underwater Options in exchange for cash, other awards or Options with an exercise price that is less than the exercise price of the corresponding original Options without stockholder approval.

(g) Time and Conditions of Exercise. The Award Agreement shall specify the time or times at which an Option may be exercised in whole or in part. The Award Agreement shall specify the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised. The Committee may waive any exercise provisions at any time in whole or in part based upon factors as the Committee may determine in its sole discretion so that the Option becomes exercisable at an earlier date. The Award Agreement may provide that an Option shall automatically exercise by means of a net settlement on a given date in the event that the expiration date occurs at a time that the participant is prohibited by law or Company policy from trading in security of the Company and such Option is in the money.

(h) Lapse of Option. The Option shall lapse ten years after it is granted, unless an earlier option expiration date is set forth in the Award Agreement, and unless an earlier lapse occurs under Section 16.8. The original term of an Option may not be extended without the prior approval of the Company's stockholders.

(i) Payment. The Award Agreement shall specify the methods by which the exercise price of an Option may be paid, the form of payment, including, without limitation, cash, shares of Stock, or other property (including "cashless exercise" arrangements) and the methods by which shares of Stock shall be delivered or deemed to be delivered to Participants.

(j) Evidence of Grant. All Options shall be evidenced by an Award Agreement between the Company and the Participant. The Award Agreement shall include such provisions, not inconsistent with the Plan, as may be specified by the Committee.

ARTICLE 8
STOCK APPRECIATION RIGHTS

8.1. Grant of SARs. The Committee is authorized to grant SARs to Participants on the following terms and conditions:

(i) Right to Payment. Upon the exercise of a SAR, the Participant to whom it is granted has the right to receive the excess, if any, of:

(1) The Fair Market Value of one share of Stock on the date of exercise; over

(2) The grant price of the SAR as determined by the Committee, which shall not be less than the Fair Market Value of one share of Stock on the Grant Date except in connection with a SAR issued as a substitute Award pursuant to Section 16.10. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of outstanding SARs may not be amended to reduce the exercise price or to cancel or replace outstanding underwater SARs in exchange for cash, other awards or SARs with an exercise price that is less than the exercise price of the corresponding original SARs without stockholder approval.

(j) Other Terms. All awards of SARs shall be evidenced by an Award Agreement. The terms, methods of exercise, methods of settlement, form of consideration payable in settlement, and any other terms and conditions of any SAR shall be determined by the Committee at the time of the grant of the Award and shall be reflected in the Award Agreement.

(k) Freestanding SARs. A SAR which is not granted in tandem with an Option or a similar right granted under any other plan of the Company shall be subject to the following:

(1) Each grant shall specify in respect of each freestanding SAR the grant price of the SAR;

(2) Successive grants may be made to the same Participant regardless of whether any freestanding SAR previously granted to such Participant remain unexercised; and

(3) Each grant shall specify the period or periods of continuous employment of the Participant by the Company or any Subsidiary that are necessary before the freestanding SARs or installments thereof shall become exercisable, and any grant may provide for the earlier exercise of such rights in the event of acceleration under Article 15.

(l) Payment in Cash or Shares. Any grant may specify that the amount payable upon the exercise of a SAR may be paid by the Company in cash, shares of Stock or any combination thereof and may (i) either grant to the Participant or reserve to the Committee the right to elect among those alternatives or (ii) preclude the right of the Participant to receive and the Company to issue shares of Stock or other equity securities in lieu of cash.

(m) Exercise Period. Any grant may specify (i) a waiting period or periods before SARs shall become exercisable and (ii) permissible dates or periods on or during which SARs shall be exercisable. No SAR granted under the Plan may be exercised more than ten years from the Grant Date. The original term of an SAR may not be extended without the prior approval of the Company's stockholders.

ARTICLE 9
PERFORMANCE SHARES OR PERFORMANCE UNITS

9.1. Grant of Performance Shares or Performance Units. The Committee is authorized to grant Performance Shares or Performance Units to Participants on such terms and conditions as may be selected by the Committee. The grant of a Performance Share to a Participant will entitle the Participant to receive at a specified later time a specified number of shares, or the equivalent cash value if the Committee so provides, if the Performance Objectives established by the Committee are achieved and the other terms and conditions thereof are satisfied. The grant of a Performance Unit to a Participant will entitle the Participant to receive at a specified later time a specified dollar value in cash or other property (including shares) as determined by the Committee, if the Performance Objectives in the Award are achieved or attained and the other terms and conditions thereof are satisfied. All

Awards of Performance Shares or Performance Units shall be evidenced by an Award Agreement. The Award Agreement shall specify the number of Performance Shares or Performance Units to which it pertains; provided that such number may be adjusted to reflect changes in compensation or other factors. Further, the Award Agreement shall state that the Performance Shares or Performance Units are subject to all of the terms and conditions of the Plan and such other terms and provisions as the Committee may determine consistent with the Plan. An Award of Performance Shares or Performance Units may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

9.2. Right to Payment. A grant of Performance Shares or Performance Units gives the Participant rights, valued as determined by the Committee, and payable to, or exercisable by, the Participant to whom the Performance Shares or Performance Units are granted, in whole or in part, as the Committee shall establish at grant or thereafter. The Committee shall set Performance Objectives and other terms or conditions to payment of the Performance Shares or Performance Units in its discretion which, depending on the extent to which they are met, will determine the number and value of Performance Shares or Performance Units that will be paid to the Participant.

9.3. Performance Period. The performance period with respect to each Performance Share or Performance Unit shall commence on the date specified in the Award Agreement and may be subject to earlier termination in the event of an acceleration under Article 15.

9.4. Threshold Performance Objectives. Each grant may specify in respect of the specified Performance Objectives a minimum acceptable level of achievement or attainment below which no payment will be made and may set forth a formula for determining the amount of any payment to be made if performance is at or above such minimum acceptable level but falls short of the maximum achievement of the specified Performance Objectives.

9.5. Payment of Performance Shares and Performance Units. Awards of Performance Shares or Performance Units may be payable in cash, Stock, Restricted Stock, or Restricted Stock Units in the discretion of the Committee, and have such other terms and conditions as determined by the Committee and reflected in the Award Agreement. For purposes of determining the number of shares of Stock to be used in payment of a Performance Unit denominated in cash but payable in whole or in part in Stock or Restricted Stock, the number of shares to be so paid will be determined by dividing the cash value of the Award to be so paid by the Fair Market Value of a share of Stock on the date of determination by the Committee of the amount of the payment under the Award.

ARTICLE 10 AWARDS OF RESTRICTED STOCK

10.1. Grant of Restricted Stock. The Committee is authorized to make Awards of Restricted Stock to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. All Awards of Restricted Stock shall be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. Each grant of Restricted Stock shall constitute an immediate transfer of the ownership of Stock to the Participant in consideration of the performance of services, subject to the substantial risk of forfeiture and restrictions on transfer hereinafter referred to.

10.2. Issuance and Restrictions. Restricted Stock shall be subject to such restrictions on transferability as the Committee may impose. Such restrictions may include, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock, and provisions subjecting the Restricted Stock to a continuing risk of forfeiture in the hands of any transferee. These restrictions may lapse separately or in combination at such times, under such circumstances, in such installments, upon the satisfaction of Performance Objectives or otherwise, as the Committee determines at the time of the grant of the Award or thereafter.

10.3. Consideration. Each grant may be made without additional consideration from the Participant or in consideration of a payment by the Participant that is less than the Fair Market Value on the Grant Date.

10.4. Dividends, Voting and Other Ownership Rights. Unless otherwise provided in an Award Agreement or any special Plan document governing an Award, an Award of Restricted Stock shall entitle the Participant to all of the rights of a stockholder with respect to Restricted Stock (including voting and other ownership rights) throughout the restricted period; provided, dividends (including the proceeds of reinvested dividends) shall be paid with respect to a performance-based Restricted Stock Award only to the extent the underlying Award has vested in accordance with the Plan and the applicable Award Agreement, and all other dividends rights shall be forfeited. Participants may only be entitled to dividends if permissible under the agreements or instruments governing the Company's indebtedness.

10.5. Performance-Based Restricted Stock. Any Award or the vesting thereof of Restricted Stock may be predicated on or further conditioned upon the achievement or attainment of Performance Objectives established by the Committee and may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

10.6. Reinvesting. Any grant may require that any or all dividends (if permitted under the agreements or instruments governing the Company's indebtedness) or other distributions paid on the Restricted Stock during the period of such restrictions be automatically sequestered and reinvested in additional shares of Stock, which may be subject to the same restrictions as the underlying Award or such other restrictions as the Committee may determine.

10.7. Issuance of Restricted Stock. Restricted Stock issued under the Plan following vesting shall be evidenced in a manner authorized by the General Corporation Law of the State of Delaware and may be evidenced in any such manner as the Committee shall determine. If certificates representing shares of Restricted Stock are registered in the name of the Participant, certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock or otherwise must be subject to reasonable precautions intended to prevent unauthorized transfer.

ARTICLE 11 DIVIDEND EQUIVALENTS

11.1. Grant of Dividend Equivalents. The Committee is authorized to grant Dividend Equivalents to Participants with respect to Full Value Awards, and only Full Value Awards, granted hereunder, subject to such terms and conditions as may be selected by the Committee (if permitted under agreements or instruments governing the Company's indebtedness). Dividend Equivalents shall entitle the Participant to receive payments equal to dividends with respect to all or a portion of the number of shares of Stock subject to a Full Value Award, as determined by the Committee. The Committee may provide that Dividend Equivalents be paid or distributed when accrued or be deemed to have been reinvested in additional shares of Stock, or otherwise reinvested; provided, dividends (including the proceeds of reinvested dividends) shall be paid or distributed with respect to a performance-based Award only to the extent the underlying Award has vested in accordance with the Plan and the applicable Award Agreement, and all other dividends rights shall be forfeited. An Award of Dividend Equivalents may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 12 RESTRICTED STOCK UNITS

12.1. Grant of RSUs. The Committee is authorized to make Awards of RSUs to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. All Awards of Restricted Stock shall be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. An Award of RSUs may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 13 OTHER STOCK-BASED AWARDS

13.1. Grant of Other Stock-Based Awards. The Committee is authorized, subject to limitations under applicable law and the provisions of the Plan, to grant to Participants such other Awards that are payable in, valued in whole or in part by reference to, or otherwise based on or related to shares of Stock, as deemed by the Committee to be consistent with the purposes of the Plan, including without limitation shares of Stock awarded purely as a "bonus" and not subject to any restrictions or conditions, convertible or exchangeable debt securities, other rights convertible or exchangeable into shares of Stock, and Awards valued by reference to book value of shares of Stock or the value of securities of or the performance of specified Parents or Subsidiaries. The Committee shall determine the terms and conditions of such Awards; provided, if dividend equivalent rights are granted, no payment, distribution or reinvestment of an accrued dividend on an Award shall be made unless and until each applicable Performance Objective, if any, has been achieved or satisfied in accordance with the Plan and the applicable Award Agreement. An Award made pursuant to this Article 13 may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 14 CASH AWARDS

14.1. Grant of Cash Awards. The Committee is authorized to make Cash Awards to Participants in such amounts and subject to such terms and conditions as may be selected by the Committee. Cash Awards may be evidenced by an Award Agreement setting forth the terms, conditions and restrictions applicable to the Award. The Committee shall determine the terms and conditions of Cash Awards. A Cash Award may or may not be designated as a Qualified Performance-Based Award, as determined by the Committee.

ARTICLE 15
CODE SECTIONS 409A AND 162(m) PROVISIONS

15.1. Code Section 409A. Notwithstanding anything in the Plan or in any Award Agreement to the contrary, to the extent that any amount or benefit that would constitute “nonqualified deferred compensation” (as defined in Section 409A of the Code) to a Participant would otherwise be payable or distributable under the Plan or any Award Agreement solely by reason of the occurrence of a Change in Control or on account of the Participant’s Disability or separation from service, such amount or benefit will not be payable or distributable to the Participant by reason of such circumstance unless (i) the circumstances giving rise to such Change in Control, Disability or separation from service meet the description or definition of “change in control event”, “disability” or “separation from service”, as the case may be, in Section 409A of the Code and the regulations promulgated thereunder, or (ii) the payment or distribution of such amount or benefit would be exempt from the application of Section 409A of the Code by reason of the short-term deferral exemption or otherwise. Any payment or distribution of an amount or benefit that would constitute “nonqualified deferred compensation” (as defined in Section 409A of the Code), which is made on account of separation from service to a Participant who is a Specified Employee (as defined in Section 409A of the Code) may not be made before the date which is six (6) months after the date of the Specified Employee’s separation from service if the payment or distribution is not exempt from the application of Section 409A of the Code by reason of the short-term deferral exemption or otherwise. This provision does not prohibit the vesting of any Award or the vesting of any right to eventual payment or distribution of any amount or benefit under the Plan or any Award Agreement. The Plan and all Awards made hereunder are intended to be exempt from the provisions of Section 409A of the Code or, to the extent subject to Section 409A of the Code, comply with Section 409A of the Code and any authoritative guidance thereunder. The Plan and all Awards made hereunder shall be interpreted, construed and administered in accordance with these intentions. Nothing in the Plan shall provide a basis for any person to take action against the Company or any affiliate based on matters covered by Section 409A of the Code, including the tax treatment of any amount paid or Award made under the Plan, and neither the Company nor any of its affiliates shall under any circumstances have any liability to any Participant or his beneficiary or estate for any taxes, penalties or interest due on amounts paid or payable under the Plan, including taxes, penalties or interest imposed under Section 409A of the Code.

15.2. Code Section 162(m). Awards issued to Covered Employees under the Plan generally are intended to be Qualified Performance-Based Awards and shall be interpreted, construed and administered in accordance with this intention. However, the Committee reserves the right to issue Awards that are not fully deductible. Further, because of ambiguities and uncertainties as to the application and interpretation of Code Section 162(m), no assurance can be given, notwithstanding the Committee’s efforts, that an Award intended to satisfy the requirements for deductibility does, in fact, do so. Nothing in the Plan shall provide a basis for any person to take action against the Company or any affiliate based on matters covered by Section 162(m) of the Code, including the tax treatment of any amount paid or Award made under the Plan.

ARTICLE 16
PROVISIONS APPLICABLE TO ALL AWARDS

16.1. Term of Award. The term of each Award shall be for the period as determined by the Committee, subject to the terms of the Plan.

16.2. Limits on Transfer.

(a) Except as provided in Section 16.2(b) below, during a Participant's lifetime, his or her Awards shall be exercisable only by the Participant. No Awards may be sold, pledged, assigned, or transferred in any manner other than by will or the laws of descent and distribution; no Awards shall be subject, in whole or in part, to attachment, execution or levy of any kind; and any purported transfer in violation hereof shall be null and void. A Participant may designate a beneficiary in accordance with procedures established by the Committee pursuant to Section 16.3 below.

(b) The Committee may, in its discretion, determine that notwithstanding Section 16.2(a), any or all Awards shall be transferable to and exercisable by such transferees, and subject to such terms and conditions, as the Committee may deem appropriate; provided, however, no Award may be transferred for value (as defined in the General Instructions to Form S-8).

(c) Notwithstanding Sections 16.2(a) and (b), an Award may be transferred pursuant to a domestic relations order that would satisfy Section 414(p)(1)(A) of the Code if such Section applied to an Award under the Plan, but only if the tax consequences flowing from the assignment or transfer are specified in said order, the order is accompanied by signed agreement by both or all parties to the domestic relations order, and, if requested by the Committee, an opinion is provided by qualified counsel for the Participant that the order is enforceable by or against the Plan under applicable law, and said opinion further specifies the tax consequences flowing from the order and the appropriate tax reporting procedures for the Plan.

16.3. Beneficiaries. Notwithstanding Section 16.2, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights under the Plan is subject to all terms and conditions of the Plan and any Award Agreement applicable to the Participant, except to the extent the Plan and Award Agreement otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If no beneficiary has been properly designated or survives the Participant, payment shall be made to the Participant's estate. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Company.

16.4. Stock Certificates. All Stock issued under the Plan is subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal or state securities laws, rules and regulations and the rules of any national securities exchange or automated quotation system on which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate to reference restrictions applicable to the Stock.

16.5. Acceleration Following a Change in Control. Except as otherwise provided in the Award Agreement, upon termination of a Participant's employment by the Company without Cause or by the Participant for Good Reason within twenty-four (24) months following the occurrence of a Change in Control or to the extent the surviving entity does not assume such Awards or substitute in lieu thereof similar awards relating to the stock of such surviving entity having an equivalent then-current value and remaining term, provided that such stock must be listed, quoted, or traded on a national securities exchange or automated quotation system, all outstanding Options, SARs, and other Awards in the nature of rights that may be exercised automatically shall become fully exercisable and all restrictions (other than Performance Objectives) on all outstanding Awards automatically shall lapse. With respect to Performance Objectives applicable to any Award for which the performance period is not complete, the Committee shall have the discretionary authority to determine whether, and if so, the extent to which, (1) the performance period or the Performance Objectives shall be deemed to be satisfied or waived following a Change in Control, and (2) the Performance Objectives shall be modified, adjusted or changed on account of the Change in Control.

16.6. Acceleration for any Other Reason. Regardless of whether an event has occurred as described in Section 16.5 above, and subject to the restrictions on Qualified Performance-Based Awards, the Committee may in its sole discretion at any time accelerate the vesting provisions and/or waive the forfeiture provisions applicable to any Award or determine that all or a portion of a Participant's Options, SARs, and other Awards in the nature of rights that may be exercised shall become fully or partially exercisable, and that all or a part of the restrictions on all or a portion of the outstanding Awards shall lapse, and that any Performance Objectives with respect to any Awards held by that Participant shall be deemed to be wholly or partially satisfied, in each case, as of such date as the Committee may, in its sole discretion, declare. The discretion of the Committee in the preceding sentence shall be limited to the death, disability or Retirement of a Participant; provided, however that the Committee may exercise such discretion for any reason with respect to Awards of up to five percent (5%) of the shares available for Awards under Section 5.1. The Committee may discriminate among Participants and among Awards granted to a Participant in exercising its discretion pursuant to this Section 16.6. Any such determinations by the Committee shall be final and binding on all parties.

16.7. Effect of Acceleration. If an Award is accelerated under Section 16.5 or 16.6, the Committee may, in its sole discretion, provide (i) that the Award will expire after a designated period of time after such acceleration to the extent not then exercised, (ii) that the Award will be settled in cash rather than Stock, (iii) that the Award will be assumed by another party to the transaction giving rise to the acceleration or otherwise be equitably converted in connection with such transaction, (iv) that the Award may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying stock, as of a specified date associated with the transaction, over the exercise price of the Award, (v) that, in the event of a Change in Control, an Award may be cancelled without payment if Fair Market Value of the underlying Stock, as of a specified date associated with such event, does not exceed the exercise price of the Award or (vi) any combination of the foregoing. The Committee's determination need not be uniform and may be different for different Participants whether or not such Participants are similarly situated.

16.8. Lapse or Forfeiture at or Following Termination of Employment. Except as otherwise provided in an Award Agreement or as otherwise determined by the Committee pursuant to the provisions of Section 16.6, the following lapse and forfeiture provisions shall apply upon a Participant's termination of employment.

(a) Termination for Cause. Any outstanding Award, including, without limitation, Awards that are unvested, vested and unexercised, or subject or not subject to restrictions, shall automatically and immediately lapse and be forfeited if the Participant's employment is terminated by the Company for Cause.

(b) Other Termination-Options and SARs. Upon a Participant's termination for any reason, the unvested portion of any outstanding Options and SARs shall terminate and be forfeited. The vested portion of any outstanding Options and SARs at the time of a Participant's termination for reasons other than for Cause shall continue to be exercisable by the Participant (or the Participant's estate in the event of the Participant's death) during the period set forth in the following chart, but in no event later than ten years from the Grant Date. At the end of such continuing exercise period, the unexercised Options and SARs shall terminate and be forfeited.

<u>Reason for Termination</u>	<u>Continuing Exercise Period</u>
Disability	1 year following termination
Death (Including death during the applicable continuing exercise period following termination for another reason)	1 year following death
Retirement	Lesser of the Original Term of Option or SAR or 3 Years
Reason Other Than Death, Disability, Retirement or Cause	90 days following termination

(c) Other Terminations - Restricted Stock, Performance Shares, Performance Units or other Awards. The following shall apply with respect to outstanding Awards of Restricted Stock, Performance Shares, Performance Units or other Awards which are unvested, unused or otherwise not immediately distributable at the time of a Participant's termination of employment for reasons other than Cause:

(i) If the Participant's employment is terminated by reason of death or Disability, then all restrictions (other than Performance Objectives) shall lapse, and, subject to the attainment of applicable Performance Objectives (which may be waived or modified by the Committee to the extent set forth below), the unearned or unvested portion of the Award shall become immediately vested, earned and nonforfeitable, and shall be distributed to the Participant (or the Participant's beneficiary in the event of the Participant's death) as soon as reasonably practical following such termination, and in any event within 90 days thereof or of the end of the performance period, as applicable.

(ii) If the Participant's employment is terminated by reason of Retirement, then the restrictions (other than Performance Objectives) shall lapse, and, subject to the attainment of applicable Performance Objectives (which may be waived or modified by the Committee to the extent set forth below), the unearned or unvested portion of the Award shall become partially vested, earned and nonforfeitable according to the following formula: The portion that becomes vested, earned and nonforfeitable shall equal the number of shares of Stock granted as of the Grant Date multiplied by the ratio of (i) the number of full months that have elapsed from the Grant Date to the date of the Participant's Retirement, to (ii), the number of full months contained in the original term of the Award.

(iii) If the Participant's employment is terminated for any reason other than by reason of death, Disability, or Retirement then the restricted, unvested or unearned portion of the Award shall automatically and immediately be cancelled and forfeited.

With respect to any Award subject to Performance Objectives, the Committee shall have the discretion, in the event of a termination described in (i) or (ii) above during the applicable Performance Period, to waive and/or modify the Performance Objectives based on any conditions that the Committee deems reasonable, including but not limited to the formula in (ii) above or the performance status as of the termination date; provided, however, with respect to any Qualified Performance-Based Award and a termination described in (ii) above, the satisfaction of the Performance Objectives shall only be determined based on achievement during the performance period as originally established. Any Restricted Stock resulting from determination of performance pursuant to this paragraph shall vest and all other restrictions thereon shall lapse at the time the performance is determined.

(d) Determinations upon Leaves of Absence. Whether military, government or other service or other leave of absence shall constitute a termination of employment shall be determined in each case by the Committee at its discretion, and any determination by the Committee shall be final and conclusive. The Committee may in its sole discretion take any further action that it deems to be equitable under the circumstances or in the best interests of the Company, including, without limitation, waiving or modifying any limitation or requirement with respect to any Award under the Plan. The period of any leave of absence shall not be credited for vesting purposes unless otherwise determined by the Committee.

(e) Cancellation for Violation of Non-Compete. Without limiting the Committee's discretion to cancel any Award at any time, the Committee shall have full power and authority to cancel an Award if the Participant, while employed by the Company or a Subsidiary or within a period which begins on the date of termination of employment and ends on the date which is one year later, engages in any activity which is in direct competition with the Company or solicits other employees or customers of the Company or its Subsidiaries in a competitive business venture. Whether a Participant has engaged in such conduct shall be determined by the Committee in its sole discretion, taking into account any determination by the Company that the Participant has acted in violation of a non-compete or non-solicitation agreement with or obligation to the Company or a Subsidiary.

16.9. Performance Objectives. The Committee may determine that any Award granted pursuant to the Plan to a Participant (including, but not limited to, Participants who are Covered Employees) shall be determined solely or partially on the basis of Performance Objectives. If a Qualified Performance-Based Award is made on the basis of Performance Objectives, the Committee shall establish objectives prior to the beginning of the period for which such Performance Objectives relate (or such later date as may be permitted under Code Section 162(m) or the regulations thereunder). Any payment of an Award granted with Performance Objectives, including any Qualified Performance-Based Award, shall be conditioned on the determination of the Committee in each case that the Performance Objectives and any other material conditions have been satisfied. The Committee's determination shall be reflected in the Committee's minutes, and shall be based on receipt of a written certification from the Company's Human Resources Department that the Performance Objectives and any other material conditions have been satisfied.

Except in the case of Disability or death of the Participant, or upon the occurrence of a Change in Control, no Qualified Performance-Based Award held by a Covered Employee or by an employee who in the reasonable judgment of the Committee may be a Covered Employee on the date of payment, may be amended, nor may the Committee exercise any discretionary authority it may otherwise have under the Plan with respect to a Qualified Performance-Based Award under the Plan, in any manner to waive the achievement of the applicable Performance Objective or to increase the amount payable pursuant thereto or the value thereof, or otherwise in a manner that would cause the Qualified Performance-Based Award to cease to qualify for the Section 162(m) exemption. Performance periods established by the Committee for a Qualified Performance-Based Award may be as short as three months and may be any longer period.

If a Participant is promoted, demoted or transferred to a different business unit or function during a performance period, the Committee may determine that the specified Performance Objectives are no longer appropriate and may (i) modify, adjust, change or eliminate the Performance Objectives or the applicable performance period as it deems appropriate to make such criteria and period comparable to the initial Performance Objectives and period, or (ii) make a cash payment to the Participant in an amount determined by the Committee. The foregoing two sentences shall not apply with respect to an Award that is intended to be a Qualified Performance-Based Award if the recipient of such Award (a) was a Covered Employee on the date of the modification, adjustment, change or elimination of the Performance Objective or performance period, or (b) in the reasonable judgment of the Committee, may be a Covered Employee on the date the Award is expected to be paid.

16.10. Substitute Awards. The Committee may grant Awards under the Plan in substitution for stock and stock-based awards held by employees of another entity who become employees of the Company or a Subsidiary as a result of a merger or consolidation of the former employing entity with the Company or a Subsidiary or the acquisition by the Company or a Subsidiary of property or stock of the former employing entity. The Committee may direct that the substitute awards be granted on such terms and conditions as the Committee considers appropriate in the circumstances.

ARTICLE 17 CHANGES IN CAPITAL STRUCTURE

17.1. General. In the event an extraordinary cash dividend, stock dividend, stock-split or a combination or consolidation of the outstanding stock of the Company into a lesser number of shares is declared upon the Stock, the authorization limits under Sections 5.1 and 5.4 shall be increased or decreased proportionately, and the shares of Stock then subject to each Award shall be increased or decreased proportionately without any change in the aggregate purchase price therefore; provided if the Committee elects to grant Dividend Equivalents with respect to an extraordinary cash dividend, the associated Awards shall not be adjusted pursuant to this Section. In the event the Stock shall be changed into or exchanged for a different number or class of shares of stock or securities of the Company or of another corporation, whether through reorganization, recapitalization, reclassification, share exchange, spin-off, stock split-up, combination or exchange of shares, merger or consolidation, the authorization limits under Sections 5.1 and 5.4 shall be adjusted proportionately, and there shall be substituted for each such share of Stock then subject to each Award the number and class of shares into which each outstanding share of Stock shall be so exchanged, all without any change in the aggregate purchase price for the shares then subject to each Award.

Notwithstanding anything to the contrary, upon the occurrence or in anticipation of such an event, the Committee may, in its sole discretion, provide (i) that Awards will be settled in cash rather than Stock, (ii) that Awards will be assumed by another party to a transaction or otherwise be equitably converted or substituted in connection with such transaction, (iii) that outstanding Awards may be settled by payment in cash or cash equivalents equal to the excess of the Fair Market Value of the underlying Stock, as of a specified date associated with the transaction, over the exercise price of the Award, (iv) that performance targets and performance periods for Awards will be modified consistent with Code Section 162(m) where applicable, or (v) any combination of the foregoing. The Committee's determination need not be uniform and may be different for different Participants whether or not such Participants are similarly situated.

ARTICLE 18 AMENDMENT, MODIFICATION AND TERMINATION

18.1. Amendment, Modification and Termination. The Committee shall have the power to amend, suspend or terminate the Plan at any time, provided that any such termination of the Plan shall not adversely affect Awards outstanding under the Plan at the time of termination. Notwithstanding the foregoing, an amendment will be contingent on approval of the Company's stockholders to the extent required by law or by the rules of any stock exchange or automated quotation system on which the Company's securities are traded or to the extent it relates to the repricing limitations set forth in Sections 7.1(a) or 8.1(a)(2) of the Plan.

18.2. Awards Previously Granted. The Committee may amend any outstanding Award in whole or in part from time to time. Any such amendment which the Committee determines, in its sole discretion, to be necessary or appropriate to conform the Award to, or otherwise satisfy, any legal requirement (including without limitation the provisions of Code Sections 162(m) or 409A or the regulations or rulings promulgated thereunder, as well as any securities laws and the rules of any applicable securities exchanges), may be made retroactively or prospectively and without the approval or consent of the Participant. Additionally, the Committee may, without the approval or consent of the Participant, make adjustments in the terms and conditions of an Award in recognition of unusual or nonrecurring events affecting the Company or the financial statements of the Company in order to prevent the dilution or enlargement of the benefits intended to be made available pursuant to the Award. Any materially adverse amendments or adjustments to Awards not expressly contemplated in the two preceding sentences may be made by the Committee with the consent of the affected Participant(s).

ARTICLE 19 GENERAL PROVISIONS

19.1. Recoupment. Awards granted hereunder, any Stock and/or cash distributed to a Participant pursuant to the exercise or vesting of an Award, and any proceeds received by a Participant upon the sale of any such Stock, shall be subject to recoupment by the Company pursuant to, and in accordance with, the terms of the Company's Compensation Recoupment Policy, as it may be amended from time to time, which policy is hereby incorporated in the Plan by reference.

19.2. No Rights to Awards. No eligible individual shall have any claim to be granted any Award under the Plan, and neither the Company nor the Committee is obligated to treat eligible individuals uniformly, and determinations made under the Plan may be made by the Committee selectively among eligible individuals who receive, or are eligible to receive, Awards.

19.3. No Stockholder Rights. No Award gives the Participant any of the rights of a stockholder of the Company unless and until shares of Stock are in fact issued to such person in connection with such Award.

19.4. Tax Withholding. Participants shall be responsible to make appropriate provision for all taxes required to be withheld in connection with any Award or the transfer of shares of Stock pursuant to the Plan. The Company or any Parent or Subsidiary shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, and local or foreign taxes (including the Participant's FICA obligation) required by law to be withheld with respect to any taxable event arising as a result of the Plan. Accordingly, the Company shall have the right to retain from the payment under an Award the number of shares of Stock or a portion of the value of such Award equal in value to the amount of any required withholdings. With respect to withholding required upon any taxable event under the Plan, the Committee may, at the time the Award is granted or thereafter, require or permit, including at the Participant's election, that any such withholding requirement be satisfied, in whole or in part, by withholding shares of Stock having a Fair Market Value on the date of withholding equal to the amount required to be withheld for tax purposes, all in accordance with such procedures as the Committee establishes. Additionally, if the Committee so determines, the Participant may deliver to the Company unrestricted shares which have been held by the Participant for at least six (6) months, or any other shorter or longer period as necessary to avoid the recognition of an expense under generally accepted accounting

principles, to satisfy any additional tax obligations owed by the Participant. The Company shall have the authority to require a Participant to remit cash to the Company in lieu of the surrender or withholding of shares of Stock for taxes if the surrender or withholding for such purpose would result in adverse tax or accounting implications for the Company.

19.5. No Right to Continued Service. Nothing in the Plan or any Award Agreement shall interfere with or limit in any way the right of the Company or any Parent or Subsidiary to terminate any Participant's employment or status as an officer or director at any time, nor confer upon any Participant any right to continue as an employee, officer or director of the Company or any Parent or Subsidiary, whether for the duration of the Participant's Award or otherwise.

19.6. Unfunded Status of Awards. The Plan is intended to be an "unfunded" plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Agreement shall give the Participant any rights that are greater than those of a general creditor of the Company or any Parent or Subsidiary. The Plan is not intended to be subject to the Employee Retirement Income Security Act of 1974.

19.7. Indemnification. To the extent allowable under applicable law, each member of the Committee and the Board and any employee of the Company acting pursuant to delegated authority and any counsel or advisor to the foregoing persons shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such persons in connection with or resulting from any claim, action, suit, or proceeding to which such person may be a party or in which he may be involved by reason of any action or failure to act under the Plan (except for willful misconduct) and against and from any and all amounts paid by such person in satisfaction of judgment in such action, suit, or proceeding against him provided he gives the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such person may be entitled under the Company's Articles of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

19.8. Relationship to Other Benefits. No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, savings, profit sharing, group insurance, welfare or benefit plan of the Company or any Parent or Subsidiary unless provided otherwise in such other plan.

19.9. Expenses. The expenses of administering the Plan shall be borne by the Company and its Parents or Subsidiaries.

19.10. No Fiduciary Relationship. Nothing contained in the Plan, and no action taken pursuant to the provisions of the Plan, shall create or shall be construed to create a trust of any kind, or a fiduciary relationship between the Committee, the Company or its affiliates, or their officers or other representatives or the Board, on the one hand, and the Participant, the Company, its Affiliates or any other person or entity, on the other.

19.11. Fractional Shares. No fractional shares of Stock shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional shares or whether such fractional shares shall be eliminated by rounding up or down.

19.12. Government and Other Regulations. The obligation of the Company to make payment of Awards in Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by government agencies as may be required. The Company shall be under no obligation to register under the 1933 Act, or any state securities act, any of the shares of Stock paid under the Plan. The shares paid under the Plan may in certain circumstances be exempt from registration under the 1933 Act, and the Company may restrict the transfer of such shares in such manner as it deems advisable to ensure the availability of any such exemption. Payment of an Award hereunder may be delayed in the sole discretion of the Committee if the Committee reasonably anticipates that payment of the Award would violate Federal securities law or other applicable law; provided that payment shall be made at the earliest date that the Committee reasonably anticipates that making the payment will not cause such violation.

19.13. Governing Law. To the extent not governed by federal law, the Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of Delaware.

19.14. Additional Provisions. Each Award Agreement may contain such other terms and conditions as the Committee may determine; provided that such other terms and conditions are not inconsistent with the provisions of the Plan.

19.15. Foreign Participants. In order to facilitate the making of any grant or combination of grants under the Plan, the Committee may provide for such special terms for Awards to Participants who are foreign nationals, or who are employed by or perform services for the Company or any Subsidiary outside of the United States of America, as the Committee may consider necessary or appropriate to accommodate differences in local law, tax policy or custom. Moreover, the Committee may approve such supplements to, or amendments, restatements or alternative versions of, the Plan as it may consider necessary or appropriate for such purposes without thereby affecting the terms of the Plan as in effect for any other purpose, provided that no such supplements, amendments, restatements or alternative versions shall include any provisions that are inconsistent with the terms of the Plan, as then in effect, unless the Plan could have been amended to eliminate such inconsistency without further approval by the stockholders of the Company.

19.16. No Limitations on Rights of Company. The grant of any Award shall not in any way affect the right or power of the Company to make adjustments, reclassification or changes in its capital or business structure or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets. The Plan shall not restrict the authority of the Company, for proper corporate purposes, to draft or assume Awards, other than under the Plan, to or with respect to any person. If the Committee so directs, the Company may issue or transfer shares of Stock to a Subsidiary or a Parent, for such lawful consideration as the Committee may specify, upon the condition or understanding that the Subsidiary or Parent will transfer such shares of Stock to a Participant in accordance with the terms of an Award granted to such Participant and specified by the Committee pursuant to the provisions of the Plan.

19.17. Limitations on Awards Granted to Non-Employee Directors. The maximum Grant Date Fair Market Value, as determined by the Committee, of the equity Awards granted to any Non-Employee Director in any Plan Year shall not exceed \$300,000. The maximum aggregate amount, as determined by the Committee, of the Cash Awards granted to any Non-Employee Director in any Plan Year also shall not exceed \$300,000. The equity and cash award limits shall be applied separately, so that the aggregate Grant Date Fair Market Value of all Awards granted to a Non-Employee Director in any Plan Year shall not exceed \$600,000; provided, however, such limits shall not apply to any compensation resulting from non-preferential dividends or dividend equivalents associated with outstanding equity awards.

19.18. Payment Deferrals. The Committee, either at the time of grant or by subsequent amendment, may require or permit deferral of the payment of Awards under such rules and procedures as it may establish; provided, however, that any Options, SARs, and similar Other Stock-Based Awards that are not otherwise subject to Section 409A of the Code but would be subject to Section 409A of the Code if a deferral were permitted, shall not be subject to any deferral. The Committee also may provide that deferred settlements include the payment or crediting of interest or other earnings on the deferred amounts, or the payment or crediting of Dividend Equivalents where the deferred amounts are denominated in Stock equivalents. Any deferral and related terms and conditions shall comply with Section 409A of the Code and any authoritative guidance thereunder.

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting _____ in the Human Resources department.

HealthSouth Corporation

NON-QUALIFIED STOCK OPTION AWARD AGREEMENT (Pursuant to the 2016 Omnibus Performance Incentive Plan)

This Non-Qualified Stock Option Award Agreement (this “*Award*”) is granted in Birmingham, Alabama by **HealthSouth Corporation**, a Delaware corporation (the “*Corporation*”), pursuant to a Summary of Grant (the “*Summary*”) previously delivered to you as the person to whom the Option is granted (“*Grantee*”) and/or displayed at the website of UBS (<http://www.ubs.com/onesource/HLS>). The Summary, which specifies the name of Grantee, the date as of which the grant is made (the “*Date of Grant*”) and other specific details of the grant, and the electronic acceptance of the Summary are incorporated herein by reference.

1. GRANT OF OPTION. The Corporation hereby grants to Grantee the option to purchase (the “*Option*”), on the terms and subject to the conditions set forth herein and in the Plan (as defined below), up to the number of shares specified in the Summary of the Corporation’s common stock, par value \$.01 per share (the “*Common Stock*”), at the exercise price per share set forth in the Summary (the “*Exercise Price*”), being not less than 100% of the Fair Market Value of such Common Stock on the Date of Grant. The Option is intended to constitute a non-qualified stock option and shall be administered consistently with such intent.

The Option is granted pursuant to the Corporation’s 2016 Omnibus Performance Incentive Plan (the “*Plan*”), a copy of which has been made available to Grantee electronically. This Award is subject in its entirety to all the applicable provisions of the Plan, which are hereby incorporated herein by reference. Capitalized terms used herein and not otherwise defined herein shall have the meanings set forth in the Plan.

2. PERIOD OF OPTION. Except as provided herein or as otherwise provided in the Plan, the Option is cumulatively vested and exercisable in installments in accordance with the schedule set forth in the Summary. The vested portions of the Option may be exercised from time to time during the term of the Option set forth in the Summary (the “*Term*”) as to the total number of shares allowable under this Section 2, or any lesser amount thereof. The Option is not exercisable before or after the dates specified in the Summary.

3. METHOD OF EXERCISE OF OPTION.

(a) Subject to the provisions of Section 2 hereof, the Corporation's Insider Trading Policy and securities laws, the Option may be exercised in whole or in part by Grantee's giving written notice, which notice may be given electronically, specifying the number of shares which Grantee elects to purchase and the date on which such purchase is to be made to the Corporation or its designated broker. Payment of the exercise price may be made in cash or shares of Common Stock, including, without limitation, a cashless exercise of the Option.

(b) In the event (i) there is an unexercised vested portion of the Option outstanding at the expiration of the Term and (ii) on such date, the last reported transaction price of the Common Stock on its primary securities exchange or automated quotation system exceeds the Exercise Price, Grantee hereby elects to exercise all such portions of the Option on such date, provided that such election is not revoked by written notice, which notice may be given electronically, to the Corporation on or before such date. In the event of any Option exercises pursuant to this subsection (b), payment of the Exercise Price shall be made in shares of Common Stock by cashless exercise, unless Grantee instructs the Corporation otherwise.

4. TERMINATION OF EMPLOYMENT.

(a) Except as provided in the subsection (b) below, the Option and this Award shall, upon termination of employment with the Corporation (including its subsidiaries), be subject to lapse and forfeiture or accelerated vesting, as the case may be, pursuant to Sections 16.5, 16.6, 16.7, and 16.8 of the Plan.

(b) In the event that Grantee dies, suffers a Disability or effects a Retirement, any unvested Option shall partially vest and become exercisable according to the following formula: the portion that becomes vested and exercisable shall equal the number of shares represented by the then unvested Option multiplied by the ratio of (i) the number of full months that have elapsed from the most recent vesting date set forth in the Summary to the date of death, Disability or Retirement, to (ii), the number of full months from the most recent vesting date set forth in the Summary to the final vesting date set forth in the Summary. All vested portions of the Option, including those subject to accelerated vesting pursuant to this subsection (b), shall be exercisable for the applicable period following termination set forth in Section 16.8(b) of the Plan.

5. TAX ISSUES.

(a) Grantee agrees to notify the Corporation immediately if Grantee recognizes taxable income generated by the grant of the Award by the Corporation to Grantee pursuant to an election under Section 83(b) of the Code.

(b) Grantee acknowledges that the Corporation has not advised Grantee regarding Grantee's income tax liability in connection with the grant or vesting of the Option and the delivery of shares of Common Stock in connection with the exercise thereof. Grantee has reviewed with Grantee's own tax advisors the federal, state, and local and tax consequences of the grant and vesting of the Option and the delivery of shares of Common Stock in connection with the

exercise thereof as contemplated by this Award and the Plan. Grantee is relying solely on such advisors and not on any statements or representations of the Corporation or any of its agents. Grantee understands that Grantee (and not the Corporation) shall be responsible for Grantee's own tax liability that may arise as a result of the transactions contemplated by this Award.

(c) Grantee shall pay to the Corporation promptly upon request, and in any event, no later than at the time the Corporation determines that Grantee will recognize taxable income in respect of the Option or the related shares of Common Stock, an amount equal to the taxes the Corporation determines it is required to withhold under applicable tax laws with respect to such securities. Such payment shall be made delivering to the Corporation, or having the Corporation withhold, a portion of the shares of Common Stock otherwise to be delivered to Grantee with respect to the Option sufficient to satisfy the minimum withholding required with respect thereto; provided, with advance notice, the Corporation may require, or lacking such a requirement the Grantee may elect, another method or a combination of such methods of satisfying the withholding requirement.

6. **TRANSFERABILITY**. Except as provided in Section 16.2 of the Plan, the Option is not transferable otherwise than by will or pursuant to the laws of descent and distribution and is exercisable during Grantee's lifetime only by Grantee.

7. **BINDING AGREEMENT**. This Award shall be binding upon and shall inure to the benefit of any successor or assign of the Corporation, and, to the extent herein provided, shall be binding upon and inure to the benefit of Grantee's beneficiary or legal representatives, as the case may be.

8. **ENTIRE AGREEMENT; AMENDMENT**. This Award contains the entire agreement of the parties with respect to the Option granted hereby. This Award may be amended in accordance with the provisions of Section 16.2 of the Plan.

9. **ACCEPTANCE OF AGREEMENT**. By accepting the Award and/or the Summary electronically, Grantee confirms that the grant is in accordance with Grantee's understanding and agrees to the terms of this Award and the terms of the Plan, all as of the Date of Grant.

10. **APPLICABLE RECOUPMENT POLICY**. Notwithstanding anything to the contrary contained in this Award, this Award is subject to the terms of the Compensation Recoupment Policy (the "*Clawback Policy*") adopted by the Board of Directors of the Corporation (the "*Board*"), published with other Plan materials on the website of UBS (<http://www.ubs.com/onesource/HLS>), and modified from time to time to comply with applicable requirements of law or the listing standards of The New York Stock Exchange. This Award may be cancelled in accordance with the Clawback Policy in the event the Board or a committee thereof determines that one of the events enumerated in the Clawback Policy has occurred and that it is in the best interests of the Corporation to do so.

11. **NONCOMPETITION, NONDISCLOSURE AND NONSOLICITATION**.

(a) From the date of termination of employment with the Corporation (including its subsidiaries) until the exercise, lapse or forfeiture of all outstanding, vested portions of the Option

under this Award (the “*Noncompetition Period*”), Grantee shall not, directly or indirectly, participate in the management, operation or control of, or have any financial or ownership interest in, or aid or knowingly assist anyone else in the conduct of, any business or entity that (i) engages in the business of owning, operating or managing inpatient rehabilitation facilities offering a range of rehabilitative healthcare services, and services directly ancillary thereto (collectively, the “*Company Business*”) in any area within seventy-five (75) miles of where an inpatient rehabilitation facility owned or operated by the Corporation (the “*Restricted Territory*”) is located, or (ii) is, to Grantee’s knowledge, making preparations for engaging in the Company Business in any Restricted Territory (collectively, “*Competitive Activity* ”); provided, however, that (x) the “beneficial ownership” by Grantee, either individually or as a member of a “group” (as such terms are used in Rule 13d of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended), of not more than one percent (1%) of the voting stock of any publicly held corporation shall not alone constitute a breach of this Section 11 and (y) Grantee may enter into, at arm’s length, any bona fide joint venture (or partnership or other business arrangement) with any person who is not directly engaged in the Company Business but which is an affiliate of another person engaged in the Company Business.

(b) Grantee shall not, directly or indirectly, within the Noncompetition Period, without the prior written consent of the Corporation, solicit or direct any other person to solicit any officer or other employee of the Corporation to: (i) terminate such officer’s or employee’s employment with the Corporation; or (ii) seek or accept employment or other affiliation with Grantee or any person engaged in any Competitive Activity in which Grantee is directly or indirectly involved (other than, in each case, any solicitation directed at the public in general in publications available to the public in general or any contact which Grantee can demonstrate was initiated by such officer, director or employee or any contact after such officer’s or employee’s employment with the Corporation is terminated). Grantee’s obligations under this subsection (b) with respect to new Corporation employees hired after the date of termination shall be subject to the condition that Grantee shall have been notified of such new employees.

(c) Grantee shall not, directly or indirectly, within the Noncompetition Period, without the prior written consent of the Corporation, solicit or direct any other Person to solicit any person or entity in a business relationship with the Corporation (whether an independent contractor, joint venture partner or otherwise) to terminated such person or entity’s business relationship with the Corporation.

(d) Grantee shall not, directly or indirectly, within the Noncompetition Period, make any statements or comments of a defamatory or disparaging nature to third parties regarding the Corporation or any of their members, principals, officers, managers, directors, personnel, employees, agents, services or products; provided, however, that nothing contained herein shall preclude Grantee from providing truthful testimony in response to a valid subpoena, court order, regulatory request or as may be required by law.

(e) In the event Grantee violates the terms of this Section 11, the Option and the Award shall be immediately cancelled, lapsed and forfeited.

12. ADMINISTRATION OF THE PLAN; INTERPRETATION OF THE PLAN AND THE AWARD. The Plan shall be administered by the Committee pursuant to Section 4 of the Plan. Furthermore, the interpretation and construction of any provision of the Plan or of this Award by the Committee shall be final, conclusive and binding. In the event there is any inconsistency or discrepancy between the provisions of this Award and the provisions of the Plan, the provisions of the Plan shall prevail.

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting _____ in the Human Resources department.

HEALTHSOUTH CORPORATION

RESTRICTED STOCK AWARD AGREEMENT (Pursuant to the 2016 Omnibus Performance Incentive Plan)

This Restricted Stock Award Agreement (this “*Award*”) is granted in Birmingham, Alabama by **HealthSouth Corporation**, a Delaware corporation (the “*Corporation*”), pursuant to a Summary of Grant (the “*Summary*”) displayed at the website of UBS (<http://www.ubs.com/onesource/HLS>). The Summary, which specifies the person to whom the Award is granted (“*Grantee*”), the date as of which the grant is made (the “*Date of Grant*”) and other specific details of the Award, and the electronic acceptance of the Summary are incorporated herein by reference.

1. GRANT OF AWARD. Upon the terms and conditions set forth herein and in the Corporation’s 2016 Omnibus Performance Incentive Plan (the “*Plan*”), a copy of which has been made available to the Grantee electronically, the Corporation hereby grants to Grantee an Award of the number of fully paid, non-assessable shares (the “*Restricted Shares*”) of common stock, par value \$.01 per share (the “*Common Stock*”), of the Corporation set forth in the Summary.

The Award is granted pursuant to the Plan and is subject in its entirety to the all applicable provisions of the Plan as in effect on the Date of Grant. Capitalized terms used herein and not otherwise defined shall have the meanings set forth in the Plan. The Corporation and Grantee agree to be bound by all of the terms and conditions of the Plan, as amended from time to time in accordance with its terms.

Subject to Section 5 hereof, the Restricted Shares shall be registered in the name of Grantee on the stock transfer books of the Corporation. However, any certificates issued with respect to Restricted Shares shall be held by the Corporation in escrow under the terms hereof, provided, that, unless the Corporation determines otherwise, no such certificates shall be distributed to Grantee prior to the date determined under Section 3 hereof. Certificates representing the Restricted Shares shall bear the legend set forth in Section 3 below or such other appropriate legend as the Committee shall determine, which legend shall be removed only on and after the date determined under Section 3 and if and when the Restricted Shares have vested.

Grantee shall be entitled to vote all Restricted Shares on matters submitted to holders of the Common Stock of the Corporation and to receive Dividend Equivalents thereon as set forth in this paragraph. Upon the declaration and payment of ordinary cash dividends and dividends in the form

of shares of Common Stock thereon, if any, such dividends on the Restricted Shares prior to their vesting accrue, but are not immediately payable, to the account of Grantee. Any Dividend Equivalents accrued are subject to forfeiture in the event the associated Restricted Shares are forfeited or otherwise do not vest as provided in the Plan or in this Award. Such Dividend Equivalents shall only be payable and deliverable, free of all restrictions, in the form declared upon vesting of the associated Restricted Shares. Grantee's right to receive any extraordinary dividends or other distributions with respect to the Restricted Shares prior to their vesting shall be at the sole discretion of the Committee, but in the event of any such extraordinary dividends or distributions are paid to the holders of Common Stock, the Committee shall take such action as may be appropriate to preserve the value of, and prevent the unintended enhancement of the value of, the Restricted Shares.

2. **VESTING.** Except as may otherwise be provided herein, the restrictions on transfer set forth in Section 3 shall lapse in accordance with the schedule set forth in the Summary, so long as the Recipient is employed by or providing services to the Corporation as of the relevant dates.

3. **RESTRICTIONS ON TRANSFERABILITY, PLEDGING, SELLING.** Restricted Shares and any interest therein, may not be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of, except by will or the laws of descent and distribution, prior to the lapse of restrictions set forth in this Award applicable thereto, as set forth in Section 2. In order to reflect the restrictions on disposition of the shares of Common Stock issued pursuant to this Award, the stock certificates for the shares of Common Stock issued pursuant to this Award will be endorsed with a restrictive legend, in substantially the following form:

“THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS, INCLUDING FORFEITURE PROVISIONS AND RESTRICTIONS AGAINST TRANSFER (THE “RESTRICTIONS”), CONTAINED IN THE HEALTHSOUTH CORPORATION 2016 OMNIBUS PERFORMANCE INCENTIVE PLAN AND AN AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND HEALTHSOUTH CORPORATION. ANY ATTEMPT TO DISPOSE OF THESE SHARES IN CONTRAVENTION OF THE APPLICABLE RESTRICTIONS, INCLUDING BY WAY OF SALE, ASSIGNMENT, TRANSFER, PLEDGE, HYPOTHECATION OR OTHERWISE, SHALL BE NULL, VOID AND WITHOUT EFFECT.”

Such legend shall be removed only on and after the date when the Restricted Shares vest. Grantee shall be entitled to vote all Restricted Shares.

4. **SECURITIES COMPLIANCE.** The Corporation shall make reasonable efforts to comply with all applicable federal and state securities laws; provided, however, notwithstanding any other provision of this Award, the Corporation shall not be obligated to issue any restricted or unrestricted Common Stock or other securities pursuant to this Award if the issuance thereof would result in a violation of any such law. Subject to Section 3 hereof, in order to comply with any applicable securities laws, the Recipient agrees that the Restricted Shares shall only be sold by the

Recipient following registration of such Shares under the Securities Act of 1933, as amended, or pursuant to an exemption therefrom. If required by the authorities of any state in connection with the issuance of the shares, the legend or legends required by such state authorities will also be endorsed on all such certificates.

5. TERMINATION OF EMPLOYMENT . The Restricted Shares and this Award shall lapse and be forfeited upon termination of employment with the Corporation (including its subsidiaries), except as provided in Section 6 hereof.

6. ACCELERATED VESTING FOR A CHANGE IN CONTROL OR OTHER REASON . Notwithstanding anything to the contrary contained in this Award, the Restricted Shares issued to Grantee pursuant to this Award shall also become vested in accordance with Sections 16.5 and 16.8 of the Plan.

7. TAX ISSUES .

(a) Grantee agrees to notify the Corporation immediately if Grantee recognizes taxable income generated by the grant of the Award by the Corporation to the Recipient pursuant to an election under Section 83(b) of the Code.

(b) Grantee acknowledges that the Corporation has not advised Grantee regarding Grantee's income tax liability in connection with this Award. Grantee has reviewed with Grantee's own tax advisors the federal, state, and local tax consequences of this Award. Grantee is relying solely on such advisors and not on any statements or representations of the Corporation or any of its agents. Grantee understands that Grantee (and not the Corporation) shall be responsible for Grantee's own tax liability that may arise as a result of the transactions contemplated by this Award.

(c) Grantee shall pay to the Corporation promptly upon request, and in any event, no later than at the time the Corporation determines that Grantee will recognize taxable income in respect of this Award, an amount equal to the taxes the Corporation determines it is required to withhold under applicable tax laws with respect to this Award. Such payment shall be made delivering to the Corporation, or having the Corporation withhold, a portion of the unrestricted shares of Common Stock otherwise to be delivered to Grantee with respect to the Restricted Shares sufficient to satisfy the minimum withholding required with respect thereto; provided, with advance notice, the Corporation may require, or lacking such a requirement the Grantee may elect, another method or a combination of such methods of satisfying the withholding requirement.

8. APPLICABLE RECOUPMENT POLICY . Notwithstanding anything to the contrary contained in this Award, this Award is subject to the terms of the Compensation Recoupment Policy (the "*Clawback Policy*") adopted by the Board of Directors of the Corporation (the "*Board*"), published with other Plan materials on the website of UBS (<http://www.ubs.com/onesource/HLS>), and modified from time to time to comply with applicable requirements of law or the listing standards of The New York Stock Exchange. This Award may be cancelled in accordance with the Clawback Policy in the event the Board or a committee thereof determines that one of the events enumerated in the Clawback Policy has occurred and that it is in the best interests of the Corporation to do so.

9. **BINDING AGREEMENT**. This Award shall be binding upon and shall inure to the benefit of any successor or assign of the Corporation, and, to the extent herein provided, shall be binding upon and inure to the benefit of Grantee's beneficiary or legal representatives, as the case may be.

10. **ENTIRE AGREEMENT; AMENDMENT**. This Award contains the entire agreement of the parties with respect to the Restricted Stock granted hereby. This Award may be amended in accordance with the provisions of Section 18.2 of the Plan.

11. **ACCEPTANCE OF AGREEMENT**. By accepting the Summary electronically, Grantee confirms that this Award is in accordance with Grantee's understanding, and that Grantee agrees to the terms of this Award and the terms of the Plan.

12. **ADMINISTRATION OF THE PLAN; INTERPRETATION OF THE PLAN AND THE AWARD**. The Plan shall be administered by the Committee, pursuant to Section 4 of the Plan. Furthermore, the interpretation and construction of any provision of the Plan or of the Award by the Committee shall be final, conclusive and binding. In the event there is any inconsistency or discrepancy between the provisions of this Award and the provisions of the Plan, the provisions of the Plan shall prevail.

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting _____ in the Human Resources department.

HEALTHSOUTH CORPORATION

PERFORMANCE SHARE UNIT AWARD AGREEMENT (Pursuant to the 2016 Omnibus Performance Incentive Plan)

This Performance Share Unit Award Agreement (this “*Award*”) is granted in Birmingham, Alabama by **HealthSouth Corporation**, a Delaware corporation (the “*Corporation*”), pursuant to one or more Summaries of Grant (collectively, the “*Summary*”) previously delivered to you as the person to whom the Award is granted (“*Grantee*”) and/or displayed at the UBS website (<http://www.ubs.com/onesource/HLS>). The Summary, which specifies the name of Grantee, the date as of which the grant is made (the “*Date of Grant*”), the relevant Performance Goals, the Performance Period (as defined in the Summary), and other specific details of the Award, and the acceptance of the Summary are incorporated herein by reference.

1. GRANT OF AWARD; TERMS.

(a) Upon the terms and conditions set forth herein and in the Corporation’s 2016 Omnibus Performance Incentive Plan (the “*Plan*”), a copy of which has been made available to Grantee electronically, the Corporation hereby grants to Grantee an award of the number of performance share units (the “*Performance Share Units*”) set forth in the Summary. The Award is granted pursuant to the Plan and is subject in its entirety to all applicable provisions of the Plan. Capitalized terms used herein and not otherwise defined shall have the meanings set forth in the Plan. The Corporation and Grantee agree to be bound by all of the terms and conditions of the Plan, as amended from time to time in accordance with its terms.

The Performance Goals applicable to the Performance Share Units and the Performance Period are set forth in the Summary and incorporated by reference herein and made a part hereof. Depending upon the extent, if any, to which the Performance Goals have been achieved, and subject to compliance with the requirements of Section 2 below, each Performance Share Unit shall entitle Grantee to receive, at such time as is determined in accordance with the provisions of Section 3 below, between 0 and 2 fully paid, non-assessable shares of common stock, par value \$.01 per share, of the Corporation (the “*Restricted Common Stock*”). The Committee shall, as soon as practicable following the last day of the Performance Period, certify (i) the extent, if any, to which, each of the Performance Goals has been achieved with respect to the Performance Period; and (ii) the number of shares of Restricted Common Stock, if any, which, subject to compliance with the requirements of Section 2, Grantee shall be entitled to receive with respect to each Performance Share Unit (with such number of shares of Restricted Common Stock being hereafter

referred to as the “ *Share Delivery Factor* ”). Such certification shall be final, conclusive and binding on Grantee, and on all other persons, to the maximum extent permitted by law.

(b) Grantee shall be not entitled to vote on matters submitted to holders of common stock of the Corporation prior to the receipt of Restricted Common Stock. Grantee shall be entitled to vote all Restricted Common Stock received following determination of performance pursuant to this Award and the issuance of the resulting Restricted Common Stock. Grantee shall be entitled to receive Dividend Equivalents on the Performance Share Units as set forth in this paragraph. Following the Date of Grant, upon the declaration and payment to the holders of the Corporation’s common stock of ordinary cash dividends and dividends in the form of shares of common stock thereon, if any, such dividends accrue, but are not immediately payable, to the account of Grantee. The accrual of Dividend Equivalents related to dividends paid, including any paid prior to the issuance of Restricted Common Stock, shall be calculated based on the number of shares of the resulting Restricted Common Stock received following the Performance Period. Any Dividend Equivalents accrued are subject to forfeiture in the event the associated Performance Share Units or the resulting Restricted Common Stock are forfeited or otherwise do not vest as provided in the Plan or in this Award. Such Dividend Equivalents shall only be payable and deliverable, free of all restrictions, in the form declared upon vesting of the associated Restricted Common Stock. Grantee’s right to receive any extraordinary dividends or other distributions with respect to the Performance Share Units or the associated Restricted Common Stock prior to their vesting shall be at the sole discretion of the Committee, but in the event of any such extraordinary dividends or distributions are paid to the holders of Common Stock, the Committee shall take such action as may be appropriate to preserve the value of, and prevent the unintended enhancement of the value of, the associated Performance Share Units and the resulting Restricted Common Stock.

2. VESTING OF PERFORMANCE SHARE UNITS.

(a) The Performance Share Units are subject to forfeiture to the Corporation until they become non-forfeitable in accordance with this Section 2. Except as provided in this Section 2 and Sections 16.5, 16.6, 16.7, and 16.8 of the Plan, the risk of forfeiture will lapse on all Performance Share Units, and all Performance Share Units shall thereupon become payable in Restricted Common Stock or otherwise, only if Grantee remains employed by the Corporation until the end of the Performance Period. In any event, the delivery of Restricted Common Stock with respect to such Performance Share Units shall be made following the conclusion of the Performance Period as provided in Section 3 hereof, unless otherwise determined by the Committee.

(b) The Performance Share Units, the related Restricted Common Stock (if any), and this Award shall be cancelled and forfeited upon termination of employment with the Corporation (including its subsidiaries), except as provided in Sections 2 and 3 hereof.

(c) Notwithstanding anything to the contrary contained in this Award, all of the Performance Share Units issued to Grantee pursuant to this Award shall also become vested and non-forfeitable pursuant to Sections 16.5 and 16.8 of the Plan. The delivery of shares of Restricted Common Stock with respect to such Performance Share Units shall be made following the conclusion of the Performance Period as provided in Section 3 hereof, unless otherwise determined by the Committee. In the event of a Change in Control prior to the completion of the Performance Period,

the Committee shall have the discretionary authority in accordance with Section 16.5 of the Plan to determine whether, and if so, the extent to which, (1) the Performance Period or each of the Performance Objectives shall be deemed to be satisfied or waived, and (2) the Performance Objectives shall be modified, adjusted or changed.

3. DELIVERY OF SHARES.

(a) Except as provided in the subsections (b) and (c) below and Section 16.8 of the Plan, the number of whole shares of Restricted Common Stock (if any) equal to the product of (i) the number of earned and payable Performance Share Units multiplied by (ii) the Share Delivery Factor (with such product rounded up to the next whole number) shall be registered in the name of Grantee on the stock transfer books of the Corporation effective as of the date of the Committee's determination of the achievement of the Performance Goals as provided for in Section 1 above. However, any certificates issued with respect to Restricted Common Stock shall be held by the Corporation in escrow under the terms hereof until the Restricted Common Stock becomes vested on the first anniversary of the end of the Performance Period, at which time the Restricted Common Stock shall become vested and shall be distributed to Grantee without restrictions. Prior to becoming vested, the Restricted Common Stock and any interest therein, may not be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of, except by will or the laws of descent and distribution, so long as Grantee is employed by or providing services to the Corporation as of the relevant date. In order to reflect the restrictions on disposition of the shares of Restricted Common Stock issued pursuant to this Award, the stock certificates, if any, for the shares of Restricted Common Stock issued pursuant to this Award will be endorsed with a restrictive legend, in substantially the following form:

“THIS CERTIFICATE AND THE SHARES OF STOCK REPRESENTED HEREBY ARE SUBJECT TO THE TERMS AND CONDITIONS, INCLUDING FORFEITURE PROVISIONS AND RESTRICTIONS AGAINST TRANSFER (THE “RESTRICTIONS”), CONTAINED IN THE HEALTHSOUTH CORPORATION 2016 OMNIBUS PERFORMANCE INCENTIVE PLAN AND AN AGREEMENT ENTERED INTO BETWEEN THE REGISTERED OWNER AND HEALTHSOUTH CORPORATION. ANY ATTEMPT TO DISPOSE OF THESE SHARES IN CONTRAVENTION OF THE APPLICABLE RESTRICTIONS, INCLUDING BY WAY OF SALE, ASSIGNMENT, TRANSFER, PLEDGE, HYPOTHECATION OR OTHERWISE, SHALL BE NULL, VOID AND WITHOUT EFFECT.”

Such legend shall be removed only on and after the date when the shares of Restricted Common Stock vest.

(b) In the event that (i) the Corporation (or any of its subsidiaries) terminates Grantee's employment for any reason prior to the first anniversary of the end of the Performance Period; or (ii) the Grantee terminates employment with the Corporation (including its subsidiaries) for any reason (other than death, Disability or Retirement) prior to such date, all Restricted Common Stock held in escrow shall be cancelled and forfeited, effective as of Grantee's termination of employment.

(c) In the event that Grantee dies, suffers a Disability or effects a Retirement prior to the first anniversary of the end of the Performance Period, the Corporation shall deliver or provide to Grantee or Grantee's beneficiary or estate (if applicable) a certificate (or the indicia of ownership, as the case may be) for the number of whole shares of Common Stock to which Grantee is entitled pursuant to Section 16.8 of the Plan, provided that the beneficiary (or estate) has otherwise complied with the requirements of Section 8 of this Award.

4. TAX CONSEQUENCES.

(a) Grantee agrees to notify the Corporation immediately if Grantee recognizes taxable income generated by the grant of this Award by the Corporation to the Recipient pursuant to an election under Section 83(b) of the Code.

(b) Grantee acknowledges that the Corporation has not advised Grantee regarding Grantee's income tax liability in connection with the grant or vesting of the Performance Share Units and the delivery of shares of Restricted Common Stock in connection therewith. Grantee has reviewed with Grantee's own tax advisors the federal, state, and local and tax consequences of the grant and vesting of the Performance Share Units and the delivery of shares of Restricted Common Stock in connection therewith as contemplated by this Award. Grantee is relying solely on such advisors and not on any statements or representations of the Corporation or any of its agents. Grantee understands that the Grantee (and not the Corporation) shall be responsible for Grantee's own tax liability that may arise as a result of the transactions contemplated by this Award.

(c) Grantee shall pay to the Corporation promptly upon request, and in any event, no later than at the time the Corporation determines that Grantee will recognize taxable income in respect of the Performance Share Units, an amount equal to the taxes the Corporation determines it is required to withhold under applicable tax laws with respect to the Performance Share Units. Such payment shall be made delivering to the Corporation, or having the Corporation withhold, a portion of the shares of Common Stock otherwise to be delivered to Grantee with respect to the Performance Share Units sufficient to satisfy the minimum withholding required with respect thereto; provided, with advance notice, the Corporation may require, or lacking such a requirement the Grantee may elect, another method or a combination of such methods of satisfying the withholding requirement.

5. TRANSFERABILITY.

(a) Except as provided below, or except to the minimal extent required by law, the Performance Share Units are nontransferable and may not be assigned, alienated, pledged, attached, sold or otherwise transferred or encumbered by Grantee, except by will or the laws of descent and distribution, and upon any such transfer, by will or the laws of descent and distribution (or upon such transfer required by law), the transferee shall hold such Performance Share Units subject to all the terms and conditions that were applicable to Grantee immediately prior to such transfer.

(b) Upon any transfer by will or the laws of descent and distribution (or upon any such transfer required by law), such transferee shall take the Performance Share Units and the

shares delivered in connection therewith (the “Transferee Shares”) subject to all the terms and conditions that were (or would have been) applicable to the Performance Share Units and the Transferee Shares immediately prior to such transfer.

6. RIGHTS OF GRANTEE . Prior to the issuance, if any, of shares of Restricted Common Stock to Grantee pursuant to the provisions of Section 3, Grantee shall not have any rights of a stockholder of the Corporation on account of the Performance Share Units.

7. UNFUNDED NATURE OF PERFORMANCE SHARE UNITS . The Corporation will not segregate any funds representing the potential liability arising under this Award. Grantee’s rights in respect of this Award are those of an unsecured general creditor of the Corporation. The liability for any payment under this Award will be a liability of the Corporation and not a liability of any of its officers, directors or affiliates.

8. SECURITIES LAWS . The Corporation may condition delivery of certificates for shares of Restricted Common Stock delivered for any vested Performance Share Units upon the prior receipt from Grantee of any undertakings which it may determine are required to assure that the certificates are being issued in compliance with federal and state securities laws.

9. SECURITIES COMPLIANCE . The Corporation shall make reasonable efforts to comply with all applicable federal and state securities laws; provided, however, notwithstanding any other provision of this Award, the Corporation shall not be obligated to issue any restricted or unrestricted Common Stock or other securities pursuant to this Award if the issuance thereof would result in a violation of any such law. Subject to Section 3 hereof, in order to comply with any applicable securities laws, Grantee agrees that the Restricted Common Stock shall only be sold by Grantee following registration of such Shares under the Securities Act of 1933, as amended, or pursuant to an exemption therefrom. If required by the authorities of any state in connection with the issuance of the shares, the legend or legends required by such state authorities will also be endorsed on all such certificates.

10. NONCOMPETITION, NONDISCLOSURE AND NONSOLICITATION .

(a) From the date of termination of employment with the Corporation (including its subsidiaries) until the lapse of all restrictions on this Award and the related Common Stock (the “*Noncompetition Period*”), Grantee shall not, directly or indirectly, participate in the management, operation or control of, or have any financial or ownership interest in, or aid or knowingly assist anyone else in the conduct of, any business or entity that (i) engages in the business of owning, operating or managing inpatient rehabilitation facilities offering a range of rehabilitative healthcare services, and services directly ancillary thereto (collectively, the “*Company Business*”) in any area within seventy-five (75) miles of where an inpatient rehabilitation facility owned or operated by the Corporation (the “*Restricted Territory*”) is located, or (ii) is, to Grantee’s knowledge, making preparations for engaging in the Company Business in any Restricted Territory (collectively, “*Competitive Activity*”); provided, however, that (x) the “beneficial ownership” by Grantee, either individually or as a member of a “group” (as such terms are used in Rule 13d of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended), of not more than one percent (1%) of the voting stock of any publicly held corporation shall not alone constitute a breach

of this Section 10(b) and (y) Grantee may enter into, at arm's length, any bona fide joint venture (or partnership or other business arrangement) with any person who is not directly engaged in the Company Business but which is an affiliate of another person engaged in the Company Business.

(b) Grantee shall not, directly or indirectly, within the Noncompetition Period, without the prior written consent of the Corporation, solicit or direct any other person to solicit any officer or other employee of the Corporation to: (i) terminate such officer's or employee's employment with the Corporation; or (ii) seek or accept employment or other affiliation with Grantee or any person engaged in any Competitive Activity in which Grantee is directly or indirectly involved (other than, in each case, any solicitation directed at the public in general in publications available to the public in general or any contact which Grantee can demonstrate was initiated by such officer, director or employee or any contact after such officer's or employee's employment with the Corporation is terminated). Grantee's obligations under this subsection (b) with respect to new Corporation employees hired after the date of termination shall be subject to the condition that Grantee shall have been notified of such new employees.

(c) Grantee shall not, directly or indirectly, within the Noncompetition Period, without the prior written consent of the Corporation, solicit or direct any other Person to solicit any person or entity in a business relationship with the Corporation (whether an independent contractor, joint venture partner or otherwise) to terminate such person or entity's business relationship with the Corporation.

(d) Grantee shall not, directly or indirectly, within the Noncompetition Period, make any statements or comments of a defamatory or disparaging nature to third parties regarding the Corporation or any of their members, principals, officers, managers, directors, personnel, employees, agents, services or products; provided, however, that nothing contained herein shall preclude Grantee from providing truthful testimony in response to a valid subpoena, court order, regulatory request or as may be required by law.

(e) In the event Grantee violates the terms of this Section 10, the Options and the Award shall be immediately cancelled, lapsed and forfeited.

11. APPLICABLE RECOUPMENT POLICY. Notwithstanding anything to the contrary contained in this Award, this Award is subject to the terms of the Compensation Recoupment Policy (the "*Clawback Policy*") adopted by the Board of Directors of the Corporation (the "*Board*"), published with other Plan materials on the UBS website (<http://www.ubs.com/onesource/HLS>), and modified from time to time to comply with applicable requirements of law or the listing standards of The New York Stock Exchange. This Award may be cancelled in accordance with the Clawback Policy in the event the Board or a committee thereof determines that one of the events enumerated in the Clawback Policy has occurred and that it is in the best interests of the Corporation to do so.

12. BINDING AGREEMENT. This Award shall be binding upon and shall inure to the benefit of any successor or assign of the Corporation, and, to the extent herein provided, shall be binding upon and inure to the benefit of Grantee's beneficiary or legal representatives, as the case may be.

13. **ENTIRE AGREEMENT; AMENDMENT**. This Award contains the entire agreement of the parties with respect to the Performance Share Units granted hereby. This Award may be amended in accordance with the provisions of Section 18.2 of the Plan.

14. **ACCEPTANCE OF AGREEMENT**. By accepting this Award electronically, including, without limitation, by electronic acceptance by e-mail, Grantee confirms that this Award is in accordance with Grantee's understanding, and that Grantee agrees to the terms of this Award, the Summary, and the terms of the Plan.

15. **ADMINISTRATION OF THE PLAN; INTERPRETATION OF THE PLAN AND THE AWARD**. The Plan shall be administered by the Committee, pursuant to Section 4 of the Plan. Furthermore, the interpretation and construction of any provision of the Plan or of the Award by the Committee shall be final, conclusive and binding. In the event there is any inconsistency or discrepancy between the provisions of this Award and the provisions of the Plan, the provisions of the Plan shall prevail. The Committee has designated this Award as a Qualified Performance-Based Award under the Plan.

This document is part of a prospectus covering securities that have been registered under the Securities Act of 1933, as amended. This document may be used only in connection with our offer and sale of the securities hereunder. You cannot use this document to offer or sell the securities that you acquire hereunder to anyone else. A paper version of this document and the other documents constituting the complete prospectus are available upon request by contacting _____ in the Human Resources department.

HEALTHSOUTH CORPORATION

RESTRICTED STOCK UNIT AGREEMENT (Pursuant to the 2016 OMNIBUS PERFORMANCE INCENTIVE PLAN)

This Restricted Stock Unit Agreement (this “ *Agreement* ”) is made as of _____ (the “ *Grant Date* ”), by **HealthSouth Corporation**, a Delaware corporation (the “ *Corporation* ”), and _____ (“ *Grantee* ”) pursuant to the HealthSouth Corporation 2016 OMNIBUS PERFORMANCE INCENTIVE PLAN (the “ *Plan* ”). Except as otherwise expressly set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any capitalized terms not otherwise defined in this Agreement shall have the definitions set forth in the Plan.

1. Grant of Award. The Corporation hereby grants to Grantee, as of the Grant Date and subject to the terms and conditions of the Plan and subject further to the terms and conditions set forth herein, _____ Restricted Stock Units (the “ *RSUs* ”).
2. Vesting. The RSUs granted to Grantee shall be fully vested as of the Grant Date and shall be settled on the second business day (the “ *Settlement Date* ”) following the earlier of (i) the date on which Grantee ceases to serve on the Board of Directors for any reason or (ii) the date of Grantee’s death or Disability.
3. Form of Payment. Each RSU granted hereunder shall represent the right to receive one share of common stock, par value \$.01 per share (the “ *Common Stock* ”), of the Corporation upon the settlement of each RSU, subject to adjustment pursuant to Section 17.1 of the Plan.
4. Dividend Equivalents. Additional RSUs shall be credited to Grantee’s account as of each date (a “ *Dividend Date* ”) on which cash dividends or special dividends and distributions are paid with respect to the Common Stock, provided that the record date with respect to such dividend or distribution occurs prior to the Settlement Date. The number of RSUs to be credited to Grantee’s account under the Plan as of any Dividend Date shall equal the quotient obtained by dividing (a) the product of (i) the number of the RSUs credited to such account on the record date for such dividend or distribution and (ii) the per share dividend

(or distribution value) payable on such Dividend Date, by (b) the Fair Market Value of a share of the Common Stock as of such Dividend Date.

5. Restrictions on Transfer. RSUs may not be transferred or otherwise disposed of by Grantee, including by way of sale, assignment, transfer, pledge, hypothecation or otherwise, except as permitted by the Committee, or by will or the laws of descent and distribution. No purported sale, assignment, mortgage, hypothecation, transfer, pledge, encumbrance, gift, transfer in trust (voting or other) or other disposition of, or creation of a security interest in or lien on, any of the RSUs by any holder thereof in violation of the provisions of this Agreement shall be valid, and the Corporation will not transfer any of such RSUs on its books, nor will any dividends be paid thereon, unless and until there has been full compliance with such provisions to the satisfaction of the Corporation. The foregoing restrictions are in addition to and not in lieu of any other remedies, legal or equitable, available to enforce said provisions.
6. Approvals. No shares of the Common Stock shall be issued under this Agreement unless and until all legal requirements applicable to the issuance of such shares have been complied with to the satisfaction of the Committee. The Committee shall have the right to condition any issuance of shares to Grantee on Grantee's undertaking in writing to comply with such restrictions on the subsequent disposition of such shares as the Committee shall deem necessary or advisable as a result of any applicable law or regulation.
7. Taxes. Grantee understands that Grantee (and not the Corporation) shall be responsible for any tax liability that may arise as a result of the transactions contemplated by this Agreement. At the time Grantee recognizes taxable income in respect to the RSUs, Grantee shall owe to the Corporation an amount equal to the federal, state or local taxes, if any, the Corporation determines it is required to withhold under applicable tax laws with respect to the payment of the RSUs. At the Corporation's discretion, Grantee may satisfy the foregoing requirement by one or a combination of the following methods: (a) making a payment to the Corporation in cash or cash equivalents; (b) with the consent of the Corporation, by authorizing the Corporation to withhold cash otherwise due to Grantee; (c) authorizing the Corporation to withhold a portion of the shares of the Common Stock to be received hereunder having a value equal to or less than the minimum amount required to be withheld or (d) a combination of the foregoing.
8. No Voting Rights. The RSUs shall not provide for or confer on Grantee any rights to vote on matters submitted to the stockholders of the Corporation.
9. Compliance with Law and Regulations. This Agreement, the RSUs granted hereby and any obligation of the Corporation hereunder shall be subject to all applicable federal, state and local laws, rules and regulations and to such approvals by any government or regulatory agency as may be required.
10. Incorporation of Plan. This Agreement is made under the provisions of the Plan (which is incorporated herein by reference) and shall be interpreted in a manner consistent with it. To the extent that this Agreement is silent with respect to, or in any way inconsistent with, the

terms of the Plan, the provisions of the Plan shall govern and this Agreement shall be deemed to be modified accordingly.

11. Binding Agreement; Successors. This Agreement shall bind and inure to the benefit of the Corporation, its successors and assigns, and Grantee and Grantee's personal representatives and beneficiaries.
12. Governing Law; Administration and Interpretation. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware . The Plan shall be administered by the Committee, pursuant to Section 4 of the Plan. Furthermore, the interpretation and construction of any provision of the Plan or of the Award by the Committee shall be final, conclusive and binding. In the event there is any inconsistency or discrepancy between the provisions of this Award and the provisions of the Plan, the provisions of the Plan shall prevail .
13. Amendment. This Agreement may be amended or modified by the Corporation at any time. Notwithstanding the foregoing, no amendment or modification that is adverse to the rights of Grantee as provided by this Agreement shall be effective unless set forth in a writing signed by the parties hereto.

[Signature Page Follows]

IN WITNESS WHEREOF, the Corporation has caused this Agreement to be duly executed by its officer thereunder duly authorized and Grantee has hereunto set his hand, all as of the day and year set forth below.

HEALTHSOUTH CORPORATION

Name:
Title:

The undersigned hereby acknowledges having read this Agreement and the Plan and hereby agrees to be bound by all provisions set forth herein and in the Plan.

GRANTEE

[Director name]

Dated as of: _____, 20__

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

I, Jay Grinney, certify that:

1. I have reviewed this quarterly report on Form 10-Q of HealthSouth Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2016

By: /s/ JAY GRINNEY

Jay Grinney

President and Chief Executive Officer

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

I, Douglas E. Coltharp, certify that:

1. I have reviewed this quarterly report on Form 10-Q of HealthSouth Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 29, 2016

By: /s/ DOUGLAS E. COLTHARP

Douglas E. Coltharp
Executive Vice President and
Chief Financial Officer

**CERTIFICATE OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of HealthSouth Corporation on Form 10-Q for the period ended June 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jay Grinney, President and Chief Executive Officer of HealthSouth Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge and belief:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HealthSouth Corporation.

Date: July 29, 2016

By: /s/ JAY G RINNEY

Jay Grinney

President and Chief Executive Officer

A signed original of this written statement has been provided to HealthSouth Corporation and will be retained by HealthSouth Corporation and furnished to the Securities and Exchange Commission or its staff upon request. This written statement shall not, except to the extent required by the 2002 Act, be deemed filed by HealthSouth Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that HealthSouth Corporation specifically incorporates it by reference.

**CERTIFICATE OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of HealthSouth Corporation on Form 10-Q for the period ended June 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Douglas E. Coltharp, Executive Vice President and Chief Financial Officer of HealthSouth Corporation, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge and belief:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of HealthSouth Corporation.

Date: July 29, 2016

By: /s/ DOUGLAS E. COLTHARP

Douglas E. Coltharp
Executive Vice President and
Chief Financial Officer

A signed original of this written statement has been provided to HealthSouth Corporation and will be retained by HealthSouth Corporation and furnished to the Securities and Exchange Commission or its staff upon request. This written statement shall not, except to the extent required by the 2002 Act, be deemed filed by HealthSouth Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that HealthSouth Corporation specifically incorporates it by reference.