HEALTHSOUTH CORP
Form 10-Q
August 05, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

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 x 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 x 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 x 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 o No x

The registrant had 93,455,973 shares of common stock outstanding, net of treasury shares, as of July 29, 2010.

Table of Contents

TABLE OF CONTENTS

		Page
PART I	Financial Information	
Item 1.	Financial Statements (Unaudited)	1
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	29
Item 4.	Controls and Procedures	47
PART II	Other Information	
Item 1.	Legal Proceedings	48
Item 1A.	Risk Factors	48
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	48
Item 6.	Exhibits	49

Table of Contents

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 future events, our business strategy, our future financial performance, or our projected business results. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “targets,” “potential,” or “continue” or the nega terms or other comparable terminology. Such forward-looking statements are necessarily estimates or forecasts based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. 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. While it is impossible to identify all such factors, factors that could cause actual 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, 2009, as well as uncertainties and factors discussed elsewhere in this Form 10-Q, in our other filings from time to time with the United States Securities and Exchange Commission, or in materials incorporated therein by reference;
- changes in the regulations of the healthcare industry at either or both of the federal and state levels;
- changes 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;
- 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 shortages;
- competitive pressures in the healthcare industry and our response to those pressures;
- our ability to successfully complete and integrate acquisitions, investments, and joint ventures consistent with our growth strategy; and
- general conditions in the economy and capital markets.

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.

Table of Contents

PART 1. 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,	
	2010	2009	2010	2009
	(In Millions, Except Per Share Data)			
Net operating revenues	$496.9	$481.6	$987.9	$954.5
Operating expenses:				
Salaries and benefits	241.6	237.8	483.5	471.1
Other operating expenses	76.6	67.0	143.5	133.9
General and administrative expenses	26.7	24.9	53.0	50.4
Supplies	28.8	28.6	57.1	56.0
Depreciation and amortization	18.7	17.6	37.0	35.0
Occupancy costs	11.4	12.0	23.0	24.0
Provision for doubtful accounts	5.9	9.7	12.8	17.5
Loss on disposal of assets	0.4	1.3	0.4	2.3
Government, class action, and related settlements	-	48.7	-	32.8
Professional fees—accounting, tax, and legal	5.7	(3.3)	8.6	1.5
Total operating expenses	415.8	444.3	818.9	824.5
Loss (gain) on early extinguishment of debt	0.1	(1.3)	0.4	(3.1)
Interest expense and amortization of debt discounts and fees	30.1	31.1	60.6	65.5
Other income	(1.4)	(1.0)	(2.1)	(0.8)
(Gain) loss on interest rate swaps	(0.3)	3.8	4.0	8.8
Equity in net (income) loss of nonconsolidated affiliates	(2.6)	2.7	(5.2)	0.2
Income from continuing operations before income tax (benefit) expense	55.2	2.0	111.3	59.4
Provision for income tax (benefit) expense	(2.2)	(0.3)	0.3	0.9
Income from continuing operations	57.4	2.3	111.0	58.5
Income (loss) from discontinued operations, net of tax	0.1	1.3	(3.0)	(1.4)
Net income	57.5	3.6	108.0	57.1
Less: Net income attributable to noncontrolling interests	(10.2)	(9.1)	(20.0)	(17.7)
Net income (loss) attributable to HealthSouth	47.3	(5.5)	88.0	39.4
Less: Convertible perpetual preferred stock dividends	(6.5)	(6.5)	(13.0)	(13.0)
Net income (loss) attributable to HealthSouth common shareholders	$40.8	$(12.0)	$75.0	$26.4
Weighted average common shares outstanding:				
Basic	92.8	87.6	92.7	87.5
Diluted	108.2	101.5	108.2	101.2
Basic and diluted earnings per common share:				
Income (loss) from continuing operations attributable to HealthSouth common shareholders	$0.44	$(0.15)	$0.84	$0.32
Income (loss) from discontinued operations, net of tax, attributable to HealthSouth common shareholders	0.00	0.01	(0.03)	(0.02)

Net income (loss) attributable to HealthSouth common shareholders	$0.44	$(0.14)	$0.81	$0.30
Amounts attributable to HealthSouth common shareholders:				
Income (loss) from continuing operations	$47.2	$(6.6)	$91.0	$41.3
Income (loss) from discontinued operations, net of tax	0.1	1.1	(3.0)	(1.9)
Net income (loss) attributable to HealthSouth	$47.3	$(5.5)	$88.0	$39.4

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

1

Table of Contents

HealthSouth Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2010	December 31, 2009
	(In Millions, Except Share Data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 172.6	$ 80.9
Restricted cash	49.7	67.8
Accounts receivable, net of allowance for doubtful accounts of $32.0 in 2010; $33.1 in 2009	224.8	219.7
Other current assets	56.8	57.6
Total current assets	503.9	426.0
Property and equipment, net	664.5	664.8
Goodwill	423.7	416.4
Intangible assets, net	35.5	37.4
Investments in and advances to nonconsolidated affiliates	31.0	29.3
Other long-term assets	97.5	107.6
Total assets	$ 1,756.1	$ 1,681.5
Liabilities and Shareholders' Deficit		
Current liabilities:		
Current portion of long-term debt	$ 21.5	$ 21.5
Accounts payable	47.3	50.2
Accrued expenses and other current liabilities	322.6	319.5
Total current liabilities	391.4	391.2
Long-term debt, net of current portion	1,633.0	1,641.0
Other long-term liabilities	161.6	159.5
	2,186.0	2,191.7
Commitments and contingencies		
Convertible perpetual preferred stock, $.10 par value; 1,500,000 shares authorized; 400,000 issued; liquidation preference of $1,000 per share	387.4	387.4
Shareholders' deficit:		
HealthSouth shareholders' deficit:		
Common stock, $.01 par value; 200,000,000 shares authorized; issued: 97,624,393 in 2010; 97,238,725 in 2009	1.0	1.0
Capital in excess of par value	2,877.6	2,879.9
Accumulated deficit	(3,629.4)	(3,717.4)
Accumulated other comprehensive loss	(4.0)	-
Treasury stock, at cost (4,166,756 shares in 2010 and 3,957,047 shares in 2009)	(141.5)	(137.5)
Total HealthSouth shareholders' deficit	(896.3)	(974.0)
Noncontrolling interests	79.0	76.4
Total shareholders' deficit	(817.3)	(897.6)

Total liabilities and shareholders’ deficit	$ 1,756.1	$ 1,681.5

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

Table of Contents

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
	(In Millions)			
COMPREHENSIVE INCOME				
Net income	$ 57.5	$ 3.6	$ 108.0	$ 57.1
Other comprehensive (loss) income, net of tax:				
Net change in unrealized gain (loss) on available-for-sale securities:				
Unrealized net holding gain arising during the period	-	1.7	0.6	0.1
Reclassifications to net income	-	-	(1.3)	1.6
Net change in unrealized (loss) gain on forward-starting interest rate swaps:				
Unrealized net holding (loss) gain arising during the period	(2.6)	2.7	(4.7)	2.0
Other comprehensive (loss) income before income taxes	(2.6)	4.4	(5.4)	3.7
Provision for income tax benefit related to other comprehensive (loss) income items	1.4	-	1.4	-
Other comprehensive (loss) income, net of tax	(1.2)	4.4	(4.0)	3.7
Comprehensive income	56.3	8.0	104.0	60.8
Comprehensive income attributable to noncontrolling interests	(10.2)	(9.1)	(20.0)	(17.7)
Comprehensive income (loss) attributable to HealthSouth	$ 46.1	$ (1.1)	$ 84.0	$ 43.1

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

Table of Contents

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

Six Months Ended June 30, 2010
(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	Comprehensive Income
Balance at beginning of period	93.3	$ 1.0	$ 2,879.9	$ (3,717.4)	$ -	$ (137.5)	$ 76.4	$ (897.6)	
Comprehensive income:									
Net income	-	-	-	88.0	-	-	20.0	108.0	$ 108.0
Other comprehensive loss, net of tax	-	-	-	-	(4.0)	-	-	(4.0)	(4.0)
Comprehensive income									$ 104.0
Forfeiture of restricted stock	(0.1)	-	2.5	-	-	(2.5)	-	-	
Receipt of treasury stock	(0.1)	-	-	-	-	(1.5)	-	(1.5)	
Dividends declared on convertible perpetual preferred stock	-	-	(13.0)	-	-	-	-	(13.0)	
Stock-based compensation	-	-	7.8	-	-	-	-	7.8	
Distributions declared	-	-	-	-	-	-	(17.0)	(17.0)	
Other	0.4	-	0.4	-	-	-	(0.4)	-	
Balance at end of period	93.5	$ 1.0	$ 2,877.6	$ (3,629.4)	$ (4.0)	$ (141.5)	$ 79.0	$ (817.3)	

Six Months Ended June 30, 2009
(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	Comprehensive Income
Balance at beginning of period	88.0	$ 1.0	$ 2,956.5	$ (3,812.2)	$ (3.2)	$ (311.5)	$ 82.2	$ (1,087.2)	
Comprehensive income:									
Net income	-	-	-	39.4	-	-	17.7	57.1	$ 57.1
Other comprehensive income, net of tax	-	-	-	-	3.7	-	-	3.7	3.7
Comprehensive income									$ 60.8
Dividends declared on convertible perpetual preferred stock	-	-	(13.0)	-	-	-	-	(13.0)	
Stock-based compensation	-	-	6.6	-	-	-	-	6.6	
Distributions declared	-	-	-	-	-	-	(15.7)	(15.7)	
Other	0.3	-	0.1	-	-	(0.6)	(1.3)	(1.8)	
Balance at end of period	88.3	$ 1.0	$ 2,950.2	$ (3,772.8)	$ 0.5	$ (312.1)	$ 82.9	$ (1,050.3)	

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

Table of Contents

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

	Six Months Ended June 30,	
	2010	2009
	(In Millions)	
Cash flows from operating activities:		
Net income	$ 108.0	$ 57.1
Loss from discontinued operations	3.0	1.4
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	12.8	17.5
Provision for government, class action, and related settlements	-	32.8
UBS Settlement proceeds, gross	-	100.0
Depreciation and amortization	37.0	35.0
Loss on interest rate swaps	4.0	8.8
Equity in net (income) loss of nonconsolidated affiliates	(5.2)	0.2
Distributions from nonconsolidated affiliates	3.3	3.9
Stock-based compensation	7.8	6.6
Deferred tax provision	2.1	1.9
Other	2.7	3.1
(Increase) decrease in assets—		
Accounts receivable	(17.9)	(25.8)
Other assets	(5.8)	(0.7)
Income tax refund receivable	4.3	45.4
(Decrease) increase in liabilities—		
Accounts payable	(2.8)	2.2
Accrued fees and expenses for derivative plaintiffs' attorneys in UBS Settlement	-	(26.2)
Other liabilities	24.4	(18.3)
Government, class action, and related settlements	(0.8)	(8.7)
Net cash used in operating activities of discontinued operations	(4.2)	(7.0)
Total adjustments	61.7	170.7
Net cash provided by operating activities	172.7	229.2

(Continued)

Table of Contents

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

	Six Months Ended June 30,	
	2010	2009
	(In Millions)	
Cash flows from investing activities:		
Capital expenditures	(29.9)	(34.4)
Acquisition of a business, net of cash acquired	(9.9)	-
Proceeds from sale of restricted investments	10.0	1.6
Purchase of restricted investments	(13.3)	(1.6)
Net change in restricted cash	18.1	(15.7)
Net settlements on interest rate swaps	(23.1)	(19.1)
Net investment in interest rate swap	-	(6.4)
Other	(0.1)	(0.8)
Net cash provided by (used in) investing activities of discontinued operations	8.5	(1.4)
Net cash used in investing activities	(39.7)	(77.8)
Cash flows from financing activities:		
Principal payments on debt, including pre-payments	(3.8)	(60.9)
Borrowings on revolving credit facility	-	10.0
Payments on revolving credit facility	-	(50.0)
Principal payments under capital lease obligations	(7.2)	(6.6)
Dividends paid on convertible perpetual preferred stock	(13.0)	(13.0)
Distributions paid to noncontrolling interests of consolidated affiliates	(18.3)	(15.8)
Other	0.9	0.7
Net cash provided by financing activities of discontinued operations	-	1.8
Net cash used in financing activities	(41.4)	(133.8)
Increase in cash and cash equivalents	91.6	17.6
Cash and cash equivalents at beginning of period	80.9	32.1
Cash and cash equivalents of facilities held for sale at beginning of period	0.1	0.1
Less: Cash and cash equivalents of facilities held for sale at end of period	-	-
Cash and cash equivalents at end of period	$172.6	$49.8

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

Table of Contents

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 provider of inpatient rehabilitative healthcare services in the United States. We operate inpatient rehabilitation hospitals and long-term acute care hospitals and provide treatment on both an inpatient and outpatient basis. References herein to "HealthSouth," the "Company," "we," "our," or "us" refer to HealthSouth Corporation and its subsidiaries unless otherwise stated or indicated by context.

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 23, 2010 (the "2009 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, 2009 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.

Business Combinations—

On June 1, 2010, we completed the acquisition of Desert Canyon Rehabilitation Hospital, a 50-bed inpatient rehabilitation hospital located in southwest Las Vegas, Nevada. We accounted for this acquisition under the purchase method of accounting and reported the results of operations of the acquired hospital from the date of acquisition. As a result of this transaction, Goodwill increased by $7.3 million. We have not prepared pro forma financial information as the results of operations of this acquired business and its assets are not material on a consolidated basis.

Long-term Debt—

As discussed in Note 8, Long-term Debt, to the consolidated financial statements accompanying the 2009 Form 10-K, our credit agreement includes a $100 million synthetic letter of credit facility. During the six months ended June 30, 2010, we permanently reduced this facility by $40 million to $60 million. As of June 30, 2010, $52.9 million were utilized under the synthetic letter of credit facility. These letters are being used in the ordinary course of business primarily to secure workers' compensation and other insurance coverages.

Stock-Based Compensation—

In February 2010, we granted 0.9 million of restricted stock awards to members of our management team and our board of directors. Approximately 0.1 million of the awards granted are restricted stock units that vest upon grant. The remaining awards are shares of restricted stock that contain a service and either a performance or market condition. For these awards, the number of shares that will ultimately be issued to employees may vary based on the Company's performance during the applicable performance measurement period. Additionally, we granted 0.2 million stock options to members of our management team. The fair value of these awards and options were determined using the policies described in the 2009 Form 10-K.

Out-of-Period Adjustments—

During the preparation of our condensed consolidated financial statements for the quarterly period ended June 30, 2009, we identified an error in our consolidated financial statements as of and for the year ended December 31, 2008 and prior periods and our condensed consolidated financial statements as of and for the quarterly period ended March 31, 2009. We corrected this error in our financial statements by adjusting Equity in net

Table of Contents

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

(income) loss of nonconsolidated affiliates, which resulted in an understatement of both our Income from continuing operations before income tax (benefit) expense and our Net income of approximately $4.9 million and $4.5 million for the three and six months ended June 30, 2009, respectively. This error related primarily to an approximate $9.6 million overstatement of our investment in a joint venture hospital we account for using the equity method of accounting due to the understatement of prior period income tax provisions of this joint venture hospital and the adjustment of certain liabilities due to this joint venture hospital. We also adjusted Accrued expenses and other current liabilities by approximately $4.7 million due to changes in amounts due to us for expenses paid on behalf of this joint venture hospital. We do not believe these adjustments are material to the condensed consolidated financial statements as of December 31, 2009 and for the three and six months ended June 30, 2009 or to any prior years' consolidated financial statements. As a result, we have not restated any prior period amounts.

Recent Accounting Pronouncements—

Since the filing of the 2009 Form 10-K, we do not believe any recently issued, but not yet effective, accounting standards will have a material effect on our consolidated financial position, results of operations, or cash flows.

2. Investments in and Advances to Nonconsolidated Affiliates:

Investments in and advances to nonconsolidated affiliates as of June 30, 2010 represents our investment in 16 partially owned subsidiaries, of which 11 are general or limited partnerships, limited liability companies, or joint ventures in which HealthSouth or one of our 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 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 June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net operating revenues	$20.2	$18.1	$40.3	$35.5
Operating expenses	(13.1)	(11.7)	(26.0)	(23.4)
Income from continuing operations, net of tax	5.5	5.3	11.8	10.3
Net income	5.5	5.3	11.8	10.3

3. Derivative Instruments

Interest Rate Swaps Not Designated as Hedging Instruments—

In March 2006, we entered into an interest rate swap to effectively convert the floating rate of a portion of our credit agreement to a fixed rate in order to limit the variability of interest-related payments caused by changes in LIBOR. Under this interest rate swap agreement, we pay a fixed rate of 5.2% on a notional principal of $984.0 million, while the counterparties to this agreement pay a floating rate based on 3-month LIBOR, which was 0.5% at June 10, 2010, which was the most recent interest rate set date. The termination date of this swap is March 10, 2011. The fair market value of this swap as of June 30, 2010 and December 31, 2009 was ($33.5) million and ($54.8) million, respectively, and is included in Accrued expenses and other current liabilities in our condensed consolidated balance sheets.

In June 2009, we entered into a receive-fixed swap as a mirror offset to $100.0 million of the $984.0 million interest rate swap discussed above in order to reduce our effective fixed rate to total debt ratio. Under this interest rate swap agreement, we pay a variable rate based on 3-month LIBOR, while the counterparty to this agreement pays a fixed rate of 5.2% on a notional principal of $100.0 million. Net settlements commenced in September 2009 and are made quarterly on the same settlement schedule as the $984.0 million interest rate swap discussed above. The termination date of this swap is March 10, 2011. Our initial net investment in this swap was

$6.4 million. The fair market value of this swap as of June 30, 2010 was $3.4 million and is included in Other current assets in our condensed consolidated balance sheet. The fair market value of this swap as of December 31, 2009 was $5.6 million. Of this amount, $4.7 million is included in Other current assets with the remainder included in Other long-term assets in our condensed consolidated balance sheet.

These interest rate swaps are not designated as hedges. Therefore, changes in the fair value of these interest rate swaps are included in current-period earnings as (Gain) loss on interest rate swaps.

During the three and six months ended June 30, 2010, we made net cash settlement payments of $11.2 million and $23.1 million, respectively, to our counterparties. During the three and six months ended June 30, 2009, we made net cash settlement payments of $10.6 million and $19.1 million, respectively, to our counterparties. Net settlement payments or receipts on these swaps are included in the line item (Gain) loss on interest rate swaps in our condensed consolidated statements of operations.

Forward-Starting Interest Rate Swaps Designated as Cash Flow Hedges—

In December 2008, we entered into a $100 million forward-starting interest rate swap as a cash flow hedge of future interest payments on our term loan facility. Under this swap agreement, we will pay a fixed rate of 2.6% while the counterparty will pay a floating rate based on 3-month LIBOR. Net settlements will commence on June 10, 2011. The termination date of this swap is December 12, 2012. The fair market value of this swap as of June 30, 2010 and December 31, 2009 was ($2.2) million and $0.4 million, respectively, and is included in Accrued expenses and other current liabilities and Other long-term assets, respectively, in our condensed consolidated balance sheets.

In March 2009, we entered into an additional $100 million forward-starting interest rate swap as a cash flow hedge of future interest payments on our term loan facility. Under this swap agreement, we will pay a fixed rate of 2.9% while the counterparty will pay a floating rate based on 3-month LIBOR. Net settlements will commence on June 10, 2011. The termination date of this swap is September 12, 2012. The fair market value of this swap as of June 30, 2010 and December 31, 2009 was ($2.5) million and ($0.3) million, respectively, and is included in Accrued expenses and other current liabilities in our condensed consolidated balance sheets.

Both forward-starting swaps are designated as cash flow hedges and are accounted for under the policies described in Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2009 Form 10-K. The effective portion of changes in the fair value of these cash flow hedges is deferred as a component of other comprehensive income and is reclassified into earnings as part of interest expense in the same period in which the forecasted transaction impacts earnings.

See Note 9, Derivative Instruments, to the consolidated financial statements accompanying the 2009 Form 10-K for additional information related to these interest rate swaps. See also Note 5, Fair Value Measurements.

4. Guarantees:

Primarily in conjunction with the sale of certain facilities, including the sale of our surgery centers, outpatient, and diagnostic divisions during 2007, HealthSouth assigned, or remained as a guarantor on, the leases of certain properties and equipment to certain purchasers and, as a condition of the lease, agreed to act as a guarantor of the purchaser’s performance on the lease. Should the purchaser fail to pay the obligations due on these leases or contracts, the lessor or vendor would have contractual recourse against us.

As of June 30, 2010, we were secondarily liable for 58 such guarantees. The remaining terms of these guarantees ranged from one month to 108 months. If we were required to perform under all such guarantees, the maximum amount we would be required to pay approximated $42.7 million.

We have not recorded a liability for these guarantees, as we do not believe it is probable we will have to perform under these agreements. If we are required to perform under these guarantees, we could potentially have recourse against the purchaser for recovery of any amounts paid. In addition, the purchasers of our surgery centers, outpatient, and diagnostic divisions have agreed to seek releases from the lessors and vendors in favor of

Table of Contents

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

HealthSouth with respect to the guarantee obligations associated with these divestitures. To the extent the purchasers of these divisions are unable to obtain releases for HealthSouth, the purchasers have agreed to indemnify HealthSouth for damages incurred under the guarantee obligations, if any. These guarantees are not secured by any assets under the agreements.

As of June 30, 2010, we have been notified by one lessor regarding our former diagnostic division's failure to perform under one equipment lease. As a result, we have recorded a charge of $0.6 million as part of discontinued operations and excluded this guarantee from the above amounts.

5. 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			
June 30, 2010	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:					
Restricted marketable securities	$ 1.0	$ -	$ 1.0	$ -	M
June 2009 trading swap	3.4	-	3.4	-	I
Other long-term assets:					
Restricted marketable securities	24.0	-	24.0	-	M
Accrued expenses and other current liabilities:					
March 2006 trading swap	(33.5)	-	(33.5)	-	I
December 2008 forward-starting swap	(2.2)	-	(2.2)		