HEALTHSOUTH CORP
Form 10-Q
April 29, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014
OR

o 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 ý No o

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 ý No o

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 ý Accelerated filer o Non-Accelerated filer o Smaller reporting company o

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

The registrant had 88,097,810 shares of common stock outstanding, net of treasury shares, as of April 22, 2014.

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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 it 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, you can identify forward-looking statements by terminology such as "may," "will," "could," "should," "expect," "plan," "anticipate," "believe," "intend," "estimate," "predict," "project," "target," "potential," or 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 events or results to differ 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, 2013, as well as uncertainties and factors discussed 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 transformation of the current healthcare system to coordinated care delivery and payment models, 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;

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- 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, and the potential reputational harm associated with those claims;
- the ability of each of our hospitals to maintain licensure, certification, and accreditation necessary to operate and receive reimbursement;
- 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;
- 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 and avoidance of unforeseen exposure to liabilities;
- 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;
- the price of our common or preferred 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 attract and retain key management personnel; and
- general conditions in the economy and capital markets, including any instability or uncertainty related to political disputes or impasses over the United States federal budget or similar matters affecting federal spending.

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 or their effects on the value of our securities.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
HealthSouth Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
	(In Millions)	
Net operating revenues	$591.2	$572.6
Less: Provision for doubtful accounts	(7.5)	(7.4)
Net operating revenues less provision for doubtful accounts	583.7	565.2
Operating expenses:		
Salaries and benefits	286.1	274.6
Other operating expenses	84.5	78.1
Occupancy costs	10.5	12.2
Supplies	27.6	26.2
General and administrative expenses	30.7	30.2
Depreciation and amortization	26.4	22.1
Professional fees—accounting, tax, and legal	1.6	1.4
Total operating expenses	467.4	444.8
Interest expense and amortization of debt discounts and fees	27.9	24.2
Other income	(1.7)	(0.7)
Equity in net income of nonconsolidated affiliates	(4.3)	(2.9)
Income from continuing operations before income tax expense	94.4	99.8
Provision for income tax expense	32.8	33.5
Income from continuing operations	61.6	66.3
Loss from discontinued operations, net of tax	(0.1)	(0.4)
Net income	61.5	65.9
Less: Net income attributable to noncontrolling interests	(14.8)	(14.6)
Net income attributable to HealthSouth	46.7	51.3
Less: Convertible perpetual preferred stock dividends	(1.6)	(5.7)
Net income attributable to HealthSouth common shareholders	$45.1	$45.6

(Continued)

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

	Three Months Ended March 31,	
	2014	2013
	(In Millions, Except Per Share Data)	
Weighted average common shares outstanding:		
Basic	87.3	94.0
Diluted	100.9	107.1
Earnings per common share:		
Basic earnings per share attributable to HealthSouth common shareholders:		
Continuing operations	$0.51	$0.48
Discontinued operations	—	—
Net income	$0.51	$0.48
Diluted earnings per share attributable to HealthSouth common shareholders:		
Continuing operations	$0.48	$0.48
Discontinued operations	—	—
Net income	$0.48	$0.48
Cash dividends per common share	$0.18	$—
Amounts attributable to HealthSouth common shareholders:		
Income from continuing operations	$46.8	$51.7
Loss from discontinued operations, net of tax	(0.1)	(0.4)
Net income attributable to HealthSouth	$46.7	$51.3

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.
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HealthSouth Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
	(In Millions)	
COMPREHENSIVE INCOME		
Net income	$61.5	$65.9
Other comprehensive income, net of tax:		
Net change in unrealized gain on available-for-sale securities:		
Unrealized net holding gain arising during the period	0.1	0.1
Other comprehensive income, net of tax	0.1	0.1
Comprehensive income	61.6	66.0
Comprehensive income attributable to noncontrolling interests	(14.8)	(14.6)
Comprehensive income attributable to HealthSouth	$46.8	$51.4

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.
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HealthSouth Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2014	December 31, 2013
	(In Millions)	
Assets		
Current assets:		
Cash and cash equivalents	$53.1	$64.5
Accounts receivable, net of allowance for doubtful accounts of $23.9 in 2014; $23.1 in 2013	272.7	261.8
Deferred income tax assets	138.9	139.0
Other current assets	120.5	115.1
Total current assets	585.2	580.4
Property and equipment, net	930.7	910.5
Goodwill	456.9	456.9
Intangible assets, net	89.6	88.2
Deferred income tax assets	325.3	354.3
Other long-term assets	151.4	144.1
Total assets	$2,539.1	$2,534.4
Liabilities and Shareholders’ Equity		
Current liabilities:		
Accounts payable	$48.5	$61.9
Accrued expenses and other current liabilities	253.5	249.7
Total current liabilities	302.0	311.6
Long-term debt, net of current portion	1,503.1	1,505.2
Other long-term liabilities	145.6	142.2
	1,950.7	1,959.0
Commitments and contingencies		
Convertible perpetual preferred stock	93.2	93.2
Redeemable noncontrolling interests	13.0	13.5
Shareholders’ equity:		
HealthSouth shareholders’ equity		
Common stock, $.01 par value; 200,000,000 shares authorized; issued:103,858,199 in 2014; 102,648,302 in 2013	1.0	1.0
Capital in excess of par value	2,849.3	2,849.4
Accumulated deficit	(2,054.4)	(2,101.1)
Accumulated other comprehensive loss	—	(0.1)
Treasury stock, at cost (15,746,690 shares in 2014 and 14,654,436 shares in 2013)	(440.3)	(404.6)
Total HealthSouth shareholders’ equity	355.6	344.6
Noncontrolling interests	126.6	124.1
Total shareholders’ equity	482.2	468.7
Total liabilities and shareholders’ equity	$2,539.1	$2,534.4

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

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

	Three Months Ended March 31, 2014 (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	88.0	$ 1.0	$ 2,849.4	$ (2,101.1)	$ (0.1)	$ (404.6)	$ 124.1	$ 468.7
Net income	—	—	—	46.7	—	—	12.8	59.5
Receipt of treasury stock	(0.3)	—	—	—	—	(9.2)	—	(9.2)
Dividends declared on common stock	—	—	(16.0)	—	—	—	—	(16.0)
Dividends declared on convertible perpetual preferred stock	—	—	(1.6)	—	—	—	—	(1.6)
Stock-based compensation	—	—	7.3	—	—	—	—	7.3
Stock options exercised	0.1	—	3.6	—	—	—	—	3.6
Stock warrants exercised	0.2	—	6.3	—	—	—	—	6.3
Distributions declared	—	—	—	—	—	—	(10.3)	(10.3)
Repurchases of common stock in open market	(0.8)	—	—	—	—	(26.3)	—	(26.3)
Other	0.9	—	0.3	—	0.1	(0.2)	—	0.2
Balance at end of period	88.1	$ 1.0	$ 2,849.3	$ (2,054.4)	$ —	$ (440.3)	$ 126.6	$ 482.2

	Three Months Ended March 31, 2013 (In Millions)							
	HealthSouth Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Noncontrolling Interests	Total
Balance at beginning of period	95.7	$ 1.0	$ 2,876.6	$ (2,424.7)	$ 1.4	$ (163.3)	$ 112.5	$ 403.5
Net income	—	—	—	51.3	—	—	13.3	64.6
Receipt of treasury stock	(0.2)	—	—	—	—	(5.4)	—	(5.4)
Dividends declared on convertible perpetual preferred stock	—	—	(5.7)	—	—	—	—	(5.7)
Stock-based compensation	—	—	6.3	—	—	—	—	6.3
Distributions declared	—	—	—	—	—	—	(10.6)	(10.6)
Repurchases of common stock through tender offer	(9.1)	—	—	—	—	(234.1)	—	(234.1)

Other	0.8	—	5.1	—	0.1	(0.3)	—	4.9
Balance at end of period	87.2	$ 1.0	$ 2,882.3	$ (2,373.4)	$ 1.5	$ (403.1)	$ 115.2	$ 223.5

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)

	Three Months Ended March 31,	
	2014	2013
	(In Millions)	
Cash flows from operating activities:		
Net income	$61.5	$65.9
Loss from discontinued operations	0.1	0.4
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	7.5	7.4
Depreciation and amortization	26.4	22.1
Equity in net income of nonconsolidated affiliates	(4.3)	(2.9)
Distributions from nonconsolidated affiliates	3.4	3.4
Stock-based compensation	7.3	6.3
Deferred tax expense	29.2	31.7
Other	3.1	0.8
(Increase) decrease in assets—		
Accounts receivable	(24.7)	(24.3)
Other assets	(4.7)	1.4
Increase (decrease) in liabilities—		
Accounts payable	2.6	12.1
Other liabilities	(0.1)	(2.2)
Net cash used in operating activities of discontinued operations	(0.2)	(0.7)
Total adjustments	45.5	55.1
Net cash provided by operating activities	107.1	121.4
Cash flows from investing activities:		
Purchases of property and equipment	(56.6)	(30.1)
Capitalized software costs	(7.0)	(8.1)
Escrow deposit — acquisition of business	—	(11.0)
Other	(4.2)	1.3
Net cash used in investing activities	(67.8)	(47.9)
Cash flows from financing activities:		
Borrowings on revolving credit facility	40.0	122.0
Payments on revolving credit facility	(42.0)	—
Repurchase of common stock, including fees and expenses	(26.3)	(232.6)
Dividends paid on common stock	(15.8)	—
Dividends paid on convertible perpetual preferred stock	(1.6)	(5.7)
Distributions paid to noncontrolling interests of consolidated affiliates	(12.0)	(13.2)
Proceeds from exercise of stock warrants	6.3	—
Other	0.7	3.3
Net cash used in financing activities	(50.7)	(126.2)
Decrease in cash and cash equivalents	(11.4)	(52.7)
Cash and cash equivalents at beginning of period	64.5	132.8
Cash and cash equivalents at end of period	$53.1	$80.1

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 the largest owner and operator of inpatient rehabilitation hospitals in the United States in terms of patients treated and discharged, revenues, and number of hospitals. We operate inpatient rehabilitation hospitals and provide specialized rehabilitative treatment on both an inpatient and outpatient basis.

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 20, 2014 (the “2013 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, 2013 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.

Net Operating Revenues—

During the three months ended March 31, 2014 and 2013, we derived consolidated Net operating revenues from the following payor sources:

	Three Months Ended March 31,			
	2014		2013	
Medicare	75.2	%	74.7	%
Medicaid	1.3	%	1.1	%
Workers’ compensation	1.3	%	1.3	%
Managed care and other discount plans, including Medicare Advantage	18.1	%	18.5	%
Other third-party payors	1.6	%	1.7	%
Patients	1.0	%	1.1	%
Other income	1.5	%	1.6	%
Total	100.0	%	100.0	%

See Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2013 Form 10-K for our policies related to Net operating revenues, Accounts receivable, and our Allowance for doubtful accounts.

2. Investments in and Advances to Nonconsolidated Affiliates

As of March 31, 2014 and December 31, 2013, we had \$20.1 million and \$20.3 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 10 partially owned subsidiaries, of which 8 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

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

affiliates. Our ownership percentages in these affiliates range from approximately 1% to 51%. We account for these investments using the cost and equity methods of accounting.

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

	Three Months Ended March 31,	
	2014	2013
Net operating revenues	$21.3	$19.5
Operating expenses	(11.2)	(11.2)
Income from continuing operations, net of tax	18.5	6.7
Net income	18.5	6.7

In December 2013, we signed an agreement to acquire an additional 30% equity interest from UMass Memorial Health Care, our joint venture partner in Fairlawn Rehabilitation Hospital in Worcester, Massachusetts. This transaction, which is subject to regulatory approval and is expected to close in 2014, will increase our ownership interest from 50% to 80% and will, when completed, result in a change in accounting for this hospital from the equity method of accounting to a consolidated entity. We expect to account for this change in control as a business combination and will consolidate this entity using the acquisition method. The consolidation of the operating results of Fairlawn Rehabilitation Hospital is not expected to have a material impact on our financial position, results of operations, or cash flows.

3. Redeemable Noncontrolling Interests

The following is a summary of the activity related to our Redeemable noncontrolling interests during the three months ended March 31, 2014 and 2013 (in millions):

	Three Months Ended March 31,	
	2014	2013
Balance at beginning of period	$13.5	$7.2
Net income attributable to noncontrolling interests	2.0	1.3
Distributions declared	(2.5)	(0.9)
Contribution to joint venture	—	6.2
Balance at end of period	$13.0	$13.8

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 months ended March 31, 2014 and 2013 (in millions):

	Three Months Ended March 31,	
	2014	2013
Net income attributable to nonredeemable noncontrolling interests	$12.8	$13.3
Net income attributable to redeemable noncontrolling interests	2.0	1.3
Net income attributable to noncontrolling interests	$14.8	$14.6

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

4. Fair Value Measurements

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

		Fair Value Measurements at Reporting Date Using			
As of March 31, 2014	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique [1]
Other current assets:					
Current portion of restricted marketable securities	$3.0	$—	$3.0	$—	M
Other long-term assets:					
Restricted marketable securities	45.6	—	45.6	—	M
As of December 31, 2013					
Other current assets:					
Current portion of restricted marketable securities	$4.7	$—	$4.7	$—	M
Other long-term assets:					
Restricted marketable securities	42.9	—	42.9	—	M

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

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 months ended March 31, 2014 and March 31, 2013, we did not record any material 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.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

As discussed in Note 1, Summary of Significant Accounting Policies, "Fair Value Measurements," to the consolidated financial statements accompanying the 2013 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 March 31, 2014		As of December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term debt:				
Advances under revolving credit facility	$43.0	$43.0	$45.0	$45.0
7.25% Senior Notes due 2018	272.4	288.0	272.4	291.4
8.125% Senior Notes due 2020	286.7	315.0	286.6	319.4
7.75% Senior Notes due 2022	252.5	276.2	252.5	275.0
5.75% Senior Notes due 2024	275.0	282.6	275.0	273.6
2.00% Convertible Senior Subordinated Notes due 2043	251.6	349.0	249.5	339.7
Other notes payable	46.3	46.3	47.6	47.6
Financial commitments:				
Letters of credit	—	37.3	—	36.5

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 2013 Form 10-K.

See also Note 3, Redeemable Noncontrolling Interests.

5. Share-Based Payments

In February 2014, we issued 0.6 million of 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 2014, 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 2013 Form 10-K.

6. Income Taxes

Our Provision for income tax expense of $32.8 million and $33.5 million for the three months ended March 31, 2014 and March 31, 2013, respectively, primarily resulted from the application of our estimated effective blended federal and state income tax rate.

We have significant federal and state net operating loss carryforwards ("NOLs") that expire in various amounts at varying times through 2031. Our utilization of NOLs could be subject to limitations under Internal Revenue Code Section 382 ("Section 382") and may be limited in the event certain cumulative changes in ownership interests of significant stockholders over a three-year period exceed 50%. Section 382 imposes an annual limitation on the use of certain carryforward losses to an amount that approximates the value of a company at the time of an ownership change multiplied by the long-term tax exempt rate. At this time, we do not believe these limitations will restrict our ability to use any NOLs before they expire. However, no such assurances can be provided.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

The $464.2 million of net deferred tax assets included in the accompanying condensed consolidated balance sheet as of March 31, 2014 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 March 31, 2014, we maintained a valuation allowance of $30.3 million due to uncertainties regarding our ability to utilize a portion of our state NOLs 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.

Our reported federal NOL of $303.0 million (approximately $866 million on a gross basis) as of March 31, 2014 excludes $11.2 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.

Total remaining gross unrecognized tax benefits were $1.1 million as of March 31, 2014 and December 31, 2013, none 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	Accrued Interest and Penalties
Balance at December 31, 2013	$1.1	$0.3
Gross amount of increases in unrecognized tax benefits related to prior periods	—	0.1
Balance at March 31, 2014	$1.1	$0.4

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 months ended March 31, 2014 and 2013 was not material. Accrued interest income related to income taxes as of March 31, 2014 and December 31, 2013 was not material.

HealthSouth and its subsidiaries' federal and state income tax returns are periodically examined by various regulatory taxing authorities. In connection with such examinations, we have settled federal income tax examinations with the IRS for all tax years through 2010. We are currently under audit by two states for tax years ranging from 2007 through 2011.

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. We do not expect a material change in our unrecognized tax benefits within the next 12 months due to the closing of the applicable statutes of limitation.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

7. Earnings per Common Share

In conjunction with the initiation of quarterly cash dividends in the third quarter of 2013, we revised our calculation to present earnings per share using the two-class method. The two-class method should have been used during all prior periods. We assessed the materiality of these revisions and concluded they were not material to any previously issued financial statements. The revision for the three months ended March 31, 2013 is presented below.

	2013 First Quarter
Basic earnings per share attributable to HealthSouth common shareholders, as reported:	
Continuing operations	$ 0.49
Discontinued operations	—
Net income	$ 0.49
Basic earnings per share attributable to HealthSouth common shareholders as revised using the two-class method:	
Continuing operations	$ 0.48
Discontinued operations	—
Net income	$ 0.48

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

	Three Months Ended March 31,	
	2014	2013
Basic:		
Numerator:		
Income from continuing operations	$61.6	$66.3
Less: Net income attributable to noncontrolling interests included in continuing operations	(14.8)	(14.6)
Less: Income allocated to participating securities	(0.5)	(0.8)
Less: Convertible perpetual preferred stock dividends	(1.6)	(5.7)
Income from continuing operations attributable to HealthSouth common shareholders	44.7	45.2
Loss from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.1)	(0.4)
Net income attributable to HealthSouth common shareholders	$44.6	$44.8
Denominator:		
Basic weighted average common shares outstanding	87.3	94.0
Basic earnings per share attributable to HealthSouth common shareholders:		
Continuing operations	$0.51	$0.48
Discontinued operations	—	—
Net income	$0.51	$0.48
Diluted:		
Numerator:		
Income from continuing operations	$61.6	$66.3
Less: Net income attributable to noncontrolling interests included in continuing operations	(14.8)	(14.6)
Add: Interest on convertible debt, net of tax	2.2	—
Income from continuing operations attributable to HealthSouth common shareholders	49.0	51.7
Loss from discontinued operations, net of tax, attributable to HealthSouth common shareholders	(0.1)	(0.4)
Net income attributable to HealthSouth common shareholders	$48.9	$51.3
Denominator:		
Diluted weighted average common shares outstanding	100.9	107.1
Diluted earnings per share attributable to HealthSouth common shareholders:		
Continuing operations	$0.48	$0.48
Discontinued operations	—	—
Net income	$0.48	$0.48

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

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 March 31,	
	2014	2013
Basic weighted average common shares outstanding	87.3	94.0
Convertible perpetual preferred stock	3.2	11.6
Convertible senior subordinated notes	8.1	—
Restricted stock awards, dilutive stock options, and restricted stock units	2.3	1.5
Diluted weighted average common shares outstanding	100.9	107.1

For the three months ended March 31, 2013, adding back the dividends for the Convertible perpetual preferred stock to Income from continuing operations attributable to HealthSouth common shareholders causes a per share increase when calculating diluted earnings per common share resulting in an antidilutive per share amount. Therefore, basic and diluted earnings per common share are the same for the three months ended March 31, 2013.

Options to purchase approximately 0.1 million and 1.4 million shares of common stock were outstanding as of March 31, 2014 and 2013, respectively, but were not included in the computation of diluted weighted-average shares because to do so would have been antidilutive.

On February 14, 2014, our board of directors approved an increase in our existing 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. During the first quarter of 2014, we repurchased 0.8 million shares of our common stock in the open market for $26.3 million using cash on hand.

On February 14, 2014, our board of directors declared a cash dividend of $0.18 per share that was paid on April 15, 2014 to stockholders of record on April 1, 2014. As of March 31, 2014, accrued common stock dividends of $16.1 million were included in Accrued expenses and other current liabilities in our condensed consolidated balance sheet. Future dividend payments are subject to declaration by our board of directors.

As discussed more fully in Note 10, Convertible Perpetual Preferred Stock, to the consolidated financial statements accompanying the 2013 Form 10-K, the agreement underlying our preferred stock 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 preferred stock had a conversion price of $30.50 per share, which was equal to an initial conversion rate of 32.7869 shares of common stock per share of preferred stock. Additionally, our convertible notes (see Note 8, Long-term Debt, to the consolidated financial statements accompanying the 2013 Form 10 K) also includes similar 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 in January of an $0.18 per share dividend on our common stock triggered the antidilutive adjustment for the preferred stock. As of January 3, 2014, the resulting exercise price of each share of preferred stock was $30.17, and the resulting conversion rate was 33.1455 for each preferred share. The payment in April of an $0.18 per share dividend on our common stock triggered the antidilutive adjustment for the preferred stock and the convertible notes. As of April 2, 2014, the resulting exercise price of each preferred stock and convertible note was $30.01 and $39.23 per share, respectively, and the resulting conversion rate was 33.3222 and 25.4896 for each preferred share and convertible note, respectively.

HealthSouth Corporation and Subsidiaries
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In January 2004, we repaid our then-outstanding 3.25% Convertible Debentures using the net proceeds of a loan arranged by Credit Suisse First Boston. In connection with this transaction, we issued ten million warrants with an expiration date of January 16, 2014 to the lender to purchase shares of our common stock. The following table summarizes information relating to these warrants and their activity from December 31, 2013 through their expiration date (number of warrants in millions):

	Number of Warrants	Weighted Average Exercise Price
Common stock warrants outstanding as of December 31, 2013	2.9	$32.50
Cashless exercise	(1.8)	32.16
Cash exercise	(1.0)	32.16
Expired	(0.1)	32.16
Common stock warrants outstanding as of January 16, 2014	—	

The above exercises resulted in the issuance of 0.2 million shares of common stock during the three months ended March 31, 2014. Cash exercises resulted in gross proceeds of $6.3 million during the three months ended March 31, 2014.

See Note 10, Convertible Perpetual Preferred Stock, and Note 17, Earnings per Common Share, to the consolidated financial statements accompanying the 2013 Form 10-K for additional information related to common stock, common stock warrants, and convertible perpetual preferred stock.

8. 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.

Litigation By and Against Former Independent Auditor—

In March 2003, claims on behalf of HealthSouth were brought against Ernst & Young, LLP in a stockholder derivative lawsuit initially filed in the Circuit Court of Jefferson County, Alabama on August 28, 2002 and captioned Tucker v. Scrushy. The Tucker derivative litigation, including the claims against various other defendants and the $2.9 billion judgment against Mr. Scrushy, our former chairman and chief executive officer, is more fully described in “Derivative Litigation” and “Litigation Against Richard M. Scrushy” in Note 18, Contingencies and Other Commitments, to the consolidated financial statements accompanying the 2013 Form 10-K. The Tucker complaint alleges that from 1996 through 2002, when Ernst & Young served as our independent auditor, Ernst & Young acted recklessly and with gross negligence in performing its duties, and specifically that Ernst & Young failed to perform reviews and audits of our financial statements with due professional care as required by law and by its contractual agreements with us. The claims further allege Ernst & Young either knew of or, in the exercise of due care, should have discovered and investigated the fraudulent and improper accounting practices being directed by certain officers and employees, and should have reported them to our board of directors and the audit committee. The claims seek compensatory and punitive damages, disgorgement of fees received from us by Ernst & Young, and attorneys’ fees and costs.

On March 18, 2005, Ernst & Young filed a lawsuit captioned Ernst & Young LLP v. HealthSouth Corp. in the Circuit Court of Jefferson County, Alabama. The complaint alleges we provided Ernst & Young with fraudulent management representation letters, financial statements, invoices, bank reconciliations, and journal entries in an effort to conceal accounting fraud. Ernst & Young claims that as a result of our actions, Ernst & Young’s reputation has been injured and it has and will incur damages, expenses, and legal fees. On April 1, 2005, we answered Ernst & Young’s claims and asserted counterclaims related or identical to those asserted in the Tucker action. Upon Ernst & Young’s motion, the Alabama state court referred Ernst & Young’s claims and our counterclaims to arbitration pursuant to a clause in the engagement agreements between HealthSouth and Ernst & Young. In August 2006, we and the derivative plaintiffs agreed to jointly prosecute the claims against Ernst & Young in arbitration.

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HealthSouth Corporation and Subsidiaries
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The trial phase of the arbitration process began on July 12, 2010 before a three-person arbitration panel selected under rules of the American Arbitration Association (the "AAA"). On December 18, 2012, the AAA panel granted Ernst & Young's motion to dismiss our claims on the grounds that HealthSouth is not permitted to pursue its claims since certain of its former officers and employees committed fraudulent acts. The panel also denied and dismissed Ernst & Young's claims against us. On December 18, 2012, we, together with the stockholder derivative plaintiffs, filed a notice of appeal of the panel's decision in the Circuit Court of Jefferson County, Alabama. On December 28, 2012, we filed a motion to vacate the decision. We assert that the panel's decision is contrary to the Federal Arbitration Act and the duties of a public accounting firm to its corporate clients, and that the arbitrators exceeded their authority by entering an award contrary to Alabama law. On April 25, 2013, the court denied our motion to vacate. On June 4, 2013, we filed a notice of appeal to the Supreme Court of Alabama seeking review of the Circuit Court's denial of our motion to vacate the arbitration panel's decision, and the parties have since submitted their briefs. At this time, we do not know how long the appellate process will take.

Based on the ruling of the arbitration panel, we do not believe there is a reasonable possibility of a loss that might result from an adverse judgment or a settlement of this case.

General Medicine Action—

On August 16, 2004, General Medicine, P.C. filed a lawsuit against us captioned General Medicine, P.C. v. HealthSouth Corp. seeking the recovery of allegedly fraudulent transfers involving assets of Horizon/CMS Healthcare Corporation, a former subsidiary of HealthSouth. The lawsuit is pending in the Circuit Court of Jefferson County, Alabama (the "Alabama Action").

General Medicine's underlying claim against Horizon/CMS originates from a services contract entered into in 1995 between General Medicine and Horizon/CMS whereby General Medicine agreed to provide medical director services to skilled nursing facilities owned by Horizon/CMS for a term of three years. Horizon/CMS terminated the agreement for cause six months after it was executed, and General Medicine then initiated a lawsuit against Horizon/CMS in the United States District Court for the Eastern District of Michigan in 1996 (the "Michigan Action"). General Medicine's complaint in the Michigan Action alleged that Horizon/CMS breached the services contract by wrongfully terminating General Medicine. We acquired Horizon/CMS in 1997 and sold it to Meadowbrook Healthcare, Inc. in 2001 pursuant to a stock purchase agreement. In 2004, Meadowbrook, without the knowledge of HealthSouth, consented to the entry of a final judgment in the Michigan Action in favor of General Medicine against Horizon/CMS for the alleged wrongful termination of the contract with General Medicine in the amount of $376 million, plus interest from the date of the judgment until paid at the rate of 10% per annum (the "Consent Judgment"). The $376 million damages figure was unilaterally selected by General Medicine and was not tested or opposed by Meadowbrook. Additionally, the settlement agreement (the "Settlement") used as the basis for the Consent Judgment provided that Meadowbrook would pay only $300,000 to General Medicine to settle the Michigan Action and that General Medicine would seek to recover the remaining balance of the Consent Judgment solely from us. We were not a party to the Michigan Action, the Settlement negotiated by Meadowbrook, or the Consent Judgment.

The complaint filed by General Medicine against us in the Alabama Action alleges that while Horizon/CMS was our wholly owned subsidiary, General Medicine was an existing creditor of Horizon/CMS by virtue of the breach of contract claim underlying the Settlement. The complaint also alleges we caused Horizon/CMS to transfer its assets to us for less than a reasonably equivalent value or, in the alternative, with the actual intent to defraud creditors of Horizon/CMS, including General Medicine, in violation of the Alabama Uniform Fraudulent Transfer Act. General Medicine further alleges in its amended complaint that we are liable for the Consent Judgment despite not being a party to it because as Horizon/CMS's parent we failed to observe corporate formalities in our operation and ownership of Horizon/CMS, misused our control of Horizon/CMS, stripped assets from Horizon/CMS, and engaged in other conduct which amounted to a fraud on Horizon/CMS's creditors. General Medicine has requested relief including recovery of the unpaid amount of the Consent Judgment, the avoidance of the subject transfers of assets, attachment of the assets transferred to us, appointment of a receiver over the transferred properties, and a monetary judgment for the value of properties transferred.

We have denied liability to General Medicine and asserted defenses and counterclaims against General Medicine for fraud, injurious falsehood, tortious interference with business relations, conspiracy, unjust enrichment, abuse of process, and other causes of action. In our counterclaims, we alleged the Consent Judgment is the product of fraud, collusion and bad faith by General Medicine and Meadowbrook and, further, that these parties were guilty of a conspiracy to manufacture a lawsuit against HealthSouth in favor of General Medicine. Consequently, we assert that the Consent Judgment is not evidence of a legitimate debt owed by Horizon/CMS to General Medicine that is collectible from HealthSouth under any theory of liability.

In 2008, after we obtained discovery concerning the circumstances that led to the entry of the Consent Judgment, we filed a motion in the Michigan Action asking the court to set aside the Consent Judgment on grounds that it was the product of fraud on the court and collusion by the parties. On May 21, 2009, the court granted our motion to set aside the Consent Judgment on grounds that it was the product of fraud on the court. On March 9, 2010, General Medicine filed an appeal of the court's decision to the Sixth Circuit Court of Appeals. The parties agreed to a voluntary stay of the Alabama Action pending the outcome of General Medicine's appeal to the Sixth Circuit Court of Appeals. On April 10, 2012, the Sixth Circuit Court of Appeals reversed the lower court's ruling and reinstated the Consent Judgment. Due to the conclusion of the appeal in the Michigan Action, General Medicine requested reactivation of the Alabama Action in the Circuit Court of Jefferson County, Alabama. On January 10, 2013, we filed a motion for partial summary judgment in the Alabama Action seeking a declaration that the Consent Judgment obtained by General Medicine is not enforceable against us because, among other reasons, it was the result of collusion. On February 27, 2013, the court denied our motion. The court also indicated it concurred with the Sixth Circuit Court of Appeals that the Consent Judgment did nothing more than establish Horizon/CMS's liability to General Medicine and did not establish the amount of General Medicine’s damages claim against Horizon/CMS or the merits of General Medicine's separate fraudulent conveyance claims against HealthSouth.

On January 9, 2014 and on February 18, 2014, the court entered rulings which together provided that the $376 million damages figure contained in the Consent Judgment is not admissible at trial and that, accordingly, the issue of collusion with respect to the amount of the Consent Judgment is now moot. Instead of relying on the Consent Judgment to prove damages against Horizon/CMS, General Medicine will be required to prove the amount of any damages it has against Horizon/CMS. On March 31, 2014, General Medicine filed a motion seeking partial summary judgment and requesting dismissal of our defenses and counterclaims which allege the Consent Judgment was the product of fraud, collusion and bad faith. A hearing on this motion has been set for May 21, 2014.

We intend to provide a vigorous defense to those damage claims and to continue to pursue our counterclaims relating to alleged fraud, collusion, and bad faith by General Medicine. The Alabama Action is still in the discovery phase and has been set for trial beginning in September 2014.

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. We intend to vigorously defend ourselves against General Medicine’s claims and to vigorously prosecute our counterclaims against General Medicine.

Other 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 consolidated with the Tucker case for discovery and other pretrial purposes and was stayed in the Circuit Court on August 8, 2005. 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. 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.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

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 U.S. Department of Health and Human Services, Office of the Inspector General (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 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 new subpoenas do not include requests for specific patient files, but it is expected that such requests will be made for the new group of hospitals.

All of the subpoenas are in connection with an investigation of alleged improper or fraudulent claims submitted to Medicare and Medicaid and requests 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 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 we are unaware of such filings or have been ordered by the presiding court not to discuss or disclose the filing of such lawsuits. 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.

9. 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 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 1.5x. 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. See Note 8, Long-term Debt, to the consolidated financial statements accompanying the 2013 Form 10-K.

As described in Note 10, Convertible Perpetual Preferred Stock, to the consolidated financial statements accompanying the 2013 Form 10-K, our preferred stock generally provides for the payment of cash dividends, subject to certain limitations. Our credit agreement and our senior note indenture do not limit the payment of dividends on the preferred stock.

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.

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

	Three Months Ended March 31, 2014				
	HealthSouth Corporation (In Millions)	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
Net operating revenues	$3.8	$427.0	$182.2	$(21.8)	$591.2
Less: Provision for doubtful accounts	—	(5.5)	(2.0)	—	(7.5)
Net operating revenues less provision for doubtful accounts	3.8	421.5	180.2	(21.8)	583.7
Operating expenses:					
Salaries and benefits	5.6	196.9	87.3	(3.7)	286.1
Other operating expenses	4.9	59.8	28.5	(8.7)	84.5
Occupancy costs	1.0	14.3	4.5	(9.3)	10.5
Supplies	—	19.6	8.0	—	27.6
General and administrative expenses	30.7	—	—	—	30.7
Depreciation and amortization	2.9	17.9	5.6	—	26.4
Professional fees—accounting, tax, and legal	1.6	—	—	—	1.6
Total operating expenses	46.7	308.5	133.9	(21.7)	467.4
Interest expense and amortization of debt discounts and fees	25.3	2.2	0.7	(0.3)	27.9
Other income	(0.2)	(1.2)	(0.6)	0.3	(1.7)
Equity in net income of nonconsolidated affiliates	—	(4.3)	—	—	(4.3)
Equity in net income of consolidated affiliates	(67.9)	(6.8)	—	74.7	—
Management fees	(26.6)	20.4	6.2	—	—
Income from continuing operations before income tax (benefit) expense	26.5	102.7	40.0	(74.8)	94.4
Provision for income tax (benefit) expense	(20.3)	42.5	10.6	—	32.8
Income from continuing operations	46.8	60.2	29.4	(74.8)	61.6
Loss from discontinued operations, net of tax	(0.1)	—	—	—	(0.1)
Net Income	46.7	60.2	29.4	(74.8)	61.5
Less: Net income attributable to noncontrolling interests	—	—	(14.8)	—	(14.8)
Net income attributable to HealthSouth	$46.7	$60.2	$14.6	$(74.8)	$46.7
Comprehensive income	$46.8	$60.2	$29.4	$(74.8)	$61.6
Comprehensive income attributable to HealthSouth	$46.8	$60.2	$14.6	$(74.8)	$46.8

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

	Three Months Ended March 31, 2013				
	HealthSouth Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries	HealthSouth Consolidated
	(In Millions)				
Net operating revenues	$3.1	$413.8	$172.6	$(16.9)	$572.6
Less: Provision for doubtful accounts	—	(5.3)	(2.1)	—	(7.4)
Net operating revenues less provision for doubtful accounts	3.1	408.5	170.5	(16.9)	565.2
Operating expenses:					
Salaries and benefits	7.5	189.0	81.7	(3.6)	274.6
Other operating expenses	2.9	57.7	25.7	(8.2)	78.1
Occupancy costs	1.0	12.0	4.2	(5.0)	12.2
Supplies	—	18.6	7.6	—	26.2
General and administrative expenses	30.2	—	—	—	30.2
Depreciation and amortization	2.1	15.2	4.8	—	22.1
Professional fees—accounting, tax, and legal	1.4	—	—	—	1.4
Total operating expenses	45.1	292.5	124.0	(16.8)	444.8
Interest expense and amortization of debt discounts and fees	22.1				