HEALTHSOUTH CORP
Form 10-Q
August 02, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-10315

HealthSouth Corporation
(Exact name of Registrant as specified in its Charter)

Delaware	63-0860407
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3660 Grandview Parkway, Suite 200 Birmingham, Alabama	35243
(Address of Principal Executive Offices)	(Zip Code)

(205) 967-7116
(Registrant's telephone number)

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

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

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

Large accelerated filer ý Accelerated filer o Smaller reporting company o
Non-Accelerated filer o (Do not check if a smaller reporting company) Emerging growth company o
If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes o No ý

The registrant had 98,734,588 shares of common stock outstanding, net of treasury shares, as of July 25, 2017.

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NOTE TO READERS

As used in this report, the terms "HealthSouth," "we," "us," "our," and the "Company" refer to HealthSouth Corporation and it consolidated subsidiaries, unless otherwise stated or indicated by context. This drafting style is suggested by the Securities and Exchange Commission and is not meant to imply that HealthSouth Corporation, the publicly traded parent company, owns or operates any specific asset, business, or property. The hospitals, operations, and businesses described in this filing are primarily owned and operated by subsidiaries of the parent company. In addition, we use the term "HealthSouth Corporation" to refer to HealthSouth Corporation alone wherever a distinction between HealthSouth Corporation and its subsidiaries is required or aids in the understanding of this filing.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to, among other things, future events, changes to Medicare reimbursement and other healthcare laws and regulations from time to time, our business strategy, our dividend and stock repurchase strategies, our financial plans, our growth plans, our future financial performance, our projected business results, or our projected capital expenditures. In some cases, the reader can identify forward-looking statements by terminology such as "may," "will," "should," "could," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "targets," "potential," or "conti negative of these terms or other comparable terminology. Such forward-looking statements are necessarily estimates based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Any forward-looking statement is based on information current as of the date of this report and speaks only as of the date on which such statement is made. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. While it is impossible to identify all such factors, factors that could cause actual results to differ, such as decreases in revenues or increases in costs or charges, materially from those estimated by us include, but are not limited to, the following:

- each of the factors discussed in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2016, as well as uncertainties and factors, if any, discussed in Part II, Item 1A, Risk Factors, and elsewhere in this Form 10-Q, in our other filings from time to time with the SEC, or in materials incorporated therein by reference;
- changes in the rules and regulations of the healthcare industry at either or both of the federal and state levels, including those contemplated now and in the future as part of national healthcare reform and deficit reduction such as the reinstatement of the "75% Rule" or the introduction of site neutral payments with skilled nursing facilities for certain conditions, payment system reforms, and related increases in the costs of complying with such changes;

- reductions or delays in, or suspension of, reimbursement for our services by governmental or private payors, including our ability to obtain and retain favorable arrangements with third-party payors;
- restrictive interpretations of the regulations governing the claims that are reimbursable by Medicare;
- delays in the administrative appeals process associated with denied Medicare reimbursement claims, including from various Medicare audit programs, and our exposure to the related delay or reduction in the receipt of the reimbursement amounts for services previously provided;
- the ongoing evolution of the healthcare delivery system, including alternative payment models and value-based purchasing initiatives, which may decrease our reimbursement rate or increase costs associated with our operations;
- our ability to comply with extensive and changing healthcare regulations as well as the increased costs of regulatory compliance and compliance monitoring in the healthcare industry, including the costs of investigating and defending asserted claims, whether meritorious or not;
- our ability to attract and retain nurses, therapists, and other healthcare professionals in a highly competitive environment with often severe staffing shortages and the impact on our labor expenses from potential union activity and staffing recruitment and retention;
- competitive pressures in the healthcare industry, including from other providers that may be participating in integrated delivery payment arrangements in which we do not participate, and our response to those pressures;
- changes in our payor mix or the acuity of our patients affecting reimbursement rates;
- our ability to successfully complete and integrate de novo developments, acquisitions, investments, and joint ventures consistent with our growth strategy, including realization of anticipated revenues, cost savings, productivity improvements arising from the related operations and avoidance of unanticipated difficulties, costs or liabilities that could arise from acquisitions or integrations;
- any adverse outcome of various lawsuits, claims, and legal or regulatory proceedings, including the ongoing investigations by the U.S. Departments of Justice and of Health and Human Services, Office of the Inspector General;
- potential incidents affecting the proper operation, availability, or security of our information systems, including the patient information stored there;
- our ongoing rebranding and name change initiative and the impact on our existing operations, including our ability to attract patient referrals to our hospitals as well as the associated costs of rebranding;
- increased costs of defending and insuring against alleged professional liability and other claims and the ability to predict the costs related to claims;
- new or changing quality reporting requirements impacting operational costs or our Medicare reimbursement;
- the price of our common stock as it affects our willingness and ability to repurchase shares and the financial and accounting effects of any repurchases;
- our ability and willingness to continue to declare and pay dividends on our common stock;
- our ability to maintain proper local, state and federal licensing, including compliance with the Medicare conditions of participation, which is required to participate in the Medicare program;
- our ability to attract and retain key management personnel, including as a part of executive management succession planning; and
- general conditions in the economy and capital markets, including any instability or uncertainty related to governmental impasse over approval of the United States federal budget, an increase to the debt ceiling, or an international sovereign debt crisis.

The cautionary statements referred to in this section also should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward-looking statements, even though our situation may change in the future. Furthermore, we cannot guarantee future results, events, levels of activity, performance, or achievements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In Millions)			
Net operating revenues	$981.3	$920.7	$1,956.1	$1,830.5
Less: Provision for doubtful accounts	(13.7)	(15.4)	(30.1)	(31.9)
Net operating revenues less provision for doubtful accounts	967.6	905.3	1,926.0	1,798.6
Operating expenses:				
Salaries and benefits	527.8	486.1	1,057.9	972.2
Other operating expenses	130.5	121.5	259.6	240.7
Occupancy costs	18.3	17.9	36.2	35.9
Supplies	37.1	34.4	74.1	69.4
General and administrative expenses	52.4	34.4	88.9	66.3
Depreciation and amortization	45.8	42.9	91.0	85.3
Professional fees—accounting, tax, and legal	—	1.7	—	1.9
Total operating expenses	811.9	738.9	1,607.7	1,471.7
Loss on early extinguishment of debt	10.4	2.4	10.4	4.8
Interest expense and amortization of debt discounts and fees	40.4	43.4	81.7	88.0
Other income	(0.9)	(0.7)	(1.9)	(1.3)
Equity in net income of nonconsolidated affiliates	(2.0)	(2.4)	(4.1)	(4.8)
Income from continuing operations before income tax expense	107.8	123.7	232.2	240.2
Provision for income tax expense	28.6	42.4	68.3	82.1
Income from continuing operations	79.2	81.3	163.9	158.1
Income (loss) from discontinued operations, net of tax	0.2	(0.1)	(0.1)	(0.2)
Net income	79.4	81.2	163.8	157.9
Less: Net income attributable to noncontrolling interests	(16.4)	(18.6)	(34.0)	(37.3)
Net income attributable to HealthSouth	$63.0	$62.6	$129.8	$120.6

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In Millions, Except Per Share Data)			
Weighted average common shares outstanding:				
Basic	90.3	89.3	89.5	89.4
Diluted	98.9	99.4	99.0	99.4
Earnings per common share:				
Basic earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	$0.70	$0.70	$1.45	$1.34
Discontinued operations	—	—	—	—
Net income	$0.70	$0.70	$1.45	$1.34
Diluted earnings per share attributable to HealthSouth common shareholders:				
Continuing operations	$0.70	$0.65	$1.42	$1.26
Discontinued operations	—	—	—	—
Net income	$0.70	$0.65	$1.42	$1.26
Cash dividends per common share	$0.24	$0.23	$0.48	$0.46
Amounts attributable to HealthSouth common shareholders:				
Income from continuing operations	$62.8	$62.7	$129.9	$120.8
Income (loss) from discontinued operations, net of tax	0.2	(0.1)	(0.1)	(0.2)
Net income attributable to HealthSouth	$63.0	$62.6	$129.8	$120.6

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In Millions)			
COMPREHENSIVE INCOME				
Net income	$79.4	$81.2	$163.8	$157.9
Other comprehensive income, net of tax:				
Net change in unrealized gain on available-for-sale securities:				
Unrealized net holding gain arising during the period	—	0.4	0.4	0.6
Other comprehensive income before income taxes	—	0.4	0.4	0.6
Provision for income tax expense related to other comprehensive income items	—	(0.2)	(0.1)	(0.3)
Other comprehensive income, net of tax	—	0.2	0.3	0.3
Comprehensive income	79.4	81.4	164.1	158.2
Comprehensive income attributable to noncontrolling interests	(16.4)	(18.6)	(34.0)	(37.3)
Comprehensive income attributable to HealthSouth	$63.0	$62.8	$130.1	$120.9

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

HealthSouth Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2017	December 31, 2016
	(In Millions)	
Assets		
Current assets:		
Cash and cash equivalents	$71.1	$ 40.5
Accounts receivable, net of allowance for doubtful accounts of $58.1 in 2017; $53.9 in 2016	426.5	443.8
Other current assets	195.9	170.2
Total current assets	693.5	654.5
Property and equipment, net	1,452.1	1,391.8
Goodwill	1,949.6	1,927.2
Intangible assets, net	404.8	411.3
Deferred income tax assets	102.1	75.8
Other long-term assets	237.9	221.3
Total assets(1)	$4,840.0	$ 4,681.9
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	$38.3	$ 37.1
Accounts payable	77.5	68.3
Accrued expenses and other current liabilities	377.5	370.2
Total current liabilities	493.3	475.6
Long-term debt, net of current portion	2,625.1	2,979.3
Other long-term liabilities	182.6	160.0
	3,301.0	3,614.9
Commitments and contingencies		
Redeemable noncontrolling interests	216.0	138.3
Shareholders' equity:		
HealthSouth shareholders' equity	1,103.7	735.9
Noncontrolling interests	219.3	192.8
Total shareholders' equity	1,323.0	928.7
Total liabilities(1) and shareholders' equity	$4,840.0	$ 4,681.9

(1) Our consolidated assets as of June 30, 2017 and December 31, 2016 include total assets of variable interest entities of $261.5 million and $262.3 million, respectively, which cannot be used by us to settle the obligations of other entities. Our consolidated liabilities as of June 30, 2017 and December 31, 2016 include total liabilities of the variable interest entities of $49.7 million and $50.3 million, respectively. See Note 3, Variable Interest Entities.

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

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

Six Months Ended June 30, 2017
(In Millions)

	HealthSouth Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total
Balance at beginning of period	88.9	$ 1.1	$2,799.1	$(1,448.4)	$ (1.2)	$(614.7)	$ 192.8	$928.7
Net income	—	—	—	129.8	—	—	28.3	158.1
Receipt of treasury stock	(0.9)	—	—	—	—	(19.8)	—	(19.8)
Dividends declared on common stock	—	—	(45.5)	—	—	—	—	(45.5)
Stock-based compensation	—	—	9.7	—	—	—	—	9.7
Stock options exercised	1.1	—	19.7	—	—	(19.3)	—	0.4
Stock warrants exercised	0.7	—	26.6	—	—	—	—	26.6
Distributions declared	—	—	—	—	—	—	(22.9)	(22.9)
Capital contributions from consolidated affiliates	—	—	—	—	—	—	21.1	21.1
Fair value adjustments to redeemable noncontrolling interests, net of tax	—	—	(45.1)	—	—	—	—	(45.1)
Repurchases of common stock in open market	(0.5)	—	—	—	—	(18.1)	—	(18.1)
Conversion of convertible debt, net of tax	8.9	—	53.7	—	—	274.5	—	328.2
Other	0.5	—	0.6	1.1	0.3	(0.4)	—	1.6
Balance at end of period	98.7	$ 1.1	$2,818.8	$(1,317.5)	$ (0.9)	$(397.8)	$ 219.3	$1,323.0

Six Months Ended June 30, 2016
(In Millions)

	HealthSouth Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total
Balance at beginning of period	90.1	$ 1.1	$2,834.9	$(1,696.0)	$ (1.2)	$(527.4)	$ 167.9	$779.3
Net income	—	—	—	120.6	—	—	29.8	150.4
Receipt of treasury stock	(0.4)	—	—	—	—	(9.9)	—	(9.9)
Dividends declared on common stock	—	—	(41.7)	—	—	—	—	(41.7)
Stock-based compensation	—	—	11.5	—	—	—	—	11.5
Stock options exercised	0.2	—	5.4	—	—	(4.7)	—	0.7
Distributions declared	—	—	—	—	—	—	(29.9)	(29.9)

Capital contributions from consolidated affiliates	—	—	—	—	—	—	7.6	7.6
Fair value adjustments to redeemable noncontrolling interests, net of tax	—	—	2.8	—	—	—	—	2.8
Repurchases of common stock in open market	(0.7)	—	—	—	—	(24.1)	—	(24.1)
Other	0.6	—	1.7	—	0.3	(0.6)	1.3	2.7
Balance at end of period	89.8	$ 1.1	$2,814.6	$(1,575.4)	$ (0.9)	$(566.7)	$ 176.7	$849.4

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

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

	Six Months Ended June 30,	
	2017	2016
	(In Millions)	
Cash flows from operating activities:		
Net income	$163.8	$157.9
Loss from discontinued operations, net of tax	0.1	0.2
Adjustments to reconcile net income to net cash provided by operating activities—		
Provision for doubtful accounts	30.1	31.9
Depreciation and amortization	91.0	85.3
Loss on early extinguishment of debt	10.4	4.8
Equity in net income of nonconsolidated affiliates	(4.1)	(4.8)
Distributions from nonconsolidated affiliates	4.4	3.0
Stock-based compensation	28.7	13.1
Deferred tax expense	44.2	73.2
Other, net	6.4	6.9
Change in assets and liabilities, net of acquisitions—		
Accounts receivable	(26.5)	(59.5)
Other assets	(22.0)	(4.3)
Accounts payable	(0.4)	1.2
Accrued payroll	(0.5)	19.2
Other liabilities	7.0	(1.9)
Premium paid on redemption of bonds	—	(3.9)
Net cash used in operating activities of discontinued operations	(0.6)	(0.5)
Total adjustments	168.1	163.7
Net cash provided by operating activities	332.0	321.8

(Continued)

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

	Six Months Ended June 30,	
	2017	2016
	(In Millions)	
Cash flows from investing activities:		
Purchases of property and equipment	(99.9)	(71.4)
Additions to capitalized software costs	(9.7)	(15.2)
Acquisitions of businesses, net of cash acquired	(20.9)	(9.4)
Net change in restricted cash	(12.1)	(11.5)
Other, net	11.0	2.0
Net cash used in investing activities	(131.6)	(105.5)
Cash flows from financing activities:		
Principal payments on debt, including pre-payments	(13.4)	(112.8)
Borrowings on revolving credit facility	105.0	165.0
Payments on revolving credit facility	(187.0)	(145.0)
Repurchases of common stock, including fees and expenses	(18.1)	(24.1)
Dividends paid on common stock	(43.5)	(41.9)
Proceeds from exercising stock warrants	26.6	—
Distributions paid to noncontrolling interests of consolidated affiliates	(24.1)	(33.6)
Taxes paid on behalf of employees for shares withheld	(19.8)	(9.9)
Other, net	4.5	(5.3)
Net cash used in financing activities	(169.8)	(207.6)
Increase in cash and cash equivalents	30.6	8.7
Cash and cash equivalents at beginning of period	40.5	61.6
Cash and cash equivalents at end of period	$71.1	$70.3
Supplemental schedule of noncash financing activity:		
Conversion of convertible debt	$319.4	$—

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.
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HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

HealthSouth Corporation, incorporated in Delaware in 1984, including its subsidiaries, is one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based patient services in 36 states and Puerto Rico through its network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies.

On July 10, 2017, we announced the plan to rebrand and change our name from HealthSouth Corporation to Encompass Health Corporation, effective January 1, 2018. The corporate name change will be accompanied by a NYSE ticker symbol change, from "HLS" to "EHC." Beginning in the first quarter of 2018, both of our business segments will begin transitioning to the Encompass Health name.

The accompanying unaudited condensed consolidated financial statements of HealthSouth Corporation and Subsidiaries should be read in conjunction with the consolidated financial statements and accompanying notes filed with the United States Securities and Exchange Commission in HealthSouth's Annual Report on Form 10-K filed on February 22, 2017 (the "2016 Form 10-K"). The unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the SEC applicable to interim financial information. Certain information and note disclosures included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been omitted in these interim statements, as allowed by such SEC rules and regulations. The condensed consolidated balance sheet as of December 31, 2016 has been derived from audited financial statements, but it does not include all disclosures required by GAAP. However, we believe the disclosures are adequate to make the information presented not misleading.

The unaudited results of operations for the interim periods shown in these financial statements are not necessarily indicative of operating results for the entire year. In our opinion, the accompanying condensed consolidated financial statements recognize all adjustments of a normal recurring nature considered necessary to fairly state the financial position, results of operations, and cash flows for each interim period presented.

See also Note 12, Segment Reporting.

Net Operating Revenues—

We derived consolidated Net operating revenues from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Medicare	75.3 %	74.7 %	75.1 %	75.1 %
Medicare Advantage	8.9 %	8.1 %	8.9 %	7.9 %
Managed care	9.6 %	10.0 %	9.8 %	9.8 %
Medicaid	2.8 %	3.2 %	2.7 %	3.3 %
Other third-party payors	1.3 %	1.4 %	1.3 %	1.4 %
Workers' compensation	0.7 %	0.7 %	0.7 %	0.8 %
Patients	0.4 %	0.5 %	0.5 %	0.5 %
Other income	1.0 %	1.4 %	1.0 %	1.2 %
Total	100.0 %	100.0 %	100.0 %	100.0 %

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Inpatient Rehabilitation Revenues

Our inpatient rehabilitation segment derived its Net operating revenues from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Medicare	72.8 %	73.1 %	73.0 %	73.3 %
Medicare Advantage	8.7 %	7.8 %	8.6 %	7.7 %
Managed care	11.1 %	11.5 %	11.2 %	11.2 %
Medicaid	3.2 %	2.9 %	3.0 %	3.0 %
Other third-party payors	1.6 %	1.7 %	1.6 %	1.7 %
Workers' compensation	0.8 %	0.8 %	0.9 %	1.0 %
Patients	0.5 %	0.6 %	0.5 %	0.6 %
Other income	1.3 %	1.6 %	1.2 %	1.5 %
Total	100.0%	100.0%	100.0%	100.0%

Home Health and Hospice Revenues

Our home health and hospice segment derived its Net operating revenues from the following payor sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Medicare	84.9 %	82.3 %	84.5 %	82.9 %
Medicare Advantage	10.1 %	9.0 %	10.2 %	8.9 %
Managed care	3.5 %	3.7 %	3.7 %	3.2 %
Medicaid	1.3 %	4.8 %	1.4 %	4.8 %
Patients	0.1 %	0.1 %	0.1 %	0.1 %
Other income	0.1 %	0.1 %	0.1 %	0.1 %
Total	100.0%	100.0%	100.0%	100.0%

See Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2016 Form 10-K for our policies related to Net operating revenues, Accounts receivable, and our Allowance for doubtful accounts.

Recent Accounting Pronouncements—

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" and has subsequently issued supplemental and/or clarifying ASUs (collectively "ASC 606"). ASC 606 outlines a five-step framework that intends to clarify the principles for recognizing revenue and eliminate industry-specific guidance. In addition, ASC 606 revises current disclosure requirements in an effort to help financial statement users better understand the nature, amount, timing, and uncertainty of revenue that is recognized. ASC 606 will be effective for our annual reporting period beginning on January 1, 2018, including interim periods within that year. Early adoption beginning on January 1, 2017 is permitted. ASC 606 may be applied retrospectively to each period presented or on a modified retrospective basis with the cumulative effect recognized as of the date of adoption. We are currently assessing the impact this guidance may have on our consolidated financial statements by analyzing our current portfolio of third-party payor contracts, including a review of historical accounting policies and practices to identify potential differences in applying the new guidance. We are also evaluating the nature and amount of data available to us in assessing implementation of ASC 606. Under ASC 606, substantially all amounts that were previously presented as Provision for doubtful accounts will be considered an implicit price concession in determining Net operating revenues.

HealthSouth Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Amounts considered to be doubtful accounts under ASC 606 will be presented as a component of Total operating expenses within the consolidated statements of operations. We expect to adopt ASC 606 retrospectively effective January 1, 2018.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities." This standard revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. This revised standard requires the change in fair value of many equity investments to be recognized in Net income. This revised standard is effective for our interim and annual periods beginning January 1, 2018. While we are currently assessing the impact this guidance may have on our consolidated financial statements, we expect to recognize mark-to-market gains and losses associated with our available-for-sale equity securities through Net income instead of Accumulated other comprehensive income. We continue to review the requirements of this revised standard and any potential impact it may have on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," in order to increase transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the new standard, lessees will recognize a right-of-use asset and a corresponding lease liability for all leases other than leases that meet the definition of a short-term lease. The liability will be equal to the present value of future minimum lease payments. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in an expense pattern similar to current capital leases. Classification will be based on criteria that are similar to those applied in current lease accounting. This standard will be effective for our annual reporting period beginning on January 1, 2019. Early adoption is permitted. In transition, we will be required to recognize and measure leases beginning in the earliest period presented using a modified retrospective approach; therefore, we anticipate restating our consolidated financial statements for the two fiscal years prior to the year of adoption. While we are currently assessing the impact this guidance may have on our consolidated financial statements, we expect that virtually all of our existing operating leases will be reflected as right-of-use assets and liabilities on our consolidated balance sheets under the new standard. We do not expect to early adopt this standard. See Note 6, Property and Equipment, to the consolidated financial statements accompanying the 2016 Form 10-K for disclosure related to our operating leases.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting (Topic 718)," to simplify various aspects of share-based payment accounting and presentation. The new standard requires entities to record all of the tax effects related to share-based payments at settlement (or expiration) through the income statement. This change is required to be applied prospectively to all excess tax benefits and tax deficiencies resulting from settlements after the date of adoption of the ASU. The standard eliminates the requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis. In addition, all income tax-related cash flows resulting from share-based windfall tax benefits are required to be reported as operating activities on the statement of cash flows as opposed to the current presentation as an inflow from financing activities and an outflow from operating activities. Either prospective or retrospective transition of this provision is permitted. The standard also clarifies that all cash payments made to taxing authorities on the employees' behalf for withheld shares should be presented as financing activities on the statement of cash flows. This change will be applied retrospectively. Finally, the standard allows entities to make an accounting policy election to either estimate forfeitures for each period or account for forfeitures as they occur. For HealthSouth, this guidance is effective for its annual reporting period beginning January 1, 2017, including interim periods within that reporting period. As a result of our adoption of this guidance effective January 1, 2017, we recorded $7.4 million and $8.6 million of tax benefits in excess of compensation cost ("windfalls") to Provision for income tax expense in our condensed consolidating statement of operations for the three and six months ended June 30, 2017, respectively. We elected to retrospectively apply the change to our condensed consolidating statements of cash flows, which will result in a reclassification of windfalls of $17.3 million from Cash flows from financing activities to Cash flows from operating activities for the year ended December 31, 2016. We also elected to retrospectively apply the change to the presentation of cash payments made to taxing authorities on the employees' behalf for withheld shares on our condensed consolidating statements of cash flows for the six months ended June 30, 2016, which resulted in a reclassification of $9.9 million from Cash flows from operating activities to Cash flows from financing activities. We did not elect an accounting policy change to record forfeitures as they occur and thus will continue to estimate forfeitures at each period. The adoption of this guidance did not have a material impact on our consolidated financial statements.

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In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326)," which provides guidance for accounting for credit losses on financial instruments. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments and modifies the impairment model for available-for-sale debt securities. The new guidance is effective for HealthSouth for the annual period beginning January 1, 2020, including interim periods within that reporting period. Early adoption is permitted for HealthSouth beginning January 1, 2019. We continue to review the requirements of this standard and any potential impact it may have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments," to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. In addition, the standard clarifies when cash receipts and cash payments have aspects of more than one class of cash flows and cannot be separated, classification will depend on the predominant source or use. The new guidance requires retrospective application and is effective for HealthSouth for the annual reporting period beginning January, 1 2018, including interim periods within that reporting period. Early adoption is permitted. We continue to review the requirements of this standard and any potential impact it may have on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230), Restricted Cash," to clarify how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance requires amounts generally described as restricted cash and restricted cash equivalents be included with Cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. The new guidance requires retrospective application and is effective for our annual reporting period beginning January 1, 2018, including interim periods within that reporting period. Early adoption is permitted. We continue to review the requirements of this revised standard and any potential impact it may have on our consolidated financial statements.

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. Business Combinations

Inpatient Rehabilitation

During the six months ended June 30, 2017, we completed the following inpatient rehabilitation acquisitions, none of which were individually material to our financial position, results of operations, or cash flows. Each acquisition was made to enhance our position and ability to provide inpatient rehabilitation services to patients in the applicable geographic areas.

- In April 2017, we acquired approximately 80% of Memorial Hospital at Gulfport, a 33-bed inpatient rehabilitation hospital in Gulfport, Mississippi, through a joint venture with Memorial Hospital at Gulfport. This acquisition was funded on March 31, 2017 using cash on hand.
- In April 2017, we also acquired 80% of Mount Carmel West, an inpatient rehabilitation unit in Columbus, Ohio, through a joint venture with Mount Carmel Health System. This acquisition was funded through a contribution of a 60 bed de novo inpatient rehabilitation hospital to the consolidated joint venture.

We accounted for these transactions under the acquisition method of accounting and reported the results of operations of the acquired hospitals from their respective dates of acquisition. Assets acquired were recorded at their estimated fair values as of the respective acquisition dates. The fair values of the identifiable intangible assets were based on valuations using the income approach. The income approach is based on management's estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill. The goodwill reflects our expectations of our ability to gain access to and penetrate the acquired hospital's historical patient base and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets. None of the goodwill recorded as a result of these transactions is deductible for federal income tax purposes.

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The fair value of the assets acquired at the acquisition date were as follows (in millions):

Identifiable intangible assets:	
Noncompete agreements (useful lives of 2 to 3 years)	$0.4
Trade name (useful life of 20 years)	0.5
Certificate of need (useful life of 20 years)	4.7
Goodwill	15.0
Total assets acquired	$20.6

Information regarding the net cash paid for the inpatient rehabilitation acquisitions during each period presented is as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Fair value of assets acquired	$5.6	$ —	$5.6	$5.3
Goodwill	15.0	—	15.0	1.8
Fair value of noncontrolling interest owned by joint venture partner	(9.7)	—	(9.7)	(7.1)
Prepaid acquisition consideration	(10.9)	—	—	—
Net cash paid for acquisition	$—	$ —	$10.9	$—

Home Health and Hospice

During the six months ended June 30, 2017, we completed the following home health acquisitions, none of which were individually material to our financial position, results of operations, or cash flows. Each acquisition was made to enhance our position and ability to provide post-acute healthcare services to patients in the applicable geographic areas. Each acquisition was funded using cash on hand.

- In February 2017, we acquired the assets of Celtic Healthcare of Maryland, Inc., a home health provider with locations in Owings Mill, Maryland and Rockville, Maryland.
- In February 2017, we also acquired the assets of two home health locations from Community Health Services, Inc., located in Owensboro, Kentucky and Elizabethtown, Kentucky.
- In May 2017, we acquired the assets of two home health locations from Bio Care Home Health Services, Inc. and Kinsman Enterprises, Inc., located in Irving, Texas and Longview, Texas.

We accounted for these transactions under the acquisition method of accounting and reported the results of operations of the acquired locations from their respective dates of acquisition. Assets acquired or liabilities assumed were recorded at their estimated fair values as of the respective acquisition dates. The fair values of identifiable intangible assets were based on valuations using the cost and income approaches. The cost approach is based on amounts that would be required to replace the asset (i.e., replacement cost). The income approach is based on management’s estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill. The goodwill reflects our expectations of our ability to utilize the acquired locations’ mobile workforce and established relationships within each community and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets. All goodwill recorded as a result of these transactions is deductible for federal income tax purposes.

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The fair value of the assets acquired and liabilities assumed at the acquisition date were as follows (in millions):

Total current assets	$0.1
Identifiable intangible asset:	
Noncompete agreements (useful lives of 5 years)	0.2
Trade name (useful life of 1 year)	0.1
Certificates of need (useful lives of 10 years)	0.7
Licenses (useful lives of 10 years)	1.6
Goodwill	7.4
Total assets acquired	10.1
Total liabilities assumed	(0.1)
Net assets acquired	$10.0

Information regarding the net cash paid for the home health acquisitions during each period presented is as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Fair value of assets acquired	$1.4	$1.4	$2.7	$1.4