

HEALTHSOUTH CORP
Form 10-Q
August 05, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

Commission File Number 001-10315

HealthSouth Corporation

(Exact name of Registrant as specified in its Charter)

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

3660 Grandview Parkway, Suite 200

Birmingham, Alabama

(Address of Principal Executive Offices)

63-0860407

(I.R.S. Employer

Identification No.)

35243

(Zip Code)

(205) 967-7116

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(Registrant's telephone number)

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

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

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

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

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

The registrant had 88,297,279 shares of common stock outstanding, net of treasury shares, as of July 31, 2009.

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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,” or “continue” or the negative of these 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, 2008, 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 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;
- changes in the regulations of the healthcare industry at either or both of the federal and state levels;
- competitive pressures in the healthcare industry and our response to those pressures;
- our ability to successfully access the credit markets on favorable terms; 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.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
HealthSouth Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(Unaudited)

	June 30, 2009	December 31, 2008
		(As Adjusted)
	(In Millions, Except Share Data)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 49.8	\$ 32.2
Restricted cash	71.7	154.0
Restricted marketable securities	21.2	20.3
Accounts receivable, net of allowance for doubtful accounts of \$33.0 in 2009; \$31.1 in 2008	244.4	235.8
Insurance recoveries receivable	181.8	182.8
Other current assets	59.3	57.6
Total current assets	628.2	682.7
Property and equipment, net	671.4	673.9
Goodwill	414.7	414.7
Intangible assets, net	39.2	42.8
Investments in and advances to nonconsolidated affiliates	27.8	36.7
Income tax refund receivable	10.5	55.9
Other long-term assets	96.6	91.5
Total assets	\$ 1,888.4	\$ 1,998.2
Liabilities and Shareholders' Deficit		
Current liabilities:		
Current portion of long-term debt	\$ 21.8	\$ 23.6
Accounts payable	47.8	45.6
Accrued expenses and other current liabilities	342.1	408.5
Government, class action, and related settlements	294.4	268.5
Total current liabilities	706.1	746.2
Long-term debt, net of current portion	1,680.1	1,789.6
Other long-term liabilities	165.1	162.2
	2,551.3	2,698.0
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: 97,238,725 in 2009; 96,890,924 in 2008	1.0	1.0
Capital in excess of par value	2,950.2	2,956.5
Accumulated deficit	(3,772.8)	(3,812.2)
Accumulated other comprehensive income (loss)	0.5	(3.2)

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Treasury stock, at cost (8,938,877 shares in 2009 and 8,872,121 shares in 2008)	(312.1)	(311.5)
Total HealthSouth shareholders' deficit	(1,133.2)	(1,169.4)
Noncontrolling interests	82.9	82.2
Total shareholders' deficit	(1,050.3)	(1,087.2)
Total liabilities and shareholders' deficit	\$ 1,888.4	\$ 1,998.2

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

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HealthSouth Corporation and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008 (As Adjusted)	June 30, 2009	2008 (As Adjusted)
	(In Millions, Except Per Share Data)			
Net operating revenues	\$ 483.7	\$ 456.6	\$ 958.8	\$ 920.8
Operating expenses:				
Salaries and benefits	239.1	234.1	473.8	464.5
Other operating expenses	67.6	63.6	134.8	132.4
General and administrative expenses	24.9	25.2	50.4	53.3
Supplies	28.7	27.7	56.2	54.9
Depreciation and amortization	17.7	17.8	35.3	47.4
Impairment of long-lived assets	–	0.6	–	0.6
Occupancy costs	12.1	12.2	24.1	24.2
Provision for doubtful accounts	9.7	6.1	17.6	13.9
Loss on disposal of assets	1.3	0.8	2.3	0.4
Government, class action, and related settlements expense	48.7	(8.6)	32.8	(45.0)
Professional fees—accounting, tax, and legal	(3.3)	5.3	1.5	8.9
Total operating expenses	446.5	384.8	828.8	755.5
(Gain) loss on early extinguishment of debt	(1.3)	3.4	(3.1)	3.7
Interest expense and amortization of debt discounts and fees	31.1	43.4	65.5	90.8
Other income	(1.0)	(1.0)	(0.8)	(1.7)
Loss (gain) on interest rate swaps	3.8	(28.5)	8.8	8.1
Equity in net loss (income) of nonconsolidated affiliates	2.7	(2.7)	0.2	(5.1)
Income from continuing operations before income tax (benefit) expense	1.9	57.2	59.4	69.5
Provision for income tax (benefit) expense	(0.3)	0.7	0.9	0.8
Income from continuing operations	2.2	56.5	58.5	68.7
Income (loss) from discontinued operations, net of tax	1.4	(4.1)	(1.4)	10.1
Net income	3.6	52.4	57.1	78.8
Less: Net income attributable to noncontrolling interests	(9.1)	(8.3)	(17.7)	(14.9)
Net (loss) income attributable to HealthSouth	(5.5)	44.1	39.4	63.9
Less: Convertible perpetual preferred stock dividends	(6.5)	(6.5)	(13.0)	(13.0)
Net (loss) income attributable to HealthSouth common shareholders	\$ (12.0)	\$ 37.6	\$ 26.4	\$ 50.9
Weighted average common shares outstanding:				
Basic	87.6	79.5	87.5	79.2
Diluted	101.5	93.0	101.2	92.6

Basic and diluted (loss) earnings per common share:

(Loss) income from continuing operations

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attributable to HealthSouth common shareholders	\$	(0.15)	\$	0.52	\$	0.32	\$	0.50
Income (loss) from discontinued operations, net of tax, attributable to HealthSouth common shareholders		0.01		(0.05)		(0.02)		0.14
Net (loss) income per share attributable to HealthSouth common shareholders	\$	(0.14)	\$	0.47	\$	0.30	\$	0.64
 Amounts attributable to HealthSouth:								
(Loss) income from continuing operations	\$	(6.7)	\$	48.3	\$	41.3	\$	52.9
Income (loss) from discontinued operations, net of tax		1.2		(4.2)		(1.9)		11.0
Net (loss) income attributable to HealthSouth	\$	(5.5)	\$	44.1	\$	39.4	\$	63.9

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 (Loss) Income

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008 (As Adjusted)	June 30, 2009	2008 (As Adjusted)
(In Millions)				
COMPREHENSIVE (LOSS) INCOME				
Net income	\$ 3.6	\$ 52.4	\$ 57.1	\$ 78.8
Other comprehensive income, net of tax:				
Net change in foreign currency translation adjustments	–	0.8	–	0.8
Net change in unrealized gain (loss) on available-for-sale securities:				
Unrealized net holding gain (loss) arising during the period	1.7	(0.4)	0.1	0.6
Reclassification adjustment for gains (losses) included in net income	–	–	1.6	(1.4)
Net change in unrealized gain on forward-starting interest rate swaps:				
Unrealized net holding gain arising during the period	2.7	–	1.8	–
Reclassification adjustment for gains included in net income	–	–	0.2	–
Other comprehensive income, net of tax	4.4	0.4	3.7	–
Comprehensive income	8.0	52.8	60.8	78.8
Comprehensive income attributable to noncontrolling interests	(9.1)	(8.3)	(17.7)	(14.9)
Comprehensive (loss) income attributable to HealthSouth	\$ (1.1)	\$ 44.5	\$ 43.1	\$ 63.9

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' Deficit

(Unaudited)

	Six Months Ended	
	June 30,	
	2009	2008
	(As Adjusted)	
	(In Millions)	
NUMBER OF COMMON SHARES OUTSTANDING		
Balance at beginning of period	88.0	78.7
Issuance of common stock	–	8.8
Issuance of restricted stock	0.4	0.4
Other, including receipt of treasury stock	(0.1)	0.2
Balance at end of period	88.3	88.1
COMMON STOCK		
Balance at beginning of period	\$ 1.0	\$ 0.9
Issuance of common stock	–	0.1
Balance at end of period	\$ 1.0	\$ 1.0
CAPITAL IN EXCESS OF PAR VALUE		
Balance at beginning of period	\$ 2,956.5	\$ 2,820.4
Dividends declared on convertible perpetual preferred stock	(13.0)	(13.0)
Issuance of common stock	–	150.1
Stock-based compensation	6.6	6.0
Other, including restricted stock cancellations	0.1	0.2
Balance at end of period	\$ 2,950.2	\$ 2,963.7
ACCUMULATED DEFICIT		
Balance at beginning of period	\$ (3,812.2)	\$ (4,064.6)
Net income attributable to HealthSouth	39.4	63.9
Balance at end of period	\$ (3,772.8)	\$ (4,000.7)
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
Balance at beginning of period	\$ (3.2)	\$ (0.8)
Net foreign currency translation adjustment, net of tax	–	0.8
Net change in unrealized gain (loss) on available-for-sale securities, net of tax	1.7	(0.8)
Net change in unrealized gain on forward-starting interest rate swaps	2.0	–
Net other comprehensive income (loss) adjustments	3.7	–
Balance at end of period	\$ 0.5	\$ (0.8)

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TREASURY STOCK

Balance at beginning of period	\$	(311.5)	\$	(310.4)
Receipt of treasury stock		(0.5)		(0.2)
Other, including restricted stock cancellations		(0.1)		(0.1)
Balance at end of period	\$	(312.1)	\$	(310.7)
Total HealthSouth shareholders' deficit	\$	(1,133.2)	\$	(1,347.5)

(Continued)

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HealthSouth Corporation and Subsidiaries

Condensed Consolidated Statements of Shareholders' Deficit (Continued)

(Unaudited)

	Six Months Ended	
	June 30,	
	2009	2008
	(As Adjusted)	
	(In Millions)	
NONCONTROLLING INTERESTS		
Balance at beginning of period	\$ 82.2	\$ 97.2
Net income attributable to noncontrolling interests	17.7	14.9
Distributions declared	(15.7)	(15.8)
Repurchases of equity interests of consolidated affiliates	(1.5)	-
Settlements with partners	-	4.2
Government, class action, and related settlements	-	(5.3)
Transfer of surgery centers to ASC	-	(6.8)
Other	0.2	(0.5)
Balance at end of period	\$ 82.9	\$ 87.9
Total shareholders' deficit	\$ (1,050.3)	\$ (1,259.6)

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

HealthSouth Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30,	
	2009	2008
	(As Adjusted)	
	(In Millions)	
Cash flows from operating activities:		
Net income	\$ 57.1	\$ 78.8
Loss (income) from discontinued operations	1.4	(10.1)
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	17.6	13.9
Provision for government, class action, and related settlements	32.8	(45.0)
UBS Settlement proceeds, gross	100.0	—
Depreciation and amortization	35.3	47.4
Amortization of debt issue costs, debt discounts, and fees	3.2	3.3
Loss on disposal of assets	2.3	0.4
(Gain) loss on early extinguishment of debt	(3.1)	3.7
Loss on interest rate swaps	8.8	8.1
Equity in net loss (income) of nonconsolidated affiliates	0.2	(5.1)
Distributions from nonconsolidated affiliates	3.9	6.0
Stock-based compensation	6.6	6.0
Deferred tax provision	1.9	1.4
Other	0.6	0.1
(Increase) decrease in assets—		
Accounts receivable	(26.2)	(33.9)
Other assets	(0.7)	6.2
Income tax refund receivable	45.4	9.4
Increase (decrease) in liabilities—		
Accounts payable	2.2	(1.4)
Accrued fees and expenses for derivative plaintiffs' attorneys in UBS Settlement	(26.2)	—
Other liabilities	(18.2)	(8.3)
Government, class action, and related settlements	(8.7)	(7.4)
Net cash used in operating activities of discontinued operations	(7.0)	(6.5)
Total adjustments	170.7	(1.7)
Net cash provided by operating activities	229.2	67.0

(Continued)

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HealthSouth Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(Unaudited)

	Six Months Ended June 30,	
	2009	2008
	(As Adjusted)	
	(In Millions)	
Cash flows from investing activities:		
Capital expenditures	(34.8)	(18.3)
Proceeds from disposal of assets	0.8	47.2
Net change in restricted cash	(15.7)	17.0
Net settlements on interest rate swap	(19.1)	(6.6)
Net investment in interest rate swap	(6.4)	-
Other	(1.5)	(0.4)
Net cash (used in) provided by investing activities of discontinued operations	(1.1)	0.7
Net cash (used in) provided by investing activities	(77.8)	39.6
Cash flows from financing activities:		
Checks in excess of bank balance	-	(5.5)
Principal payments on debt, including pre-payments	(60.9)	(92.4)
Borrowings on revolving credit facility	10.0	75.0
Payments on revolving credit facility	(50.0)	(150.0)
Principal payments under capital lease obligations	(6.6)	(6.1)
Issuance of common stock	-	150.2
Dividends paid on convertible perpetual preferred stock	(13.0)	(13.0)
Distributions paid to noncontrolling interests of consolidated affiliates	(15.8)	(16.5)
Other	0.7	-
Net cash provided by (used in) financing activities of discontinued operations	1.8	(2.1)
Net cash used in financing activities	(133.8)	(60.4)
Effect of exchange rate changes on cash and cash equivalents	-	0.8
Increase in cash and cash equivalents	17.6	47.0
Cash and cash equivalents at beginning of period	32.2	19.8
Cash and cash equivalents of divisions and facilities held for sale at beginning of period	-	0.4
Less: Cash and cash equivalents of divisions and facilities held for sale at end of period	-	-
Cash and cash equivalents at end of period	\$ 49.8	\$ 67.2

The accompanying notes to condensed consolidated financial

statements are an integral part of these condensed statements.

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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 (the "SEC") in HealthSouth's Annual Report on Form 10-K filed on February 24, 2009 (the "2008 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 ("GAAP") have been omitted in these interim statements, as allowed by such SEC rules and regulations. The condensed consolidated balance sheet as of December 31, 2008 has been derived from audited financial statements, as adjusted for our adoption of Financial Accounting Standards Board ("FASB") Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*, 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.

Subsequent events have been evaluated through August 5, 2009, which represents the issuance date of these unaudited condensed consolidated financial statements.

Reclassifications—

Certain financial results have been reclassified to conform to the current year presentation. Such reclassifications primarily relate to rental properties where we terminated the leases associated with certain properties during the first quarter of 2009. In accordance with FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we reclassified our condensed consolidated balance sheet as of December 31, 2008, our condensed consolidated statements of operations for the three and six months ended June 30, 2008, and our condensed consolidated statement of cash flows for the six months ended June 30, 2008 to include these properties and their results of operations in discontinued operations.

On January 1, 2009, we adopted FASB Statement No. 160. As a result, we have reclassified our noncontrolling interests (formerly known as "minority interests") as a component of equity and now report net income and comprehensive income attributable to our noncontrolling interests separately from net income and comprehensive income attributable to HealthSouth.

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 loss (income) 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

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

this joint venture hospital. We do not believe these adjustments are material to the condensed consolidated financial statements as of June 30, 2009 and for the three and six months then ended or to any prior years' consolidated financial statements. As a result, we have not restated any prior period amounts.

Stock-Based Compensation—

In February 2009, we granted 1.7 million shares of restricted common stock to members of our management team and our board of directors. Approximately 0.5 million shares of the restricted stock granted contain only a service condition, while the remaining 1.2 million shares contain a service and either a performance or market condition. Additionally, we granted 0.3 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 2008 Form 10-K.

Recent Accounting Pronouncements—

In April 2009, the FASB issued FASB Staff Position ("FSP") No. FAS 115-2 and FAS 124-~~2~~ *Recognition and Presentation of Other-Than-Temporary Impairments*. This FSP amends the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. HealthSouth elected to adopt this FSP in the first quarter of 2009. While its adoption did not have a material impact on our financial position, results of operations, or cash flows, it does require interim disclosures related to our available-for-sale equity securities. See Note 3, *Cash and Marketable Securities*.

In April 2009, the FASB also issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FSP amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, and Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. HealthSouth elected to adopt this FSP in the first quarter of 2009. Its adoption resulted in additional interim disclosures only. See Note 7, *Fair Value Measurements*.

In May 2009, the FASB issued FASB Statement No. 165, *Subsequent Events*, to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This Statement is effective for interim or annual financial periods ending after June 15, 2009. Our adoption of this Statement resulted only in additional disclosure regarding the date through which subsequent events have been evaluated in each set of interim or annual financial statements and had no impact on our financial position, results of operations, or cash flows.

In June 2009, the FASB issued FASB Statement No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. FASB Statement No. 168 establishes the *FASB Accounting Standards Codification* as the single authoritative source for GAAP. The Codification is effective for financial statements that cover interim and annual periods ending after September 15, 2009. While not intended to change GAAP, the Codification significantly changes the way in which the accounting literature is organized. Because the Codification completely replaces existing standards, it will affect the way GAAP is referenced by companies in their financial statements and accounting policies. Our adoption of this Statement and our use of the Codification beginning in the third quarter of 2009 will not have an impact on our financial position, results of operations, or cash flows.

Since the filing of our 2008 Form 10-K, we do not believe any other 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. Liquidity:

We continue to make progress in improving our leverage and liquidity.

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HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

During the six months ended June 30, 2009, we reduced our total debt by approximately \$111 million. In February 2009, we used our federal income tax refund for tax years 1995 through 1999 (see Note 17, *Income Taxes*, to the consolidated financial statements accompanying our 2008 Form 10-K) along with available cash to reduce our Term Loan Facility (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K) by \$24.5 million and amounts outstanding under our revolving credit facility to zero. In addition, during the first six months of 2009, we used a portion of the net proceeds from our settlement with UBS (see Note 11, *Settlements*) to redeem \$36.4 million of our Floating Rate Senior Notes due 2014 (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K). See also Note 5, *Long-term Debt*.

As of June 30, 2009, we had \$49.8 million in *Cash and cash equivalents*. This amount excludes \$71.7 million in *Restricted cash* and \$21.2 million of *Restricted marketable securities*. Our restricted assets pertain to various obligations we have under partnership agreements and other arrangements, primarily related to our captive insurance company. As of December 31, 2008, our *Restricted cash* included \$97.9 million related to our settlement with UBS (see Note 11, *Settlements*).

We have scheduled principal payments of \$10.8 million and \$21.9 million in the remainder of 2009 and 2010, respectively, related to long-term debt obligations (see Note 5, *Long-term Debt*). We do not face substantial near-term refinancing risk, as our revolving credit facility does not expire until 2012, our Term Loan Facility does not mature until 2013, and the majority of our bonds are not due until 2014 and 2016.

Our Credit Agreement (as defined in Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K) governs the vast majority of our senior secured borrowings and contains financial covenants that include a leverage ratio and an interest coverage ratio. As of June 30, 2009, we were in compliance with the covenants under our Credit Agreement. If we anticipated a potential covenant violation, we would seek relief from our lenders, which would have some cost to us, and such relief might not be on terms as favorable to those in our existing Credit Agreement. Under such circumstances, there is also the potential our lenders would not grant relief to us which, among other things, would depend on the state of the credit markets at that time. However, we believe we have reduced this risk by significantly lowering our senior secured leverage ratio since the inception of our Credit Agreement.

Our Credit Agreement also contains excess cash flow provisions. To the extent we have available cash at the end of 2009 that has not been used to make qualified capital expenditures or debt reductions, and depending upon our leverage ratio under our Credit Agreement, we may be required to use a portion of our excess cash to reduce amounts outstanding on our Term Loan Facility.

Our primary sources of liquidity are cash on hand, cash flows from operations, and borrowings under our revolving credit facility. We monitor the financial strength of our depositories, creditors, insurance carriers, and other counterparties using publicly available information, as well as qualitative inputs. Based on our current borrowing capacity and compliance with the financial covenants under our Credit Agreement, we do not believe there is significant risk in our ability to make draws under our revolving credit facility, if needed. However, no such assurances can be provided. We continue to analyze our capital structure, and we will use our available cash in a manner that provides the most beneficial impact to our capital structure, including deleveraging.

See Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 Form 10-K for a discussion of risks and uncertainties facing us. Changes in our business or other factors may occur that might have a material adverse impact on our financial position, results of operations, and cash flows.

3. Cash and Marketable Securities:

As of June 30, 2009 and December 31, 2008, our investments consist of cash and cash equivalents and marketable securities. Our investments in marketable securities are classified as available-for-sale.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

The components of our investments as of June 30, 2009 are as follows (in millions):

	Cash & Cash Equivalents	Restricted Cash	Nonrestricted Marketable Securities	Restricted Marketable Securities	Total
Cash	\$ 49.8	\$ 71.7	\$ –	\$ –	\$ 121.5
Equity securities	–	–	0.3	21.2	21.5
Total	\$ 49.8	\$ 71.7	\$ 0.3	\$ 21.2	\$ 143.0

The components of our investments as of December 31, 2008 are as follows (in millions):

	Cash & Cash Equivalents	Restricted Cash	Nonrestricted Marketable Securities	Restricted Marketable Securities	Total
Cash	\$ 32.2	\$ 154.0	\$ –	\$ –	\$ 186.2
Equity securities	–	–	0.2	20.3	20.5
Total	\$ 32.2	\$ 154.0	\$ 0.2	\$ 20.3	\$ 206.7

Restricted cash as of December 31, 2008 includes cash associated with the UBS Settlement discussed in Note 11, *Settlements*. Nonrestricted marketable securities are included in *Other current assets* in our condensed consolidated balance sheets.

A summary of our restricted marketable securities as of June 30, 2009 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	\$ 21.2	\$ 1.0	\$ (1.0)	\$ 21.2

A summary of our restricted marketable securities as of December 31, 2008 is as follows (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity securities	\$ 21.9	\$ 0.4	\$ (2.0)	\$ 20.3

Cost in the above tables includes adjustments made to the cost basis of our equity securities for other-than-temporary impairments. During the three and six months ended June 30, 2009, we recorded \$0.1 million and \$0.8 million, respectively, of impairments related to our restricted marketable securities. These impairment charges are included in *Other income* in our condensed consolidated statements of operations for the three and six months ended June 30, 2009. No impairments were recorded during the three or six months ended June 30, 2008.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

Investing information related to our marketable securities is as follows (in millions):

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
Nonrestricted:				
Gross realized gains – nonrestricted	\$ –	\$ –	\$ –	\$ 0.6
Restricted:				
Proceeds from sales of restricted available-for-sale securities	\$ 1.2	\$ 0.8	\$ 1.6	\$ 1.3
Gross realized gains - restricted	\$ 0.2	\$ 0.1	\$ 0.2	\$ 0.1
Gross realized losses - restricted	\$ (0.1)	\$ (0.1)	\$ (0.2)	\$ (0.2)

The following table shows the fair value and gross unrealized losses of our marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by the length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2009 and December 31, 2008 (in millions):

	As of	As of
	June 30, 2009	December 31, 2008
Less than 12 months:		
Fair value	\$ 14.3	\$ 15.5
Gross unrealized losses	\$ (1.0)	\$ (1.9)
12 months or greater:		
Fair value	\$ 0.1	\$ 0.1
Gross unrealized losses	\$ –	\$ (0.1)
Total:		
Fair value	\$ 14.4	\$ 15.6
Gross unrealized losses	\$ (1.0)	\$ (2.0)

Our portfolio of marketable securities is comprised of numerous individual equity securities and mutual funds across a variety of industries. For our marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired, we examined the severity and duration of the impairments in relation to the cost of the individual investments. We also considered the industry in which each investment is held and the near-term prospects for a recovery in each specific industry. In addition, the majority of our marketable securities with unrealized losses that are not deemed to be other-than-temporarily impaired are investments in mutual funds which are more diversified than a security held in one specific company or industry. Based on our evaluation and our ability and intent to hold these investments for a reasonable period of time sufficient for a potential recovery of fair value, we do not believe these investments are other-than-temporarily impaired at June 30, 2009.

4. Investments in and Advances to Nonconsolidated Affiliates:

Investments in and advances to nonconsolidated affiliates as of June 30, 2009 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 4% to 51%. We account for these investments using the cost and equity methods of accounting.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
Net operating revenues	\$ 18.1	\$ 19.0	\$ 35.5	\$ 37.3
Operating expenses	(11.7)	(3.3)	(23.2)	(14.9)
Income from continuing operations	5.3	14.8	10.3	20.5
Net income	5.3	14.8	10.3	20.5

The following summarizes the results of operations of New England Rehabilitation Services of Central Massachusetts, Inc., which qualified during the three months ended June 30, 2009 as a "significant subsidiary" under Regulation S-X promulgated by the SEC and requiring separate disclosure (on a 100% basis, in millions):

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
Net operating revenues	\$ 9.4	\$ 7.6	\$ 17.6	\$ 15.3
Operating expenses	(6.3)	(5.7)	(12.7)	(11.6)
Income from continuing operations	1.9	1.2	3.1	2.2
Net income	1.9	1.2	3.1	2.2

See also Note 1, *Basis of Presentation*, "Out-of-Period Adjustments."

5. Long-term Debt:

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

	June 30,	December 31,
	2009	2008
Advances under \$400 million revolving credit facility	\$ —	\$ 40.0
Term Loan Facility	755.1	783.6
Bonds Payable—		
8.375% Senior Notes due 2011	0.3	0.3
7.625% Senior Notes due 2012	1.5	1.5
Floating Rate Senior Notes due 2014	329.6	366.0
10.75% Senior Notes due 2016	494.6	494.3
Other notes payable at interest rates from 8.1% to 12.9%	12.5	12.8
Capital lease obligations	108.3	114.7
	1,701.9	1,813.2
Less: Current portion	(21.8)	(23.6)
Long-term debt, net of current portion	\$ 1,680.1	\$ 1,789.6

For a description of our indebtedness, see Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K.

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In February 2009, we used our federal income tax refund for tax years 1995 through 1999 (see Note 17, *Income Taxes*, to the consolidated financial statements accompanying our 2008 Form 10-K) along with available cash to reduce our Term Loan Facility by \$24.5 million and amounts outstanding under our revolving credit facility to zero.

During the first and second quarters of 2009, we used a portion of the net proceeds from our settlement with UBS (see Note 11, *Settlements*) to redeem \$15.4 million and \$21.0 million, respectively, of our Floating Rate Senior Notes due 2014.

In addition to the pre-payments discussed above, we also used available cash to make quarterly principal payments on the Term Loan Facility and scheduled principal payments on capital leases during the six months ended June 30, 2009.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

	Face Amount	Net Amount
July 1 through December 31, 2009	\$ 10.8	\$ 10.8
2010	21.9	21.9
2011	21.2	21.2
2012	20.6	20.6
2013	737.5	737.5
2014	336.0	336.0
Thereafter	559.9	553.9
Total	\$ 1,707.9	\$ 1,701.9

The following table provides information regarding our *Interest expense and amortization of debt discounts and fees* presented in our condensed consolidated statements of operations (in millions):

	Three Months Ended		Six Months Ended	
	June 30, 2009	2008	June 30, 2009	2008
Interest expense	\$ 29.5	\$ 41.7	\$ 62.3	\$ 87.5
Amortization of debt discounts and fees	1.6	1.7	3.2	3.3
Interest expense and amortization of debt discounts and fees	\$ 31.1	\$ 43.4	\$ 65.5	\$ 90.8

*Interest Rate Swaps—*Interest Rate Swaps Not Designated as Hedging Instruments

Based on the requirements under our Credit Agreement, 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 an amortizing notional principal of \$1.1 billion, while the counterparties to this agreement pay a floating rate based on 3-month LIBOR. The termination date of this swap is March 10, 2011. The fair market value of this swap as of June 30, 2009 and December 31, 2008 was (\$68.1) million and (\$78.2) million, respectively, and is included in *Accrued expenses and other current liabilities* in our condensed consolidated balance sheets. See Note 8, *Long-term Debt*, to the consolidated financial statements accompanying our 2008 Form 10-K for additional information related to this interest rate swap.

In June 2009, we entered into a receive-fixed swap as a mirror offset to \$100.0 million of the \$1.1 billion 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 will commence in September 2009 and will be made quarterly thereafter on the same settlement schedule as the \$1.1 billion 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, 2009 was \$6.7 million. Of this amount, \$4.3 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 a hedge under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Therefore, changes in the fair value of these interest rate swaps during the three and six months ended June 30, 2009 and 2008 have been included in current-period earnings as *Loss (gain) on interest rate swaps*.

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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. During the three and six months ended June 30, 2008, we made net cash settlement payments of \$6.4 million and \$6.6 million, respectively, to our counterparties. Net settlement payments or receipts on these swaps are included in the line item *Loss (gain) on interest rate swaps* in our condensed consolidated statements of operations.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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 pay a fixed rate of 2.6% while the counterparty pays 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, 2009 and December 31, 2008 was \$1.3 million and (\$0.2) million, respectively, and is included in *Other long-term assets* and *Accrued expenses and other current liabilities*, 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 pay a fixed rate of 2.9% while the counterparty pays 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, 2009 was \$0.5 million and is included in *Other long-term assets* in our condensed consolidated balance sheet.

Both forward-starting swaps are designated as cash flow hedges under the guidance in FASB Statement No. 133 and are accounted for under the policies described in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying our 2008 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 also Note 7, *Fair Value Measurements*.

6. 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. HealthSouth also remained as a guarantor to certain purchase contracts that were assigned to the buyer of our diagnostic division in connection with the sale. 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, 2009, we were secondarily liable for 90 such guarantees. The remaining terms of these guarantees ranged from one month to 120 months. If we were required to perform under all such guarantees, the maximum amount we would be required to pay approximated \$56.4 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 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, 2009, we have been required to perform under one such guarantee. Amounts were paid under this guarantee during 2008 and were not material to our financial position, results of operations, or cash flows.

HealthSouth Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements

7. Fair Value Measurements:

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

<u>June 30, 2009</u>	Fair Value	Fair Value Measurements at Reporting Date Using			Valuation Technique (1)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Restricted marketable securities	\$ 21.2	\$ 21.2	\$ -	\$ -	M
Other current assets:					
Marketable securities	0.3	0.3	-	-	M
June 2009 trading swap	4.3	-	4.3	-	I
Other long-term assets:					
December 2008 forward-starting swap	1.3	-	1.3	-	I
March 2009 forward-starting swap	0.5	-	0.5	-	I
June 2009 trading swap	2.4	-	2.4	-	I
Accrued expenses and other current liabilities:					
March 2006 trading swap (68.1)					
Katherine A. Anderson, C.P.A.		2,874	(3)	*	*
Daniel F. Cain		24,250	(4)	*	*
Jean L. Fourcroy, M.D., Ph.D., M.P.H.		23,900	(4)	*	*
Nola E. Masterson		27,000	(5)	*	*
Joseph S. Podolski		230,470	(6)	2.5	% 2.0%
Jaye Thompson, Ph.D.		4,165	(7)	*	*
Ronald Wiehle, Ph.D.		77,838	(8)	*	*
All directors and executive officers as a group (7 persons)		390,497 ⁽³⁾⁻⁽⁸⁾		4.2	% 3.3%

*

Does not exceed 1%.

(1) Unless otherwise noted, we believe that all persons named in the table have sole voting and investment power with respect to all shares of common stock beneficially owned by such persons.

(2) In accordance with SEC rules, each beneficial owner's percentage ownership assumes the exercise of all options and warrants held by such person that are exercisable within 60 days after December 31, 2010.

(3) Includes 2,499 shares of common stock issuable upon exercise of options.

(4) Includes 23,750 shares of common stock issuable upon exercise of options.

Includes (i) 24,250 shares of common stock issuable upon exercise of options and (ii) 2,750 shares of common (5) stock held by Science Futures LLC. As the managing director of Science Futures LLC, Ms. Masterson may be deemed to beneficially own such shares.

Includes (i) 750 shares of common stock which are held by certain of Mr. Podolski's family members and (ii) (6) 179,525 shares of common stock issuable upon the exercise of options. Mr. Podolski disclaims beneficial ownership of the shares owned by his family members.

(7) Includes 4,165 shares of common stock issuable upon exercise of options.

(8) Includes 72,334 shares of common stock issuable upon exercise of options.

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DESCRIPTION OF SECURITIES

Our authorized capital stock consists of 75,000,000 shares of common stock, par value \$0.001 per share, and 5,000,000 shares of preferred stock, par value \$0.001 per share.

As of December 31, 2010, we had 8,930,022 outstanding shares of common stock and no outstanding shares of preferred stock. Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2010 reflected that we had 8,930,057 shares of common stock outstanding as of November 4, 2010. This 35 share discrepancy was due to our uncertainty at such time of the specific number of fractional shares resulting from the one-for-four reverse split of our common stock on October 14, 2010.

As of December 31, 2010, we had outstanding stock options to purchase 613,869 shares of common stock at prices ranging from \$1.33 to \$133.00. As of December 31, 2010, we had no warrants outstanding.

Common Stock

Subject to any special voting rights of any series of preferred stock that we may issue in the future, each share of common stock has one vote on all matters voted on by our stockholders, including the election of our directors. Because holders of common stock do not have cumulative voting rights, the holders of a majority of the shares of common stock can elect all of the members of the board of directors standing for election, subject to the rights, powers and preferences of any outstanding series of preferred stock.

No share of common stock affords any preemptive rights or is convertible, redeemable, assessable or entitled to the benefits of any sinking or repurchase fund. Holders of common stock will be entitled to dividends in the amounts and at the times declared by our board of directors in its discretion out of funds legally available for the payment of dividends.

Holders of common stock will share equally in our assets on liquidation after payment or provision for all liabilities and any preferential liquidation rights of any preferred stock then outstanding. All outstanding shares of common stock are fully paid and non-assessable.

Preferred Stock

Our certificate of incorporation provides that shares of preferred stock may be issued from time to time in one or more series. Our board of directors has authority to issue up to 5,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by our stockholders. The rights of holders of our common stock may be subject to, and adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control and may adversely affect the voting and other rights of holders of our common stock. We have no present plans to issue any shares of preferred stock after this offering.

Warrants to be Issued in Offering

In connection with this offering, we will sell common stock and warrants in units, with each unit consisting of four shares of common stock, three Series A Warrants and 2.45 Series B Warrants. The shares of common stock and warrants are immediately separable and will be issued and trade separately.

Series A Warrants

Each Series A Warrant will be exercisable for one share of our common stock at an exercise price of \$0.01 per share. The exercise price and number of shares issuable upon exercise of the Series A Warrants are subject to appropriate adjustment in the event of stock dividends and distributions, stock splits, stock combinations, reclassifications or similar events affecting our common stock.

The Series A Warrants are exercisable immediately upon issuance and expire five years from the date of issuance. Except as indicated below, the Series A Warrants will be exercisable, at the option of each holder, in whole or in part, by delivering to us a duly executed exercise notice accompanied by payment in full for the number of shares of our common stock purchased upon such exercise. If such shares of common stock are not delivered to such holder within three trading days following such exercise, we have agreed to pay to such holder, in cash, as liquidated damages, an amount equal to (A) the difference between (i) the closing price of

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our common stock on such third trading day and (ii) the closing price of our common stock on the date such shares of common stock are actually delivered multiplied by (B) the number of shares of common stock purchased upon such exercise.

If, at any time during the Series A Warrant exercisability period, the fair market value of our common stock exceeds the exercise price of the Series A Warrants, the holder may elect to effect a cashless exercise of the Series A Warrants, in whole or in part, by surrendering the Series A Warrants to us, together with delivery to us of a duly executed exercise notice, and canceling a portion of the relevant Series A Warrant in payment of the purchase price payable in respect of the number of shares of our common stock purchased upon such exercise.

The number of shares of common stock that may be acquired by the registered holder upon any exercise of Series A Warrants shall be limited to the extent necessary to ensure that, following such exercise, the total number of shares of common stock then beneficially owned by such holder and any other persons whose beneficial ownership of common stock would be aggregated with the holder's for purposes of Section 13(d) of the Exchange Act does not exceed 9.999% of the total number of issued and outstanding shares of our common stock (including for such purpose the shares of common stock issuable upon such exercise). This restriction may be waived by such holder upon not less than 61 days' prior notice to us. In no event, however, may a holder exercise warrants if, following such exercise, such holder would beneficially own 20% or more of our outstanding common stock.

If, at any time while the Series A Warrants are outstanding, we effect (i) any reclassification of our common stock or any compulsory share exchange pursuant to which our common stock is effectively converted into or exchanged for other securities, cash or property, (ii) any consolidation, merger or combination with or into another corporation as a result of which holders of our common stock shall be entitled to receive stock, securities or other property or assets (including cash) with respect to or in exchange for such common stock, or (iii) any sale or conveyance of our property or assets as, or substantially as, an entirety to any other entity as a result of which holders of our common stock shall be entitled to receive stock, securities or other property or assets (including cash) with respect to or in exchange for such common stock (in any such case, a Fundamental Transaction), then we, or such successor corporation or transferee, as the case may be, will make appropriate provision by amendment of the warrant agreement or by the successor corporation or transferee executing with the warrant agent an agreement so that the holders of the Series A Warrants then outstanding shall have the right at any time thereafter, upon exercise of such warrants to receive the kind and amount of securities, cash and other property receivable upon such Fundamental Transaction as would be received by a holder of the number of shares of our common stock issuable upon exercise of such holder's Series A Warrants immediately prior to such Fundamental Transaction.

Upon the closing of this offering, the Series A Warrants will be listed on the Nasdaq Capital Market under the symbol RPRXW.

Except by virtue of such holder's ownership of shares of our common stock, the holders of the Series A Warrants do not have the rights or privileges of holders of our common stock, including any voting rights, until they exercise their Series A Warrants.

No fractional warrants will be issued and no fractional shares will be issued upon exercise of the Series A Warrants, but rather we will round such fraction down to the nearest whole warrant or share, as the case may be.

The terms of the Series A Warrants may not be amended without consent of holders of Series A Warrants entitled, upon exercise thereof, to receive not less than 66 2/3% of shares of our common stock issuable thereunder.

Series B Warrants

Each Series B Warrant will be exercisable for one share of our common stock at an exercise price of \$2.49 per share. The exercise price and number of shares issuable upon exercise of the Series B Warrants are subject to appropriate adjustment in the event of stock dividends and distributions, stock splits, stock combinations, reclassifications or similar events affecting our common stock.

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The Series B Warrants are exercisable immediately upon issuance and expire five years from the date of issuance. Except as indicated below, the Series B Warrants will be exercisable, at the option of each holder, in whole or in part, by delivering to us a duly executed exercise notice accompanied by payment in full for the number of shares of our common stock purchased upon such exercise. If such shares of common stock are not delivered to such holder within three trading days following such exercise, we have agreed to pay to such holder, in cash, as liquidated damages, an amount equal to (A) the difference between (i) the closing price of our common stock on such third trading day and (ii) the closing price of our common stock on the date such shares of common stock are actually delivered multiplied by (B) the number of shares of common stock purchased upon such exercise.

If, at any time during the Series B Warrant exercisability period, the fair market value of our common stock exceeds the exercise price of the Series B Warrants, the holder may elect to effect a cashless exercise of the Series B Warrants, in whole or in part, by surrendering the Series B Warrants to us, together with delivery to us of a duly executed exercise notice, and canceling a portion of the relevant Series B Warrant in payment of the purchase price payable in respect of the number of shares of our common stock purchased upon such exercise.

The number of shares of common stock that may be acquired by the registered holder upon any exercise of Series B Warrants shall be limited to the extent necessary to ensure that, following such exercise, the total number of shares of common stock then beneficially owned by such holder and any other persons whose beneficial ownership of common stock would be aggregated with the holder's for purposes of Section 13(d) of the Exchange Act does not exceed 9.999% of the total number of issued and outstanding shares of common stock (including for such purpose the shares of common stock issuable upon such exercise) of the Company. This restriction may be waived by such holder upon not less than 61 days' prior notice to us. In no event, however, may a holder exercise warrants if, following such exercise, such holder would beneficially own 20% or more of our outstanding common stock.

In the event that our common stock trades at or above \$8.00 per share for a period of at least 20 trading days over a period of 30 consecutive trading days, we will have the option to require holders of Series B Warrants to exercise the Series B Warrants for the number of shares of our common stock which such holder is able to sell to maintain such holder's beneficial ownership below 10% of the total number of issued and outstanding shares of our common stock. In the event we exercise this option, holders of Series B Warrants will be required to use commercially reasonable efforts to sell their shares of our common stock to the extent necessary to exercise all of their Series B Warrants. We are obligated to provide at least 60 days notice prior to the date by which such exercise is required by such holder.

If, at any time while the Series B Warrants are outstanding, we effect a Fundamental Transaction, then we, or such successor corporation or transferee, as the case may be, will make appropriate provision by amendment of the warrant agreement or by the successor corporation or transferee executing with the warrant agent an agreement so that the holders of the Series B Warrants then outstanding shall have the right at any time thereafter, upon exercise of such warrants to receive the kind and amount of securities, cash and other property receivable upon such Fundamental Transaction as would be received by a holder of the number of shares of our common stock issuable upon exercise of such holder's Series B Warrants immediately prior to such Fundamental Transaction.

Upon the closing of this offering, the Series B Warrants will be listed on the Nasdaq Capital Market under the symbol RPRXZ.

Except by virtue of such holder's ownership of shares of our common stock, the holders of the Series B Warrants do not have the rights or privileges of holders of our common stock, including any voting rights, until they exercise their Series B Warrants.

No fractional warrants will be issued and no fractional shares will be issued upon exercise of the Series B Warrants, but rather we will round such fraction down to the nearest whole warrant or share, as the case may be.

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The terms of the Series B Warrants may not be amended without consent of holders of Series B Warrants entitled, upon exercise thereof, to receive not less than 66 2/3% of shares of our common stock issuable thereunder.

Rights Agreement

Pursuant to our rights agreement we entered into in September 1999, as amended, each share of our common stock, including those being issued in this offering, has four preferred stock purchase rights attached to it. Each right entitles the holder to purchase from us one one-hundredth of a share of Series One Junior Participating Preferred Stock at a price of \$20.00, subject to adjustment.

The rights will separate from our common stock and a distribution date will occur upon the earlier of (i) 10 days following the date of public announcement that a person or group of persons has become an acquiring person (defined below) or (ii) 10 business days (or such later date as may be determined by action of the board of directors prior to the time a person becomes an acquiring person) following the commencement of, or the announcement of an intention to make, a tender offer or exchange offer upon consummation of which the offeror would, if successful, become an acquiring person (the earlier of such dates being called the distribution date). The term acquiring person means any person who or which, together with all of its affiliates and associates, shall be the beneficial owner of 20% or more of our outstanding common stock.

The rights are not exercisable until the distribution date. The rights will expire on September 13, 2015.

In the event that following the date of public announcement that an acquiring person has become such, we are acquired in a merger or other business combination transaction or more than 50% of our consolidated assets or earning power are sold, proper provision will be made so that each holder of a right will thereafter have the right to receive, upon the exercise thereof at the then current exercise price of the right, that number of shares of common stock of the acquiring company which at the time of such transaction will have a market value of two times the exercise price of the right. This is known as a flip-over right.

In the event that a person who is not exempt becomes an acquiring person, proper provision shall be made so that each holder of a right (other than the acquiring person and its affiliates and associates) will thereafter have the right to receive upon exercise that number of shares of our common stock (or, under certain circumstances, cash, other equity securities or property) having a market value equal to two times the purchase price of the rights. This is known as a flip-in right. Upon the occurrence of the foregoing event giving rise to the exercisability of the rights, any rights that are or were at any time owned by an acquiring person shall become void.

We may redeem the rights in whole, but not in part, at a price of \$0.01 per right prior to the earlier of the expiration of the rights or their triggering; provided, that (i) if the board authorizes redemption on or after the time a person becomes an acquiring person, then such authorization must be with the approval of a majority of our directors and (ii) the period for redemption may, upon approval of a majority of our directors, be extended by amending the rights agreement.

The terms of the rights may be amended by the board without the consent of the holders of the rights at any time and from time to time provided that such amendment does not adversely affect the interests of the holders of the rights. In addition, during any time that the rights are subject to redemption, the terms of the rights may be amended by approval of a majority of our directors, including an amendment that adversely affects the interests of the holders of the rights, without the consent of the holders of rights.

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A complete description of the rights, the rights agreement with Computershare Trust Company, N.A., as rights agent, and the Series One Junior Participating Preferred Stock is hereby incorporated by reference from the information appearing under the caption Item 1. Description of the Registrant's Securities to be Registered contained in the Registration Statement on Form 8-A filed on September 3, 1999, and as amended by amendments to such Registration Statement on Form 8-A/A filed on September 11, 2002, October 31, 2002, June 30, 2005, January 10, 2008, October 10, 2008 and September 9, 2010.

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Transfer Agent and Warrant Agent

The transfer agent for our common stock and warrant agent for our warrants is Computershare Trust Company, N.A.

Anti-Takeover Effects of Certificate, Bylaws, Stockholder Rights Plan and Delaware Law

General

Our certificate of incorporation, bylaws and stockholder rights plan contain provisions that are designed in part to make it more difficult and time-consuming for a person to obtain control of our company. The provisions of our certificate of incorporation, bylaws and stockholder rights plan reduce the vulnerability of our company to an unsolicited takeover proposal. These provisions may also have an adverse effect on the ability of stockholders to influence the governance of our company and may result in entrenchment of management. This may adversely affect the liquidity and price of our common stock in certain situations. We have summarized the material terms of our certificate of incorporation and bylaws below and the terms of our stockholder rights plan above. You may read our certificate of incorporation, bylaws and stockholder rights plan in their entirety for the full terms of the rights of holders of our common stock.

Delaware Business Combination Statute

Section 203 of the Delaware General Corporation Law provides that, subject to specified exceptions, an interested stockholder of a Delaware corporation may not engage in any business combination, including general mergers or consolidations or acquisitions of additional shares of the corporation, with the corporation for a three-year period following the time that such stockholder becomes an interested stockholder unless:

before such time, the board of directors of the corporation approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder;

upon consummation of the transaction which resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding specified shares; or

on or after such time, the business combination is approved by the board of directors of the corporation and authorized not by written consent, but at an annual or special meeting of stockholders, by the affirmative vote of at least 66 2/3% of the outstanding voting stock not owned by the interested stockholder.

Under Section 203, the restrictions described above also do not apply to specified business combinations proposed by an interested stockholder following the announcement or notification of a transaction specified in Section 203 and involving the corporation and a person who:

had not been an interested stockholder during the previous three years; or

became an interested stockholder with the approval of a majority of the corporation's directors,

if such transaction is approved or not opposed by a majority of the directors who were directors prior to any person becoming an interested stockholder during the previous three years or were recommended for election or elected to succeed such directors by a majority of such directors.

Except as otherwise specified in Section 203, an interested stockholder is defined to include:

any person that is the owner of 15% or more of the outstanding voting stock of the corporation, or is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock of the corporation at any time within three years immediately before the date of determination; and

the affiliates and associates of any such person.

Under some circumstances, Section 203 makes it more difficult for an interested stockholder to effect various business combinations with a corporation for a three-year period.

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Advance Notice Requirements for Director Nominations and Other Stockholder Proposals

In order to nominate a director at an annual meeting, our bylaws require that a stockholder follow certain procedures.

In order to recommend a nominee for director, a stockholder must be a stockholder of record at the time the stockholder gives notice of its recommendation and the stockholder must be entitled to vote for the election of directors at the meeting at which such nominee will be considered. Stockholder recommendations must be made pursuant to written notice delivered to our principal executive offices no less than 50 days nor more than 75 days prior to the date of the annual or special meeting at which directors are to be elected; provided, that if less than 65 days notice or prior public disclosure of the date of the meeting is given or made to the stockholders, notice by the stockholder must be received at our principal executive offices not later than the close of business on the 15th day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made.

The stockholder notice must set forth the following:

1. As to each person the stockholder proposes to nominate for election as a director, all information relating to such person that would be required to be disclosed in solicitations of proxies for the election of such nominees as directors pursuant to rules promulgated under the Exchange Act;
2. The written consent to serve as a director if elected by each person nominated;
3. Name and address of the stockholder as they appear on our books; and
4. The class and number of shares of our common stock beneficially owned by such stockholder.

In addition to complying with the foregoing procedures, any stockholder nominating a director must also comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder.

Additionally, with respect to other stockholder proposals, notice of the proposal must be received no less than 50 nor more than 75 days prior to the annual meeting at which such proposal is to be considered; provided, that if less than 65 days notice or prior public disclosure of the date of the meeting is given or made to the stockholders, notice by the stockholder must be received at our principal executive offices not later than the close of business on the 15th day following the day on which such notice of the date of the annual meeting was mailed or such public disclosure was made.

Authorized But Unissued Shares

Our authorized but unissued shares of common stock and preferred stock are available for future issuances without stockholder approval and could be utilized for a variety of corporate purposes, including future offerings to raise additional capital, corporate acquisitions and employee benefit plans. The existence of authorized but unissued and unreserved common stock and preferred stock could render more difficult or discourage an attempt to obtain control of us by means of a proxy contest, tender offer, merger or otherwise.

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UNDERWRITING

In accordance with the terms and conditions contained in the underwriting agreement, we have agreed to sell to Ladenburg Thalmann & Co. Inc., which we refer to as the underwriter, and the underwriter has agreed to purchase from us on a firm commitment basis, the number of units offered in this offering set forth opposite its name below:

Underwriter	Number of Units
Ladenburg Thalmann & Co. Inc.	600,000
Total	600,000

A copy of the underwriting agreement will be filed as an exhibit to the registration statement of which this prospectus forms a part.

We have been advised by the underwriter that it proposes to offer units directly to the public at the public offering price set forth on the cover page of this prospectus. Any units sold by the underwriter to securities dealers will be sold at the public offering price less a selling concession not in excess of \$0.7203 per unit. The underwriter may allow, and these selected dealers may re-allow, a concession of not more than \$0.10 per unit to other brokers and dealers.

The underwriting agreement provides that the underwriter's obligation to purchase units is subject to conditions contained in the underwriting agreement. The underwriter is obligated to purchase and pay for all of the units offered by this prospectus other than those covered by the over-allotment option, if any of these securities are purchased.

No action has been taken by us or the underwriter that would permit a public offering of the units, common stock or warrants included in this offering in any jurisdiction where action for that purpose is required. None of our securities included in this offering may be offered or sold, directly or indirectly, nor may this prospectus or any other offering material or advertisements in connection with the offer and sales of any of our units, common stock or warrants be distributed or published in any jurisdiction, except under circumstances that will result in compliance with the applicable rules and regulations of that jurisdiction. Persons who receive this prospectus are advised to inform themselves about and to observe any restrictions relating to this offering of the units, common stock and warrants and the distribution of this prospectus. This prospectus is neither an offer to sell nor a solicitation of any offer to buy units, common stock or warrants in any jurisdiction where that would not be permitted or legal.

The underwriter has advised us that it does not intend to confirm sales to any accounts over which it exercises discretionary authority.

Underwriting discount and expenses

The following table summarizes the underwriting discount to be paid to the underwriter by us.

	Total, without over-allotment	Total, with over-allotment
Underwriting discount to be paid to the underwriter by us for the units (7% of gross proceeds)	\$ 720,300	\$ 828,345

We also have agreed to reimburse the out-of-pocket expenses incurred by the underwriter in connection with the

underwriting, including reasonable attorneys fees and expenses of the underwriter's counsel retained for this purpose by the underwriter, in an amount of up to \$75,000. The underwriter does not have any right of first refusal or any similar rights with respect to the provision of services to us in the future.

The underwriter has performed investment banking services for us for which it has received customary fees and expenses. The underwriter may, from time to time, engage in transactions with or perform services for us in the ordinary course of its business.

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Over-allotment option

We have granted to the underwriter an option, exercisable not later than 45 days after the date of this prospectus, to purchase up to 90,000 units at the public offering price, less the underwriting discount, set forth on the cover page of this prospectus. The underwriter may exercise the option solely to cover over-allotments, if any, made in connection with this offering. If any additional units are purchased pursuant to the over-allotment option, the underwriter will offer these additional units on the same terms as those on which the other units are being offered hereby.

Determination of offering price

The public offering price of the units and the exercise price and other terms of the warrants were negotiated between us and the underwriter, based on the trading of our common stock prior to the offering, among other things. Other factors considered in determining the public offering price of the units and the exercise price and other terms of the warrants include the history and prospects of the Company, the stage of development of our business, our business plans for the future and the extent to which they have been implemented, an assessment of our management, general conditions of the securities markets at the time of the offering and such other factors as were deemed relevant.

Stabilization, short positions and penalty bids

The underwriter may engage in over-allotment, syndicate covering transactions, stabilizing transactions and penalty bids or purchases for the purpose of pegging, fixing or maintaining the price of our common stock or warrants:

Over-allotment involves sales by the underwriter of units in excess of the number of units the underwriter is obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of units over-allotted by the underwriter is not greater than the number of units that it may purchase in the over-allotment option. In a naked short position, the number of units involved is greater than the number of units in the over-allotment option. The underwriter may close out any short position by exercising its over-allotment option, in whole or in part, or purchasing shares and warrants in the open market.

Syndicate covering transactions involve purchases of securities in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of securities needed to close out the short position, the underwriter will consider, among other things, the price of the securities available for purchase in the open market as compared to the price at which it may purchase the securities through the over-allotment option. If the underwriter sells more securities than could be covered by the over-allotment option, a naked short position, the position can only be closed out by buying securities in the open market. A naked short position is more likely to be created if the underwriter is concerned that there could be downward pressure on the price of the securities in the open market after pricing that could adversely affect investors who purchase in the offering.

Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specific maximum.

Penalty bids permit the underwriter to reclaim a selling concession from a syndicate member when the securities originally sold by the syndicate member are purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These syndicate covering transactions, stabilizing transactions and penalty bids may have the effect of raising or maintaining the market prices of our securities or preventing or retarding a decline in the market prices of our securities. As a result, the price of our common stock and warrants may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the Nasdaq Capital Market, in the over-the-counter

market or on any other trading market and, if commenced, may be discontinued at any time.

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In connection with this offering, the underwriter also may engage in passive market making transactions in our common stock on the Nasdaq Capital Market in accordance with Regulation M during a period before the commencement of offers or sales of shares of our common stock in this offering and extending through the completion of the distribution. In general, a passive market maker must display its bid at a price not in excess of the highest independent bid for that security. However, if all independent bids are lowered below the passive market maker's bid, that bid must then be lowered when specific purchase limits are exceeded. Passive market making may stabilize the market price of the securities at a level above that which might otherwise prevail in the open market and, if commenced, may be discontinued at any time.

Neither we nor the underwriter make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the prices of our securities. In addition, neither we nor the underwriter make any representation that the underwriter will engage in these transactions or that any transactions, once commenced, will not be discontinued without notice.

Indemnification

We have agreed to indemnify the underwriter against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the underwriter may be required to make with respect to any of these liabilities.

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LEGAL MATTERS

The validity of the securities being offered hereby will be passed upon by Winstead PC, The Woodlands, Texas. Jeffrey R. Harder, a member of the law firm Winstead PC, beneficially owned as of December 31, 2010, an aggregate of 11,874 shares of our common stock. Mr. Harder also holds options to purchase 13,125 shares of our common stock. Certain legal matters will be passed upon for the underwriter by Schulte Roth & Zabel LLP, New York, New York.

EXPERTS

The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) incorporated in this prospectus by reference to the Annual Report on Form 10-K for the year ended December 31, 2009 have been so incorporated in reliance on the report (which contains an explanatory paragraph relating to the Company's ability to continue as a going concern as described in Note 1 to the consolidated financial statements) of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

The consolidated statements of stockholders' equity for each of the eight years in the period ended December 31, 2001 were audited by Arthur Andersen LLP. Arthur Andersen LLP has not consented to the incorporation of their reports on the consolidated statements of stockholders' equity for each of the eight years in the period ended December 31, 2001 incorporated in this prospectus by reference to the Annual Report on Form 10-K for the year ended December 31, 2009, and we have dispensed with the requirement to file their consent in reliance upon Rule 437a of the Securities Act. Because Arthur Andersen LLP has not consented to the incorporation of their reports in this prospectus, you will not be able to recover against Arthur Andersen LLP under Section 11 of the Securities Act for any untrue statements of a material fact contained in the financial statements audited by Arthur Andersen LLP or any omissions to state a material fact required to be stated therein.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1 relating to the securities covered by this prospectus. This prospectus is a part of the registration statement and does not contain all the information in the registration statement. For further information with respect to us and the securities we are offering under this prospectus, we refer you to the registration statement and the exhibits and schedules filed as a part of the registration statement. We also file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy the registration statement, as well as any other material we file with the SEC, at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for more information on the Public Reference Room. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including Repros. The SEC's Internet site can be found at <http://www.sec.gov>.

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INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to incorporate by reference the information we file with it, which means that we can disclose important information to you by referring you to another document that we have filed separately with the SEC. You should read the information incorporated by reference because it is an important part of this prospectus. Any information incorporated by reference into this prospectus is considered to be part of this prospectus from the date we file that document. We incorporate by reference the following information or documents that we have filed with the SEC which shall not include, in each case, documents, or information deemed to have been furnished and not filed in accordance with SEC rules:

Annual Report of Form 10-K for the fiscal year ended December 31, 2009;

Quarterly Report on Form 10-Q for the quarters ended March 31, 2010, June 30, 2010 and September 30, 2010;

Proxy Statement on Schedule 14A filed with the SEC on April 6, 2010;

Current Reports on Form 8-K filed with the SEC on January 11, 2010, January 19, 2010, January 26, 2010, January 27, 2010, February 2, 2010, February 8, 2010, February 19, 2010, March 3, 2010, March 4, 2010, March 11, 2010, March 16, 2010, March 31, 2010, April 5, 2010, April 15, 2010, April 28, 2010, April 30, 2010, May 10, 2010, May 13, 2010, May 18, 2010, June 11, 2010, June 17, 2010, June 21, 2010, July 23, 2010, August 3, 2010, August 10, 2010, August 12, 2010, August 16, 2010, August 18, 2010, September 10, 2010, September 29, 2010, September 30, 2010, October 15, 2010, October 25, 2010, November 1, 2010, November 10, 2010, December 17, 2010, December 23, 2010, December 30, 2010 and January 3, 2011;

the description of our Rights Agreement contained in our registration statement on Form 8-A filed on September 3, 1999, as amended on September 6, 2002, October 30, 2002, June 30, 2005, January 10, 2008, October 10, 2008 and September 9, 2010, including any amendments or reports filed for the purposes of updating this description; and the description of our common stock contained in our registration statement on Form 8-A filed with the SEC on February 2, 1993, including all amendments and reports filed for the purpose of updating such information.

Information furnished to the SEC under Item 2.02 or Item 7.01 in Current Reports on Form 8-K, and any exhibit relating to such information, filed prior to, on or subsequent to the date of this prospectus is not incorporated by reference into this prospectus.

Any statement contained in any document incorporated by reference herein shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or any prospectus supplement modifies or supersedes such statement. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

We will provide to each person, including any beneficial owner, to whom a prospectus is delivered, without charge upon written or oral request, a copy of any or all of the reports or documents that are incorporated by reference into this prospectus but not delivered with the prospectus, including exhibits which are specifically incorporated by reference into such documents. If you would like to request documents from us, please send a request in writing or by telephone to us at the following address:

Repros Therapeutics Inc.
2408 Timberloch Place, Suite B-7
The Woodlands, Texas 77380
(281) 719-3400
Attn: Secretary

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These documents are posted on our Web site at www.reprosrx.com; select the Investors & Media link and then the SEC Filings link. Any other information contained on, or accessible through, our website does not constitute a part of this prospectus.

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TABLE OF CONTENTS**REPROS THERAPEUTICS INC. AND SUBSIDIARY**

(A development stage company)

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited and in thousands except share and per share amounts)

	September 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	\$4,216	\$ 1,886
Prepaid expenses and other current assets	211	177
Total current assets	4,427	2,063
Fixed assets, net	9	12
Other assets, net	1,131	885
Total assets	\$5,567	\$ 2,960
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	\$1,172	\$ 2,043
Accrued expenses	182	355
Total current liabilities	1,354	2,398
Commitments and contingencies (note 5)		
Stockholders Equity		
Undesignated Preferred Stock, \$.001 par value, 5,000,000 shares authorized, none issued and outstanding		
Common Stock, \$.001 par value, 75,000,000 shares authorized, 9,042,407 and 6,496,999 shares issued, respectively and 8,930,057 and 6,384,649 shares outstanding, respectively	9	6
Additional paid-in capital	183,644	176,412
Cost of treasury stock, 112,350 shares	(1,380)	(1,380)
Deficit accumulated during the development stage	(178,060)	(174,476)
Total stockholders equity	4,213	562
Total liabilities and stockholders equity	\$5,567	\$ 2,960

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

TABLE OF CONTENTS**REPROS THERAPEUTICS INC. AND SUBSIDIARY**
(A development stage company)**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
(unaudited and in thousands except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,		From Inception (August 20, 1987) through September 30, 2010
	2010	2009	2010	2009	
Revenues					
Licensing fees	\$	\$	\$	\$	\$28,755
Product royalties					627
Research and development grants					1,219
Interest income					16,297
Gain on disposal of fixed assets				4	102
Other Income	85		138		720
Total revenues and other income	85		138	4	47,720
Expenses					
Research and development	736	8,282	1,950	21,765	172,280
General and administrative	533	1,962	1,772	4,126	43,769
Interest expense and amortization of intangibles					388
Total expenses	1,269	10,244	3,722	25,891	216,437
Loss from continuing operations	(1,184)	(10,244)	(3,584)	(25,887)	(168,717)
Loss from discontinued operations					(1,828)
Gain on disposal of discontinued operation					939
Net loss before cumulative effect of change in accounting principle	(1,184)	(10,244)	(3,584)	(25,887)	(169,606)
Cumulative effect of change in accounting principle					(8,454)
Net loss	\$(1,184)	\$(10,244)	\$(3,584)	\$(25,887)	\$(178,060)
Loss per share basic and diluted:	\$(0.13)	\$(2.64)	\$(0.46)	\$(6.77)	
Weighted average shares used in loss per share calculation:					
Basic	8,875	3,876	7,763	3,821	
Diluted	8,875	3,876	7,763	3,821	

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

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REPROS THERAPEUTICS INC. AND SUBSIDIARY

(A development stage company)

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(unaudited and in thousands except share and per share amounts)

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

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TABLE OF CONTENTS**REPROS THERAPEUTICS INC. AND SUBSIDIARY**

(A development stage company)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited and in thousands)

	Nine Months Ended September 30,		From Inception (August 20, 1987) through September 30, 2010
	2010	2009	
Cash Flows from Operating Activities			
Net loss	\$(3,584)	\$(25,887)	\$(178,060)
Gain on disposal of discontinued operations			(939)
Gain on disposal of fixed assets			(102)
Adjustments to reconcile net loss to net cash used in operating activities:			
Noncash financing costs			316
Noncash inventory impairment			4,417
Noncash patent impairment		989	2,614
Noncash other income	(138)		(685)
Noncash decrease in accounts payable			(1,308)
Depreciation and amortization	60	51	4,014
Noncash stock-based compensation	471	1,110	7,112
Common stock issued for agreement not to compete			200
Series B Preferred Stock issued for consulting services			18
Changes in operating assets and liabilities (net effects of purchase of businesses in 1988 and 1994):			
Increase in receivables			(199)
Increase in inventory			(4,447)
(Increase) decrease in prepaid expenses and other current assets	(34)	1,114	91
Increase (decrease) in accounts payable and accrued expenses	(536)	5,246	9,502
Net cash used in operating activities	(3,761)	(17,377)	(157,456)
Cash Flows from Investing Activities			
Change in trading marketable securities			(191)
Capital expenditures	(6)		(2,377)
Purchase of technology rights and other assets	(297)	(424)	(4,569)
Proceeds from sale of PP&E			225
Cash acquired in purchase of FTI			3
Proceeds from sale of subsidiary, less \$12,345 for operating losses during 1990 phase-out period			138
Proceeds from sale of the assets of FTI			2,250
Increase in net assets held for disposal			(213)
Net cash used in investing activities	(303)	(424)	(4,734)

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Cash Flows from Financing Activities			
Proceeds from issuance of common stock, net of offering costs	6,394	869	162,399
Exercise of stock options		9	372
Proceeds from a shareholder transaction			327
Proceeds from issuance of preferred stock			23,688
Purchase of treasury stock			(21,487)
Proceeds from issuance of notes payable			2,839
Principal payments on notes payable			(1,732)
Net cash provided by financing activities	6,394	878	166,406
Net increase (decrease) in cash and cash equivalents	2,330	(16,923)	4,216
Cash and cash equivalents at beginning of period	1,886	19,470	
Cash and cash equivalents at end of period	\$4,216	\$2,547	\$4,216

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

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**REPROS THERAPEUTICS INC. AND SUBSIDIARY
(A development stage company)**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS
September 30, 2010
(Unaudited)**

NOTE 1 Organization, Operations and Liquidity

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) considered necessary for a fair statement of the interim periods presented have been included. The year-end balance sheet data was derived from audited financial statements, but does not include all the disclosures required by accounting principles generally accepted in the United States of America. Operating results for the three month and nine month periods ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. For further information, refer to the financial statements and footnotes thereto included in the Repros Therapeutics Inc. (the Company , Repros, or we, us or o Annual Report on Form 10-K for the year ended December 31, 2009.

The Company was organized on August 20, 1987. We are a development stage biopharmaceutical company focused on the development of oral small molecule drugs for major unmet medical needs that treat male and female reproductive disorders.

Our portfolio of products includes:

Androxal®

As a treatment for men of reproductive age with low testosterone levels that spares fertility, unlike testosterone replacement therapy; and

As a treatment for type 2 diabetes
Proellex®

As a treatment of symptoms associated with uterine fibroids and endometriosis, subject to the current FDA partial clinical hold on the Proellex® clinical trials; however, the FDA has allowed us to run a single study to explore both safety and signals of efficacy in an escalating dose fashion. The new study will test 5 different doses of Proellex® (1, 3, 6, 9 and 12 mg) with 1 mg being the first dose tested.

As of September 30, 2010, we had accumulated losses of \$178.1 million, approximately \$4.2 million in cash and cash

equivalents, and our accounts payable and accrued expenses were approximately \$1.4 million. The amount of cash on hand is not sufficient to fund the (i) escalating dose study for Proellex® permitted by the FDA, (ii) Phase 2B and upcoming Phase 3 hypogonadism trials for Androxal®, (iii) type 2 diabetes trial for Androxal®, (iv) preclinical assessment of vaginal delivery of Proellex® and (v) second generation Proellex® molecules. Based on these current and planned clinical trials, we will need to raise additional capital no later than the first quarter of 2011. We continue to explore potential additional financing and capital raising alternatives to provide additional funds to enable us to continue to develop our two product candidates through completion of clinical trials; however, there can be no assurance that we will be successful in raising any such additional funds on a timely basis or at all. Significant additional funding will be required for us to continue development of either of our product candidates. Additionally, as discussed in Note 5, we have various pending legal proceedings that could adversely impact us. The foregoing and other matters raise substantial doubt about our ability to continue as a going concern.

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**REPROS THERAPEUTICS INC. AND SUBSIDIARY
(A development stage company)**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS
September 30, 2010
(Unaudited)**

NOTE 1 Organization, Operations and Liquidity (continued)

On October 14, 2010, the Company effected a one-for-four reverse stock split of its common stock. The split-adjusted shares of the Company's common stock began trading on the Nasdaq Capital Market on October 15, 2010. The one-for-four reverse stock split converted all shares of the Company's common stock issued and outstanding, plus all outstanding stock options and the number of shares of common stock available for issuance under the Company's approved stock plans. The number of authorized shares of common stock was not affected by the reverse split. The reverse split enabled the Company to meet the continued listing rules of the Nasdaq Capital Market as evidenced by the Compliance Letter received from Nasdaq on October 29, 2010. All share and per share amounts have been retroactively adjusted to reflect the reverse stock split for all periods presented.

We also continue to maintain our patent portfolio of our phentolamine-based products for the treatment of sexual dysfunction and in order to create value from these assets in various ways which includes product out-licensing.

NOTE 2 Patents and Patent Applications

As of September 30, 2010, the Company had approximately \$1.1 million in capitalized patent and patent application costs reflected on its balance sheet. This entire amount relates to patent and patent application costs for Androxal®.

Should the Company not continue development of Androxal® or should the Company not continue as a going concern, the remaining capitalized patent and patent application costs may not be recoverable, which would result in charges to operating results in future periods.

NOTE 3 Accrued Expenses

Accrued expenses consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Personnel related costs	\$ 103	\$ 181
Other	69	159

Patent costs	10	15
Total	\$ 182	\$ 355

NOTE 4 Loss Per Share

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Diluted loss per share is computed using the average share price for the period and applying the treasury stock method to potentially dilutive outstanding options. In all applicable periods, all potential common stock equivalents were antidilutive and, accordingly, were not included in the computation of diluted loss per share. Additionally, on October 14, 2010, the Company effected a one-for-four reverse stock split of its common stock. The split-adjusted shares of the Company's common stock began trading on the Nasdaq Capital Market on October 15, 2010. All share and per share amounts have been retroactively adjusted to reflect the reverse stock split for all periods presented.

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REPROS THERAPEUTICS INC. AND SUBSIDIARY
(A development stage company)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL
STATEMENTS
September 30, 2010
(Unaudited)

NOTE 4 Loss Per Share (continued)

The following table presents information necessary to calculate loss per share for the three month and nine month periods ended September 30, 2010 and 2009 (in thousands, except per share amounts):

	Three Months Ended Sept. 30,		Nine Months Ended Sept. 30,	
	2010	2009	2010	2009
Net Loss	\$ (1,184)	\$ (10,244)	\$ (3,584)	\$ (25,887)
Average common shares outstanding	8,875	3,876	7,763	3,821
Basic and diluted loss per share	\$ (0.13)	\$ (2.64)	\$ (0.46)	\$ (6.77)

Other potential common stock of 538,582 and 552,402 common shares underlying stock options for the periods ended September 30, 2010 and 2009, respectively, were excluded from the above calculation of diluted loss per share because they were not dilutive.

NOTE 5 Commitments and Contingencies

Therapeutic uses of our Androxal® product candidate are covered in the United States by four issued U.S. patents and four pending patent applications. Foreign coverage of therapeutic uses of our Androxal® product candidate includes 40 issued foreign patents and 75 foreign pending patent applications. The issued patents and pending applications relate to methods for treating certain conditions including the treatment of testosterone deficiency in men, the treatment of metabolic syndrome and conditions associated therewith, and the treatment of infertility in hypogonadal men. Androxal® (the trans-isomer of clomiphene) is purified from clomiphene citrate. A third party individual holds two issued patents related to the use of an anti-estrogen such as clomiphene citrate and others for use in the treatment of androgen deficiency and disorders related thereto. In our prior filings with the SEC, we have described our request to the U.S. Patent and Trademark Office, or PTO, for re-examination of one of these patents based on prior art. The third party amended the claims in the re-examination proceedings, which led the PTO to determine that the amended claims are patentable in view of those publications under consideration and a re-examination certificate was issued. However, we believe that the amended claims are invalid based on additional prior art publications, and we filed a second request for re-examination by the PTO in light of a number of these additional publications and other publications cited by the PTO. The request was granted and all of the claims were finally rejected by the PTO in the re-examination. The patent holder appealed the rejections to the PTO Board of Patent Appeals and Interferences (the

Board) which affirmed the rejection of all of the claims. The patent holder subsequently filed a request for rehearing, which led the Board to reverse the rejections of several dependent claims in view of those publications under consideration. The patent holder has filed a Notice of Appeal to the Federal Circuit contesting the rejections maintained by the Board. We also believe that the second of these two patents is invalid in view of published prior art not considered by the PTO. Nevertheless, there is no assurance that either patent will ultimately be found invalid over the prior art. If such patents are not invalidated by the PTO we may be required to obtain a license from the holder of such patents in order to develop Androxal® further or attempts may be made to undertake further legal action to invalidate such patents. If such licenses were not available on acceptable terms, or at all, we may not be able to successfully commercialize or out-license Androxal®.

On August 7, 2009, R.M. Berry filed a putative class action lawsuit naming the Company, Joseph Podolski, Paul Lammers, and Louis Ploth, Jr. as defendants. The lawsuit is pending in the United States District Court for the Southern District of Texas, Houston Division. The lawsuit, styled R.M. Berry, on Behalf of Himself and all Others Similarly Situated v. Repros Therapeutics, Inc., Joseph Podolski, Paul Lammers, and Louis Ploth, Jr., alleges that the defendants made certain misleading statements related to the Company's Proellex® drug. Among other claims, the lawsuit contends that the defendants misrepresented the side effects of the drug related to liver function, and the risk that these side effects could cause a suspension of clinical

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**REPROS THERAPEUTICS INC. AND SUBSIDIARY
(A development stage company)**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL
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(Unaudited)**

NOTE 5 Commitments and Contingencies (continued)

trials of Proellex®. The lawsuit seeks to establish a class of shareholders allegedly harmed by the misleading statements, and asserts causes of action under the Securities Exchange Act of 1934. On August 14, 2009, a lawsuit making similar allegations and naming the same defendants was also filed in the United States District Court for the Southern District of Texas. This suit is styled Josephine Medina, Individually and On Behalf of all Others Similarly Situated v. Repros Therapeutics, Inc., Joseph Podolski, Paul Lammers, and Louis Ploth, Jr. On September 25, 2009, a lawsuit also making allegations similar to those in the Berry action, and naming the same defendants, was filed in the United States District Court for the Southern District of Texas. That lawsuit is styled Shane Simpson, Paul Frank and Clayton Scobie, on Behalf of Themselves and all Others Similarly Situated v. Repros Therapeutics, Inc., Joseph Podolski, Paul Lammers, and Louis Ploth, Jr. The lawsuits have now been consolidated, and lead plaintiffs appointed. On January 27, 2010, the lead plaintiffs filed a Consolidated Class Action Complaint styled In re Repros Therapeutics, Inc. Securities Litigation, Civil Action No. 09 Civ. 2530 (VDG). The lawsuit names Repros Therapeutics, Inc., Joseph Podolski, Paul Lammers, and Louis Ploth, Jr. as defendants. The allegations in the Consolidated Class Action Complaint are substantially the same as those contained in the prior complaints, and focus on the claim that the defendants deliberately withheld information concerning the negative side-effects of Proellex® related to liver function. Plaintiffs seek to establish a class action for all persons who purchased or otherwise acquired Repros common stock between July 1, 2009, and August 2, 2009. No discovery has yet occurred in the matter. Defendants filed a motion to dismiss the Consolidated Class Action Complaint on March 15, 2010. Briefing has been completed on that motion, but the court has not yet ruled on it. An estimate of the possible loss or range of losses in connection with the lawsuits cannot be made at this time.

On March 1, 2010, we were served with a lawsuit where we were named as a co-defendant along with one of our clinical regulatory service providers (CRO) relating to the Proellex® clinical trial study. The lawsuit was filed in the State of Tennessee, 30th Judicial District Chancery Court at Memphis by an investigator and claims that the CRO did not pay it amounts owing to it relating to the Proellex® study. We did not engage the investigator and under our agreement with the CRO, we believe the CRO is responsible for any such costs or damages regarding such lawsuit. Pursuant to a Settlement Agreement and Mutual Release entered into in October 2009, such CRO, on behalf of itself and its agents, released us from all claims which could be asserted by them against us. We believe such release covers the claims set forth in this lawsuit. The CRO failed to respond to the lawsuit, and a default judgment was entered against it in the amount of \$172,901.29. We intend to vigorously defend any and all claims asserted by the investigator. An estimate of the possible costs or expenses to defend ourselves in this matter or risk of exposure under the litigation cannot be made at this time.

NOTE 6 Other Recent Events, Including Subsequent Events

Between November 30, 2009 and March 31, 2010, we entered into settlement agreements and mutual releases (the Prior Settlement Agreements) with certain of our creditors, pursuant to which we issued an aggregate of 352,459 shares of common stock and paid an aggregate of \$140,572 in cash as payment in full for our then-outstanding liabilities to such creditors. On April 8, 2010, we entered into an additional settlement agreement and mutual release (together with the Prior Settlement Agreements, the Settlement Agreements) with a creditor, pursuant to which we issued 34,885 shares of common stock (together with the shares issued under the Prior Settlement Agreements, the Settlement Shares) and paid \$8,721 in cash as payment in full for our then-outstanding liability to such creditor. The

Settlement Shares were issued by the Company pursuant to Section 4(2) and /or Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended. Pursuant to the Settlement Agreements, we filed a registration statement to register the Settlement Shares on June 9, 2010, which was declared effective by the SEC on June 25, 2010, and we agreed

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**REPROS THERAPEUTICS INC. AND SUBSIDIARY
(A development stage company)**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL
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(Unaudited)**

**NOTE 6 Other Recent Events, Including Subsequent Events
(continued)**

to use our best efforts to maintain such registration statement until all such Settlement Shares registered thereunder to such creditors have been sold or for a period of one year, whichever comes first.

In addition to the Settlement Agreements, we settled with several of our creditors during the second and third quarter of 2010, in an amount less than our then-outstanding liabilities to such creditors. These settlements resulted in recognition of \$85,000 and \$138,000 in other income for the three and nine month periods ended September 30, 2010, respectively, on the Condensed Consolidated Statement of Operations.

On February 12, 2010, we entered into an Equity Distribution Agreement (the "Equity Distribution Agreement") with Ladenburg Thalmann & Co. Inc. ("Ladenburg"), pursuant to which we may issue and sell from time to time through Ladenburg, as sales agent and/or principal, shares of our common stock having an aggregate offering price of up to \$10 million (the "ATM Shares"). Ladenburg is not required to sell on our behalf any specific number or dollar amount of the ATM Shares, but Ladenburg, upon acceptance of written instructions from us, agreed to use its commercially reasonable efforts consistent with its customary trading and sales practices, to sell the ATM Shares up to the amount specified, and otherwise in accordance with the terms of a placement notice delivered to Ladenburg. We have no obligation to sell any ATM Shares under the Equity Distribution Agreement, and may at any time suspend sales under the Equity Distribution Agreement, provided that such suspension shall not affect either party's obligations with respect to the ATM Shares sold prior to the receipt of notice of such suspension. Ladenburg receives a commission of 4% of the gross sales price of all ATM Shares sold through it under the Equity Distribution Agreement. The ATM Shares are issued pursuant to our shelf registration statement on Form S-3, as amended (File No. 333-163648).

Between July 1, 2010 and September 30, 2010, we have sold an aggregate of 277,164 ATM Shares at a weighted average share price of \$1.51, for proceeds of approximately \$401,000, net of expenses. Cumulative through September 30, 2010, we have sold 2,448,572 ATM Shares at a weighted average share price of \$2.77, for proceeds of approximately \$6.4 million, net of expenses. Pursuant to General Instruction I.B.6. of Form S-3, we may not sell more than one-third of the aggregate market value of our common stock held by non-affiliates during a period of 12 calendar months immediately prior to, and including, the date of such sale of such common stock. Due to this limitation, we announced on August 3, 2010 that we have suspended this ATM offering of Company securities.

On November 1, 2010, we were notified by The Department of the Treasury that our application submitted requesting certification for qualified investment in a qualifying therapeutic discovery project under section 48D of the Internal

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Revenue Code was accepted. As a result, we have been awarded a grant in the amount of \$244,479. It is anticipated that proceeds from this grant will be received late in November 2010.

On November 8, 2010, we had a Type B meeting with the FDA. In that meeting the FDA recommended that we conduct a Phase 2B study in men with secondary hypogonadism but naïve to testosterone treatment before moving into Phase 3. The FDA opined further that such a Phase 2B study would provide for a more solid data base for design of Phase 3 studies and eventual approval of such studies under a Special Protocol Assessment (SPA). The FDA did note the Division agrees in general with the outline of your program for the development of enclomiphene (Androxal®).

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**600,000 UNITS, CONSISTING OF
2,400,000 SHARES OF COMMON STOCK,
SERIES A WARRANTS TO PURCHASE 1,800,000
SHARES OF COMMON STOCK AND
SERIES B WARRANTS TO PURCHASE 1,470,000
SHARES OF COMMON STOCK**

PROSPECTUS

February 3, 2011

Ladenburg Thalmann & Co. Inc.
