

HEALTHSOUTH CORP
Form 10-Q
October 31, 2017
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 September 30, 2017
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 63-0860407
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

3660 Grandview Parkway, Suite 200 35243
Birmingham, Alabama
(Address of Principal Executive Offices) (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," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Smaller reporting company
Non-Accelerated filer (Do not check if a smaller reporting company) Emerging growth company
If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The registrant had 98,310,804 shares of common stock outstanding, net of treasury shares, as of October 25, 2017.

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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 “contingent,” 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, 2016, as well as uncertainties and factors, if any, discussed elsewhere in this Form 10-Q, including in the “Executive Overview—Key Challenges” section of Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, 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,” the introduction of site neutral payments with skilled nursing facilities for certain conditions, or the home health groupings model), payment system reforms, 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;

restrictive interpretations of the regulations governing the claims that are reimbursable by Medicare;

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, which may decrease our reimbursement rate or increase costs associated with our operations; 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, including from other providers that may be participating in integrated delivery payment arrangements in which we do not participate, and our response to those pressures;

changes in our payor mix or the acuity of our patients affecting reimbursement rates;

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, productivity improvements arising from the related operations and avoidance of unanticipated difficulties, costs or liabilities that could arise from acquisitions or integrations;

any adverse outcome of various lawsuits, claims, and legal or regulatory proceedings, including the ongoing investigations by the U.S. Departments of Justice and of Health and Human Services, Office of the Inspector General;

potential incidents affecting the proper operation, availability, or security of our information systems, including the patient information stored there;

our ongoing rebranding and name change initiative and the impact on our existing operations, including our ability to attract patient referrals to our hospitals as well as the associated costs of rebranding;

increased costs of defending and insuring against alleged professional liability and other claims and the ability to predict the costs related to claims;

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 maintain proper local, state and federal licensing, including compliance with the Medicare conditions of participation, which is required to participate in the Medicare program;

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		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
	(In Millions)			
Net operating revenues	\$995.6	\$926.8	\$2,951.7	\$2,757.3
Less: Provision for doubtful accounts	(12.6)	(14.8)	(42.7)	(46.7)
Net operating revenues less provision for doubtful accounts	983.0	912.0	2,909.0	2,710.6
Operating expenses:				
Salaries and benefits	542.1	497.4	1,600.0	1,469.6
Other operating expenses	137.6	126.3	397.2	367.0
Occupancy costs	18.6	17.6	54.8	53.5
Supplies	36.5	34.8	110.6	104.2
General and administrative expenses	39.7	30.3	128.6	96.6
Depreciation and amortization	46.2	43.5	137.2	128.8
Professional fees—accounting, tax, and legal	—	—	—	1.9
Total operating expenses	820.7	749.9	2,428.4	2,221.6
Loss on early extinguishment of debt	0.3	2.6	10.7	7.4
Interest expense and amortization of debt discounts and fees	36.8	42.5	118.5	130.5
Other income	(1.0)	(0.8)	(2.9)	(2.1)
Equity in net income of nonconsolidated affiliates	(2.1)	(2.5)	(6.2)	(7.3)
Income from continuing operations before income tax expense	128.3	120.3	360.5	360.5
Provision for income tax expense	43.1	42.1	111.4	124.2
Income from continuing operations	85.2	78.2	249.1	236.3
Loss from discontinued operations, net of tax	(0.1)	(0.1)	(0.2)	(0.3)
Net income	85.1	78.1	248.9	236.0
Less: Net income attributable to noncontrolling interests	(19.2)	(16.4)	(53.2)	(53.7)
Net income attributable to HealthSouth	\$65.9	\$61.7	\$195.7	\$182.3

(Continued)

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

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
	(In Millions, Except Per Share Data)			
Weighted average common shares outstanding:				
Basic	97.8	89.1	92.3	89.3
Diluted	99.0	99.4	99.1	99.5
Earnings per common share:				
Basic earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	\$0.67	\$0.69	\$2.11	\$2.03
Discontinued operations	—	—	—	—
Net income	\$0.67	\$0.69	\$2.11	\$2.03
Diluted earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	\$0.67	\$0.64	\$2.08	\$1.90
Discontinued operations	—	—	—	—
Net income	\$0.67	\$0.64	\$2.08	\$1.90
Cash dividends per common share	\$0.25	\$0.24	\$0.73	\$0.70
Amounts attributable to HealthSouth common shareholders:				
Income from continuing operations	\$66.0	\$61.8	\$195.9	\$182.6
Loss from discontinued operations, net of tax	(0.1)	(0.1)	(0.2)	(0.3)
Net income attributable to HealthSouth	\$65.9	\$61.7	\$195.7	\$182.3

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)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
	(In Millions)			
COMPREHENSIVE INCOME				
Net income	\$85.1	\$78.1	\$248.9	\$236.0
Other comprehensive (loss) income, net of tax:				
Net change in unrealized gain (loss) on available-for-sale securities:				
Unrealized net holding gain (loss) arising during the period	0.1	(0.2)	0.5	0.4
Other comprehensive income (loss) before income taxes	0.1	(0.2)	0.5	0.4
Provision for income tax (expense) benefit related to other comprehensive income items	(0.1)	0.1	(0.2)	(0.2)
Other comprehensive (loss) income, net of tax	—	(0.1)	0.3	0.2
Comprehensive income	85.1	78.0	249.2	236.2
Comprehensive income attributable to noncontrolling interests	(19.2)	(16.4)	(53.2)	(53.7)
Comprehensive income attributable to HealthSouth	\$65.9	\$61.6	\$196.0	\$182.5

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)

	September 30, 2017	December 31, 2016
	(In Millions)	
Assets		
Current assets:		
Cash and cash equivalents	\$67.6	\$ 40.5
Accounts receivable, net of allowance for doubtful accounts of \$58.5 in 2017; \$53.9 in 2016	441.6	443.8
Other current assets	178.2	170.2
Total current assets	687.4	654.5
Property and equipment, net	1,482.3	1,391.8
Goodwill	1,971.7	1,927.2
Intangible assets, net	405.1	411.3
Deferred income tax assets	91.6	75.8
Other long-term assets	245.3	221.3
Total assets ⁽¹⁾	\$4,883.4	\$ 4,681.9
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$31.1	\$ 37.1
Accounts payable	81.8	68.3
Accrued expenses and other current liabilities	398.3	370.2
Total current liabilities	511.2	475.6
Long-term debt, net of current portion	2,591.3	2,979.3
Other long-term liabilities	186.4	160.0
	3,288.9	3,614.9
Commitments and contingencies		
Redeemable noncontrolling interests	221.3	138.3
Shareholders' equity:		
HealthSouth shareholders' equity	1,136.4	735.9
Noncontrolling interests	236.8	192.8
Total shareholders' equity	1,373.2	928.7
Total liabilities ⁽¹⁾ and shareholders' equity	\$4,883.4	\$ 4,681.9

Our consolidated assets as of September 30, 2017 and December 31, 2016 include total assets of variable interest entities of \$262.7 million and \$262.3 million, respectively, which cannot be used by us to settle the obligations of ⁽¹⁾ other entities. Our consolidated liabilities as of September 30, 2017 and December 31, 2016 include total liabilities of the variable interest entities of \$53.9 million and \$50.3 million, respectively. 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)

Nine Months Ended September 30, 2017								
(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	88.9	\$ 1.1	\$2,799.1	\$(1,448.4)	\$ (1.2)	\$(614.7)	\$ 192.8	\$928.7
Net income	—	—	—	195.7	—	—	43.3	239.0
Receipt of treasury stock	(0.9)	—	—	—	—	(19.8)	—	(19.8)
Dividends declared on common stock	—	—	(70.3)	—	—	—	—	(70.3)
Stock-based compensation	—	—	15.2	—	—	—	—	15.2
Stock options exercised	1.1	—	20.4	—	—	(19.3)	—	1.1
Stock warrants exercised	0.7	—	26.6	—	—	—	—	26.6
Distributions declared	—	—	—	—	—	—	(37.1)	(37.1)
Capital contributions from consolidated affiliates	—	—	—	—	—	—	37.8	37.8
Fair value adjustments to redeemable noncontrolling interests, net of tax	—	—	(44.4)	—	—	—	—	(44.4)
Repurchases of common stock in open market	(0.9)	—	—	—	—	(38.1)	—	(38.1)
Conversion of convertible debt, net of tax	8.9	—	53.7	—	—	274.5	—	328.2
Other	0.5	—	5.7	1.1	0.3	(0.8)	—	6.3
Balance at end of period	98.3	\$ 1.1	\$2,806.0	\$(1,251.6)	\$ (0.9)	\$(418.2)	\$ 236.8	\$1,373.2

Nine Months Ended September 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	—	—	—	182.3	—	—	42.5	224.8
Receipt of treasury stock	(0.4)	—	—	—	—	(9.9)	—	(9.9)
Dividends declared on common stock	—	—	(63.4)	—	—	—	—	(63.4)
Stock-based compensation	—	—	16.1	—	—	—	—	16.1
Stock options exercised	0.3	—	6.6	—	—	(4.8)	—	1.8
Distributions declared	—	—	—	—	—	—	—	—