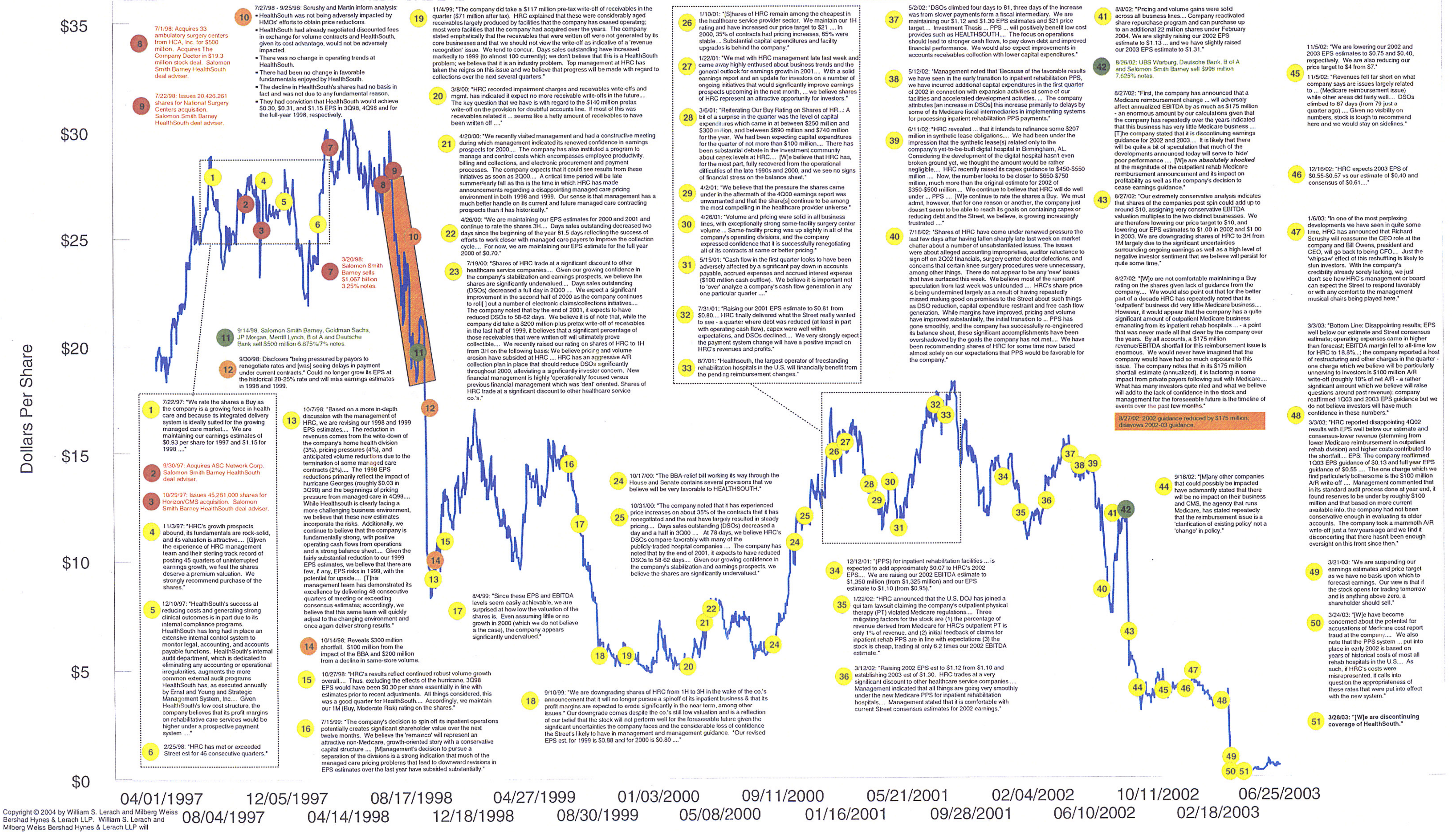
HealthSouth Corp. -- Salomon Smith Barney

Underwritings/Loans/Analyst Reports And Daily Share Prices

April 1997 to June 2003

Appendix 10

- 🟤 Acquisition Advisor
- 🟠 HRC's Statements
- 🟢 Notes Offering
- 🟡 SSB Analyst Report



1 7/22/97: "We rate the shares a Buy as the company is a growing force in health care and because its integrated delivery system is ideally suited for the growing managed care market.... We are maintaining our earnings estimates of $0.93 per share for 1997 and $1.15 for 1998 ...."

2 9/30/97: Acquires ASC Network Corp. Salomon Smith Barney HealthSouth deal adviser.

3 10/29/97: Issues 45,261,000 shares for Horizon/CMS acquisition. Salomon Smith Barney HealthSouth deal adviser.

4 11/3/97: "HRC's growth prospects abound, its fundamentals are rock-solid, and its valuation is attractive.... [G]iven the experience of HRC management team and their sterling track record of posting 45 quarters of uninterrupted earnings growth, we feel the shares deserve a premium valuation. We strongly recommend purchase of the shares."

5 12/10/97: "HealthSouth's success at reducing costs and generating strong clinical outcomes is in part due to its internal compliance programs. HealthSouth has long had in place an extensive internal control system to monitor legal, accounting, and accounts payable functions. HealthSouth's internal audit department, which is dedicated to eliminating any accounting or operational irregularities, augments the more common external audit programs HealthSouth has, as executed annually by Ernst and Young and Strategic Management System, Inc.... Given HealthSouth's low cost structure, the company believes that its profit margins on rehabilitative care services would be higher under a prospective payment system ...."

6 2/25/98: "HRC has met or exceeded Street est for 46 consecutive quarters."

7 3/20/98: Salomon Smith Barney sells $1.067 billion 3.25% notes.

8 7/1/98: Acquires 33 ambulatory surgery centers from HCA, Inc. for $500 million. Acquires The Company Doctor in $19.3 million stock deal. Salomon Smith Barney HealthSouth deal adviser.

9 7/22/98: Issues 20,426,261 shares for National Surgery Centers acquisition. Salomon Smith Barney HealthSouth deal adviser.

10 7/27/98 - 9/25/98: Scrushy and Martin inform analysts:

- HealthSouth was not being adversely impacted by HMOs' efforts to obtain price reductions.
- HealthSouth had already negotiated discounted fees in exchange for volume contracts and HealthSouth, given its cost advantage, would not be adversely impacted.
- There was no change in operating trends at HealthSouth.
- There had been no change in favorable fundamentals enjoyed by HealthSouth.
- The decline in HealthSouth's shares had no basis in fact and was not due to any fundamental reason.
- They had conviction that HealthSouth would achieve $0.30, $0.31, and $1.15 EPS in 3Q98, 4Q98 and for the full-year 1998, respectively.

11 9/14/98. Salomon Smith Barney, Goldman Sachs, JP Morgan, Merrill Lynch, B of A and Deutsche Bank sell $500 million 6.875%/7% notes.

12 9/30/98: Discloses "being pressured by payors to renegotiate rates and [was] seeing delays in payment under current contracts." Could no longer grow its EPS at the historical 20-25% rate and will miss earnings estimates in 1998 and 1999.

13 10/7/98: "Based on a more in-depth discussion with the management of HRC, we are revising our 1998 and 1999 EPS estimates.... The reduction in revenues comes from the write-down of the company's home health division (3%), pricing pressures (4%), and anticipated volume reductions due to the termination of some managed care contracts (2%).... The 1998 EPS reductions primarily reflect the impact of hurricane Georges (roughly $0.03 in 3Q98) and the beginnings of pricing pressure from managed care in 4Q98.... While Healthsouth is clearly facing a more challenging business environment, we believe that these new estimates incorporate the risks. Additionally, we continue to believe that the company is fundamentally strong, with positive operating cash flows from operations and a strong balance sheet.... Given the fairly substantial reduction to our 1999 EPS estimates, we believe that there are few, if any, EPS risks in 1999, with the potential for upside.... [T]his management team has demonstrated its excellence by delivering 48 consecutive quarters of meeting or exceeding consensus estimates; accordingly, we believe that this same team will quickly adjust to the changing environment and once again deliver strong results."

14 10/14/98: Reveals $300 million shortfall. $100 million from the impact of the BBA and $200 million from a decline in same-store volume.

15 10/27/98: "HRC's results reflect continued robust volume growth overall.... Thus, excluding the effects of the hurricane, 3Q98 EPS would have been $0.30 per share essentially in line with estimates prior to recent adjustments. All things considered, this was a good quarter for HealthSouth.... Accordingly, we maintain our 1M (Buy, Moderate Risk) rating on the shares."

16 7/15/99: "The company's decision to spin off its inpatient operations potentially creates significant shareholder value over the next twelve months. We believe the 'remainco' will represent an attractive non-Medicare, growth-oriented story with a conservative capital structure .... [M]anagement's decision to pursue a separation of the divisions is a strong indication that much of the managed care pricing problems that lead to downward revisions in EPS estimates over the last year have subsided substantially."

17 8/4/99: "Since these EPS and EBITDA levels seem easily achievable, we are surprised at how low the valuation of the shares is. Even assuming little or no growth in 2000 (which we do not believe is the case), the company appears significantly undervalued."

18 9/10/99: "We are downgrading shares of HRC from 1H to 3H in the wake of the co.'s announcement that it will no longer pursue a spinoff of its inpatient business & that its profit margins are expected to erode significantly in the near term, among other issues." Our downgrade comes despite the co.'s still low valuation and is a reflection of our belief that the stock will not perform well for the foreseeable future given the significant uncertainties the company faces and the considerable loss of confidence the Street's likely to have in management and management guidance. "Our revised EPS est. for 1999 is $0.88 and for 2000 is $0.80 ...."

19 11/4/99: "The company did take a $117 million pre-tax write-off of receivables in the quarter ($71 million after tax). HRC explained that these were considerably aged receivables largely produced by facilities that the company has ceased operating; most were facilities that the company had acquired over the years. The company stated emphatically that the receivables that were written off were not generated by its core businesses and that we should not view the write-off as indicative of a 'revenue recognition' issue. We tend to concur. Days sales outstanding have increased markedly to 1999 (to almost 100 currently); we don't believe that this is a HealthSouth problem; we believe that it is an industry problem. Top management at HRC has taken the reigns on this issue and we believe that progress will be made with regard to collections over the next several quarters."

20 3/8/00: "HRC recorded impairment charges and receivables write-offs and mgmt. has indicated it expect no more receivable write-offs in the future.... The key question that we have is with regard to the $140 million pretax write-off on the provision for doubtful accounts line. If most of this was receivables related it ... seems like a hefty amount of receivables to have been written off ...."

21 4/20/00: "We recently visited management and had a constructive meeting during which management indicated its renewed confidence in earnings prospects for 2000.... The company has also instituted a program to manage and control costs which encompasses employee productivity, billing and collections, and electronic procurement and payment processes. The company expects that it could see results from these initiatives as soon as 2Q00.... A critical time period will be late summer/early fall as this is the time in which HRC has made announcements regarding a disappointing managed care pricing environment in both 1998 and 1999. Our sense is that management has a much better handle on its current and future managed care contracting prospects than it has historically."

22 4/26/00: "We are maintaining our EPS estimates for 2000 and 2001 and continue to rate the shares 3H.... Days sales outstanding decreased two days since the beginning of the year 81.5 days reflecting the success of efforts to work closer with managed care payers to improve the collection cycle.... For now, we are maintaining our EPS estimate for the full year 2000 of $0.70."

23 7/19/00: "Shares of HRC trade at a significant discount to other healthcare service companies.... Given our growing confidence in the company's stabilization and earnings prospects, we believe the shares are significantly undervalued.... Days sales outstanding (DSOs) decreased a full day in 2Q00 .... We expect a significant improvement in the second half of 2000 as the company continues to roll[ ] out a number of electronic claims/collections initiatives.... The company noted that by the end of 2001, it expects to have reduced DSOs to 58-62 days. We believe it is of note that, while the company did take a $200 million-plus pretax write-off of receivables in the last half of 1999, it believes that a significant percentage of those receivables that were written off will ultimately prove collectible.... We recently raised our rating on shares of HRC to 1H from 3H on the following basis: We believe pricing and volume erosion have subsided at HRC .... HRC has an aggressive A/R collection plan in place that should reduce DSOs significantly throughout 2000, alleviating a significantly investor concern. New financial management is highly 'operationally' focused versus previous financial management which was 'deal' oriented. Shares of HRC trade at a significant discount to other healthcare service co.'s."

24 10/17/00: "The BBA-relief bill working its way through the House and Senate contains several provisions that we believe will be very favorable to HEALTHSOUTH."

25 10/31/00: "The company noted that it has experienced price increases on about 35% of the contracts that it has renegotiated and the rest have largely resulted in steady pricing.... Days sales outstanding (DSOs) decreased a day and a half in 3Q00 .... At 78 days, we believe HRC's DSOs compare favorably with many of the publicly-traded hospital companies .... The company has noted that by the end of 2001, it expects to have reduced DSOs to 58-62 days.... Given our growing confidence in the company's stabilization and earnings prospects, we believe the shares are significantly undervalued."

26 1/10/01: "[S]hares of HRC remain among the cheapest in the healthcare service provider sector. We maintain our 1H rating and have increased our price target to $21 .... In 2000, 35% of contracts had pricing increases, 65% were stable.... Substantial capital expenditures and facility upgrades is behind the company."

27 1/22/01: "We met with HRC management late last week and came away highly enthused about business trends and the general outlook for earnings growth in 2001.... With a solid earnings report and an update for investors on a number of ongoing initiatives that would significantly improve earnings prospects upcoming in the next month, ... we believe shares of HRC represent an attractive opportunity for investors."

28 3/6/01: "Reiterating Our Buy Rating on Shares of HR...: A bit of a surprise in the quarter was the level of capital expenditures which came in at between $250 million and $300 million, and between $690 million and $740 million for the year. We had been expecting capital expenditures for the quarter of not more than $100 million.... There has been substantial debate in the investment community about capex levels at HRC.... [W]e believe that HRC has, for the most part, fully recovered from the operational difficulties of the late 1990s and 2000, and we see no signs of financial stress on the balance sheet."

29 4/2/01: "We believe that the pressure the shares came under in the aftermath of the 4Q00 earnings report was unwarranted and that the share[s] continue to be among the most compelling in the healthcare provider universe."

30 4/26/01: "Volume and pricing were solid in all business lines, with exceptionally strong same-facility surgery center volume.... Same-facility pricing was up slightly in all of the company's operating divisions, and the company expressed confidence that it is successfully renegotiating all of its contracts at same or better pricing."

31 5/15/01: "Cash flow in the first quarter looks to have been adversely affected by a significant pay down in accounts payable, accrued expenses and accrued interest expense ($100 million cash outflow). We believe it is important not to 'over' analyze a company's cash flow generation in any one particular quarter ...."

32 7/31/01: "Raising our 2001 EPS estimate to $0.81 from $0.80.... HRC finally delivered what the Street really wanted to see - a quarter where debt was reduced (at least in part with operating cash flow), capex were well within expectations, and DSOs declined.... We very strongly expect the payment system change will have a positive impact on HRC's revenues and profits."

33 8/7/01: "Healthsouth, the largest operator of freestanding rehabilitation hospitals in the U.S. will financially benefit from the pending reimbursement changes."

34 12/12/01: "(PPS) for inpatient rehabilitation facilities ... is expected to add approximately $0.07 to HRC's 2002 EPS.... We are raising our 2002 EBITDA estimate to $1,350 million (from $1,325 million) and our EPS estimate to $1.10 (from $0.95)."

35 1/22/02: "HRC announced that the U.S. DOJ has joined a qui tam lawsuit claiming the company's outpatient physical therapy (PT) violated Medicare regulations.... Three mitigating factors for the stock are (1) the percentage of revenue derived from Medicare for HRC's outpatient PT is only 1% of revenue, and (2) initial feedback of claims for inpatient rehab PPS are in line with expectations (3) the stock is cheap, trading at only 6.2 times our 2002 EBITDA estimate."

36 3/12/02: "Raising 2002 EPS est to $1.12 from $1.10 and establishing 2003 est of $1.30. HRC trades at a very significant discount to other healthcare service companies .... Management indicated that all things are going very smoothly under the new Medicare PPS for inpatient rehabilitation hospitals.... Management stated that it is comfortable with current Street consensus estimates for 2002 earnings."

37 5/2/02: "DSOs climbed four days to 81, three days of the increase was from slower payments form a fiscal intermediary. We are maintaining our $1.12 and $1.30 EPS estimates and $21 price target.... Investment Thesis ... PPS ... will positively benefit low cost provides such as HEALTHSOUTH.... The focus on operations should lead to stronger cash flows, to pay down debt and improved financial performance. We would also expect improvements in accounts receivables collection with lower capital expenditures."

38 5/12/02: "Management noted that 'Because of the favorable results we have seen in the early transition to inpatient rehabilitation PPS, we have incurred additional capital expenditures in the first quarter of 2002 in connection with expansion activities at some of our facilities and accelerated development activities. ... The company attributes [an increase in DSOs] this increase primarily to delays by some of its Medicare fiscal intermediaries in implementing systems for processing inpatient rehabilitation PPS payments."

39 6/11/02: "HRC revealed ... that it intends to refinance some $207 million in synthetic lease obligations.... We had been under the impression that the synthetic lease(s) related only to the company's yet-to-be-built digital hospital in Birmingham, AL. Considering the development of the digital hospital hasn't even broken ground yet, we thought the amount would be rather negligible.... HRC recently raised its capex guidance to $450-$550 million .... Now, the number looks to be closer to $650-$750 million, much more than the original estimate for 2002 of $350-$500 million.... We continue to believe that HRC will do well under ... PPS .... [W]e continue to rate the shares a Buy. We must admit, however, that for one reason or another, the company just doesn't seem to be able to reach its goals on containing capex or reducing debt and the Street, we believe, is growing increasingly frustrated ...."

40 7/18/02: "Shares of HRC have come under renewed pressure the last few days after having fallen sharply late last week on market chatter about a number of unsubstantiated issues. The issues were about alleged accounting improprieties, auditor reluctance to sign off on 2Q02 financials, surgery center doctor defections, and concerns that certain knee surgery procedures were unnecessary, among other things. There do not appear to be any 'new' issues that have surfaced this week. We believe most of the rampant speculation from last week was unfounded .... HRC's share price is being undermined largely as a result of having repeatedly missed making good on promises to the Street about such things as DSO reduction, capital expenditure restraint and free cash flow generation. While margins have improved, pricing and volume have improved substantially, the initial transition to ... PPS has gone smoothly, and the company has successfully re-engineered its balance sheet, these significant accomplishments have been overshadowed by the goals the company has not met.... We have been recommending shares of HRC for some time now based almost solely on our expectations that PPS would be favorable for the company."

41 8/8/02: "Pricing and volume gains were solid across all business lines.... Company reactivated share repurchase program and can purchase up to an additional 22 million shares under February 2004. We are slightly raising our 2002 EPS estimate to $1.13 ... and we have slightly raised our 2003 EPS estimate to $1.31."

42 8/26/02: UBS Warburg, Deutsche Bank, B of A and Salomon Smith Barney sell $998 million 7.625% notes.

43 8/27/02: "First, the company has announced that a Medicare reimbursement change ... will adversely affect annualized EBITDA by as much as $175 million - an enormous amount by our calculations given that the company has repeatedly over the years indicated that this business has very little Medicare business .... [T]he company stated that it is discontinuing earnings guidance for 2002 and 2003.... It is likely that there will be quite a bit of speculation that much of the developments announced today will serve to 'hide' poor performance .... [W]e are ***absolutely shocked*** at the magnitude of the outpatient rehab Medicare reimbursement announcement and its impact on profitability as well as the company's decision to cease earnings guidance."

8/27/02: "Our extremely conservative analysis indicates that shares of the companies post spin could add up to around $10, assigning very conservative EBITDA valuation multiples to the two distinct businesses. We are therefore lowering our price target to $10, and lowering our EPS estimates to $1.00 in 2002 and $1.00 in 2003. We are downgrading shares of HRC to 3H from 1M largely due to the significant uncertainties surrounding ongoing earnings as well as a high level of negative investor sentiment that we believe will persist for quite some time."

8/27/02: "[W]e are not comfortable maintaining a Buy rating on the shares given lack of guidance from the company.... We would also point out that for the better part of a decade HRC has repeatedly noted that its 'outpatient' business did very little Medicare business.... However, it would appear that the company has a quite significant amount of outpatient Medicare business emanating from its inpatient rehab hospitals ... - a point that was never made all that clear by the company over the years. By all accounts, a $175 million revenue/EBITDA shortfall for this reimbursement issue is enormous. We would never have imagined that the company would have had so much exposure to this issue. The company notes that in its $175 million shortfall estimate (annualized), it is factoring in some impact from private payers following suit with Medicare.... What has many investors quite riled and what we believe will add to the lack of confidence in the stock and management for the foreseeable future is the timeline of events over the past few months."

8/27/02: 2002 guidance reduced by $175 million; disavows 2002-03 guidance.

44 9/18/02: "[M]any other companies that could possibly be impacted have adamantly stated that there will be no impact on their business and CMS, the agency that runs Medicare, has stated repeatedly that the reimbursement issue is a 'clarification of existing policy' not a 'change' in policy."

45 11/5/02: "We are lowering our 2002 and 2003 EPS estimates to $0.75 and $0.40, respectively. We are also reducing our price target to $4 from $7."

11/5/02: "Revenues fell far short on what company says are issues largely related to ... (Medicare reimbursement issue) while other areas did fairly well.... DSOs climbed to 87 days (from 79 just a quarter ago) .... Given no visibility on numbers, stock is tough to recommend here and we would stay on sidelines."

46 12/16/02: "HRC expects 2003 EPS of $0.55-$0.57 vs our estimate of $0.40 and consensus of $0.61...."

47 1/6/03: "In one of the most perplexing developments we have seen in quite some time, HRC has announced that Richard Scrushy will reassume the CEO role at the company and Bill Owens, president and CEO, will go back to being CFO.... Just the 'whipsaw' effect of this reshuffling is likely to stun investors. With the company's credibility already sorely lacking, we just don't see how HRC's management or board can expect the Street to respond favorably or with any comfort to the management musical chairs being played here."

48 3/3/03: "Bottom Line: Disappointing results; EPS well below our estimate and Street consensus estimate; operating expenses came in higher than forecast; EBITDA margin fell to all-time low for HRC to 18.8%...; the company reported a host of restructuring and other charges in the quarter - one charge which we believe will be particularly unnerving to investors is $100 million A/R write-off (roughly 10% of net A/R - a rather significant amount which we believe will raise questions around past revenue); company reaffirmed 1Q03 and 2003 EPS guidance but we do not believe investors will have much confidence in these numbers."

3/3/03: "HRC reported disappointing 4Q02 results with EPS well below our estimate and consensus-lower revenue (stemming from lower Medicare reimbursement in outpatient rehab division) and higher costs contributed to the shortfall.... EPS: The company reaffirmed 1Q03 EPS guidance of $0.13 and full year EPS guidance of $0.55 .... The one charge which we find particularly bothersome is the $100 million A/R write-off .... Management commented that in its standard audit process done at year end, it found reserves to be under by roughly $100 million and that based on more current available info, the company had not been conservative enough in evaluating its older accounts. The company took a mammoth A/R write-off just a few years ago and we find it disconcerting that there hasn't been enough oversight on this front since then."

49 3/21/03: "We are suspending our earnings estimates and price target as we have no basis upon which to forecast earnings. Our view is that if the stock opens for trading tomorrow and is anything above zero, a shareholder should sell."

50 3/24/03: "[W]e have become concerned about the potential for accusations of Medicare cost report fraud at the company.... We also note that the PPS system ... put into place in early 2002 is based on years of historical costs of most all rehab hospitals in the U.S.... As such, if HRC's costs were misrepresented, it calls into question the appropriateness of these rates that were put into effect with the new system."

51 3/28/03: **"[W]e are discontinuing coverage of HealthSouth."**