Vale S.A.
Form 6-K
October 02, 2017


# United States

# Securities and Exchange Commission

**Washington, D.C. 20549**

# FORM 6-K

**Report of Foreign Private Issuer**

**Pursuant to Rule 13a-16 or 15d-16**

**of the**

**Securities Exchange Act of 1934**

**For the month of**

**September 2017**

# Vale S.A.

**Avenida das Américas, No. 700 Bloco 8, Sala 218**
**22640-100 Rio de Janeiro, RJ, Brazil**

(Address of principal executive office)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

(Check One) Form 20-F x Form 40-F o

(Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1))

(Check One) Yes o No x

(Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7))

(Check One) Yes o No x

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

(Check One) Yes o No x

(If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b). 82- .)

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PUBLICLY HELD COMPANY

National Corporate Taxpayer Number (*Cadastro Nacional de Pessoas Jurídicas* CNPJ) 33.592.510/0001-54

**EXTRAORDINARY SHAREHOLDERS MEETING**

**NOTICE OF MEETING**

The Shareholders of Vale S.A. ( Vale or the Company ) are invited to meet in an Extraordinary Shareholders Meeting, to be held on October 18, 2017, at 10 a.m., at the address Avenida das Américas n. 700, 2nd floor, room 218 (auditorium), Città America, Barra da Tijuca, in this City, in order to vote on the following items on the Agenda:

I. Amend Vale s By-laws to implement certain adjustments and improvements described below, namely:

1. Amend the head paragraph of Art. 5 to reflect the composition of the Company s capital stock after the corporate restructuring;

2. Modify the head paragraph of Art. 9, to set forth that the Secretary of the Meeting will henceforth be appointed by the Chairman of the Meeting;

3. Amend the Sole Paragraph of Art. 9 which becomes §1, in order to set forth that any person appointed by the Chairman of the Board of Directors may preside over the Meeting, in cases of absence or temporary impediment of the Chairman or Vice-Chairman of the Board of Directors or their respective alternates;

4. Include §2 to Art. 9 to establish that the minutes of the meetings will be drawn up in the form of summary and that they will be signed by enough shareholders needed to constitute the quorum necessary for approval of the items;

5. Amend Art. 14, item XVIII, to set forth that the secretary of governance shall be appointed by the Board of Directors, and, as a result, exclude §15 of Art. 11 and §2 of Art. 13 that mentioned the Secretary of the Board of Directors;

6. Modify Art. 14, item XXVI, to clarify the wording on the provision of guarantees in general by the Company;

7. Include §3 in Art. 14 in order to establish that Vale and its subsidiaries are prohibited from contributing to political parties, and to their representatives or candidates;

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8. Amend the head paragraph of Art. 15 to create the Financial Committee, Personnel Committee, Compliance and Risk Committee, Audit Committee and Sustainability Committee;

9. Adapt the wording of §1 of Art. 18 on the appointment of members of Vale s Advisory Committees ( Committees );

10. Amend the title and head paragraph of Art. 19 to determine that the working and responsibilities of the Committees shall be defined by the Board of Directors in the internal rules of each of the Committees;

11. Due to the amendment above, exclude Subsection IV, Arts. 20 to 25, with the consequent renumbering of the other articles of the By-laws and updating of the cross references mentioned in the current Arts. 14, XVII; 31, §1; 33, V and VI; 34, IV; 46; 49, I; 51, §§ 5th, 6th and 8th; 53; 54; 55 and 56;

12. Include §3 in Art.19 to set forth that it is the Board of Directors duty, within its legal limits, to determine that certain responsibilities of the Fiscal Council will henceforth be exercised, exclusively, by the Audit Committee; and

13. Include a cross reference in §1 of Art. 39 to set forth that certain additional responsibilities of the Fiscal Council will henceforth be exercised by the Audit Committee;

II. Proposal for conversion of all class A preferred shares issued by the Company into common shares at the ratio of 0.9342 common shares to each class A preferred share; and

III. Election of two independent members of the Board of Directors in order to fill vacant positions until the end of the management term of the current Board of Directors.

The effectiveness of the vote made with regard to item II of the Agenda shall be subject to prior approval of the item by holders of more than half of the class A preferred shares, meeting in a Special Shareholders Meeting, to be held on the same date, pursuant to §1 of Art. 136 of Law No. 6,404/1976 and amendments.

All the relevant documentation regarding the items to be voted on in the Shareholders Meeting are available to the shareholders at Vale s head office, on its website (http://www.vale.com) and on the websites of the Brazilian Securities and Exchange Commission (*Comissão de Valores*

*Mobiliários*) (www.cvm.gov.br), the B3 Brazilian Stock Exchange (*B3 S.A. Brasil, Bolsa, Balcão*) (www.b3.com.br) and the Securities and Exchange Commission (www.sec.gov).

The shareholder may participate in the Meeting in person or through a duly established proxy, observing the terms of §1 of Art. 126 of Law 6,404/76. In this case, the proxy must have been established within one (1) year and be a shareholder, administrator, lawyer registered with the Brazilian Bar Association or a financial institution. As provided in Circular Letter/CVM/SEP/No.01/2017, legal entity shareholders may be represented at the Meeting through their legal representatives or through duly constituted agents, in

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accordance with the company s formation documents and under the rules of the Brazilian Civil Code, and in this specific case there is no need for the agent to be a shareholder, an administrator of the company or a lawyer. Similarly, the shareholders that are investment funds, as decided by the CVM Board in the scope of CVM Administrative Procedure No. RJ-2014-3578, may be represented at the Meeting through legal representatives or through agents duly established by their manager or administrator, as provided under their by-laws.

We inform that the shareholder should appear at the Meeting providing proof of ownership of Vale shares issued within four (4) business days prior to the date of the Meeting, by the depository financial institution or custodian, as well as: **(a)** in the case of an individual shareholder, valid photo I.D. or, if applicable, the I.D. of the shareholder s proxy and respective power of attorney; **(b)** in the case of a legal entity shareholder, the valid photo I.D. of the legal representative and the documents proving representation, including the proxy appointment and copy of the formation documents and of the minutes of the election of the administrators, and, **(c)** in the case of investment fund, the valid photo I.D. of the legal representative and the documents proving representation, including the proxy appointment and copy of the fund by-laws in force, of the formation documents of its administrator or manager, as the case may be, and minutes of the election of the administrators of the administrator or manager. If such documents are in a foreign language, they must be translated into Portuguese by a sworn translator, and notarization and consularization shall not be necessary. It should be noted that documents in English and Spanish do not need to be translated.

The representation documents will be checked to ensure they are in order before the Meeting is held.

To expedite the process of conducting the Meeting, we request that the shareholders who will be represented by proxy kindly deliver the documents proving representation, as mentioned above, at least 72 (seventy-two) hours prior to the Meeting.

The Company shall also allow its shareholders, for this Shareholders Meeting, to exercise their voting rights through absentee ballot. In this case, by October 11, 2017 (inclusive), the shareholder must transmit instructions for completion, sending the respective absentee ballot to: 1) the depository of the Company s shares; 2) their respective custodians that render this service, in the case of shareholders holding shares deposited in the central depository; or 3) directly to the Company. For additional information, the shareholder shall comply with the rules set forth in CVM Instruction 481/2009 and the procedures described in the absentee ballot provided by the Company, as well as the respective Manual for Participation in the Meeting.

Rio de Janeiro, September 15, 2017.

**Gueitiro Matsuo Genso**

**Chairman of the Board of Directors**

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**Manual for Participation**

**in the Vale S.A.**

**Extraordinary Shareholders Meeting**

**October 18, 2017**

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**Exhibit II** Information about the candidates to the two available positions on the Board of Directors, as set forth in Art. 10 of CVM Instruction 481/2009.

**Exhibit III** Report in table form, detailing the origin and justification of the amendments proposed to Vale s By-Laws, including any legal and economic effects, as well as the draft of Vale s By-Laws, highlighting the proposal for wording of each provisions of the by-laws to be changed, pursuant to article 11 of CVM Instruction 481/2009.

**Exhibit IV** Information required by article 17 of CVM Instruction 481/2009.

**Exhibit V** Information required by article 20 of CVM Instruction 481/2009.

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## I. Notice of Meeting

The Shareholders of Vale S.A. ( Vale or Company ) are hereby called to the Extraordinary Shareholders Meeting which will be held on October 18, 2017, at 10 a.m., at the address Avenida das Américas no. 700, 2nd floor, Room 218 (auditorium), Città America, Barra da Tijuca, in the city of Rio de Janeiro, in order to vote on the following items on the Agenda:

I. Amendment to Vale s By-Laws to implement certain adjustments and improvements described below, namely:

1. Amend the head paragraph of Art. 5 to reflect the composition of the Company s capital stock after the corporate restructuring;

2. Modify the head paragraph of Art. 9, to set forth that the Secretary of the Meeting become to be appointed by the Chairman of the Meeting;

3. Amend Sole Paragraph of Art. 9 which becomes §1, in order to provide that any person appointed by the Chairman of the Board of Directors presided over by the Meeting, in cases of absence or temporary impediment of the Chairman or vice-chairman of the Board of Directors of their respective alternates;

4. Include §2 to Art. 9 to establish that the minutes of the meetings will be drawn up in the form of summary and that they will be signed by enough shareholders needed to constitute the quorum necessary for approval of the items;

5. Amend Art. 14, item XVIII, to set forth that the secretary of governance shall be appointed by the Board of Directors, and, as a result, exclude §15 of Art. 11 and §2 of Art. 13 that mentioned the Secretary of the Board of Directors;

6. Modify Art. 14, item XXVI, to clarify the wording on the provision of guarantees in general by the Company;

7. Include §3 in Art. 14 in order to establish that Vale and its subsidiaries are prohibited from contributing to political parties, and to their representatives or candidates;

8. Amend the head paragraph of Art. 15 to organize the Financial Committee, Personnel Committee, Compliance and Risk Committee, Audit Committee and Sustainability Committee;

9. Adapt the wording of §1 of Art. 18 on the appointment of members of Vale s Advisory Committees ( Committees );

10. Amend the title and head paragraph of Art. 19 to determine that the working and responsibilities of the Committees shall be defined by the Board of Directors in the internal rules of each of the Committees;

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11. Due to the amendment above, exclude Subsection IV, Arts. 20 to 25, with the consequent renumbering of the other articles of the By-laws and updating of the cross references mentioned in the current Arts. Arts. 14, XVII; 31, §1; 33, V and VI; 34, IV; 46; 49, I; 51, §§ 5th, 6th and 8th; 53; 54; 55 and 56;

12. Include §3 in Art.19 to set forth that it is the Board of Directors duty, within its legal limits, to determine that certain responsibilities of the Fiscal Council will henceforth be exercised, exclusively, by the Audit Committee; and

13. Include a cross reference in §1 of Art. 39 to set forth that certain additional responsibilities of the Fiscal Council will henceforth be exercised by the Audit Committee;

II. Proposal for conversion of all class A preferred shares issued by the Company into common shares at the ratio of 0.9342 common shares to each class A preferred share; and

III. Election of two independent members of the Board of Directors in order to fill vacant positions until the end of the management term of the current Board of Directors.

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## II. Procedures for Participation in the Meeting

The shareholders participation in the Extraordinary Shareholders Meeting ( Meeting ) is of utmost importance. For the Meeting to be held, the presence of at least ¼ (one quarter) of the Company s capital stock with voting rights is necessary to vote on the issues set forth in items (ii) and (iii) of the Meeting s Agenda, and 2/3 (two thirds) of the Company s capital stock with voting rights is necessary to address the proposals of the amendments to the by-laws, item (i) of the Meeting s Agenda. If either of these quorums is not met, the Company will publish a new Notice of Meeting announcing the new date for the Meeting to be held at second call to address the pending subjects, which can be held with the presence of any number of shareholders.

Vale s shareholders may attend the Shareholders Meeting **in person**, by **a duly constituted proxy**, or **by sending an absentee ballot, pursuant to** CVM Instruction 481/2009 of the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* CVM ), as amended ( CVM Instruction 481/2009 ).

### 2.1. Participation in Person

The following documents are required for shareholders to participate in person in the Meeting:

| | |
|---|---|
| **Individual** | • valid photo I.D. (original or certified copy) of the shareholder. The following documents may be submitted: (i) Identity Card (RG); (ii) Foreigner s Identity Card (RNE); (iii) Passport; (iv) Professional Association card accepted as identification for legal purposes (for example, OAB, CRM, CRC, CREA); or (v) Driver s License (CNH).<br><br>• proof of ownership of shares issued by Vale issued by the depository financial institution or custodian up to four (4) business days before the date of the Meeting. |

| | |
|---|---|
| **Legal Entity** | • valid photo I.D. of the legal representative (original or certified copy). The following documents may be submitted: (i) Identity Card (RG) or Foreigner s Identity Card (RNE); (ii) Passport; (iii) Professional Association card accepted as identification for legal purposes (for example, OAB, CRM, CRC, CREA); or (iv) Driver s License (CNH).<br><br>• documents proving representation, including the proxy appointment and copy of the formation documents and of the minutes of the election of |

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the directors, and, in the case of investment fund, copies of (i) the fund by-laws in force, (ii) the formation documents of its director or manager, as the case may be, and (iii) the election of such directors. If such documents are in a foreign language, they must be translated into Portuguese by a sworn translator, and notarization and consularization shall not be necessary. It should be noted that documents in English and Spanish do not need to be translated either.

- proof of ownership of shares issued by Vale issued by the depository financial institution or custodian up to four (4) business days before the date of the Meeting.

We remind you that the documents will be checked to ensure they are in order before the beginning of the Meeting. For this reason, the shareholders are requested to kindly arrive in advance of the aforementioned Meeting so that the documents can be duly checked in a timely manner for their participation.

## 2.2. Participation by Proxy

Shareholder participation in the Meeting can be through a duly constituted proxy, observing the terms of Art. 126, §1 of Law no. 6,404 of December 15, 1976, as amended ( Law 6,404/76 ). The proxy must have been nominated less than one (1) year previously, and be a shareholder, a manager, a lawyer registered with the Brazilian Bar Association (*Ordem de Advogados do Brasil* OAB), or be a financial institution, and the members of investment funds must be represented by their fund management company.

Pursuant to the provisions set forth in Circular-Letter/CVM/SEP/no. 01/2017, shareholders that are **legal entities** may be represented in the shareholders meeting by their legal representatives or by a duly constituted proxy in accordance with the provisions of their respective formation documents and the Brazilian Civil Code. In this specific case, it is not required that the proxy of the legal entity shareholder be qualified as a shareholder, a company manager or a lawyer. Accordingly, **investment fund** shareholders, pursuant to the decision of the CVM Board under CVM Administrative Proceeding no. RJ-2014-3578, may be represented in the shareholders meeting through legal representatives or through proxies duly constituted by their manager or director, in accordance with their by-laws. In any case, it should be noted that **legal entity** shareholders and **investment fund** shareholders who wish to be represented in the Meeting by proxy must submit, in addition to the proxy appointment and proxy s I.D., all the documents mentioned in item 2.1 above.

Any proxy written in a foreign language must be accompanied by the corporate documents, in the case of a legal entity, and the proxy instrument, all duly translated into Portuguese by a sworn translator, and notarization and consularization shall not be

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necessary. It should be noted that documents in English and Spanish do not need to be translated.

In item VI of this Manual, there is a proxy template for the shareholders reference. Shareholders may also use proxies other than that suggested in this Manual, as long as they are in accordance with the provisions of Law 6,404/76 and the Brazilian Civil Code.

To expedite the process of conducting the Meeting, those shareholders represented through a power of attorney (proxy) may, at their sole and exclusive discretion, send the representation documents at least 72 (seventy-two) hours prior to aforementioned Meeting, to the following address:

**Attn.: Investor Relations Officer**

Avenida das Américas no. 700, bloco 8, 2 andar, sala 218

Barra da Tijuca Rio de Janeiro RJ

Despite the above-mentioned deadline, we point out that the shareholder who appears by the start of the Meeting with the required documents will be entitled to participate and vote, even if he or she has not submitted them to the Company in advance.

We remind you that the representation documents will be checked before the beginning of the Meeting to ensure they are in order. For this reason, shareholders are requested to kindly arrive in advance of the Meeting so that the documents necessary for their participation can be duly checked in timely manner for their participation.

## 2.3. Participation of Holders of American Depositary Shares (ADSs)

Holders of ADSs may attend the Meeting, in which they will be represented by Citibank N.A. (Citibank), as a depository financial institution, observing the terms and procedures set forth in the Deposit Agreement signed with Vale. Citibank will send the voting cards (proxies) to the ADS holders so that they may exercise their voting rights, and will be representing in the Meeting through its representative in Brazil, Banco Bradesco S.A.

## 2.4. Participation by Absentee Ballot

As set forth in art. 21-A and subsequent articles of CVM Instruction 481/2009, the Company s shareholders may send, as of this date, their voting instructions with respect to the matters addressed at the Meeting by completing and sending the absentee ballot ( Ballot ), attached as Exhibit I to this Manual. The content of the Ballot should reflect Exhibit 21-F of CVM Instruction 481/2009, which unites all the proposals for vote included in the Meeting s Agenda.

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The Ballot must:

- be accessed, to be printed and completed in advance, under the banner AGE 10.18.2017 on the first page of the Company s website (www.vale.com), as well as on the website of the CVM; and

- be received at least seven (7) days prior to the Meeting date, i.e., by 10.11.2017 (inclusive). Any voting ballots received after this date will be disregarded.

The shareholder opting to exercise his or her vote through the Ballot must do so through one of the following options:

(i) through instructions for completion transmitted to the Company s depository;

(ii) through instructions for completion transmitted to their respective custodians, in the case of shareholders holding shares deposited in a central depository; or

(iii) through sending the Ballot directly to the Company.

After the deadline for absentee voting, namely, as of 10.12.2017, the shareholders can no longer change the voting instructions sent, except at the Meeting, in person or through a duly constituted proxy, upon specific request to disregard the voting instructions sent by Ballot, before the respective matter is put up to vote.

**2.4.1. Through instructions for completion transmitted to the Company s depository**

This option is exclusively for shareholders holding shares deposited with Banco Bradesco S.A. and that are not deposited in the central depository:

The shareholder holding shares that are not deposited in the central depository namely, at the *B3 S.A. Brasil, Bolsa, Balcão* (São Paulo Stock Exchange) ( B3 ) and who opts to exercise his or her right to absentee voting through providers of depository services of the Company s shares, Banco Bradesco S.A. ( Bradesco ), shall appear at any one of Bradesco s 5,300 branches at least 7 days before the Meeting date, during the local banking hours, and submit the completed Ballot, initialed and signed, as well as the documents identified in the table below, so that the information in the Ballot may be transferred to Bradesco s systems.

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| Documents to be submitted at the Bradesco branch, together with the Ballot | Individual | Legal Entity | Investment Fund |
|---|---|---|---|
| CPF and Photo ID of the shareholder or legal representative * | x | x | x |
| Formation Documents, consolidated and updated ** | o | x | x |
| Document proving powers of representation ** | o | x | x |
| Consolidated and updated fund by-laws | o | o | x |

* Types of I.D. accepted: RG, RNE, CNH, Passport and officially recognized professional association card.

** For investment funds, manager and/or administrator documents, observing the voting policy.

Under art. 21-B of CVM Instruction 481/2009, the shareholder must transmit the instructions for completing the Ballot to the depository agent at least seven (7) days before the Meeting is conducted, i.e., by 10.11.2017 (inclusive).

Shareholders with questions may contact Bradesco as follows:

Tel: 0800 701 1616

e-mail: 4010.acecustodia@bradesco.com.br

**Bradesco informs that the information above was inserted solely so the shareholder can have a channel to ask any questions related to sending the ballot to the depository agent. However, Bradesco shall not accept the receipt of Ballots through electronic mail, and only ballots submitted through any Bradesco branch shall be considered, in the terms and conditions set forth in this Manual.**

### 2.4.2. Through instructions for completion transmitted to their respective custodians

This option is exclusively for shareholders holding shares under custody of the central depository i.e., at B3. In this case, the absentee vote shall be exercised by shareholders in accordance with the procedures adopted by their respective custodians.

The shareholder holding the shares deposited in the Central Depository of B3 and who opts to exercise his or her right to absentee vote through service providers must transmit their voting instructions to their respective custodians, observing the rules established by them, which, in turn, shall forward such voting intentions to the Central Depository of B3.

To do so, the shareholders should get in touch with their respective custodians and check the procedures established by them to issue the voting instructions through the Ballot, as well as the documents and information they require to exercise such right, in order to send the respective ballot in a timely manner for their participation.

Under art. 21-B of CVM Instruction 481/2009, the shareholder must transmit the instructions for completing the Ballot to their custodians at least seven days before the Meeting is conducted, i.e., by 10.11.2017 (inclusive), unless a different deadline, which must colspan="2" valign="bottom" style="padding:0in 0in 0in 0in;width:12.0%;">

| | |
|---|---|
| | 16,095 |
| | 16,095 |
| Due to third party payors | |
| | 5,526 |
| | 6,011 |
| | 5,526 |
| | 6,011 |
| Total Current Liabilities | |
| | 383,938 |

| | |
|---|---|
| | 380,969 |
| | 386,062 |
| | 380,516 |
| Long-term debt, net of current portion | |
| | 1,385,950 |
| | 1,399,039 |
| | 1,218,650 |
| | 1,231,739 |
| Non-current deferred tax liability | |

| | |
|---|---|
| | 82,028 |
| | 85,029 |
| | 82,028 |
| | 85,029 |
| Other non-current liabilities | |
| | 64,905 |
| | 69,459 |
| | 64,905 |
| | 69,459 |

| | |
|---|---|
| Total Liabilities | 1,916,821 |
| | 1,934,496 |
| | 1,751,645 |
| | 1,766,743 |
| Stockholders Equity: | |

| | | |
|---|---|---|
| Common stock of Holdings, $0.001 par value, 700,000,000 shares authorized, 145,268,190 shares and 142,158,133 shares issued and outstanding in 2011 and 2012, respectively | 145 | 142 |
| Common stock of Select, $0.01 par value, 100 shares issued and outstanding | 0 | 0 |
| Capital in excess of par | 493,828 | 479,547 |

| | |
|---|---|
| | 848,844 |
| | 850,800 |
| Retained earnings | |
| | 328,882 |
| | 359,990 |
| | 137,778 |
| | 155,316 |
| Total Select Medical Holdings Corporation and Select Medical Corporation Stockholders Equity | |
| | 822,855 |
| | 839,679 |
| | 986,622 |
| | 1,006,116 |
| Non-controlling interest | |
| | 32,471 |

| | |
|---|---|
| | 32,403 |
| | 32,471 |
| | 32,403 |
| Total Equity | |
| | 855,326 |
| | 872,082 |
| | 1,019,093 |
| | 1,038,519 |
| **Total Liabilities and Equity** | |

| | |
|---|---|
| $ | 2,772,147 |
| $ | 2,806,578 |
| $ | 2,770,738 |
| $ | 2,805,262 |

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

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**Consolidated Statements of Operations**

**(unaudited)**

**(in thousands, except per share amounts)**

| | Select Medical Holdings Corporation For the Quarter Ended March 31, 2011 | Select Medical Holdings Corporation For the Quarter Ended March 31, 2012 | Select Medical Corporation For the Quarter Ended March 31, 2011 | Select Medical Corporation For the Quarter Ended March 31, 2012 |
|---|---|---|---|---|
| Net operating revenues | $ 693,186 | $ 744,021 | $ 693,186 | $ 744,021 |
| Costs and expenses: | | | | |
| Cost of services | 557,416 | 611,619 | 557,416 | 611,619 |
| General and administrative | 16,566 | 14,224 | 16,566 | 14,224 |
| Bad debt expense | 14,350 | 10,375 | 14,350 | 10,375 |
| Depreciation and amortization | 17,222 | 16,199 | 17,222 | 16,199 |
| Total costs and expenses | 605,554 | 652,417 | 605,554 | 652,417 |
| Income from operations | 87,632 | 91,604 | 87,632 | 91,604 |
| Other income and expense: | | | | |
| Equity in earnings (losses) of unconsolidated subsidiaries | (73) | 2,465 | (73) | 2,465 |
| Interest income | 56 | | 56 | |
| Interest expense | (25,664) | (23,922) | (18,662) | (21,250) |
| Income before income taxes | 61,951 | 70,147 | 68,953 | 72,819 |
| Income tax expense | 26,564 | 27,575 | 29,014 | 28,510 |
| Net income | 35,387 | 42,572 | 39,939 | 44,309 |
| Less: Net income attributable to non-controlling interests | 1,715 | 1,030 | 1,715 | 1,030 |
| Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation | $ 33,672 | $ 41,542 | $ 38,224 | $ 43,279 |
| Income per common share: | | | | |
| Basic | $ 0.22 | $ 0.29 | | |
| Diluted | $ 0.22 | $ 0.29 | | |

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

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**Select Medical Holdings Corporation**

**Consolidated Statement of Changes in Equity and Income**

**(unaudited)**

**(in thousands)**

| | | | Select Medical Holdings Corporation Stockholders | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **Total** | **Common Stock Issued** | | **Common Stock Par Value** | | **Capital in Excess of Par** | | **Retained Earnings** | | **Non-controlling Interests** |
| Balance at December 31, 2011 | $ | 855,326 | 145,268 | $ | 145 | $ | 493,828 | $ | 328,882 | $ | 32,471 |
| Net income | | 42,572 | | | | | | | 41,542 | | 1,030 |
| Issuance and vesting of restricted stock | | 960 | 65 | | 0 | | 960 | | | | |
| Exercise of stock options | | 95 | 29 | | 0 | | 95 | | | | |
| Stock option expense | | 300 | | | | | 300 | | | | |
| Repurchase of common shares | | (25,739) | (3,204) | | (3) | | (15,302) | | (10,434) | | |
| Distributions to non-controlling interests | | (1,098) | | | | | | | | | (1,098) |
| Other | | (334) | | | | | (334) | | | | |
| Balance at March 31, 2012 | $ | 872,082 | 142,158 | $ | 142 | $ | 479,547 | $ | 359,990 | $ | 32,403 |

**Select Medical Corporation**

**Consolidated Statement of Changes in Equity and Income**

**(unaudited)**

**(in thousands)**

| | | | Select Medical Corporation Stockholders | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **Total** | **Common Stock Issued** | | **Common Stock Par Value** | | **Capital in Excess of Par** | | **Retained Earnings** | | **Non-controlling Interests** |
| Balance at December 31, 2011 | $ | 1,019,093 | 0 | $ | 0 | $ | 848,844 | $ | 137,778 | $ | 32,471 |
| Net income | | 44,309 | | | | | | | 43,279 | | 1,030 |
| Federal tax benefit of losses contributed by Holdings | | 935 | | | | | 935 | | | | |
| Additional investment by Holdings | | 95 | | | | | 95 | | | | |
| Net change in dividends payable to Holdings | | 5,240 | | | | | | | 5,240 | | |
| Dividends declared and paid to Holdings | | (30,981) | | | | | | | (30,981) | | |
| | | (1,098) | | | | | | | | | (1,098) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Distributions to non-controlling interests | | | | | | |
| Other | (334) | | | (334) | | |
| Contribution related to restricted stock awards and stock option issuances by Holdings | 1,260 | | | 1,260 | | |
| Balance at March 31, 2012 | $ 1,038,519 | 0 | $ 0 | $ 850,800 | $ 155,316 | $ 32,403 |

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

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**Consolidated Statements of Cash Flows**

**(unaudited)**

**(in thousands)**

| | Select Medical Holdings Corporation For the Three Months Ended March 31, 2011 | Select Medical Holdings Corporation For the Three Months Ended March 31, 2012 | Select Medical Corporation For the Three Months Ended March 31, 2011 | Select Medical Corporation For the Three Months Ended March 31, 2012 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net income | $ 35,387 | $ 42,572 | $ 39,939 | $ 44,309 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | |
| Depreciation and amortization | 17,222 | 16,199 | 17,222 | 16,199 |
| Provision for bad debts | 14,350 | 10,375 | 14,350 | 10,375 |
| Loss (gain) from disposal or sale of assets | 188 | (3,550) | 188 | (3,550) |
| Non-cash stock compensation expense | 880 | 1,261 | 880 | 1,261 |
| Amortization of debt discount | 507 | 311 | | 311 |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | |
| Accounts receivable | (100,135) | (62,319) | (100,135) | (62,319) |
| Other current assets | (3,076) | (4,419) | (3,076) | (4,419) |
| Other assets | 2,052 | 2,028 | 1,914 | 1,935 |
| Accounts payable | 11,777 | (1,560) | 11,777 | (1,560) |
| Due to third-party payors | (474) | 485 | (474) | 485 |
| Accrued expenses | (9,948) | (20,585) | (3,588) | (17,922) |
| Income and deferred taxes | 26,238 | 27,382 | 28,688 | 28,317 |
| Net cash provided by (used in) operating activities | (5,032) | 8,180 | 7,685 | 13,422 |
| **Investing activities** | | | | |
| Purchases of property and equipment | (12,920) | (11,751) | (12,920) | (11,751) |
| Proceeds from sale of assets | 250 | 16,511 | 250 | 16,511 |
| Investment in business | | (7,840) | | (7,840) |
| Acquisition of businesses, net of cash acquired | (2,000) | | (2,000) | |
| Net cash used in investing activities | (14,670) | (3,080) | (14,670) | (3,080) |
| **Financing activities** | | | | |
| Borrowings on revolving credit facilities | 205,000 | 230,000 | 205,000 | 230,000 |
| Payments on revolving credit facilities | (105,000) | (215,000) | (105,000) | (215,000) |
| Payments on 2011 credit facility term loans | | (2,125) | | (2,125) |
| Payments on 2005 credit facility term loans | (59,563) | | (59,563) | |
| Borrowings of other debt | 5,496 | 5,835 | 5,496 | 5,835 |
| Principal payments on other debt | (2,494) | (2,328) | (2,494) | (2,328) |
| Dividends paid to Holdings | | | (14,743) | (30,981) |
| Repurchase of common stock | (2,026) | (25,739) | | |
| Proceeds from issuance of common stock | 81 | 95 | | |
| Equity investment by Holdings | | | 81 | 95 |
| Proceeds from (repayment of) bank overdrafts | (9,418) | 2,491 | (9,418) | 2,491 |
| Distributions to non-controlling interests | (1,671) | (1,098) | (1,671) | (1,098) |
| Net cash provided by (used in) financing activities | 30,405 | (7,869) | 17,688 | (13,111) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net increase (decrease in) cash and cash equivalents | | 10,703 | | (2,769) | | 10,703 | | (2,769) |
| | | | | | | | | |
| Cash and cash equivalents at beginning of period | | 4,365 | | 12,043 | | 4,365 | | 12,043 |
| Cash and cash equivalents at end of period | $ | 15,068 | $ | 9,274 | $ | 15,068 | $ | 9,274 |
| | | | | | | | | |
| **Supplemental Cash Flow Information** | | | | | | | | |
| Cash paid for interest | $ | 41,365 | $ | 31,285 | $ | 28,648 | $ | 26,042 |
| Cash paid for taxes | $ | 103 | $ | 204 | $ | 103 | $ | 204 |

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

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**SELECT MEDICAL HOLDINGS CORPORATION AND SELECT MEDICAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## 1. Basis of Presentation

Select Medical Corporation ( Select ) was formed in December 1996 and commenced operations during February 1997 upon the completion of its first acquisition. Select Medical Holdings Corporation ( Holdings ) was formed in October 2004 for the purpose of affecting a leveraged buyout of Select, which was a publicly traded entity. On February 24, 2005, Select merged with a subsidiary of Holdings, which resulted in Select becoming a wholly-owned subsidiary of Holdings (the Merger ). On September 30, 2009 Holdings completed its initial public offering of common stock. Generally accepted accounting principles ( GAAP ) require that any amounts recorded or incurred (such as goodwill and compensation expense) by the parent as a result of the Merger or for the benefit of the subsidiary be pushed down and recorded in Select s consolidated financial statements. Holdings and Select and their subsidiaries are collectively referred to as the Company. The consolidated financial statements of Holdings include the accounts of its wholly-owned subsidiary Select. Holdings conducts substantially all of its business through Select and its subsidiaries.

The unaudited condensed consolidated financial statements of the Company as of March 31, 2012 and for the three month period ended March 31, 2011 and 2012 have been prepared in accordance with GAAP. In the opinion of management, such information contains all adjustments, which are normal and recurring in nature, necessary for a fair statement of the financial position, results of operations and cash flow for such periods. All significant intercompany transactions and balances have been eliminated. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2012.

Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted consistent with the rules and regulations of the Securities and Exchange Commission (the SEC ), although the Company believes the disclosure is adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011 contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2012.

## 2. Accounting Policies

### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

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**Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income ( Update 2011-05 ) that improves the comparability, consistency and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. Update 2011-05 requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income ( OCI ) to net income, in both net income and OCI. Update 2011-05 does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, Update 2011-05 does not affect the calculation or reporting of earnings per share. Update 2011-05 was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and is to be applied retrospectively. The Company adopted Update 2011-05 on January 1, 2012. Update 2011-05 had no effect on the Company s presentation of other comprehensive income for the three months ended March 31, 2011 and 2012 because the Company did not have any items of other comprehensive income during these periods.

**3. Intangible Assets**

The Company s intangible assets consist of the following:

| | As of March 31, 2012 Gross Carrying Amount (in thousands) | Accumulated Amortization |
|---|---|---|
| Amortized intangible assets: | | |
| Non-compete agreements | $ 25,909 | $ (25,824) |
| | | |
| Indefinite-lived intangible assets: | | |
| Goodwill | $ 1,631,383 | |
| Trademarks | 57,709 | |
| Certificates of need | 11,914 | |
| Accreditations | 2,160 | |
| Total | $ 1,703,166 | |

The Company s accreditations and trademarks have renewal terms. The costs to renew these intangibles are expensed as incurred. At March 31, 2012, the accreditations and trademarks have a weighted average time until next renewal of approximately 1.5 years and 8.2 years, respectively.

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Amortization expense for the Company s intangible assets with finite lives follows:

| | | Three Months Ended March 31, 2011 | | 2012 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Amortization expense | $ | 326 | $ | 255 |

Amortization expense for the Company s intangible assets primarily relates to the amortization of the value associated with the non-compete agreement entered into in connection with the acquisition of the outpatient rehabilitation division of HealthSouth Corporation. The useful life of the outpatient rehabilitation division of HealthSouth Corporation s non-compete is five years. Amortization expense related to this intangible asset for each of the next five years commencing January 1, 2012 is approximately as follows (in thousands):

| | | |
|---|---|---|
| 2012 | $ | 340 |
| 2013 | | 0 |
| 2014 | | 0 |
| 2015 | | 0 |
| 2016 | | 0 |

The changes in the carrying amount of goodwill for the Company s reportable segments for the three months ended March 31, 2012 are as follows:

| | | Specialty Hospitals | | Outpatient Rehabilitation (in thousands) | | Total |
|---|---|---|---|---|---|---|
| Balance as of December 31, 2011 | $ | 1,333,553 | $ | 298,163 | $ | 1,631,716 |
| Other | | (333) | | | | (333) |
| Balance as of March 31, 2012 | $ | 1,333,220 | $ | 298,163 | $ | 1,631,383 |

**4. Restructuring Reserves**

In connection with the acquisition of substantially all of the outpatient rehabilitation division of HealthSouth Corporation, the Company recorded an estimated liability of $18.7 million in 2007 for business restructuring which was accounted for as additional purchase price. This reserve primarily included costs associated with workforce reductions and lease termination costs in accordance with the Company s restructuring plan.

In connection with the acquisition of all the issued and outstanding equity securities of Regency Hospital Company, L.L.C. ( Regency ), an operator of long term acute care hospitals, the Company recorded an estimated liability of $4.3 million in 2010 for business restructuring related to lease termination costs.

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The following summarizes the Company s restructuring activity:

| | | Lease Termination Costs (in thousands) |
|---|---|---|
| December 31, 2011 | $ | 5,027 |
| Amounts paid in 2012 | | (435) |
| Accretion expense | | 83 |
| Revision of estimate | | (350) |
| March 31, 2012 | $ | 4,325 |

The Company expects to pay out the remaining lease termination costs through 2014 for the acquisition of the outpatient rehabilitation division of HealthSouth Corporation and through 2015 for the Regency acquisition.

**5. Fair Value**

Financial instruments include cash and cash equivalents, notes payable and long-term debt. The carrying amount of cash and cash equivalents approximates fair value because of the short-term maturity of these instruments.

The carrying value of Select s senior secured credit facility was $878.0 million and $891.2 million at December 31, 2011 and March 31, 2012, respectively. The fair value of Select s senior secured credit facility was $823.3 million and $859.0 million at December 31, 2011 and March 31, 2012, respectively. The fair value of Select s senior secured credit facility was based on quoted market prices for this debt in the syndicated loan market.

The carrying value of Select s 7 5/8% senior subordinated notes was $345.0 million at both December 31, 2011 and March 31, 2012. The fair value of Select s 7 5/8% senior subordinated notes was $326.4 million and $341.1 million at December 31, 2011 and March 31, 2012, respectively. The fair value of this registered debt was based on quoted market prices.

The carrying value of Holdings senior floating rate notes was $167.3 million at both December 31, 2011 and March 31, 2012. The fair value of Holdings senior floating rate notes was $143.9 million and $147.6 million at December 31, 2011 and March 31, 2012, respectively. The fair value of this registered debt was based on quoted market prices.

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**6. Segment Information**

The Company s reportable segments consist of (i) specialty hospitals and (ii) outpatient rehabilitation. All other represents amounts associated with corporate activities and non-healthcare related services. The outpatient rehabilitation reportable segment has two operating segments: outpatient rehabilitation clinics and contract therapy. These operating segments are aggregated for reporting purposes as they have common economic characteristics and provide a similar service to a similar patient base. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance of the segments based on Adjusted EBITDA. Adjusted EBITDA is defined as net income before interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, equity in earnings (losses) of unconsolidated subsidiaries, and other income (expense).

The following tables summarize selected financial data for the Company s reportable segments for the three months ended March 31, 2011 and 2012. The segment results of Holdings are identical to those of Select with the exception of total assets:

| | Three Months Ended March 31, 2011 | | | |
|---|---|---|---|---|
| | Specialty Hospitals | Outpatient Rehabilitation | All Other | Total |
| | (in thousands) | | | |
| Net operating revenue | $ 519,924 | $ 173,191 | $ 71 | $ 693,186 |
| Adjusted EBITDA | 100,353 | 21,406 | (16,025) | 105,734 |
| Total assets: | | | | |
| Select Medical Corporation | 2,140,798 | 482,444 | 178,201 | 2,801,443 |
| Select Medical Holdings Corporation | 2,140,798 | 482,444 | 180,577 | 2,803,819 |
| Capital expenditures | 10,487 | 2,181 | 252 | 12,920 |

| | Three Months Ended March 31, 2012 | | | |
|---|---|---|---|---|
| | Specialty Hospitals | Outpatient Rehabilitation | All Other | Total |
| | (in thousands) | | | |
| Net operating revenue | $ 553,038 | $ 190,899 | $ 84 | $ 744,021 |
| Adjusted EBITDA | 99,954 | 22,478 | (13,368) | 109,064 |
| Total assets: | | | | |
| Select Medical Corporation | 2,222,825 | 437,364 | 145,073 | 2,805,262 |
| Select Medical Holdings Corporation | 2,222,825 | 437,364 | 146,389 | 2,806,578 |
| Capital expenditures | 7,051 | 3,791 | 909 | 11,751 |

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A reconciliation of Adjusted EBITDA to income before income taxes is as follows (in thousands):

| | Three Months Ended March 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Specialty Hospitals | Outpatient Rehabilitation | All Other | Select Medical Holdings Corporation | Select Medical Corporation |
| Adjusted EBITDA | $ 100,353 | $ 21,406 | $ (16,025) | | |
| Depreciation and amortization | (12,046) | (4,459) | (717) | | |
| Stock compensation expense | | | (880) | | |
| Income (loss) from operations | $ 88,307 | $ 16,947 | $ (17,622) | $ 87,632 | $ 87,632 |
| Equity in losses of unconsolidated subsidiaries | | | | (73) | (73) |
| Interest expense, net | | | | (25,608) | (18,606) |
| Income before income taxes | | | | $ 61,951 | $ 68,953 |

| | Three Months Ended March 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Specialty Hospitals | Outpatient Rehabilitation | All Other | Select Medical Holdings Corporation | Select Medical Corporation |
| Adjusted EBITDA | $ 99,954 | $ 22,478 | $ (13,368) | | |
| Depreciation and amortization | (11,843) | (3,650) | (706) | | |
| Stock compensation expense | | | (1,261) | | |
| Income (loss) from operations | $ 88,111 | $ 18,828 | $ (15,335) | $ 91,604 | $ 91,604 |
| Equity in earnings of unconsolidated subsidiaries | | | | 2,465 | 2,465 |
| Interest expense, net | | | | (23,922) | (21,250) |
| Income before income taxes | | | | $ 70,147 | $ 72,819 |

**7. Income per Common Share**

The Company applies the two-class method for calculating and presenting income per common share. The two-class method is an earnings allocation formula that determines earnings per share for each class of stock participation rights in undistributed earnings. Effective January 1, 2009 the Financial Accounting Standards Board ( FASB ) clarified that share based payment awards that have not yet vested meet the definition of a participating security provided the right to receive the dividend is non-forfeitable and non-contingent. Participating securities are defined as securities that participate in dividends with common stock according to a predetermined formula. These participating securities should be included in the computation of basic earnings per share under the two class method. Based upon the clarification made by FASB, the Company

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concluded that its non-vested restricted stock awards meet the definition of a participating security and should be included in the Company s computation of basic earnings per share.

The following table sets forth for the periods indicated the calculation of net income per share in the Company s consolidated statement of operations and the differences between basic weighted average shares outstanding and diluted weighted average shares outstanding used to compute basic and diluted earnings per share, respectively:

| | For the Three Months Ended March 31, 2011 | | 2012 | |
|---|---|---|---|---|
| | (in thousands, except per share data) | | | |
| Numerator: | | | | |
| Net income attributable to Select Medical Holdings Corporation | $ | 33,672 | $ | 41,542 |
| Less: Earnings allocated to unvested restricted stockholders | | 361 | | 633 |
| Net income available to common stockholders | $ | 33,311 | $ | 40,909 |
| | | | | |
| Denominator: | | | | |
| Weighted average shares basic | | 152,838 | | 141,426 |
| Effect of dilutive securities: | | | | |
| Stock options | | 218 | | 214 |
| Weighted average shares diluted | | 153,056 | | 141,640 |
| | | | | |
| Basic income per common share | $ | 0.22 | $ | 0.29 |
| Diluted income per common share | $ | 0.22 | $ | 0.29 |

The following share amounts are shown here for informational and comparative purposes only since their inclusion would be anti-dilutive:

| | Three Months Ended March 31, 2011 | 2012 |
|---|---|---|
| | (in thousands) | |
| Stock options | 2,372 | 2,415 |

**8. Commitments and Contingencies**

**Litigation**

The Company is a party to various legal actions, proceedings and claims (some of which are not insured), and regulatory and other governmental audits and investigations in the ordinary course of its business. The Company cannot predict the ultimate outcome of pending litigation, proceedings and regulatory and other governmental audits and investigations. These matters could potentially subject us to sanctions, damages,

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recoupments, fines and other penalties. The Department of Justice, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company s businesses in the future that may, either individually or in the aggregate, have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

To cover claims arising out of the operations of the Company s specialty hospitals and outpatient rehabilitation facilities, the Company maintains professional malpractice liability insurance and general liability insurance, subject to self-insured retention of $2.0 million per medical incident for professional liability claims and $2.0 million per occurrence for general liability claims. The Company also maintains umbrella liability insurance covering claims which, due to their nature or amount, are not covered by or not fully covered by the Company s other insurance policies. These insurance policies also do not generally cover punitive damages and are subject to various deductibles and policy limits. Significant legal actions could subject the Company to substantial uninsured liabilities. In the Company s opinion, the outcome of these actions, individually or in the aggregate, will not have a material adverse effect on its financial position, results of operations, or cash flows.

Healthcare providers are subject to lawsuits under the qui tam provisions of the federal False Claims Act. Qui tam lawsuits typically remain under seal (hence, usually unknown to the defendant) for some time while the government decides whether or not to intervene on behalf of a private qui tam plaintiff (known as a relator) and take the lead in the litigation. These lawsuits can involve significant monetary damages and penalties and award bounties to private plaintiffs who successfully bring the suits. The Company has been a defendant in these cases in the past, and may be named as a defendant in similar cases from time to time in the future.

During April 2012, the Company s long term acute care hospital in Evansville, Indiana ( SSH Evansville ) received two subpoenas from the Office of Attorney General for the State of Indiana. One subpoena demanded certain patient medical records of SSH Evansville. The second subpoena demanded reports and documents related to SSH Evansville for various periods beginning in 2006, including certain financial, statistical, billing and quality reports; certain policies and procedures; joint venture board meeting minutes and documents related to certain complaints and internal investigations. Two days later, SSH-Evansville received a Request for Information or Assistance from the Office of Inspector General of the U.S. Department of Health and Human Services (Indianapolis, Indiana Field Office) covering the period beginning in 2007 seeking substantially the same records demanded by the Office of Attorney General for the State of Indiana, additional patient medical records of SSH Evansville and additional documents and information of SSH Evansville, including documents concerning SSH Evansville s relationships with its joint venture partner and eight other identified persons and entities. Separately, also in April 2012, the Company s long term acute care hospital in Beech Grove, Indiana received a request from an investigator with the Medicaid Fraud Control Unit of the Office of Attorney General for the State of Indiana to produce the medical records of a single patient. On May 1, 2012, the Evansville (Indiana) Police Department executed a search warrant at SSH-Evansville purporting to seek evidence pertaining to the crime of theft. The search warrant sought various items of personal property, including copy machines, facsimile machines, printers and personal communication devices, and various documents and business records regarding SSH-Evansville for a period beginning in May 2004, including claims for Medicaid and Medicare payment, EOB forms, patient files, Medicaid and Medicare reimbursement manuals, personnel files, complaints and investigations of employees, contractors and physicians and other documents. The Company has produced and will continue to produce documents in response to these requests, and intends to fully cooperate with these government investigations. At this time, the Company is unable to predict the timing and outcome of this matter.

**Construction Commitments**

At March 31, 2012, the Company had outstanding commitments under construction contracts related to new construction, improvements and renovations at the Company s long term acute care properties and inpatient rehabilitation facilities totaling approximately $6.1 million.

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**9. Financial Information for Subsidiary Guarantors and Non-Guarantor Subsidiaries under Select s 7 5/8% Senior Subordinated Notes**

Select s 7 5/8% senior subordinated notes are fully and unconditionally guaranteed, except for customary limitations, on a senior subordinated basis by all of Select s wholly-owned subsidiaries (the Subsidiary Guarantors ). Certain of Select s subsidiaries did not guarantee the 7 5/8% senior subordinated notes (the Non-Guarantor Subsidiaries ).

Select conducts a significant portion of its business through its subsidiaries. Presented below is condensed consolidating financial information for Select, the Subsidiary Guarantors and the Non-Guarantor Subsidiaries at December 31, 2011 and March 31, 2012 and for the three months ended March 31, 2011 and 2012.

The equity method has been used by Select with respect to investments in subsidiaries. The equity method has been used by Subsidiary Guarantors with respect to investments in Non-Guarantor Subsidiaries. Separate financial statements for Subsidiary Guarantors are not presented.

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**Select Medical Corporation**
**Condensed Consolidating Balance Sheet**
**March 31, 2012**
**(unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Current Assets: | | | | | |
| Cash and cash equivalents | $ 5,255 | $ 3,355 | $ 664 | $ | $ 9,274 |
| Accounts receivable, net | | 419,428 | 46,259 | | 465,687 |
| Current deferred tax asset | 13,388 | 2,798 | 3,708 | | 19,894 |
| Other current assets | 10,817 | 19,262 | 4,099 | | 34,178 |
| Total Current Assets | 29,460 | 444,843 | 54,730 | | 529,033 |
| Property and equipment, net | 14,844 | 421,174 | 55,755 | | 491,773 |
| Investment in affiliates | 2,798,795 | 74,531 | | (2,873,326)(a) (b) | |
| Goodwill | | 1,631,383 | | | 1,631,383 |
| Other identifiable intangibles | | 71,868 | | | 71,868 |
| Assets held for sale | 2,742 | | | | 2,742 |
| Other assets | 25,832 | 51,852 | 779 | | 78,463 |
| **Total Assets** | $ 2,871,673 | $ 2,695,651 | $ 111,264 | $ (2,873,326) | $ 2,805,262 |
| **Liabilities and Equity** | | | | | |
| Current Liabilities: | | | | | |
| Bank overdrafts | $ 19,100 | $ | $ | $ | $ 19,100 |
| Current portion of long-term debt and notes payable | 12,519 | 365 | 1,567 | | 14,451 |
| Accounts payable | 8,755 | 72,263 | 13,040 | | 94,058 |
| Intercompany accounts | 968,181 | (880,432) | (87,749) | | |
| Accrued payroll | 95 | 70,296 | 243 | | 70,634 |
| Accrued vacation | 4,219 | 43,784 | 6,698 | | 54,701 |
| Accrued interest | 5,286 | 203 | | | 5,489 |
| Accrued restructuring | | 4,325 | | | 4,325 |
| Accrued other | 36,427 | 52,441 | 6,784 | | 95,652 |
| Income taxes payable | 16,095 | | | | 16,095 |
| Due to third party payors | | 18,661 | (12,650) | | 6,011 |
| Total Current Liabilities | 1,070,677 | (618,094) | (72,067) | | 380,516 |
| Long-term debt, net of current portion | 749,069 | 419,086 | 63,584 | | 1,231,739 |
| Non-current deferred tax liability | (3,660) | 79,745 | 8,944 | | 85,029 |
| Other non-current liabilities | 49,471 | 19,608 | 380 | | 69,459 |
| Total Liabilities | 1,865,557 | (99,655) | 841 | | 1,766,743 |
| Stockholder s Equity: | | | | | |
| Common stock | 0 | | | | 0 |
| Capital in excess of par | 850,800 | | | | 850,800 |
| Retained earnings | 155,316 | 669,785 | 18,861 | (688,646)(b) | 155,316 |
| Subsidiary investment | | 2,125,521 | 59,159 | (2,184,680)(a) | |
| Total Select Medical Corporation Stockholder s Equity | 1,006,116 | 2,795,306 | 78,020 | (2,873,326) | 1,006,116 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Non-controlling interest | | | | | | 32,403 | | | | 32,403 |
| Total Equity | | 1,006,116 | | 2,795,306 | | 110,423 | | (2,873,326) | | 1,038,519 |
| **Total Liabilities and Equity** | $ | 2,871,673 | $ | 2,695,651 | $ | 111,264 | $ | (2,873,326) | $ | 2,805,262 |

(a) Elimination of investments in consolidated subsidiaries.

(b) Elimination of investments in consolidated subsidiaries earnings.

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**Select Medical Corporation**
**Condensed Consolidating Statement of Operations**
**For the Quarter Ended March 31, 2012**
**(Unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Net operating revenues | $ 84 | $ 644,325 | $ 99,612 | $ | $ 744,021 |
| | | | | | |
| Costs and expenses: | | | | | |
| Cost of services | 489 | 525,465 | 85,665 | | 611,619 |
| General and administrative | 14,110 | 114 | | | 14,224 |
| Bad debt expense | | 8,842 | 1,533 | | 10,375 |
| Depreciation and amortization | 705 | 13,170 | 2,324 | | 16,199 |
| Total costs and expenses | 15,304 | 547,591 | 89,522 | | 652,417 |
| | | | | | |
| Income (loss) from operations | (15,220) | 96,734 | 10,090 | | 91,604 |
| | | | | | |
| Other income and expense: | | | | | |
| Intercompany interest and royalty fees | (793) | 785 | 8 | | |
| Intercompany management fees | 29,374 | (25,083) | (4,291) | | |
| Equity in earnings of unconsolidated subsidiaries | | 2,455 | 10 | | 2,465 |
| Interest expense | (12,974) | (7,198) | (1,078) | | (21,250) |
| | | | | | |
| Income from operations before income taxes | 387 | 67,693 | 4,739 | | 72,819 |
| | | | | | |
| Income tax expense (benefit) | (235) | 28,527 | 218 | | 28,510 |
| Equity in earnings of subsidiaries | 42,657 | 3,499 | | (46,156)(a) | |
| | | | | | |
| Net income | 43,279 | 42,665 | 4,521 | (46,156) | 44,309 |
| | | | | | |
| Less: Net income attributable to non-controlling interests | | | 1,030 | | 1,030 |
| | | | | | |
| Net income attributable to Select Medical Corporation | $ 43,279 | $ 42,665 | $ 3,491 | $ (46,156) | $ 43,279 |

(a) Elimination of equity in earnings of subsidiaries.

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**Select Medical Corporation**
**Condensed Consolidating Statement of Cash Flows**
**For the Quarter Ended March 31, 2012**
**(Unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Operating activities** | | | | | |
| Net income | $ 43,279 | $ 42,665 | $ 4,521 | $ (46,156)(a) | $ 44,309 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | |
| Depreciation and amortization | 705 | 13,170 | 2,324 | | 16,199 |
| Provision for bad debts | | 8,842 | 1,533 | | 10,375 |
| Loss (gain) from disposal of assets | | (3,565) | 15 | | (3,550) |
| Non-cash stock compensation expense | 1,261 | | | | 1,261 |
| Amortization of debt discount | 311 | | | | 311 |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | | |
| Equity in earnings of subsidiaries | (42,657) | (3,499) | | 46,156(a) | |
| Intercompany | (9,083) | 11,082 | (1,999) | | |
| Accounts receivable | | (60,482) | (1,837) | | (62,319) |
| Other current assets | (4,477) | 82 | (24) | | (4,419) |
| Other assets | 2,554 | (693) | 74 | | 1,935 |
| Accounts payable | 1,402 | (3,944) | 982 | | (1,560) |
| Due to third-party payors | | 5,028 | (4,543) | | 485 |
| Accrued expenses | (17,577) | (286) | (59) | | (17,922) |
| Income and deferred taxes | 28,317 | | | | 28,317 |
| Net cash provided by operating activities | 4,035 | 8,400 | 987 | | 13,422 |
| **Investing activities** | | | | | |
| Purchases of property and equipment | (909) | (7,438) | (3,404) | | (11,751) |
| Proceeds from sale of assets | | 16,511 | | | 16,511 |
| Investment in business | | (7,840) | | | (7,840) |
| Net cash provided by (used in) investing activities | (909) | 1,233 | (3,404) | | (3,080) |
| **Financing activities** | | | | | |
| Borrowings on revolving credit facility | 230,000 | | | | 230,000 |
| Payments on revolving credit facility | (215,000) | | | | (215,000) |
| Payments on 2011 credit facility term loans | (2,125) | | | | (2,125) |
| Borrowings of other debt | 5,557 | | 278 | | 5,835 |
| Principal payments on other debt | (1,893) | (137) | (298) | | (2,328) |
| Dividends paid to Holdings | (30,981) | | | | (30,981) |
| Equity investment by Holdings | 95 | | | | 95 |
| Repayment of bank overdrafts | 2,491 | | | | 2,491 |
| Intercompany debt reallocation | 2,558 | (6,141) | 3,583 | | |
| Distributions to non-controlling interests | | | (1,098) | | (1,098) |
| Net cash provided by (used in) financing activities | (9,298) | (6,278) | 2,465 | | (13,111) |
| Net increase (decrease) in cash and cash equivalents | (6,172) | 3,355 | 48 | | (2,769) |

| | | | | | |
|---|---|---|---|---|---|
| Cash and cash equivalents at beginning of period | 11,427 | | 616 | | 12,043 |
| Cash and cash equivalents at end of period | $ 5,255 | $ 3,355 | $ 664 | $ | $ 9,274 |

(a) Elimination of equity in earnings of consolidated subsidiaries.

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**Select Medical Corporation**
**Condensed Consolidating Balance Sheet**
**December 31, 2011**
**(unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries (in thousands) | Eliminations | Consolidated |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Current Assets: | | | | | |
| Cash and cash equivalents | $ 11,427 | $ | $ 616 | $ | $ 12,043 |
| Accounts receivable, net | | 369,321 | 44,422 | | 413,743 |
| Current deferred tax asset | 11,415 | 3,221 | 3,669 | | 18,305 |
| Prepaid income taxes | 9,497 | | | | 9,497 |
| Other current assets | 6,340 | 19,407 | 4,075 | | 29,822 |
| Total Current Assets | 38,679 | 391,949 | 52,782 | | 483,410 |
| | | | | | |
| Property and equipment, net | 14,641 | 440,736 | 54,651 | | 510,028 |
| Investment in affiliates | 2,751,776 | 83,772 | | (2,835,548)(a) (b) | |
| Goodwill | | 1,631,716 | | | 1,631,716 |
| Other identifiable intangibles | | 72,123 | | | 72,123 |
| Assets held for sale | 2,742 | | | | 2,742 |
| Other assets | 28,386 | 41,480 | 853 | | 70,719 |
| | | | | | |
| **Total Assets** | $ 2,836,224 | $ 2,661,776 | $ 108,286 | $ (2,835,548) | $ 2,770,738 |
| | | | | | |
| **Liabilities and Equity** | | | | | |
| Current Liabilities: | | | | | |
| Bank overdrafts | $ 16,609 | $ | $ | $ | $ 16,609 |
| Current portion of long-term debt and notes payable | 8,853 | 390 | 1,605 | | 10,848 |
| Accounts payable | 7,353 | 76,207 | 12,058 | | 95,618 |
| Intercompany accounts | 975,809 | (880,537) | (95,272) | | |
| Accrued payroll | 229 | 82,518 | 141 | | 82,888 |
| Accrued vacation | 3,703 | 41,305 | 6,242 | | 51,250 |
| Accrued interest | 11,843 | 137 | | | 11,980 |
| Accrued restructuring | | 5,027 | | | 5,027 |
| Accrued other | 47,829 | 51,086 | 7,401 | | 106,316 |
| Due to third party payors | | 13,633 | (8,107) | | 5,526 |
| Total Current Liabilities | 1,072,228 | (610,234) | (75,932) | | 386,062 |
| | | | | | |
| Long-term debt, net of current portion | 733,328 | 425,315 | 60,007 | | 1,218,650 |
| Non-current deferred tax liability | (2,509) | 75,750 | 8,787 | | 82,028 |
| Other non-current liabilities | 46,555 | 17,970 | 380 | | 64,905 |
| | | | | | |
| Total Liabilities | 1,849,602 | (91,199) | (6,758) | | 1,751,645 |
| | | | | | |
| Stockholder s Equity: | | | | | |
| Common stock | 0 | | | | 0 |
| Capital in excess of par | 848,844 | | | | 848,844 |
| Retained earnings | 137,778 | 627,120 | 23,154 | (650,274)(b) | 137,778 |
| Subsidiary investment | | 2,125,855 | 59,419 | (2,185,274)(a) | |
| Total Select Medical Corporation Stockholder s Equity | 986,622 | 2,752,975 | 82,573 | (2,835,548) | 986,622 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Non-controlling interest | | | | | | 32,471 | | | | 32,471 |
| Total Equity | | 986,622 | | 2,752,975 | | 115,044 | | (2,835,548) | | 1,019,093 |
| **Total Liabilities and Equity** | $ | 2,836,224 | $ | 2,661,776 | $ | 108,286 | $ | (2,835,548) | $ | 2,770,738 |

(a) Elimination of investments in consolidated subsidiaries.

(b) Elimination of investments in consolidated subsidiaries earnings.

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**Select Medical Corporation**
**Condensed Consolidating Statement of Operations**
**For the Quarter Ended March 31, 2011**
**(unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Net operating revenues | $ 71 | $ 600,253 | $ 92,862 | $ | $ 693,186 |
| Costs and expenses: | | | | | |
| Cost of services | 638 | 481,222 | 75,556 | | 557,416 |
| General and administrative | 16,455 | 111 | | | 16,566 |
| Bad debt expense | | 13,001 | 1,349 | | 14,350 |
| Depreciation and amortization | 646 | 14,356 | 2,220 | | 17,222 |
| Total costs and expenses | 17,739 | 508,690 | 79,125 | | 605,554 |
| Income (loss) from operations | (17,668) | 91,563 | 13,737 | | 87,632 |
| Other income and expense: | | | | | |
| Intercompany interest and royalty fees | (995) | 986 | 9 | | |
| Intercompany management fees | 23,472 | (19,230) | (4,242) | | |
| Equity in earnings (losses) of unconsolidated subsidiaries | | (88) | 15 | | (73) |
| Interest income | 31 | 24 | 1 | | 56 |
| Interest expense | (7,365) | (9,949) | (1,348) | | (18,662) |
| Income (loss) before income taxes | (2,525) | 63,306 | 8,172 | | 68,953 |
| Income tax expense | 926 | 27,820 | 268 | | 29,014 |
| Equity in earnings of subsidiaries | 41,675 | 5,797 | | (47,472)(a) | |
| Net income | 38,224 | 41,283 | 7,904 | (47,472) | 39,939 |
| Less: Net income attributable to non-controlling interests | | | 1,715 | | 1,715 |
| Net income attributable to Select Medical Corporation | $ 38,224 | $ 41,283 | $ 6,189 | $ (47,472) | $ 38,224 |

(a) Elimination of equity in earnings of subsidiaries.

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**Select Medical Corporation**
**Condensed Consolidating Statement of Cash Flows**
**For the Quarter Ended March 31, 2011**
**(unaudited)**

| | Select Medical Corporation (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Operating activities** | | | | | |
| Net income | $ 38,224 | $ 41,283 | $ 7,904 | $ (47,472)(a) | $ 39,939 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | | |
| Depreciation and amortization | 646 | 14,356 | 2,220 | | 17,222 |
| Provision for bad debts | | 13,001 | 1,349 | | 14,350 |
| Loss from disposal of assets | 2 | 181 | 5 | | 188 |
| Non-cash stock compensation expense | 880 | | | | 880 |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | | |
| Equity in earnings of subsidiaries | (41,675) | (5,797) | | 47,472(a) | |
| Intercompany | 3,234 | (3,781) | 547 | | |
| Accounts receivable | | (94,955) | (5,180) | | (100,135) |
| Other current assets | (4,480) | 1,267 | 137 | | (3,076) |
| Other assets | 676 | 1,174 | 64 | | 1,914 |
| Accounts payable | 1,778 | 8,352 | 1,647 | | 11,777 |
| Due to third-party payors | | 8,422 | (8,896) | | (474) |
| Accrued expenses | (6,487) | 4,096 | (1,197) | | (3,588) |
| Income and deferred taxes | 28,688 | | | | 28,688 |
| Net cash provided by (used in) operating activities | 21,486 | (12,401) | (1,400) | | 7,685 |
| | | | | | |
| **Investing activities** | | | | | |
| Purchases of property and equipment | (288) | (11,561) | (1,071) | | (12,920) |
| Proceeds from sale of assets | | 250 | | | 250 |
| Acquisition of businesses, net of cash acquired | | (2,000) | | | (2,000) |
| Net cash used in investing activities | (288) | (13,311) | (1,071) | | (14,670) |
| | | | | | |
| **Financing activities** | | | | | |
| Borrowings on revolving credit facility | 205,000 | | | | 205,000 |
| Payments on revolving credit facility | (105,000) | | | | (105,000) |
| Payments on 2005 credit facility term loans | (59,563) | | | | (59,563) |
| Borrowings of other debt | 5,496 | | | | 5,496 |
| Principal payments on other debt | (1,880) | (279) | (335) | | (2,494) |
| Dividends paid to Holdings | (14,743) | | | | (14,743) |
| Equity investment by Holdings | 81 | | | | 81 |
| Proceeds from bank overdrafts | (9,418) | | | | (9,418) |
| Intercompany debt reallocation | (32,456) | 28,014 | 4,442 | | |
| Distributions to non-controlling interests | | | (1,671) | | (1,671) |
| Net cash provided by (used in) financing activities | (12,483) | 27,735 | 2,436 | | 17,688 |
| | | | | | |
| Net increase (decrease) in cash and cash equivalents | 8,715 | 2,023 | (35) | | 10,703 |
| | | | | | |
| Cash and cash equivalents at beginning of period | 149 | 3,567 | 649 | | 4,365 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents at end of period | $ | 8,864 | $ | 5,590 | $ | 614 | $ | | $ | 15,068 |

(a) Elimination of equity in earnings of subsidiaries.

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**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read this discussion together with the Selected Financial Data and consolidated financial statements and accompanying notes included elsewhere herein.*

**Forward-Looking Statements**

This report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words may, could, would, should, believe, expect, anticipate, plan, target, project, intend and similar expressions. These statements include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement our strategy, our objectives, the amount and timing of capital expenditures, the likelihood of our success in expanding our business, financing plans, budgets, working capital needs and sources of liquidity.

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management s beliefs and assumptions, which in turn are based on currently available information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding our services, the expansion of our services, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve known and unknown risks and uncertainties, which could cause actual results to differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict. Such factors include, but are not limited to, the following:

- additional changes in government reimbursement for our services, including changes that will result from the expiration of the moratorium for long term acute care hospitals established by the Medicare, Medicaid, and SCHIP Extension Act of 2007, the American Recovery and Reinvestment Act, and the Patient Protection and Affordable Care Act may result in a reduction in net operating revenues, an increase in costs and a reduction in profitability;

- the failure of our specialty hospitals to maintain their Medicare certifications may cause our net operating revenues and profitability to decline;

- the failure of our facilities operated as hospitals within hospitals to qualify as hospitals separate from their host hospitals may cause our net operating revenues and profitability to decline;

- a government investigation or assertion that we have violated applicable regulations may result in sanctions or reputational harm and increased costs;

- acquisitions or joint ventures may prove difficult or unsuccessful, use significant resources or expose us to unforeseen liabilities;

- private third-party payors for our services may undertake future cost containment initiatives that limit our future net operating revenues and profitability;

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- the failure to maintain established relationships with the physicians in the areas we serve could reduce our net operating revenues and profitability;
- shortages in qualified nurses or therapists could increase our operating costs significantly;
- competition may limit our ability to grow and result in a decrease in our net operating revenues and profitability;
- the loss of key members of our management team could significantly disrupt our operations;
- the effect of claims asserted against us could subject us to substantial uninsured liabilities; and
- other factors discussed from time to time in our filings with the Securities and Exchange Commission (the SEC ), including factors discussed under the heading Risk Factors for the year ended December 31, 2011 contained in our annual report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2012.

Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the SEC, we are under no obligation to publicly update or revise any forward-looking statements, whether as a result of any new information, future events or otherwise. You should not place undue reliance on our forward-looking statements. Although we believe that the expectations reflected in forward-looking statements are reasonable, we cannot guarantee future results or performance.

Investors should also be aware that while we do, from time to time, communicate with securities analysts, it is against our policy to disclose to securities analysts any material non-public information or other confidential commercial information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any securities analyst irrespective of the content of the statement or report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of the Company.

**Overview**

We believe that we are one of the largest operators of both specialty hospitals and outpatient rehabilitation clinics in the United States based on number of facilities. As of March 31, 2012, we operated 111 long term acute care hospitals and 12 acute medical rehabilitation hospitals in 28 states, and 950 outpatient rehabilitation clinics in 32 states and the District of Columbia. We also provide medical rehabilitation services on a contracted basis to nursing homes, hospitals, assisted living and senior care centers, schools and work sites. We began operations in 1997 under the leadership of our current management team. As of March 31, 2012 we had operations in 44 states and the District of Columbia.

We manage our Company through two business segments, our specialty hospital segment and our outpatient rehabilitation segment. We had net operating revenues of $744.0 million for the three months ended March 31, 2012. Of this total, we earned approximately 74% of our net operating revenues from our specialty hospitals and approximately 26% from our outpatient rehabilitation business. Our specialty hospital segment consists of hospitals designed to serve the needs of long term stay acute patients and hospitals designed to serve patients that require intensive medical rehabilitation care. Patients are typically admitted to our specialty hospitals from general acute care hospitals. These patients have specialized needs, and serious and often complex medical

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conditions such as respiratory failure, neuromuscular disorders, traumatic brain and spinal cord injuries, strokes, non-healing wounds, cardiac disorders, renal disorders and cancer. Our outpatient rehabilitation segment consists of clinics and contract services that provide physical, occupational and speech rehabilitation services. Our outpatient rehabilitation patients are typically diagnosed with musculoskeletal impairments that restrict their ability to perform normal activities of daily living.

**Significant 2012 Events**

***Stock Repurchase Program***

On February 22, 2012, the Company s board of directors authorized an increase of $100.0 million in the capacity of its common stock repurchase program from $150.0 million to $250.0 million. The program will remain in effect until March 31, 2013, unless extended by the board of directors. Stock repurchases under this program may be made in the open market or through privately negotiated transactions, and at times and in such amounts as the Company deems appropriate. The timing of purchases of stock will be based upon market conditions and other factors. The Company is funding this program with cash on hand or borrowings under its revolving credit facility. The Company repurchased 3,203,692 shares at a cost of $25.7 million, which includes transaction costs, during the three months ended March 31, 2012. Since the inception of the program through March 31, 2012, the Company has repurchased 19,968,299 shares at a cost of $142.6 million, which includes transaction costs.

**Summary Financial Results**

***First Quarter Ended March 31, 2012***

For the three months ended March 31, 2012, our net operating revenues increased 7.3% to $744.0 million compared to $693.2 million for the three months ended March 31, 2011. This increase in net operating revenues resulted principally from a 6.4% increase in our specialty hospital net operating revenue. We had income from operations for the three months ended March 31, 2012 of $91.6 million compared to $87.6 million for the three months ended March 31, 2011. Our Adjusted EBITDA for the three months ended March 31, 2012, was $109.1 million compared to $105.7 million for the three months ended March 31, 2011. See the section entitled *Results of Operations* for a reconciliation of net income to Adjusted EBITDA. The increase in our income from operations and Adjusted EBITDA is due to a reduction in our general and administrative expense that resulted primarily from a gain on the sale of a building and an increase in the operating performance of our outpatient rehabilitation segment.

Holdings interest expense for the three months ended March 31, 2012 was $23.9 million compared to $25.7 million for the three months ended March 31, 2011. Select s interest expense for the three months ended March 31, 2012 was $21.3 million compared to $18.7 million for the three months ended March 31, 2011. The decrease in interest expense for Holdings is attributable to lower interest rates on portions of the debt we refinanced on June 1, 2011, and reduced borrowings for the three months ended March 31, 2012 compared to the three months ended March 31, 2011. The increase in the interest expense for Select is due to the refinancing of $150.0 million of Holdings debt, for which Select was not previously obligated, through indebtedness incurred by Select under its new senior secured credit facility on June 1, 2011.

Net income attributable to Holdings   increased 23.4% to $41.5 million for the three months ended March 31, 2012 compared to $33.7 million for the three months ended March 31, 2011.  The increase resulted from an increase in our income from operations described above, increases in our equity earnings principally related to

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our investment in our joint venture with the Baylor Health Care System that was formed on April 1, 2011 ( Baylor JV ), and a reduction of interest expense as described above.

Cash flow from operations provided $8.2 million of cash for the three months ended March 31, 2012 for Holdings and $13.4 million of cash for the three months ended March 31, 2012 for Select. The difference in cash flow from operations between Holdings and Select primarily relates to interest payments on Holdings senior floating rate notes.

**Regulatory Changes**

In the past few years, there have been significant regulatory changes that have affected our net operating revenues and, in some cases, caused us to change our operating models and strategies. The following is a discussion of recent regulatory changes that have affected our results of operations for the three months ended March 31, 2012 or may have an affect on our future results of operations. Our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the Securities and Exchange Commission ( SEC ) on March 2, 2012 contains a more detailed discussion of the regulations that affect our business in Part I Business Government Regulations, and the information below should be read in connection with that more detailed discussion.

***Health Reform Legislation***

Federal agencies, including the Centers for Medicare & Medicaid Services ( CMS ), continue to implement provisions of the Patient Protection and Affordable Care Act ( PPACA ). The PPACA expands access to health insurance through subsidies, coverage mandates and other insurance market reforms. In addition, PPACA makes dramatic changes to the Medicare and Medicaid programs by adopting numerous initiatives addressing, among other things, reductions in healthcare spending, patient safety incentives and protections against fraud and abuse of federal healthcare programs. The PPACA adopts significant changes to the Medicare program that are particularly relevant to long term acute care hospitals ( LTCHs ), inpatient rehabilitation facilities ( IRFs ) and outpatient rehabilitation services. As part of health reform legislation, President Obama also signed the Health Care and Education Affordability Reconciliation Act of 2010, which made some limited but important changes to the PPACA.

We have included in our Annual Report on Form 10-K for the year ended December 31, 2011 a discussion of the PPACA provisions that affect our business, as well as regulatory initiatives adopted by CMS in response to particular provisions of the PPACA.

A number of states attorneys general and other parties have filed legal challenges to the PPACA seeking to block its implementation on constitutional grounds. The United States Supreme Court agreed to review the law and issue a final ruling, which is expected in June 2012. The Court could uphold the law, strike down some or all of its provisions, or determine that a decision is premature at this time.

***Budget Control Act of 2011***

Beginning in January 2013, the Budget Control Act of 2011 will automatically reduce federal spending by approximately $1.2 trillion split evenly between domestic and defense spending.  Payments to Medicare providers are subject to these automatic spending reductions, subject to a 2% cap.  Unless further legislation is enacted, we believe this will generally result in a 2% reduction to Medicare payments, beginning in January 2013.

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***Medicare Payment of Long Term Acute Care Hospitals during Fiscal Year 2012***

On August 18, 2011, CMS published the policies and payment rates for LTCH-PPS for fiscal year 2012 (affecting discharges and cost reporting periods beginning on or after October 1, 2011 through September 30, 2012). The standard federal rate for fiscal year 2012 is $40,222, an increase from the fiscal year 2011 standard federal rate of $39,600. The final rule establishes a fixed-loss amount for high cost outlier cases for fiscal year 2012 of $17,931, which is a decrease from the fixed-loss amount in the 2011 fiscal year of $18,785.

The labor-related share of the LTCH-PPS standard federal rate is adjusted annually to account for geographic differences in area wage levels by applying the applicable LTCH-PPS wage index. CMS adopted a decrease in the labor-related share from 75.271% to 70.199% under the LTCH-PPS for fiscal year 2012.

In addition, CMS applied an area wage level budget neutrality factor to the standard federal rate to make annual changes to the area wage level adjustment budget neutral. Previously, there was no statutory or regulatory requirement that these adjustments to the area wage level be made in a budget neutral manner. The final rule creates a regulatory requirement that any adjustments or updates to the area wage level adjustment be made in a budget neutral manner such that estimated aggregate LTCH-PPS payments are not affected.

An LTCH must have an average inpatient length of stay for Medicare patients (including both Medicare covered and non-covered days) of greater than 25 days. In the preamble to the final rule for fiscal year 2012, CMS clarified its policy on the calculation of the average length of stay by specifying that all data on all Medicare inpatient days, including Medicare Advantage days, must be included in the average length of stay calculation effective for cost reporting periods beginning on or after January 1, 2012.

***Medicare Payment of Long Term Acute Care Hospitals during Fiscal Year 2013***

On April 24, 2012, CMS released an advanced copy of the proposed policies and payment rates for LTCH-PPS for fiscal year 2013 (affecting discharges and cost reporting periods beginning on or after October 1, 2012 through September 30, 2013). Under the proposal, two different standard federal rates would apply during fiscal year 2013. The standard federal rate for the first three months of fiscal year 2013 would be set at $41,027, an increase from $40,222 applicable during fiscal year 2012. The standard federal rate for the last nine months of fiscal year 2013 would be set at $40,507. The increase for the first three months of fiscal year 2013, if adopted, would be based on a market basket increase estimate of 3.0% less a productivity adjustment of -0.8% and less an additional reduction of -0.1% mandated by the PPACA. For the last nine months of fiscal year 2013 the market basket increase is further reduced by a portion of the one-time budget neutrality adjustment, as discussed below. The fixed loss amount for high cost outlier cases would be set at $15,728. This is a decrease from the fixed loss amount in the 2011 fiscal year of $17,931.

***Very Short Stay Outlier Policy***

CMS established a different payment methodology for Medicare patients with a length of stay less than or equal to five-sixths of the geometric average length of stay for that particular MS-LTC-DRG, referred to as a short stay outlier, or SSO. The SSO rule was further revised adding a category referred to as a very short stay outlier for discharges occurring after July 1, 2007. For cases with a length of stay that is less than the average length of stay plus one standard deviation for the same MS-DRG under IPPS, referred to as the so-called IPPS comparable threshold, the rule lowers the LTCH payment to a rate based on the general acute care hospital IPPS per diem. SSO cases with covered lengths of stay that exceed the IPPS comparable threshold would continue to be paid under the SSO payment policy. The SCHIP Extension Act, as amended by the PPACA, prevented CMS from applying the very short-stay outlier policy before December 29, 2012. Under existing regulations Medicare payment for very short-stay cases will be generally lowered to a rate based on the general acute care hospital IPPS per diem beginning with discharges on or after December 29, 2012.

***25 Percent Rule***

The 25 Percent Rule is a downward payment adjustment that applies to Medicare patients discharged from LTCHs who were admitted from a co-located hospital or a non-co-located hospital and caused the LTCH to exceed the applicable percentage thresholds of discharged Medicare patients. The SCHIP Extension Act as amended by the American Recovery and Reinvestment Act, or ARRA, and the PPACA limited the full application of the Medicare percentage threshold and, in some cases, postponed application of the percentage threshold until cost reporting periods beginning on or after July 1, 2012 or October 1, 2012.

CMS has proposed a one-year extension of relief granted by the SCHIP Extension Act from the full application of Medicare admission thresholds in a proposed rule that would update the Medicare policies and payment rates for the long-term care hospital prospective payment system for fiscal year 2013. If the one-year extension is adopted, full implementation of the Medicare admission thresholds would not go into effect until cost reporting periods beginning on or after October 1, 2013, except for LTCHs with cost reporting periods that begin between July 1, 2012 and September 30, 2012 that would not qualify for the proposed one-year extension of relief until their subsequent cost reporting period.

In the preamble to the proposed update to the Medicare policies and payment rates for fiscal year 2013, CMS indicates that within the near future it may recommend revisions to the payment policies addressing MedPAC s recommendations for the development of patient-level and facility-level criteria. CMS also indicates that these recommendations may render unnecessary the existing payment reductions for Medicare patients admitted from a general acute care hospital in excess of the applicable admission thresholds.

***One-Time Budget Neutrality Adjustment***

Congress required that the LTCH-PPS payment rates maintain budget neutrality during the first years of the prospective payment system with total expenditures that would have been made under the previous reasonable cost-based payment system. The LTCH-PPS regulations give CMS the ability to make a one-time adjustment to the standard federal rate to correct any significant difference between actual payments and estimated payments for the first year of LTCH-PPS. The SCHIP Extension Act, as amended by the PPACA, precluded CMS from implementing the one-time prospective adjustment to the LTCH standard federal rate before December 29, 2012.

In the proposed update to the Medicare policies and payment rates for fiscal year 2013, CMS proposed to adopt a one-time budget neutrality adjustment that, if adopted, would result in a permanent negative adjustment of 3.75% to the LTCH base rate. CMS is proposing to implement the adjustment over a three-year period by applying a factor of 0.98734 to the standard federal rate in fiscal years 2013, 2014 and 2015, except that the adjustment would not apply to payments for discharges occurring on or after October 1, 2012 through December 29, 2012.

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***Medicare Market Basket Adjustments***

In the proposed update to the Medicare policies and payment rates for fiscal year 2013, CMS proposed to adopt for the first time an LTCH-specific market basket based entirely on Medicare cost report data from LTCHs. The LTCH-specific market basket would replace the rehabilitation, psychiatric and long-term care hospital market basket currently used to determine the annual update to the LTCH-PPS. CMS estimates that the LTCH-specific market basket update for fiscal year 2013 would be the same as the market basket update using the existing rehabilitation, psychiatric and long-term care hospital market basket.

The PPACA institutes a market basket payment adjustment to LTCHs. For fiscal years 2012 and 2013, the reduction is 0.1%. For fiscal year 2014, the reduction is 0.3%. For fiscal years 2015 and 2016, the reduction is 0.2%. For fiscal years 2017 through fiscal year 2019, the reduction is 0.75%.

***Medicare Payment of Inpatient Rehabilitation Facilities during Fiscal Year 2012***

On August 5, 2011, CMS published the policies and payment rates for IRF-PPS for fiscal year 2012 (affecting discharges and cost reporting periods beginning on or after October 1, 2011 and through September 30, 2012). The standard payment conversion factor for discharges for fiscal year 2012 is $14,076, an increase from the fiscal year 2011 standard payment conversion factor of $13,860. CMS initially decreased the outlier threshold amount for fiscal year 2012 to $10,660 from $11,410 for fiscal year 2011. In a notice published September 26, 2011, CMS corrected its calculation of the outlier threshold amount for fiscal year 2012 to $10,713.

The PPACA instituted a market basket payment reduction adjustment for IRFs. For fiscal years 2012 and 2013, the reduction is 0.1%. For fiscal year 2014, the reduction is 0.3%. For fiscal years 2015 and 2016, the reduction is 0.2%. For fiscal years 2017 - 2019, the reduction is 0.75%.

In its March 2012 Report to Congress, MedPAC recommended that CMS provide no annual update to the payment rates for IRF-PPS for fiscal year 2013.

***Medicare Payment of Inpatient Rehabilitation Facilities during Fiscal Year 2013***

CMS has not published the policies and payment rates for IRF-PPS for fiscal year 2013 (affecting discharges and cost reporting periods beginning on or after October 1, 2012 through September 30, 2013). We expect CMS to issue a notice updating the IRF-PPS payment rates before the start of fiscal year 2013 on October 1, 2013. We expect the notice to include the annual update to the market basket and a negative adjustment of 0.1% as required by the PPACA.

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***Medicare Payment of Outpatient Rehabilitation Services***

*Medicare Physician Fee Schedule Sustainable Growth Rate Update*

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare physician fee schedule. The Medicare physician fee schedule rates are automatically updated annually based on the sustainable growth rate ( SGR ) formula contained in legislation. The SGR formula has resulted in automatic reductions in rates in every year since 2002; however, for each year through 2012 CMS or Congress has taken action to prevent the SGR formula reductions. The Middle Class Tax Relief and Job Creation Act of 2012 froze Medicare physician fee schedule rates at 2011 levels through December 31, 2012, temporarily averting a scheduled 27.4% cut as a result of the SGR formula that would have taken effect on March 1, 2012. A reduction in the Medicare physician fee schedule payment rates will occur on January 1, 2013, unless Congress again takes legislative action to prevent the SGR formula reductions from going into effect.

On October 6, 2011, MedPAC recommended that Congress repeal and replace the statutory SGR formula. The MedPAC proposal, which would require Congressional approval, would freeze current Medicare physician fee schedule rates for primary care services for 10 years, while other services would be subject to annual payment reductions of 5.9% for 3 years, followed by a freeze on payments for the next seven years. MedPAC offered a list of options for Congress to consider if it decides to offset SGR repeal costs (estimated at about $200 billion over 10 years) within the Medicare program.

In addition to the SGR proposal, MedPAC recommended that Congress direct CMS to collect data on provider service volume and work time to establish more accurate relative value unit payment rates and to identify and reduce overpriced fee schedule services. Similarly, the PPACA requires CMS to identify and review potentially misvalued codes and make appropriate adjustments to the relative values of those services identified as being misvalued. In the final update to the Medicare physician fee schedule for calendar year 2012 CMS identified several CPT codes used by physical therapists as codes they will review.

*Therapy Caps*

Beginning on January 1, 1999, the Balanced Budget Act of 1997 subjected certain outpatient therapy providers reimbursed under the Medicare physician fee schedule to annual limits for therapy expenses. Effective January 1, 2012, the annual limit on outpatient therapy services is $1,880 for combined physical and speech language pathology services and $1,880 for occupational therapy services. The per beneficiary caps were $1,870 for calendar year 2011. The annual limits for therapy expenses do not apply to services furnished and billed by outpatient hospital departments. However, beginning no later than October 1, 2012 and expiring on December 31, 2012, the Middle Class Tax Relief and Job Creation Act of 2012 will apply the annual limits on therapy expenses to hospital outpatient department settings. The application of annual limits to hospital outpatient department settings will sunset at the end of 2012 unless extended by Congress. We operated 950 outpatient rehabilitation clinics at March 31, 2012, of which 133 are provider-based outpatient rehabilitation clinics operated as departments of the inpatient rehabilitation hospitals.

In the Deficit Reduction Act of 2005, Congress implemented an exceptions process to the annual limit for therapy expenses. Under this process, a Medicare enrollee (or person acting on behalf of the Medicare enrollee) is able to request an exception from the therapy caps if the provision of therapy services was deemed to be medically necessary. Therapy cap exceptions have been available automatically for certain conditions and on a case-by-case basis upon submission of documentation of medical necessity.  The Middle Class Tax Relief and Job Creation Act of 2012 extended the exceptions process for outpatient therapy caps through December 31, 2012.  Unless Congress extends the exceptions process, the therapy caps will apply to all outpatient therapy

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services beginning January 1, 2013, except those services furnished and billed by outpatient hospital departments.

The Middle Class Tax Relief and Job Creation Act of 2012 made several changes to the exceptions process to the annual limit for therapy expenses. For any claim above the annual limit, the claim must contain a modifier, such as the KX modifier, indicating that the services are medically necessary and justified by appropriate documentation in the medical record. Effective October 1, 2012, all claims exceeding $3,700 will be subject to a manual medical review process. The $3,700 threshold will be applied separately to the combined physical therapy/speech therapy cap and the occupational therapy cap. Effective October 1, 2012, all therapy claims, whether above or below the annual limit, must include the national provider identifier (NPI) of the physician responsible for certifying and periodically reviewing the plan of care.

Several government agencies are expected to release reports on aspects of the Medicare payment system for therapy services. In the final 2011 Medicare physician fee schedule rule, CMS indicated the agency is evaluating alternative payment methodologies that would provide appropriate payment for medically necessary and effective therapy services furnished to Medicare beneficiaries based on patient needs rather than the current therapy caps. The Middle Class Tax Relief and Job Creation Act of 2012 directs the MedPAC to submit a report to Congress by June 15, 2013 making recommendations on how to reform the payment system to better reflect acuity, condition, and the therapy needs of the patient. The MedPAC report is to include an examination of private sector initiatives related to therapy benefits. In addition, the GAO is directed to issue a report no later than May 1, 2013 regarding implementation of the manual medical review process instituted by the Middle Class Tax Relief and Job Creation Act of 2012. The report must detail the number of beneficiaries subject to the process, the number of reviews conducted, and the outcome of the reviews. Finally, beginning on January 1, 2013, CMS is required to collect additional data on therapy claims related to patient function during the course of therapy in order to better understand patient conditions and outcomes.

*Multiple Procedure Payment Reduction*

CMS adopted a multiple procedure payment reduction for therapy services in the final update to the Medicare physician fee schedule for calendar year 2011. Under the policy, the Medicare program pays 100% of the practice expense component of the therapy procedure or unit of service with the highest Relative Value Unit and then reduces the payment for the practice expense component by 20% in office and other non-institutional settings and 25% in institutional settings for the second and subsequent therapy procedures or units of service furnished during the same day for the same patient, regardless of whether those therapy services are furnished in separate sessions. This multiple procedure payment reduction policy became effective January 1, 2011 and applies to all outpatient therapy services paid under Medicare Part B. Furthermore, the multiple procedure payment reduction policy applies across all therapy disciplines occupational therapy, physical therapy and speech-language pathology. Our outpatient rehabilitation therapy services are primarily offered in institutional settings and, as such, are subject to the applicable 25% payment reduction in the practice expense component for the second and subsequent therapy services furnished by us to the same patient on the same day. In the 2012 Medicare physician fee schedule rule, CMS indicated that over the next year it will continue to review whether specific CPT codes billed under the fee schedule are overvalued or undervalued, including certain specific CPT codes used by physical therapists.

***Medicare Quality Reporting Program for LTCHs and IRFs***

The PPACA requires that CMS establish new quality data reporting programs for LTCHs and IRFs by fiscal year 2014. CMS has adopted a quality data reporting program requiring LTCHs to submit data from three quality measures in order to receive the full payment update in fiscal year 2014, including measures related to

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(1) catheter-associated urinary tract infections, (2) central line catheter-associated blood stream infection, and (3) pressure ulcers that are new or have worsened. In addition to the foregoing measures, CMS has proposed adding the following quality measures for LTCH reporting beginning in fiscal year 2016 (1) percent of nursing home residents who were assessed and appropriately given the seasonal influenza vaccine, (2) percent of residents assessed and appropriately given the pneumococcal vaccine, (3) ventilator bundle, (4) restraint rate per 1,000 patient days, (5) influenza vaccination coverage among healthcare personnel. CMS adopted a quality data reporting program requiring IRFs to submit data from two quality measures in order to receive the full payment update in fiscal year 2014, including measures related to (1) catheter-associated urinary tract infections and (2) pressure ulcers that are new or have worsened. Under the PPACA and CMS regulations, if an LTCH or IRF fails to report on the selected quality measures, it will see its reimbursement reduced by 2.0% of the annual market basket update. The reduction can result in payment rates less than the prior year. However, the reduction will not carry over into the subsequent fiscal years.

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**Operating Statistics**

The following tables set forth operating statistics for our specialty hospitals and our outpatient rehabilitation clinics for each of the periods presented. The data in the tables reflect the changes in the number of specialty hospitals and outpatient rehabilitation clinics we operate that resulted from acquisitions, start-up activities, closures and sales. The operating statistics reflect data for the period of time these operations were managed by us.

| | Three Months Ended March 31, 2011 | 2012 |
|---|---|---|
| **Specialty hospital data(1):** | | |
| Number of hospitals owned start of period | 116 | 115 |
| Number of hospitals acquired | 1 | 1 |
| Number of hospital start-ups | | 1 |
| Number of hospitals closed/sold | (1) | |
| Number of hospitals owned end of period | 116 | 117 |
| Number of hospitals managed end of period | 2 | 6 |
| Total number of hospitals (all) end of period | 118 | 123 |
| Long term acute care hospitals | 110 | 111 |
| Rehabilitation hospitals | 8 | 12 |
| Available licensed beds (2) | 5,153 | 5,205 |
| Admissions (2) | 13,810 | 14,055 |
| Patient days (2) | 333,856 | 343,021 |
| Average length of stay (days) (2) | 25 | 24 |
| Net revenue per patient day (2)(3) | $ 1,514 | $ 1,525 |
| Occupancy rate (2) | 72% | 73% |
| Percent patient days Medicare (2) | 64% | 65% |
| | | |
| **Outpatient rehabilitation data:** | | |
| Number of clinics owned start of period | 875 | 850 |
| Number of clinic start-ups | 8 | 8 |
| Number of clinics closed/sold | (9) | (10) |
| Number of clinics owned end of period | 874 | 848 |
| Number of clinics managed end of period | 71 | 102 |
| Total number of clinics (all) end of period | 945 | 950 |
| Number of visits (2) | 1,138,700 | 1,152,209 |
| Net revenue per visit (2)(4) | $ 103 | $ 103 |

(1) Specialty hospitals consist of long term acute care hospitals and inpatient rehabilitation facilities.

(2) Data excludes specialty hospitals and outpatient clinics managed by the Company.

(3) Net revenue per patient day is calculated by dividing specialty hospital direct patient service revenues by the total number of patient days.

(4) Net revenue per visit is calculated by dividing outpatient rehabilitation clinic revenue by the total number of visits. For purposes of this computation, outpatient rehabilitation clinic revenue does not include contract services revenue.

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**Results of Operations**

The following table outlines, for the periods indicated, selected operating data as a percentage of net operating revenues:

| | Select Medical Holdings Corporation Three Months Ended March 31, | | Select Medical Corporation Three Months Ended March 31, | |
|---|---|---|---|---|
| | **2011** | **2012** | **2011** | **2012** |
| Net operating revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of services(1) | 80.4 | 82.2 | 80.4 | 82.2 |
| General and administrative | 2.4 | 1.9 | 2.4 | 1.9 |
| Bad debt expense | 2.1 | 1.4 | 2.1 | 1.4 |
| Depreciation and amortization | 2.5 | 2.2 | 2.5 | 2.2 |
| Income from operations | 12.6 | 12.3 | 12.6 | 12.3 |
| Equity in earnings (losses) of unconsolidated subsidiaries | (0.0) | 0.3 | (0.0) | 0.3 |
| Interest expense, net | (3.7) | (3.2) | (2.7) | (2.9) |
| Income before income taxes | 8.9 | 9.4 | 9.9 | 9.7 |
| Income tax expense | 3.8 | 3.7 | 4.2 | 3.8 |
| Net income | 5.1 | 5.7 | 5.7 | 5.9 |
| Net income attributable to non-controlling interest | 0.2 | 0.1 | 0.2 | 0.1 |
| Net income attributable to Holdings and Select | 4.9% | 5.6% | 5.5% | 5.8% |

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The following tables summarize selected financial data by business segment, for the periods indicated:

| | Select Medical Holdings Corporation Three Months Ended March 31, 2011 | 2012 | % Change | Select Medical Corporation Three Months Ended March 31, 2011 | 2012 | % Change |
|---|---|---|---|---|---|---|
| | (in thousands) | | | | | |
| Net operating revenues: | | | | | | |
| Specialty hospitals | $ 519,924 | $ 553,038 | 6.4% | $ 519,924 | $ 553,038 | 6.4% |
| Outpatient rehabilitation | 173,191 | 190,899 | 10.2 | 173,191 | 190,899 | 10.2 |
| Other(3) | 71 | 84 | 18.3 | 71 | 84 | 18.3 |
| Total company | $ 693,186 | $ 744,021 | 7.3% | $ 693,186 | $ 744,021 | 7.3% |
| Income (loss) from operations: | | | | | | |
| Specialty hospitals | $ 88,307 | $ 88,111 | (0.2)% | $ 88,307 | $ 88,111 | (0.2)% |
| Outpatient rehabilitation | 16,947 | 18,828 | 11.1 | 16,947 | 18,828 | 11.1 |
| Other(3) | (17,622) | (15,335) | 13.0 | (17,622) | (15,335) | 13.0 |
| Total company | $ 87,632 | $ 91,604 | 4.5% | $ 87,632 | $ 91,604 | 4.5% |
| Adjusted EBITDA:(2) | | | | | | |
| Specialty hospitals | $ 100,353 | $ 99,954 | (0.4)% | $ 100,353 | $ 99,954 | (0.4)% |
| Outpatient rehabilitation | 21,406 | 22,478 | 5.0 | 21,406 | 22,478 | 5.0 |
| Other(3) | (16,025) | (13,368) | 16.6 | (16,025) | (13,368) | 16.6 |
| Total company | $ 105,734 | $ 109,064 | 3.1% | $ 105,734 | $ 109,064 | 3.1% |
| Adjusted EBITDA margins:(2) | | | | | | |
| Specialty hospitals | 19.3% | 18.1% | | 19.3% | 18.1% | |
| Outpatient rehabilitation | 12.4 | 11.8 | | 12.4 | 11.8 | |
| Other(3) | N/M | N/M | | N/M | N/M | |
| Total company | 15.3% | 14.7% | | 15.3% | 14.7% | |
| Total assets: | | | | | | |
| Specialty hospitals | $ 2,140,798 | $ 2,222,825 | | $ 2,140,798 | $ 2,222,825 | |
| Outpatient rehabilitation | 482,444 | 437,364 | | 482,444 | 437,364 | |
| Other(3) | 180,577 | 146,389 | | 178,201 | 145,073 | |
| Total company | $ 2,803,819 | $ 2,806,578 | | $ 2,801,443 | $ 2,805,262 | |
| Purchases of property and equipment, net: | | | | | | |
| Specialty hospitals | $ 10,487 | $ 7,051 | | $ 10,487 | $ 7,051 | |
| Outpatient rehabilitation | 2,181 | 3,791 | | 2,181 | 3,791 | |
| Other(3) | 252 | 909 | | 252 | 909 | |
| Total company | $ 12,920 | $ 11,751 | | $ 12,920 | $ 11,751 | |

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N/M Not Meaningful.

(1) Cost of services includes salaries, wages and benefits, operating supplies, lease and rent expense and other operating costs.

(2) We define Adjusted EBITDA as net income before interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, equity in earnings (losses) of unconsolidated subsidiaries, and other income (expense). We believe that the presentation of Adjusted EBITDA is important to investors because Adjusted EBITDA is commonly used as an analytical indicator of performance by investors within the healthcare industry. Adjusted EBITDA is used by management to evaluate financial performance and determine resource allocation for each of our operating units. Adjusted EBITDA is not a measure of financial performance under generally accepted accounting principles. Items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Adjusted EBITDA should not be considered in isolation or as an alternative to, or substitute for, net income, cash flows generated by operations, investing or financing activities, or other financial statement data presented in the consolidated financial statements as indicators of financial performance or liquidity. Because Adjusted EBITDA is not a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, Adjusted EBITDA as presented may not be comparable to other similarly titled measures of other companies.

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Following is a reconciliation of net income to Adjusted EBITDA as utilized by us in reporting our segment performance:

| | Select Medical Holdings Corporation Three Months Ended March 31, | | Select Medical Corporation Three Months Ended March 31, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (in thousands) | | (in thousands) | |
| Net income | $ 35,387 | $ 42,572 | $ 39,939 | $ 44,309 |
| Income tax expense | 26,564 | 27,575 | 29,014 | 28,510 |
| Interest expense, net of interest income | 25,608 | 23,922 | 18,606 | 21,250 |
| Equity in (earnings) losses of unconsolidated subsidiaries | 73 | (2,465) | 73 | (2,465) |
| Stock compensation expense: | | | | |
| Included in general and administrative | 470 | 772 | 470 | 772 |
| Included in cost of services | 410 | 489 | 410 | 489 |
| Depreciation and amortization | 17,222 | 16,199 | 17,222 | 16,199 |
| Adjusted EBITDA | $ 105,734 | $ 109,064 | $ 105,734 | $ 109,064 |

(3) Other includes our general and administrative services and non-healthcare services.

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**Three Months Ended March 31, 2012 Compared to Three Months Ended March 31, 2011**

In the following discussion, we address the results of operations of Select and Holdings. With the exception of incremental interest expense and income taxes, the results of operations of Holdings are identical to those of Select. Therefore, discussion related to net operating revenues, operating expenses, Adjusted EBITDA, income from operations and non-controlling interest is identical for Holdings and Select.

***Net Operating Revenues***

Our net operating revenues increased by 7.3% to $744.0 million for the three months ended March 31, 2012 compared to $693.2 million for the three months ended March 31, 2011.

*Specialty Hospitals.* Our specialty hospital net operating revenues increased by 6.4% to $553.0 million for the three months ended March 31, 2012 compared to $519.9 million for the three months ended March 31, 2011. The growth in net operating revenue primarily resulted from increases in Medicare patient volumes and revenues that are generated from contracted labor services provided to the Baylor JV. Our patient days increased 2.7% to 343,021 days for the three months ended March 31, 2012 primarily as a result of an increase in Medicare patient days. The occupancy percentage increased to 73% for the three months ended March 31, 2012 compared to 72% for the three months ended March 31, 2011. Our average net revenue per patient day was $1,525 for the three months ended March 31, 2012 compared to $1,514 for the three months ended March 31, 2011. The increase in our net revenue per patient day was principally due to increases in our average non-Medicare net revenue per patient day.

*Outpatient Rehabilitation.* Our outpatient rehabilitation net operating revenues increased 10.2% to $190.9 million for the three months ended March 31, 2012 compared to $173.2 million for the three months ended March 31, 2011. The net operating revenues generated by our outpatient rehabilitation clinics for the three months ended March 31, 2012 grew approximately 5.1% compared to the three months ended March 31, 2011. The increase was related to revenues we generated from contracted labor services provided to the Baylor JV and volume growth in our outpatient clinics. The number of patient visits in our owned outpatient rehabilitation clinics increased 1.2% for the three months ended March 31, 2012 to 1,152,209 visits compared to 1,138,700 visits for the three months ended March 31, 2011. Excluding the clinics transferred to the Baylor JV, clinics acquired, newly opened clinics and closed clinics, our patient visits in our owned clinics increased approximately 3.3%. Net revenue per visit in our clinics was $103 for both the three months ended March 31, 2012 and 2011. Our contract services business experienced an increase in net operating revenues of approximately 27.6% compared to the three months ended March 31, 2011, which resulted from the addition of new contracts.

***Operating Expenses***

Our operating expenses include our cost of services, general and administrative expense and bad debt expense. Our operating expenses increased by $47.9 million to $636.2 million for the three months ended March 31, 2012 compared to $588.3 million for the three months ended March 31, 2011. As a percentage of our net operating revenues, our operating expenses were 85.5% for the three months ended March 31, 2012 compared to 84.9% for the three months ended March 31, 2011. Our cost of services, a major component of which is labor expense, were $611.6 million or 82.2% of net operating revenue for the three months ended March 31, 2012 compared to $557.4 million or 80.4% of net operating revenue for the three months ended March 31, 2011. The principal causes of the increase in cost of services as a percentage of net operating revenue resulted from increased labor costs in our specialty hospitals. Our specialty hospitals experienced an increase in relative labor costs due to the labor costs associated with the Baylor JV services agreement and our

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inefficiency in adjusting our staffing to correspond to a lower acuity patient population we treated during the three months ended March 31, 2012 compared to the three months ended March 31, 2011. Our Medicare case mix index, which is an indicator of patient acuity, declined in the three months ended March 31, 2012 compared to the three months ended March 31, 2011. We believe the decline in our patient acuity was due to the lower incident of respiratory illnesses experienced nationwide during the three months ended March 31, 2012. Facility rent expense, which is a component of cost of services, was $30.3 million for three months ended March 31, 2012 compared to $30.0 million for the three months ended March 31, 2011. General and administrative expenses were 1.9% of net operating revenue or $14.2 million for the three months ended March 31, 2012 compared to 2.4% of net operating revenue or $16.6 million for the three months ended March 31, 2011. The decline in our general and administrative expenses resulted primarily from a gain on the sale of a building that occurred during the three months ended March 31, 2012. Our bad debt expense was $10.4 million or 1.4% of net operating revenues for the three months ended March 31, 2012 compared to $14.4 million or 2.1% for the three months ended March 31, 2011. The decline in our bad debt expense was primarily attributed to our favorable collections experience of accounts receivable associated with our Regency hospitals for the three months ended March 31, 2012 as compared to the three months ended March 31, 2011.

***Adjusted EBITDA***

*Specialty Hospitals*. Adjusted EBITDA for our specialty hospitals decreased by 0.4% to $100.0 million for the three months ended March 31, 2012 compared to $100.4 million for the three months ended March 31, 2011. Our Adjusted EBITDA margins for the segment decreased to 18.1% for the three months ended March 31, 2012 from 19.3% for the three months ended March 31, 2011. The decrease in the Adjusted EBITDA for our specialty hospitals was primarily the result of increases in our labor costs discussed above under Operating Expenses offset in part by a reduction in bad debt expense.

*Outpatient Rehabilitation*. Our Adjusted EBITDA for our outpatient rehabilitation segment increased 5.0% to $22.5 million for the three months ended March 31, 2012 from $21.4 million for the three months ended March 31, 2011. Our Adjusted EBITDA margins decreased to 11.8% for the three months ended March 31, 2012 from 12.4% for the three months ended March 31, 2011. The Adjusted EBITDA in our outpatient rehabilitation clinics increased by $0.6 million for the three months ended March 31, 2012 compared to the three months ended March 31, 2011. Our Adjusted EBITDA margins for our outpatient rehabilitation clinics decreased to 13.2% for the three months ended March 31, 2012 from 13.4% for the three months ended March 31, 2011. The decline in our Adjusted EBITDA margin in our rehabilitation clinics was principally due to increased labor costs associated with the Baylor JV services agreement. The Adjusted EBITDA in our contract services business increased by $0.5 million for the three months ended March 31, 2012 compared to the three months ended March 31, 2011. The Adjusted EBITDA margins for our contract services business declined to 7.8% for the three months ended March 31, 2012 compared to 8.7% for the three months ended March 31, 2011. The decline in Adjusted EBITDA margins was principally due to increased labor costs associated with new business and lower productivity resulting from regulatory changes that became effective on October 1, 2011.

*Other*. The Adjusted EBITDA loss was $13.4 million for the three months ended March 31, 2012 compared to an Adjusted EBITDA loss of $16.0 million for the three months ended March 31, 2011 and is primarily related to lower general and administrative expenses, as described under Operating Expenses.

***Income from Operations***

For the three months ended March 31, 2012 we had income from operations of $91.6 million compared to $87.6 million for the three months ended March 31, 2011. The increase in our income from operations resulted

principally from a reduction in our general and administrative expenses and an increase in the operating performance of our outpatient rehabilitation segment.

***Interest Expense***

*Select Medical Corporation.* Interest expense was $21.3 million for the three months ended March 31, 2012 compared to $18.7 million for the three months ended March 31, 2011. The increase in interest expense resulted primarily from the refinancing of $150.0 million of Holdings debt, for which Select was not previously obligated, through indebtedness incurred by Select under the new senior secured credit facility on June 1, 2011.

*Select Medical Holdings Corporation.* Interest expense was $23.9 million for the three months ended March 31, 2012 compared to $25.7 million for the three months ended March 31, 2011. The decrease in interest expense resulted primarily from the lower interest rates on the portions of the debt that were refinanced on June 1, 2011 and reduced borrowings for the three months ended March 31, 2012 compared to the three months ended March 31, 2011.

***Income Taxes***

*Select Medical Corporation.* We recorded income tax expense of $28.5 million for the three months ended March 31, 2012. The expense represented an effective tax rate of 39.2%. We recorded income tax expense of $29.0 million for the three months ended March 31, 2011. The expense represented an effective tax rate of 42.1%. Select Medical Corporation is part of the consolidated federal tax return for Select Medical Holdings Corporation. We allocate income taxes between Select and Holdings for purposes of financial statement presentation. Because Holdings is a passive investment company incorporated in Delaware, it does not incur any state income tax expense or benefit on its specific income or loss and, as such, receives a tax allocation equal to the federal statutory rate of 35% on its specific income or loss. Based upon the relative size of Holdings income or loss, this can cause the effective tax rate for Select to differ from the effective tax rate for the consolidated company.

*Select Medical Holdings Corporation.* We recorded income tax expense of $27.6 million for the three months ended March 31, 2012. The expense represented an effective tax rate of 39.3%. We recorded income tax expense of $26.6 million for the three months ended March 31, 2011. The expense represented an effective tax rate of 42.9%. The decline in our effective tax rate is primarily a consequence of the 2011 rate having been impacted by a tax gain associated with a hospital exchange that occurred in 2011.

***Non-Controlling Interests***

Non-controlling interests in consolidated earnings were $1.0 million for the three months ended March 31, 2012 and $1.7 million for the three months ended March 31, 2011.

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**Liquidity and Capital Resources**

***Cash Flows for the Three Months Ended March 31, 2012 and Three Months Ended March 31, 2011***

| | Select Medical Holdings Corporation Three Months Ended March 31, (in thousands) | | Select Medical Corporation Three Months Ended March 31, (in thousands) | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| Cash flows provided by (used in) operating activities | $ (5,032) | $ 8,180 | $ 7,685 | $ 13,422 |
| Cash flows used in investing activities | (14,670) | (3,080) | (14,670) | (3,080) |
| Cash flows provided by (used in) financing activities | 30,405 | (7,869) | 17,688 | (13,111) |
| Net increase (decrease) in cash and cash equivalents | 10,703 | (2,769) | 10,703 | (2,769) |
| Cash and cash equivalents at beginning of period | 4,365 | 12,043 | 4,365 | 12,043 |
| Cash and cash equivalents at end of period | $ 15,068 | $ 9,274 | $ 15,068 | $ 9,274 |

Operating activities for Select provided $13.4 million of cash flows for the three months ended March 31, 2012. Our days sales outstanding were 57 days at March 31, 2012 and at March 31, 2011 and 53 days at December 31, 2011. The increase in days sales outstanding between December 31, 2011 and March 31, 2012 is primarily related to the timing of the periodic interim payments we receive from Medicare for the services provided at our specialty hospitals.

The operating cash flows of Select exceeded the operating cash flows of Holdings by $5.2 million for the three months ended March 31, 2012 and by $12.7 million for the three months ended March 31, 2011. The difference relates to interest payments on Holdings indebtedness.

Investing activities used $3.1 million of cash flow for the three months ended March 31, 2012. The principal use of cash included $11.8 million related to the purchase of property and equipment and $7.8 million related to an investment in a business. This use of cash was offset by $16.5 million in proceeds related to the sale of a building. Investing activities used $14.7 million of cash flow for the three months ended March 31, 2011. The principal use of cash included $12.9 million related to the purchase of property and equipment and $2.0 million related to a hospital exchange.

Financing activities for Select used $13.1 million of cash flow for the three months ended March 31, 2012. The primary uses of cash related to dividends paid to Holdings to fund interest payments and stock repurchases of $31.0 million and distributions to non-controlling interests of $1.1 million. These uses were offset by net borrowings under our senior secured credit facility of $12.9 million, net borrowings of other debt of $3.5 million and proceeds from bank overdrafts of $2.5 million. Financing activities for Select provided $17.7 million of cash flow for the three months ended March 31, 2011. The primary sources of cash related to proceeds from net borrowings under our revolving credit facility of $100.0 million and net borrowings of other debt of $3.0 million. These borrowings were offset by aggregate payments on our term loans of $59.6 million,

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dividends paid to Holdings to fund interest payments and stock repurchases of $14.7 million, reduction in bank overdrafts of $9.4 million and $1.7 million in distributions to non-controlling interests.

***Capital Resources***

*Select Medical Corporation.* Select had net working capital of $148.5 million at March 31, 2012 compared to a net working capital of $97.3 million at December 31, 2011. The increase in net working capital is primarily due to increases in accounts receivable as of March 31, 2012.

*Select Medical Holdings Corporation.* Holdings had net working capital of $148.1 million at March 31, 2012 compared to a net working capital of $99.5 million at December 31, 2011. The increase in net working capital is primarily due to increases in accounts receivable as of March 31, 2012.

Holdings has authorized a program to repurchase up to $250.0 million worth of shares of our common stock. The program will remain in effect until March 31, 2013, unless extended by the board of directors. During the three months ended March 31, 2012, Holdings has repurchased 3,203,692 shares at a cost of $25.7 million and since the inception of the program has repurchased 19,968,299 shares under the program at a cost of $142.6 million, which includes related transaction costs. We anticipate funding this program through available operating cash flow and borrowings under our senior secured credit facility.

We may from time to time seek to retire or purchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions, tender offers or otherwise. Such repurchases or exchanges, if any, may be funded from operating cash flows or other sources and will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

We believe our internally generated cash flows and borrowing capacity under our senior secured credit facility will be sufficient to finance operations over the next twelve months.

As a result of the SCHIP Extension Act as amended by PPACA, which prohibits the establishment and classification of new LTCHs or satellites during the five calendar years commencing on December 29, 2007, we have stopped all new LTCH development. However, we continue to evaluate opportunities to develop new joint venture relationships with significant health systems, and from time to time we may also develop new inpatient rehabilitation hospitals. We also intend to open new outpatient rehabilitation clinics in local areas that we currently serve where we can benefit from existing referral relationships and brand awareness to produce incremental growth. In addition to our development activities, we may grow our network of specialty hospitals through opportunistic acquisitions.

**Recent Accounting Pronouncements**

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income ( Update 2011-05 ) that improves the comparability, consistency and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. Update 2011-05 requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income ( OCI ) to net income, in both net income and OCI. Update 2011-05 does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that

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such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, Update 2011-05 does not affect the calculation or reporting of earnings per share. Update 2011-05 was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and is to be applied retrospectively. We adopted Update 2011-05 on January 1, 2012. Update 2011-05 had no effect on our presentation of other comprehensive income for the three months ended March 31, 2011 and 2012 because we did not have any items of other comprehensive income during these periods.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Quantitative and Qualitative Disclosures About Market Risk**

We are subject to interest rate risk in connection with our long-term indebtedness. Our principal interest rate exposure relates to the loans outstanding under Select s senior secured credit facility and Holdings senior floating rate notes. As of March 31, 2012, we had $891.2 million in term and revolving loans outstanding under our senior secured credit facility and $167.3 million in senior floating rate notes outstanding, which bear interest at variable rates. Each eighth point change in interest rates on the variable rate portion of our long-term indebtedness would result in a $1.3 million annual change in interest expense on our term loans. However, because the variable interest rate for our $843.6 million in term loans is subject to an Adjusted LIBO Rate floor of 1.75% until the Adjusted LIBO Rate exceeds 1.75%, our interest rate on this indebtedness is effectively fixed at 5.50% as long as LIBOR remains under 1.75%.

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## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered in this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures, including the accumulation and communication of disclosure to our principal executive officer and principal financial officer as appropriate to allow timely decisions regarding disclosure, are effective as of March 31, 2012 to provide reasonable assurance that material information required to be included in our periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in the relevant SEC rules and forms.

### Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred during the first quarter ended March 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### Inherent Limitations on Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only reasonable assurance that our controls will succeed in achieving their goals under all potential future conditions.

## PART II OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

The Company is a party to various legal actions, proceedings and claims (some of which are not insured), and regulatory and other governmental audits and investigations in the ordinary course of its business. The Company cannot predict the ultimate outcome of pending litigation, proceedings and regulatory and other governmental audits and investigations. These matters could potentially subject us to sanctions, damages, recoupments, fines and other penalties. The Department of Justice, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company s businesses in the future that may, either individually or in the aggregate, have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

To cover claims arising out of the operations of the Company s specialty hospitals and outpatient rehabilitation facilities, the Company maintains professional malpractice liability insurance and general liability insurance, subject to self-insured retention of $2.0 million per medical incident for professional liability claims and $2.0 million per occurrence for general liability claims. The Company also maintains umbrella liability insurance covering claims which, due to their nature or amount, are not covered by or not fully covered by the Company s other insurance policies. These insurance policies also do not generally cover punitive damages and are subject to various deductibles and policy limits. Significant legal actions could subject the Company to

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substantial uninsured liabilities. In the Company s opinion, the outcome of these actions, individually or in the aggregate, will not have a material adverse effect on its financial position, results of operations, or cash flows.

Healthcare providers are subject to lawsuits under the qui tam provisions of the federal False Claims Act. Qui tam lawsuits typically remain under seal (hence, usually unknown to the defendant) for some time while the government decides whether or not to intervene on behalf of a private qui tam plaintiff (known as a relator) and take the lead in the litigation. These lawsuits can involve significant monetary damages and penalties and award bounties to private plaintiffs who successfully bring the suits. The Company has been a defendant in these cases in the past, and may be named as a defendant in similar cases from time to time in the future.

During April 2012, the Company s long term acute care hospital in Evansville, Indiana ( SSH Evansville ) received two subpoenas from the Office of Attorney General for the State of Indiana. One subpoena demanded certain patient medical records of SSH Evansville. The second subpoena demanded reports and documents related to SSH Evansville for various periods beginning in 2006, including certain financial, statistical, billing and quality reports; certain policies and procedures; joint venture board meeting minutes and documents related to certain complaints and internal investigations. Two days later, SSH-Evansville received a Request for Information or Assistance from the Office of Inspector General of the U.S. Department of Health and Human Services (Indianapolis, Indiana Field Office) covering the period beginning in 2007 seeking substantially the same records demanded by the Office of Attorney General for the State of Indiana, additional patient medical records of SSH Evansville and additional documents and information of SSH Evansville, including documents concerning SSH Evansville s relationships with its joint venture partner and eight other identified persons and entities. Separately, also in April 2012, the Company s long term acute care hospital in Beech Grove, Indiana received a request from an investigator with the Medicaid Fraud Control Unit of the Office of Attorney General for the State of Indiana to produce the medical records of a single patient. On May 1, 2012, the Evansville (Indiana) Police Department executed a search warrant at SSH-Evansville purporting to seek evidence pertaining to the crime of theft. The search warrant sought various items of personal property, including copy machines, facsimile machines, printers and personal communication devices, and various documents and business records regarding SSH-Evansville for a period beginning in May 2004, including claims for Medicaid and Medicare payment, EOB forms, patient files, Medicaid and Medicare reimbursement manuals, personnel files, complaints and investigations of employees, contractors and physicians and other documents. The Company has produced and will continue to produce documents in response to these requests, and intends to fully cooperate with these government investigations. At this time, the Company is unable to predict the timing and outcome of this matter.

**ITEM 1A. RISK FACTORS.**

There have been no material changes from our risk factors as previously reported in our Annual Report on Form 10-K for the year ended December 31, 2011.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Purchases of Equity Securities by the Issuer**

In November 2010, our board of directors authorized a stock repurchase program pursuant to which we may purchase up to $100.0 million worth of our common stock. On August 3, 2011, our board of directors authorized an increase of $50.0 million in the capacity of our common stock repurchase program, from $100.0 million to $150.0 million and on February 22, 2012 increased the capacity by an additional $100.0 million to $250.0 million. The other terms of the plan remain unchanged. Stock repurchases under this program may be made in the open market or through privately negotiated transactions, and at times and in such amounts as the Company deems appropriate. The program will remain in effect until March 31, 2013, unless extended by our board of directors. During the three months ended March 31, 2012, we purchased a total of 3,203,692 shares of our common stock at an average purchase price of $8.02.

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The following table sets forth the monthly purchases made under this program during the three months ended March 31, 2012:

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| January 1, 2012 to January 31, 2012 | 1,800,000 | $ 7.99 | 1,800,000 | $ 118,727,928 |
| February 1, 2012 to February 29, 2012 | 509,192 | $ 8.39 | 509,192 | $ 114,456,624 |
| March 1, 2012 to March 31, 2012 | 894,500 | $ 7.86 | 894,500 | $ 107,406,829 |
| First Quarter 2012 | 3,203,692 | $ 8.02 | 3,203,692 | $ 107,406,829 |

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

The exhibits to this report are listed in the Exhibit Index appearing on page 46 hereof.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

SELECT MEDICAL CORPORATION

| | |
|---|---|
| By: | /s/ Martin F. Jackson<br>Martin F. Jackson<br>Executive Vice President and Chief Financial Officer<br>(Duly Authorized Officer) |
| By: | /s/ Scott A. Romberger<br>Scott A. Romberger<br>Senior Vice President, Chief Accounting Officer and Controller<br>(Principal Accounting Officer) |

**Dated: May 3, 2012**

SELECT MEDICAL HOLDINGS CORPORATION

| | |
|---|---|
| By: | /s/ Martin F. Jackson<br>Martin F. Jackson<br>Executive Vice President and Chief Financial Officer<br>(Duly Authorized Officer) |
| By: | /s/ Scott A. Romberger<br>Scott A. Romberger<br>Senior Vice President, Chief Accounting Officer and Controller<br>(Principal Accounting Officer) |

**Dated: May 3, 2012**

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## EXHIBIT INDEX

| Exhibit | Description |
|---|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Executive Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer, and Executive Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following financial information from the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011, (ii) Consolidated Balance Sheets as of March 31, 2012 and December 31, 2011, (iii) Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011, (iv) Consolidated Statements of Changes in Equity and Income for the three months ended March 31, 2012 and (v) Notes to Consolidated Financial Statements.* |

* XBRL information is furnished and not filed herewith, is not part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.