

SELECT MEDICAL HOLDINGS CORP
Form 10-Q
August 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended June 30, 2016

- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Transition Period From to .

Commission File Number: 001 34465 and 001 31441

SELECT MEDICAL HOLDINGS CORPORATION

SELECT MEDICAL CORPORATION

(Exact name of Registrant as specified in its charter)

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Delaware
Delaware
(State or other jurisdiction of
incorporation or organization)

20-1764048
23-2872718
(I.R.S. employer identification
number)

4714 Gettysburg Road, P.O. Box 2034, Mechanicsburg, Pennsylvania 17055

(Address of principal executive offices and zip code)

(717) 972-1100

(Registrants telephone number, including area code)

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods as such Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the Registrants have submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrants were required to submit and post such files).

YES NO

Indicate by check mark whether the registrant, Select Medical Holdings Corporation, is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated
filer

Accelerated
filer

Non-accelerated
filer

Smaller reporting
company

(Do not check if a smaller
reporting company)

Indicate by check mark whether the registrant, Select Medical Corporation, is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated
filer

Accelerated
filer

Non-accelerated
filer
(Do not check if a smaller
reporting company)

Smaller reporting
company

Indicate by check mark whether the Registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act).

YES NO

As of June 30, 2016, Select Medical Holdings Corporation had outstanding 131,472,188 shares of common stock.

This Form 10-Q is a combined quarterly report being filed separately by two Registrants: Select Medical Holdings Corporation and Select Medical Corporation. Unless the context indicates otherwise, any reference in this report to "Holdings" refers to Select Medical Holdings Corporation and any reference to "Select" refers to Select Medical Corporation, the wholly owned operating subsidiary of Holdings, and any of Select's subsidiaries. Any reference to "Concentra" refers to Concentra Inc., the indirect operating subsidiary of Concentra Group Holdings, LLC ("Group Holdings"), and its subsidiaries. References to the "Company," "we," "us" and "our" refer collectively to Holdings, Select, and Group Holdings and its subsidiaries.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Condensed Consolidated Balance Sheets****(unaudited)****(in thousands, except share and per share amounts)**

| | Select Medical Holdings Corporation | | Select Medical Corporation | |
|---|-------------------------------------|---------------------|----------------------------|---------------------|
| | December 31, 2015 | June 30, 2016 | December 31, 2015 | June 30, 2016 |
| ASSETS | | | | |
| Current Assets: | | | | |
| Cash and cash equivalents | \$ 14,435 | \$ 78,420 | \$ 14,435 | \$ 78,420 |
| Accounts receivable, net of allowance for doubtful accounts of \$61,133 and \$56,664 at 2015 and 2016, respectively | 603,558 | 613,790 | 603,558 | 613,790 |
| Current deferred tax asset | 28,688 | 43,955 | 28,688 | 43,955 |
| Prepaid income taxes | 16,694 | | 16,694 | |
| Other current assets | 85,779 | 88,862 | 85,779 | 88,862 |
| Total Current Assets | 749,154 | 825,027 | 749,154 | 825,027 |
| Property and equipment, net | 864,124 | 889,171 | 864,124 | 889,171 |
| Goodwill | 2,314,624 | 2,638,286 | 2,314,624 | 2,638,286 |
| Other identifiable intangibles, net | 318,675 | 343,928 | 318,675 | 343,928 |
| Other assets | 142,101 | 141,937 | 142,101 | 141,937 |
| Total Assets | \$ 4,388,678 | \$ 4,838,349 | \$ 4,388,678 | \$ 4,838,349 |
| Current Liabilities: | | | | |
| Bank overdrafts | \$ 28,615 | \$ 26,477 | \$ 28,615 | \$ 26,477 |
| Current portion of long-term debt and notes payable | 225,166 | 10,511 | 225,166 | 10,511 |
| Accounts payable | 137,409 | 118,420 | 137,409 | 118,420 |
| Accrued payroll | 120,989 | 135,552 | 120,989 | 135,552 |
| Accrued vacation | 73,977 | 81,074 | 73,977 | 81,074 |
| Accrued interest | 9,401 | 16,927 | 9,401 | 16,927 |
| Accrued other | 133,728 | 134,085 | 133,728 | 134,085 |
| Income taxes payable | | 12,314 | | 12,314 |
| Total Current Liabilities | 729,285 | 535,360 | 729,285 | 535,360 |
| Long-term debt, net of current portion | 2,160,730 | 2,707,311 | 2,160,730 | 2,707,311 |
| Non-current deferred tax liability | 218,705 | 201,538 | 218,705 | 201,538 |
| Other non-current liabilities | 133,220 | 131,699 | 133,220 | 131,699 |
| Total Liabilities | 3,241,940 | 3,575,908 | 3,241,940 | 3,575,908 |
| Commitments and contingencies (Note 11) | | | | |

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| | | | | |
|---|--------------|--------------|--------------|--------------|
| Redeemable non-controlling interests | 238,221 | 245,784 | 238,221 | 245,784 |
| Stockholders' Equity: | | | | |
| Common stock of Holdings, \$0.001 par value, 700,000,000 shares authorized, 131,282,798 and 131,472,188 shares issued and outstanding at 2015 and 2016, respectively | 131 | 131 | | |
| Common stock of Select, \$0.01 par value, 100 shares issued and outstanding | | | 0 | 0 |
| Capital in excess of par | 424,506 | 432,951 | 904,375 | 913,058 |
| Retained earnings (accumulated deficit) | 434,616 | 522,995 | (45,122) | 43,019 |
| Total Select Medical Holdings Corporation and Select Medical Corporation Stockholders' Equity | 859,253 | 956,077 | 859,253 | 956,077 |
| Non-controlling interest | 49,264 | 60,580 | 49,264 | 60,580 |
| Total Equity | 908,517 | 1,016,657 | 908,517 | 1,016,657 |
| Total Liabilities and Equity | \$ 4,388,678 | \$ 4,838,349 | \$ 4,388,678 | \$ 4,838,349 |

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

Table of Contents**Condensed Consolidated Statements of Operations**

(unaudited)

(in thousands, except per share amounts)

| | Select Medical Holdings Corporation For the Three Months Ended June 30, | | Select Medical Corporation For the Three Months Ended June 30, | |
|---|--|--------------|---|--------------|
| | 2015 | 2016 | 2015 | 2016 |
| Net operating revenues | \$ 887,065 | \$ 1,097,631 | \$ 887,065 | \$ 1,097,631 |
| Costs and expenses: | | | | |
| Cost of services | 743,879 | 916,985 | 743,879 | 916,985 |
| General and administrative | 24,041 | 25,870 | 24,041 | 25,870 |
| Bad debt expense | 12,286 | 17,517 | 12,286 | 17,517 |
| Depreciation and amortization | 21,848 | 36,205 | 21,848 | 36,205 |
| Total costs and expenses | 802,054 | 996,577 | 802,054 | 996,577 |
| Income from operations | 85,011 | 101,054 | 85,011 | 101,054 |
| Other income and expense: | | | | |
| Equity in earnings of unconsolidated subsidiaries | 3,848 | 4,546 | 3,848 | 4,546 |
| Non-operating gain | | 13,035 | | 13,035 |
| Interest expense | (25,288) | (44,332) | (25,288) | (44,332) |
| Income before income taxes | 63,571 | 74,303 | 63,571 | 74,303 |
| Income tax expense | 23,517 | 33,450 | 23,517 | 33,450 |
| Net income | 40,054 | 40,853 | 40,054 | 40,853 |
| Less: Net income attributable to non-controlling interests | 3,114 | 6,918 | 3,114 | 6,918 |
| Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation | \$ 36,940 | \$ 33,935 | \$ 36,940 | \$ 33,935 |
| Basic | \$ 0.28 | \$ 0.26 | | |
| Diluted | \$ 0.28 | \$ 0.26 | | |
| Weighted average shares outstanding: | | | | |
| Basic | 127,674 | 127,626 | | |
| Diluted | 128,009 | 127,820 | | |

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

Table of Contents**Condensed Consolidated Statements of Operations****(unaudited)****(in thousands, except per share amounts)**

| | Select Medical Holdings Corporation For the Six Months Ended June 30, | | Select Medical Corporation For the Six Months Ended June 30, | |
|---|--|--------------|---|--------------|
| | 2015 | 2016 | 2015 | 2016 |
| Net operating revenues | \$ 1,682,408 | \$ 2,185,961 | \$ 1,682,408 | \$ 2,185,961 |
| Costs and expenses: | | | | |
| Cost of services | 1,408,264 | 1,839,247 | 1,408,264 | 1,839,247 |
| General and administrative | 45,716 | 54,138 | 45,716 | 54,138 |
| Bad debt expense | 24,956 | 33,914 | 24,956 | 33,914 |
| Depreciation and amortization | 39,196 | 70,722 | 39,196 | 70,722 |
| Total costs and expenses | 1,518,132 | 1,998,021 | 1,518,132 | 1,998,021 |
| Income from operations | 164,276 | 187,940 | 164,276 | 187,940 |
| Other income and expense: | | | | |
| Loss on early retirement of debt | | (773) | | (773) |
| Equity in earnings of unconsolidated subsidiaries | 6,440 | 9,198 | 6,440 | 9,198 |
| Non-operating gain | | 38,122 | | 38,122 |
| Interest expense | (46,676) | (83,180) | (46,676) | (83,180) |
| Income before income taxes | 124,040 | 151,307 | 124,040 | 151,307 |
| Income tax expense | 46,701 | 50,510 | 46,701 | 50,510 |
| Net income | 77,339 | 100,797 | 77,339 | 100,797 |
| Less: Net income attributable to non-controlling interests | 5,336 | 12,029 | 5,336 | 12,029 |
| Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation | \$ 72,003 | \$ 88,768 | \$ 72,003 | \$ 88,768 |
| Basic | \$ 0.55 | \$ 0.68 | | |
| Diluted | \$ 0.55 | \$ 0.68 | | |
| Dividends paid per share | \$ 0.10 | \$ | | |
| Weighted average shares outstanding: | | | | |
| Basic | 127,620 | 127,563 | | |
| Diluted | 127,944 | 127,709 | | |

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

Table of Contents**Condensed Consolidated Statement of Changes in Equity and Income**

(unaudited)

(in thousands)

| | Comprehensive Income | Total | Select Medical Holdings Corporation Stockholders | | | | Non-controlling Interests |
|---|----------------------|--------------|--|--------------------|-------------------|-------------------|---------------------------|
| | | | Common Stock Issued | Common Stock Value | ParCapital of Par | Retained Earnings | |
| Balance at December 31, 2015 | | \$ 908,517 | 131,283 | \$ 131 | \$ 424,506 | \$ 434,616 | \$ 49,264 |
| Net income | \$ 90,774 | 90,774 | | | | 88,768 | 2,006 |
| Net income - attributable to redeemable non-controlling interests | 10,023 | | | | | | |
| Total comprehensive income | \$ 100,797 | | | | | | |
| Issuance and vesting of restricted stock | | 7,786 | 149 | 0 | 7,786 | | |
| Tax benefit from stock based awards | | 269 | | | 269 | | |
| Repurchase of common shares | | (506) | (38) | 0 | (238) | (268) | |
| Stock option expense | | 4 | | | 4 | | |
| Exercise of stock options | | 657 | 78 | 0 | 657 | | |
| Non-controlling interests acquired in business combination | | 2,514 | | | | | 2,514 |
| Distributions to non-controlling interests | | (3,505) | | | | | (3,505) |
| Issuance of non-controlling interests | | 9,831 | | | | | 9,831 |
| Purchase of redeemable non-controlling interests | | 320 | | | | 320 | |
| Other | | (4) | | | (33) | (441) | 470 |
| Balance at June 30, 2016 | | \$ 1,016,657 | 131,472 | \$ 131 | \$ 432,951 | \$ 522,995 | \$ 60,580 |

| | Comprehensive Income | Total | Select Medical Corporation Stockholders | | | | Non-controlling Interests |
|--|----------------------|------------|---|--------------------|-------------------|---|---------------------------|
| | | | Common Stock Issued | Common Stock Value | ParCapital of Par | Retained Earnings (Accumulated Deficit) | |
| Balance at December 31, 2015 | | \$ 908,517 | 0 | \$ 0 | \$ 904,375 | \$ (45,122) | \$ 49,264 |
| Net income | \$ 90,774 | 90,774 | | | | 88,768 | 2,006 |
| Net income - attributable to redeemable non-controlling interests | 10,023 | | | | | | |
| Total comprehensive income | \$ 100,797 | | | | | | |
| Additional investment by Holdings | | 657 | | | 657 | | |
| Dividends declared and paid to Holdings | | (506) | | | | (506) | |
| Contribution related to restricted stock awards and stock option issuances by Holdings | | 7,790 | | | 7,790 | | |
| Tax benefit from stock based awards | | 269 | | | 269 | | |
| | | 2,514 | | | | | 2,514 |

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| | | | | | | | | | |
|--|--------------|---|----|---|----|---------|----|---------|-----------|
| Non-controlling interests acquired in business combination | | | | | | | | | |
| Distributions to non-controlling interests | (3,505) | | | | | | | (3,505) | |
| Issuance of non-controlling interests | 9,831 | | | | | | | 9,831 | |
| Purchase of redeemable non-controlling interests | 320 | | | | | | | 320 | |
| Other | (4) | | | | | (33) | | (441) | 470 |
| Balance at June 30, 2016 | \$ 1,016,657 | 0 | \$ | 0 | \$ | 913,058 | \$ | 43,019 | \$ 60,580 |

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

Table of Contents**Condensed Consolidated Statements of Cash Flows**

(unaudited)

(in thousands)

| | Select Medical Holdings Corporation For the Six Months Ended June 30, | | Select Medical Corporation For the Six Months Ended June 30, | |
|---|--|------------|---|------------|
| | 2015 | 2016 | 2015 | 2016 |
| Operating activities | | | | |
| Net income | \$ 77,339 | \$ 100,797 | \$ 77,339 | \$ 100,797 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Distributions from unconsolidated subsidiaries | 52 | 12,039 | 52 | 12,039 |
| Depreciation and amortization | 39,196 | 70,722 | 39,196 | 70,722 |
| Amortization of leasehold interests | | 295 | | 295 |
| Provision for bad debts | 24,956 | 33,914 | 24,956 | 33,914 |
| Equity in earnings of unconsolidated subsidiaries | (6,440) | (9,198) | (6,440) | (9,198) |
| Loss on early retirement of debt | | 773 | | 773 |
| Loss on disposal of assets | 251 | 55 | 251 | 55 |
| Gain on sale of assets and business | | (43,461) | | (43,461) |
| Impairment of equity investment | | 5,339 | | 5,339 |
| Stock compensation expense | 5,794 | 8,174 | 5,794 | 8,174 |
| Amortization of debt discount, premium and issuance costs | 4,027 | 7,077 | 4,027 | 7,077 |
| Deferred income taxes | (4,428) | (13,286) | (4,428) | (13,286) |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | |
| Accounts receivable | (89,265) | (44,096) | (89,265) | (44,096) |
| Other current assets | (8,038) | 11,011 | (8,038) | 11,011 |
| Other assets | 3,568 | 4,213 | 3,568 | 4,213 |
| Accounts payable | 8,925 | (15,852) | 8,925 | (15,852) |
| Accrued expenses | 707 | 20,632 | 707 | 20,632 |
| Income taxes | 18,416 | 28,821 | 18,416 | 28,821 |
| Net cash provided by operating activities | 75,060 | 177,969 | 75,060 | 177,969 |
| Investing activities | | | | |
| Purchases of property and equipment | (68,912) | (80,258) | (68,912) | (80,258) |
| Proceeds from sale of assets and business | | 71,366 | | 71,366 |
| Investment in businesses | (855) | (1,590) | (855) | (1,590) |
| Acquisition of businesses, net of cash acquired | (1,047,997) | (421,519) | (1,047,997) | (421,519) |
| Net cash used in investing activities | (1,117,764) | (432,001) | (1,117,764) | (432,001) |
| Financing activities | | | | |
| Borrowings on revolving facilities | 660,000 | 320,000 | 660,000 | 320,000 |
| Payments on revolving facilities | (400,000) | (380,000) | (400,000) | (380,000) |
| Net proceeds from Select term loans | | 600,127 | | 600,127 |
| Net proceeds from Concentra term loans | 623,575 | | 623,575 | |
| Payments on term loans | (26,884) | (229,649) | (26,884) | (229,649) |
| Borrowings of other debt | 9,590 | 22,082 | 9,590 | 22,082 |
| Principal payments on other debt | (8,320) | (9,926) | (8,320) | (9,926) |
| Dividends paid to common stockholders | (13,129) | | | |
| Dividends paid to Holdings | | | (13,129) | (506) |

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| | | | | | |
|--|-----------|-----------|-----------|-----------|--|
| Repurchase of common stock | | (506) | | | |
| Proceeds from issuance of common stock | 1,325 | 657 | | | |
| Equity investment by Holdings | | | 1,325 | 657 | |
| Proceeds from issuance of non-controlling interest | 217,065 | 3,103 | 217,065 | 3,103 | |
| Proceeds from (repayments of) bank overdrafts | 5,590 | (2,138) | 5,590 | (2,138) | |
| Tax benefit from stock based awards | 11 | 269 | 11 | 269 | |
| Purchase of non-controlling interests | | (1,294) | | (1,294) | |
| Distributions to non-controlling interests | (4,282) | (4,708) | (4,282) | (4,708) | |
| Net cash provided by financing activities | 1,064,541 | 318,017 | 1,064,541 | 318,017 | |
| Net increase in cash and cash equivalents | 21,837 | 63,985 | 21,837 | 63,985 | |
| Cash and cash equivalents at beginning of period | 3,354 | 14,435 | 3,354 | 14,435 | |
| Cash and cash equivalents at end of period | \$ 25,191 | \$ 78,420 | \$ 25,191 | \$ 78,420 | |
| Supplemental Cash Flow Information | | | | | |
| Cash paid for interest | \$ 39,932 | \$ 69,315 | \$ 39,932 | \$ 69,315 | |
| Cash paid for taxes | \$ 32,702 | \$ 35,518 | \$ 32,702 | \$ 35,518 | |

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

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SELECT MEDICAL HOLDINGS CORPORATION AND SELECT MEDICAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

The unaudited condensed consolidated financial statements of Select Medical Holdings Corporation (Holdings) and Select Medical Corporation (Select) as of June 30, 2016, and for the three and six month periods ended June 30, 2015 and 2016, have been prepared in accordance with generally accepted accounting principles (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 and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2016. Holdings and Select and their subsidiaries are collectively referred to as the Company. The condensed 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.

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, 2015 contained in the Company s Annual Report on Form 10-K filed with the SEC on February 26, 2016.

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.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2016-09, *Compensation-Stock Compensation*, which simplifies various aspects of accounting for share-based payments to employees. The areas for simplification involve several aspects of the accounting for employee share-based payment transactions, including the income tax consequences,

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classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2016. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU includes a lessee accounting model that recognizes two types of leases; finance and operating. This ASU requires that a lessee recognize on the balance sheet assets and liabilities for all leases with lease terms of more than twelve months. Lessees will need to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or finance. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a

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lessee will depend on its classification as finance or operating lease. For short-term leases of twelve months or less, lessees are permitted to make an accounting election by class of underlying asset not to recognize right-of-use assets or lease liabilities. If the alternative is elected, lease expense would be recognized generally on the straight-line basis over the respective lease term.

The amendments in ASU 2016-02 will take effect for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted as of the beginning of an interim or annual reporting period. A modified retrospective approach is required for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the adoption methodology and the impact of this update on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, which changes the presentation of deferred income taxes. The intent is to simplify the presentation of deferred income taxes through the requirement that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The revised guidance is effective for annual fiscal periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the standard.

In May 2014, March 2016, and April 2016 the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, ASU 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing*, and ASU 2016-12, *Revenue from Contracts with Customers, Narrow Scope Improvements and Practical Expedients*, respectively, which supersede most of the current revenue recognition requirements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. New disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. The original standards were effective for fiscal years beginning after December 15, 2016; however, in July 2015, the FASB approved a one-year deferral of these standards, with a new effective date for fiscal years beginning after December 15, 2017. The standards require the selection of a modified retrospective or cumulative effect transition method for retrospective application. The Company is currently evaluating the standards to determine the impact they will have on its consolidated financial statements.

Recently Adopted Accounting Pronouncements

In April and August 2015, the FASB issued ASU 2015-03 and ASU 2015-15, each titled *Interest- Imputation of Interest*, to simplify the presentation of debt issuance costs. The standard requires debt issuance costs be presented in the balance sheet as a direct deduction from the carrying value of the debt liability. The FASB clarified that debt issuance costs related to line-of-credit arrangements can be presented as an asset and amortized over the term of the arrangement. The Company adopted the standard at the beginning of the first quarter of 2016. The balance sheet as of December 31, 2015 was retrospectively conformed to reflect the adoption of the standard and approximately \$38.0 million of unamortized debt issuance costs are now classified as a direct reduction of debt, rather than a component of other assets.

Table of Contents**3. Acquisitions*****Physiotherapy Acquisition***

On March 4, 2016, Select acquired 100% of the issued and outstanding equity securities of Physiotherapy Associates Holdings, Inc. (Physiotherapy) for \$408.7 million, which is subject to a post closing purchase price adjustment, net of \$12.3 million of cash acquired. Select financed the acquisition using a combination of cash on hand and proceeds from an incremental term loan facility under the Select credit facilities, as defined below (see note 7 for more details). During the six months ended June 30, 2016, \$3.2 million of Physiotherapy acquisition costs were recognized in general and administrative expense.

Physiotherapy is a national provider of outpatient physical rehabilitation care offering a wide range of services, including general orthopedics, spinal care and neurological rehabilitation, as well as orthotics and prosthetics services.

The Physiotherapy acquisition is being accounted for under the provisions of Accounting Standards Codification (ASC) 805, Business Combinations. The Company has prepared a preliminary allocation of the purchase price to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The Company is in the process of completing its assessment of fair values for identifiable tangible and intangible assets, and liabilities assumed; therefore, the values set forth below are subject to adjustment during the measurement period for such activities as estimating useful lives of long-lived assets and finite lived intangibles and completing assessment of fair values by obtaining appraisals. The amount of these potential adjustments could be significant. The Company expects to complete its purchase price allocation activities by December 31, 2016.

The following table summarizes the preliminary allocation of the purchase price to the fair value of identifiable assets acquired and liabilities assumed, in accordance with the acquisition method of accounting (in thousands):

| | | |
|---|----|----------|
| Cash and cash equivalents | \$ | 12,340 |
| Identifiable tangible assets, excluding cash and cash equivalents | | 93,426 |
| Identifiable intangible assets | | 33,495 |
| Goodwill | | 319,203 |
| Total assets | | 458,464 |
| Total liabilities | | 34,956 |
| Acquired non-controlling interests | | 2,514 |
| Net assets acquired | | 420,994 |
| Less: Cash and cash equivalents acquired | | (12,340) |
| Net cash paid | \$ | 408,654 |

Goodwill of \$319.2 million has been preliminarily recognized in the transaction, representing the excess of the purchase price over the value of the tangible and intangible assets acquired and liabilities assumed. The factors considered in determining the goodwill that resulted from the Physiotherapy purchase price included Physiotherapy's future earnings potential and the value of the assembled workforce. The goodwill has been allocated to the outpatient rehabilitation segment and is not deductible for tax purposes. However, prior to its acquisition by the Company, Physiotherapy completed certain acquisitions that resulted in goodwill with an estimated value of \$8.8 million that is deductible for tax purposes.

which the Company will deduct through 2030.

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Due to the integrated nature of our operations, it is not practicable to separately identify net revenue and earnings of Physiotherapy on a stand-alone basis.

Concentra Acquisition

On June 1, 2015, MJ Acquisition Corporation, a joint venture that Select created with Welsh, Carson, Anderson & Stowe XII, L.P., consummated the acquisition of Concentra, Inc. (Concentra), the indirect operating subsidiary of Concentra Group Holdings, LLC, and its subsidiaries. Pursuant to the terms of the stock purchase agreement, dated as of March 22, 2015, by and among MJ Acquisition Corporation, Concentra and Humana Inc., MJ Acquisition Corporation acquired 100% of the issued and outstanding equity securities of Concentra from Humana, Inc. for \$1,047.2 million, net of \$3.8 million of cash acquired.

During the year ended December 31, 2015, the Company finalized the purchase price allocation to identifiable intangible assets, fixed assets, non-controlling interests, and certain pre-acquisition contingencies. During the quarter ended June 30, 2016, the Company completed the accounting for certain deferred tax matters.

The following table summarizes the allocation of the purchase price to the fair value of identifiable assets acquired and liabilities assumed, in accordance with the acquisition method of accounting (in thousands):

| | | |
|---|----|-----------|
| Cash and cash equivalents | \$ | 3,772 |
| Identifiable tangible assets, excluding cash and cash equivalents | | 406,926 |
| Identifiable intangible assets | | 254,990 |
| Goodwill | | 651,152 |
| Total assets | | 1,316,840 |
| Total liabilities | | 248,797 |
| Acquired non-controlling interests | | 17,084 |
| Net assets acquired | | 1,050,959 |
| Less: Cash and cash equivalents acquired | | (3,772) |
| Net cash paid | \$ | 1,047,187 |

Goodwill of \$651.2 million was recognized in the transaction, representing the excess of the purchase price over the value of the tangible and intangible assets acquired and liabilities assumed. The factors considered in determining the goodwill that resulted from the Concentra purchase price included Concentra's future earnings potential and the value of Concentra's assembled workforce. The goodwill is allocated to the Concentra segment and is not deductible for tax purposes. However, prior to its acquisition by MJ Acquisition Corporation, Concentra completed certain acquisitions that resulted in goodwill with an estimated value of \$23.9 million that is deductible for tax purposes, which the Company will deduct through 2025.

For the three months ended June 30, 2016, Concentra contributed net revenue of \$254.9 million and net income of approximately \$4.7 million, which are reflected in the Company's consolidated statements of operations. For the six months ended June 30, 2016, Concentra contributed net revenue of \$505.7 million and net income of approximately \$7.0 million, which are reflected in the Company's consolidated statements of operations.

Table of Contents**Pro Forma Results**

The following pro forma unaudited results of operations have been prepared assuming the acquisitions of Concentra and Physiotherapy occurred January 1, 2014 and 2015, respectively. These results are not necessarily indicative of results of future operations nor of the results that would have actually occurred had the acquisitions been consummated on the aforementioned dates. The three months ended June 30, 2016, includes both Concentra and Physiotherapy for the entire period and there are no pro forma adjustments; therefore, no pro forma information is presented for the period.

| | For the Three Months Ended June 30, 2015 | | For the Six Months Ended June 30, 2015 | | 2016 |
|-------------------------------------|--|-----------|--|-----------|--------------|
| | (in thousands, except per share amounts) | | | | |
| Net revenue | \$ | 1,135,268 | \$ | 2,250,274 | \$ 2,239,491 |
| Net income attributable to Holdings | | 38,671 | | 64,069 | 85,820 |
| Income per common share: | | | | | |
| Basic | \$ | 0.29 | \$ | 0.49 | \$ 0.64 |
| Diluted | \$ | 0.29 | \$ | 0.49 | \$ 0.64 |

The pro forma financial information is based on the preliminary allocation of the purchase price of the Physiotherapy acquisition, and therefore subject to adjustment upon finalizing the purchase price allocation, as described above, during the measurement period. The net income tax impact was calculated at a statutory rate, as if Concentra and Physiotherapy had been subsidiaries of the Company as of January 1, 2014 and 2015, respectively.

Pro forma results for the six months ended June 30, 2015 were adjusted to include \$3.2 million of Physiotherapy acquisition costs and exclude \$4.7 million of Concentra acquisition costs. Pro forma results for the six months ended June 30, 2016 were adjusted to exclude approximately \$3.2 million of Physiotherapy acquisition costs.

Other Acquisitions

In addition to the acquisition of Physiotherapy, during the six months ended June 30, 2016, the Company acquired interests in several businesses. The Company provided total consideration of \$49.7 million, consisting of cash amounting to \$12.5 million (net of cash acquired), minority interest issued of \$9.8 million, and liabilities assumed of \$1.3 million, for identifiable tangible net assets consisting principally of accounts receivable and property and equipment with an aggregate fair value of \$11.0 million. Based on the preliminary purchase price allocations, these acquisitions resulted in recognition of goodwill of \$14.6 million in the specialty hospital segment, \$0.5 million in the outpatient rehabilitation segment and \$3.5 million in the Concentra segment.

4. Sale of Businesses

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The Company recognized a non-operating gain of \$43.4 million for the six months ended June 30, 2016. The Company sold its contract therapy businesses for \$65.0 million, resulting in a non-operating gain of \$33.9 million. The Company also transferred five specialty hospitals in an exchange transaction and sold nine outpatient rehabilitation clinics, which resulted in non-operating gains of \$7.8 million and \$1.7 million, respectively.

Table of Contents**5. Impairment of Equity Investment**

During the six months ended June 30, 2016, the Company recognized an impairment loss of \$5.3 million on one of its equity investments. The loss, which was triggered by a planned sale of the investee by the controlling interest, is reflected as part of non-operating gain on the Company's consolidated statements of operations.

6. Intangible Assets

The net carrying value of the Company's goodwill and identifiable intangible assets consist of the following:

| | December 31, 2015 | | June 30, 2016 |
|---|----------------------|----|------------------|
| | (in thousands) | | |
| Goodwill | \$ 2,314,624 | \$ | 2,638,286 |
| Identifiable intangibles Indefinite lived assets: | | | |
| Trademarks | 162,609 | | 166,419 |
| Certificates of need | 13,022 | | 13,156 |
| Accreditations | 2,045 | | 2,135 |
| Identifiable intangibles Finite lived assets: | | | |
| Customer relationships | 132,751 | | 125,765 |
| Favorable leasehold interests | 8,248 | | 11,699 |
| Non-compete agreements | | | 24,754 |
| Total identifiable intangibles | \$ 2,633,299 | \$ | 2,982,214 |

The Company's customer relationships and non-compete agreement assets amortize over their estimated useful lives. Amortization expense for the Company's customer relationships and non-compete agreements was \$4.3 million and \$1.1 million for the three months ended June 30, 2016 and 2015, respectively. Amortization expense was \$8.1 million and \$1.2 million for the six months ended June 30, 2016 and 2015, respectively. Estimated amortization expense of the Company's customer relationships and non-compete agreements for each of the five succeeding years is \$16.4 million.

In addition, the Company has recognized unfavorable leasehold interests which are recorded as liabilities. The net carrying value of unfavorable leasehold interests was \$4.3 million and \$3.0 million as of June 30, 2016 and December 31, 2015, respectively.

The Company's favorable leasehold assets and unfavorable leasehold liabilities are amortized to rent expense over the remaining term of their respective leases to reflect a market rent per period based upon the market conditions present at the acquisition date. The net effect of this amortization increased rent expense by \$0.2 million for the three months ended June 30, 2016 and \$0.3 million for the six months ended June 30, 2016.

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The Company's accreditations and trademarks have renewal terms. The costs to renew these intangibles are expensed as incurred. At June 30, 2016, the accreditations and trademarks have a weighted average time until next renewal of 1.5 years and 3.1 years, respectively.

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The changes in the carrying amount of goodwill for the Company's reportable segments for the six months ended June 30, 2016 are as follows:

| | Specialty Hospitals | Outpatient Rehabilitation | Concentra | Total |
|---------------------------------|------------------------|------------------------------|------------|--------------|
| | (in thousands) | | | |
| Balance as of December 31, 2015 | \$ 1,357,379 | \$ 306,595 | \$ 650,650 | \$ 2,314,624 |
| Acquired | 14,600 | 357,808 | 3,545 | 375,953 |
| Measurement period adjustment | | (38,090) | 4,825 | (33,265) |
| Disposed | (10,633) | (8,393) | | (19,026) |
| Balance as of June 30, 2016 | \$ 1,361,346 | \$ 617,920 | \$ 659,020 | \$ 2,638,286 |

See Note 3 for details of the goodwill acquired during the period.

7. Indebtedness

For purposes of this indebtedness footnote, references to Select exclude Concentra, because the Concentra credit facilities are non-recourse to Holdings and Select.

The components of long-term debt and notes payable are shown in the following tables:

| | December 31, 2015 | June 30, 2016 |
|-------------------------------------|----------------------|------------------|
| | (in thousands) | |
| Select 6.375% senior notes(1) | \$ 700,867 | \$ 701,703 |
| Select credit facilities: | | |
| Select revolving facility | 295,000 | 240,000 |
| Select term loans(2) | 743,071 | 1,121,105 |
| Other Select | 11,987 | 24,158 |
| Total Select debt | 1,750,925 | 2,086,966 |
| Less: Select current maturities | 222,905 | 6,778 |
| Select long-term debt maturities | \$ 1,528,020 | \$ 2,080,188 |
| Concentra credit facilities: | | |
| Concentra revolving facility | \$ 5,000 | \$ |
| Concentra term loans(3) | 624,659 | 624,113 |
| Other Concentra | 5,312 | 6,743 |
| Total Concentra debt | 634,971 | 630,856 |
| Less: Concentra current maturities | 2,261 | 3,733 |
| Concentra long-term debt maturities | \$ 632,710 | \$ 627,123 |
| Total current maturities | \$ 225,166 | \$ 10,511 |
| Total long-term debt maturities | 2,160,730 | 2,707,311 |
| Total debt | \$ 2,385,896 | \$ 2,717,822 |

(1) Includes unamortized premium of \$1.2 million and \$1.1 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$10.4 million and \$9.4 million at December 31, 2015 and June 30, 2016, respectively.

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(2) Includes unamortized discounts of \$2.8 million and \$13.8 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$7.4 million and \$16.0 million at December 31, 2015 and June 30, 2016, respectively.

(3) Includes unamortized discounts of \$2.9 million and \$2.7 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$20.2 million and \$18.7 million at December 31, 2015 and June 30, 2016, respectively.

Maturities of Long-Term Debt and Notes Payable

Maturities of the Company's long-term debt for the period from July 1, 2016 through December 31, 2016 and the years after 2016 are approximately as follows:

| | | Select | | Concentra (in thousands) | | Total |
|------------------------------------|-------------------|--------------|----|-----------------------------|----|-----------|
| July 1, 2016 | December 31, 2016 | \$ 8,880 | \$ | 3,559 | \$ | 12,439 |
| 2017 | | 15,257 | | 5,871 | | 21,128 |
| 2018 | | 771,228 | | 4,597 | | 775,825 |
| 2019 | | 18,070 | | 4,615 | | 22,685 |
| 2020 | | 6,288 | | 4,636 | | 10,924 |
| 2021 and beyond | | 1,305,313 | | 628,965 | | 1,934,278 |
| Total principal | | 2,125,036 | | 652,243 | | 2,777,279 |
| Unamortized discounts and premiums | | (12,663) | | (2,677) | | (15,340) |
| Unamortized debt issuance costs | | (25,407) | | (18,710) | | (44,117) |
| Total | | \$ 2,086,966 | \$ | 630,856 | \$ | 2,717,822 |

Excess Cash Flow Payment

On March 2, 2016, Select made a principal prepayment of \$10.2 million associated with its term loans (the "Select term loans") in accordance with the provision in the Select credit facilities that requires mandatory prepayments of term loans as a result of annual excess cash flow as defined in the Select credit facilities.

Select Credit Facilities

On March 4, 2016, Select entered into an Additional Credit Extension Amendment (the "Additional Credit Extension Amendment") to Select's senior secured credit facility with JPMorgan Chase Bank, N.A., as administrative agent, collateral agent and lender, and the additional lenders named therein (the "Select credit facilities"). The Additional Credit Extension Amendment (i) provides for the lenders named therein to make

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available an aggregate of \$625.0 million of Series F Tranche B Term Loans, (ii) extends the financial covenants through March 3, 2021, (iii) adds a 1.00% prepayment premium for prepayments made with new term loans on or prior to March 4, 2017 if such new term loans have a lower yield than the Series F Tranche B Term Loans, and (iv) makes certain other technical amendments to the Select credit facilities. The Series F Tranche B Term Loans will bear interest at a rate per annum equal to the Adjusted LIBO Rate (as defined in the Select credit facilities, subject to an Adjusted LIBO Rate floor of 1.00%) plus 5.00% for Eurodollar Loans or the Alternate Base Rate (as defined in the Select credit facilities) plus 4.00% for Alternate Base Rate Loans (as defined in the Select credit facilities). Select is required to make principal payments on the Series F Tranche B Term Loans in quarterly installments on the last day of each of March, June, September and December, beginning June 30, 2016, in amounts equal to 0.25% of the aggregate principal amount of the Series F Tranche B Term Loans outstanding as of the date of the Additional Credit Extension Amendment. The balance of the Series F Tranche

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B Term Loans will be payable on March 3, 2021. Except as specifically set forth in the Additional Credit Extension Amendment, the terms and conditions of the Series F Tranche B Term Loans are identical to the terms of the outstanding Series E Term B Loans under the Select credit facilities and the other loan documents to which Select is party.

Select used the proceeds of the Series F Tranche B Term Loans to (i) refinance in full the Series D Tranche B Term Loans due December 20, 2016, (ii) consummate the acquisition of Physiotherapy, and (iii) pay fees and expenses incurred in connection with the acquisition of Physiotherapy, the refinancing, and the Additional Credit Extension Amendment.

As a result of the Additional Credit Extension Amendment relating to the Series F Tranche B Term Loans, the interest rate payable on the Series E Tranche B Term Loans was increased from Adjusted LIBO plus 4.00% (subject to an Adjusted LIBO rate floor of 1.00%), or Alternative Base Rate plus 3.00%, to Adjusted LIBO plus 5.00% (subject to an Adjusted LIBO rate floor of 1.00%), or Alternative Base Rate plus 4.00%.

During the six months ended June 30, 2016, the Company recognized a loss on early retirement of debt of \$0.8 million relating to the repayment of the Series D Tranche B Term Loans under the Select credit facilities.

8. 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.

| | Face Value | December 31, 2015 Carrying Value | Fair Value | Face Value | June 30, 2016 Carrying Value | Fair Value |
|--------------------------------|----------------|-------------------------------------|------------|------------|---------------------------------|------------|
| | (in thousands) | | | | | |
| Select 6.375% senior notes(1) | \$ 710,000 | \$ 700,867 | \$ 623,948 | \$ 710,000 | \$ 701,703 | \$ 674,926 |
| Select credit facilities(2) | 1,048,277 | 1,038,071 | 1,023,616 | 1,390,877 | 1,361,105 | 1,376,415 |
| Concentra credit facilities(3) | 652,750 | 629,659 | 645,392 | 645,500 | 624,113 | 638,159 |

(1) The carrying value includes unamortized premium of \$1.2 million and \$1.1 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$10.4 million and \$9.4 million at December 31, 2015 and June 30, 2016, respectively.

(2) The carrying value includes unamortized discounts of \$2.8 million and \$13.8 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$7.4 million and

\$16.0 million at December 31, 2015 and June 30, 2016, respectively.

(3) The carrying value includes unamortized discounts of \$2.9 million and \$2.7 million at December 31, 2015 and June 30, 2016, respectively. Includes unamortized debt issuance costs of \$20.2 million and \$18.7 million at December 31, 2015 and June 30, 2016, respectively.

The fair value of the Select credit facilities and the Concentra credit facilities was based on quoted market prices for this debt in the syndicated loan market. The fair value of Select's 6.375% senior notes debt was based on quoted market prices.

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The Company considers the inputs in the valuation process to be Level 2 in the fair value hierarchy. Level 2 in the fair value hierarchy is defined as inputs that are observable for the asset or liability, either directly or indirectly, which includes quoted prices for identical assets or liabilities in markets that are not active.

9. Segment Information

The Company's reportable segments consist of: (i) specialty hospitals, (ii) outpatient rehabilitation, and (iii) Concentra. Other activities include the Company's corporate services and certain other non-consolidating joint ventures and minority investments in other healthcare related businesses. 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 earnings excluding interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, Concentra acquisition costs, Physiotherapy acquisition costs, non-operating gain (loss), and equity in earnings (losses) of unconsolidated subsidiaries.

The following tables summarize selected financial data for the Company's reportable segments. The segment results of Holdings are identical to those of Select.

| | Three Months Ended June 30, 2015 | | | | |
|------------------------|----------------------------------|---------------------------|--------------------------------|----------|------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra(1) (in thousands) | Other | Total |
| Net operating revenues | \$ 592,336 | \$ 207,795 | \$ 86,829 | \$ 105 | \$ 887,065 |
| Adjusted EBITDA | 91,447 | 28,722 | 11,199 | (16,471) | 114,897 |
| Total assets | 2,372,723 | 538,586 | 1,320,941 | 109,085 | 4,341,335 |
| Capital expenditures | 31,042 | 3,103 | 3,854 | 3,065 | 41,064 |

| | Three Months Ended June 30, 2016 | | | | |
|------------------------|----------------------------------|---------------------------|-----------------------------|----------|--------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra (in thousands) | Other | Total |
| Net operating revenues | \$ 585,816 | \$ 256,928 | \$ 254,868 | \$ 19 | \$ 1,097,631 |
| Adjusted EBITDA | 82,739 | 38,132 | 43,039 | (22,453) | 141,457 |
| Total assets | 2,448,390 | 984,140 | 1,333,293 | 72,526 | 4,838,349 |
| Capital expenditures | 21,313 | 3,825 | 4,716 | 3,636 | 33,490 |

| | Six Months Ended June 30, 2015 | | | | |
|------------------------|--------------------------------|---------------------------|--------------------------------|----------|--------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra(1) (in thousands) | Other | Total |
| Net operating revenues | \$ 1,191,117 | \$ 404,238 | \$ 86,829 | \$ 224 | \$ 1,682,408 |
| Adjusted EBITDA | 187,919 | 50,855 | 11,199 | (36,136) | 213,837 |
| Total assets | 2,372,723 | 538,586 | 1,320,941 | 109,085 | 4,341,335 |
| Capital expenditures | 53,835 | 7,025 | 3,854 | 4,198 | 68,912 |

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| | Six Months Ended June 30, 2016 | | | | |
|------------------------|---------------------------------------|---|-------------------------------------|--------------|--------------|
| | Specialty Hospitals | Outpatient Rehabilitation(2) | Concentra (in thousands) | Other | Total |
| Net operating revenues | \$ 1,184,770 | \$ 495,010 | \$ 505,745 | \$ 436 | \$ 2,185,961 |
| Adjusted EBITDA | 169,495 | 67,011 | 77,192 | (43,626) | 270,072 |
| Total assets | 2,448,390 | 984,140 | 1,333,293 | 72,526 | 4,838,349 |
| Capital expenditures | 54,988 | 8,798 | 7,927 | 8,545 | 80,258 |

A reconciliation of Adjusted EBITDA to income before income taxes is as follows:

| | Three Months Ended June 30, 2015 | | | | |
|---|---|--------------------------------------|--|--------------|--------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra(1) (in thousands) | Other | Total |
| Adjusted EBITDA | \$ 91,447 | \$ 28,722 | \$ 11,199 | \$ (16,471) | |
| Depreciation and amortization | (13,404) | (3,177) | (4,194) | (1,073) | |
| Stock compensation expense | | | | (3,323) | |
| Concentra acquisition costs | | | (4,715) | | |
| Income (loss) from operations | \$ 78,043 | \$ 25,545 | \$ 2,290 | \$ (20,867) | \$ 85,011 |
| Equity in earnings of unconsolidated subsidiaries | | | | | 3,848 |
| Interest expense | | | | | (25,288) |
| Income before income taxes | | | | | \$ 63,571 |

| | Three Months Ended June 30, 2016 | | | | |
|---|---|--------------------------------------|-------------------------------------|--------------|--------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra (in thousands) | Other | Total |
| Adjusted EBITDA | \$ 82,739 | \$ 38,132 | \$ 43,039 | \$ (22,453) | |
| Depreciation and amortization | (13,812) | (6,202) | (14,916) | (1,275) | |
| Stock compensation expense | | | (192) | (4,006) | |
| Income (loss) from operations | \$ 68,927 | \$ 31,930 | \$ 27,931 | \$ (27,734) | \$ 101,054 |
| Equity in earnings of unconsolidated subsidiaries | | | | | 4,546 |
| Non-operating gain | | | | | 13,035 |
| Interest expense | | | | | (44,332) |
| Income before income taxes | | | | | \$ 74,303 |

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| | Six Months Ended June 30, 2015 | | | | |
|---|--------------------------------|------------------------------|--------------------------------|-------------|------------|
| | Specialty Hospitals | Outpatient Rehabilitation | Concentra(1) (in thousands) | Other | Total |
| Adjusted EBITDA | \$ 187,919 | \$ 50,855 | \$ 11,199 | \$ (36,136) | |
| Depreciation and amortization | (26,627) | (6,317) | (4,194) | (2,058) | |
| Stock compensation expense | | | | (5,650) | |
| Concentra acquisition costs | | | (4,715) | | |
| Income (loss) from operations | \$ 161,292 | \$ 44,538 | \$ 2,290 | \$ (43,844) | \$ 164,276 |
| Equity in earnings of unconsolidated subsidiaries | | | | | 6,440 |
| Interest expense | | | | | (46,676) |
| Income before income taxes | | | | | \$ 124,040 |

| | Six Months Ended June 30, 2016 | | | | |
|---|--------------------------------|---------------------------------|-----------------------------|-------------|------------|
| | Specialty Hospitals | Outpatient Rehabilitation(2) | Concentra (in thousands) | Other | Total |
| Adjusted EBITDA | \$ 169,495 | \$ 67,011 | \$ 77,192 | \$ (43,626) | |
| Depreciation and amortization | (27,705) | (10,238) | (30,292) | (2,487) | |
| Stock compensation expense | | | (384) | (7,790) | |
| Physiotherapy acquisition costs | | | | (3,236) | |
| Income (loss) from operations | \$ 141,790 | \$ 56,773 | \$ 46,516 | \$ (57,139) | \$ 187,940 |
| Loss on early retirement of debt | | | | | (773) |
| Equity in earnings of unconsolidated subsidiaries | | | | | 9,198 |
| Non-operating gain | | | | | 38,122 |
| Interest expense | | | | | (83,180) |
| Income before income taxes | | | | | \$ 151,307 |

(1) The selected financial data for the Company's Concentra segment for the periods presented begins as of June 1, 2015, which is the date the Concentra acquisition was consummated.

(2) The outpatient rehabilitation segment includes the operating results of contract therapy businesses through March 31, 2016 and Physiotherapy beginning March 4, 2016.

10. Income per Common Share

Holdings 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. The following table sets forth for the periods indicated the calculation of income per common share in Holdings' consolidated statements of operations and the differences between basic weighted average shares outstanding and diluted weighted average shares outstanding used to compute basic and diluted income per common share, respectively:

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| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--|--|-----------|--------------------------------------|-----------|
| | 2015 | 2016 | 2015 | 2016 |
| (in thousands, except per share amounts) | | | | |
| Numerator: | | | | |
| Net income attributable to Select Medical Holdings Corporation | \$ 36,940 | \$ 33,935 | \$ 72,003 | \$ 88,768 |
| Less: Earnings allocated to unvested restricted stockholders | 1,011 | 972 | 1,984 | 2,552 |
| Net income available to common stockholders | \$ 35,929 | \$ 32,963 | \$ 70,019 | \$ 86,216 |
| Denominator: | | | | |
| Weighted average shares basic | 127,674 | 127,626 | 127,620 | 127,563 |
| Effect of dilutive securities: | | | | |
| Stock options | 335 | 194 | 324 | 146 |
| Weighted average shares diluted | 128,009 | 127,820 | 127,944 | 127,709 |
| Basic income per common share | \$ 0.28 | \$ 0.26 | \$ 0.55 | \$ 0.68 |
| Diluted income per common share | \$ 0.28 | \$ 0.26 | \$ 0.55 | \$ 0.68 |

11. 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 the Company to sanctions, damages, recoupments, fines and other penalties. The Department of Justice, Centers for Medicare and Medicaid Services (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 address claims arising out of the Company's operations, 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, as well as the cost and possible lack of available insurance, 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

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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 is and 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.

On October 19, 2015, the plaintiff-relators filed a Second Amended Complaint in United States of America, ex rel. Tracy Conroy, Pamela Schenk and Lisa Wilson v. Select Medical Corporation, Select Specialty Hospital Evansville, LLC (SSH-Evansville), Select Employment Services, Inc., and Dr. Richard Sloan. The case is a civil action filed in the United States District Court for the Southern District of Indiana by private plaintiff-relators on behalf of the United States under the federal False Claims Act. The plaintiff-relators are the former CEO and two former case managers at SSH-Evansville, and the defendants currently include the Company, SSH-Evansville, a subsidiary of the Company serving as common paymaster for its employees, and a physician who practices at SSH-Evansville. The plaintiff-relators allege that SSH-Evansville discharged patients too early or held patients too long, improperly discharged patients to and readmitted them from short stay hospitals, up-coded diagnoses at admission, and admitted patients for whom long-term acute care was not medically necessary. They also allege that the defendants engaged in retaliation in violation of federal and state law. The Second Amended Complaint replaces a prior complaint that was filed under seal on September 28, 2012 and served on the Company on February 15, 2013, after a federal magistrate judge unsealed it on January 8, 2013. All deadlines in the case had been stayed after the seal was lifted in order to allow the government time to complete its investigation and to decide whether or not to intervene. On June 19, 2015, the U.S. Department of Justice notified the court of its decision not to intervene in the case, and the court thereafter approved a case management plan imposing certain deadlines. The defendants filed a Motion to Dismiss the Second Amended Complaint in December 2015. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

On July 13, 2015, the federal District Court for the Eastern District of Tennessee unsealed a qui tam Complaint in Armes v. Garman, et al, No. 3:14-cv-00172-TAV-CCS, which named as defendants Select, Select Specialty Hospital Knoxville, Inc. (SSH-Knoxville), Select Specialty Hospital North Knoxville, Inc. and ten current or former employees of these facilities. The Complaint was unsealed after the United States and the State of Tennessee notified the court on July 13, 2015 that each had decided not to intervene in the case. The Complaint is a civil action that was filed under seal on April 29, 2014 by a respiratory therapist formerly employed at SSH-Knoxville. The Complaint alleges violations of the federal False Claims Act and the Tennessee Medicaid False Claims Act based on extending patient stays to increase reimbursement and to increase average length of stay; artificially prolonging the lives of patients to increase Medicare reimbursements and decrease inspections; admitting patients who do not require medically necessary care; performing unnecessary procedures and services; and delaying performance of procedures to increase billing. The Complaint was served on some of the defendants during October 2015. The defendants filed a Motion to Dismiss such Complaint in November 2015, and the court approved such Motion and dismissed the lawsuit in June 2016. In July 2016, the plaintiff filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. The Company intends to vigorously defend this action if the relators pursue it, but at this time the Company is unable to predict the timing and outcome of this matter.

Construction Commitments

At June 30, 2016, the Company had outstanding commitments under construction contracts related to new construction, improvements and renovations at the Company's long term acute care properties, inpatient rehabilitation facilities, and Concentra centers totaling approximately \$9.4 million

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12. Financial Information for Subsidiary Guarantors and Non-Guarantor Subsidiaries under Select's 6.375% Senior Notes

Select's 6.375% senior notes are fully and unconditionally guaranteed, except for customary limitations, on a senior basis by all of Select's wholly owned subsidiaries (the Subsidiary Guarantors) which is defined as a subsidiary where Select or a subsidiary of Select holds all of the outstanding ownership interests. Certain of Select's subsidiaries did not guarantee the 6.375% senior notes (the Non-Guarantor Subsidiaries, including Group Holdings and its subsidiaries, which were designated as Non-Guarantor subsidiaries by Select's board of directors at the closing of the Concentra acquisition, the Non-Guarantor Concentra).

Select conducts a significant portion of its business through its subsidiaries. Presented below is condensed consolidating financial information for Select, the Subsidiary Guarantors, the Non-Guarantor Subsidiaries, and Non-Guarantor Concentra at December 31, 2015 and June 30, 2016 and for the three and six months ended June 30, 2015 and 2016.

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.

Certain reclassifications have been made to prior reported amounts in order to conform to the current year guarantor structure.

Table of Contents**Select Medical Corporation****Condensed Consolidating Balance Sheet****June 30, 2016****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|---------------------------------------|------------------------------------|-----------------------|--|
| | (in thousands) | | | | | |
| Assets | | | | | | |
| Current Assets: | | | | | | |
| Cash and cash equivalents | \$ 4,071 | \$ 8,111 | \$ 5,374 | \$ 60,864 | \$ | \$ 78,420 |
| Accounts receivable, net | | 420,863 | 74,638 | 118,289 | | 613,790 |
| Current deferred tax asset | 9,106 | 21,379 | 4,432 | 9,038 | | 43,955 |
| Intercompany receivables | | 2,065,057 | 162,585 | | (2,227,642)(a) | |
| Other current assets | 13,459 | 41,891 | 6,691 | 26,821 | | 88,862 |
| Total Current Assets | 26,636 | 2,557,301 | 253,720 | 215,012 | (2,227,642) | 825,027 |
| Property and equipment, net | 44,793 | 582,067 | 61,493 | 200,818 | | 889,171 |
| Investment in affiliates | 4,547,761 | 66,319 | | | (4,614,080)(b) (c) | |
| Goodwill | | 1,979,267 | | 659,019 | | 2,638,286 |
| Other identifiable intangibles, net | | 105,280 | | 238,648 | | 343,928 |
| Non-current deferred tax asset | 15,175 | | | | (15,175)(d) | |
| Other assets | 8,110 | 112,864 | 1,167 | 19,796 | | 141,937 |
| Total Assets | \$ 4,642,475 | \$ 5,403,098 | \$ 316,380 | \$ 1,333,293 | \$ (6,856,897) | \$ 4,838,349 |
| Liabilities and Equity | | | | | | |
| Current Liabilities: | | | | | | |
| Bank overdrafts | \$ 26,477 | \$ | \$ | \$ | \$ | \$ 26,477 |
| Current portion of long-term debt and notes payable | 6,112 | 508 | 158 | 3,733 | | 10,511 |
| Accounts payable | 8,204 | 79,941 | 13,815 | 16,460 | | 118,420 |
| Intercompany payables | 2,065,057 | 162,585 | | | (2,227,642)(a) | |
| Accrued payroll | 8,569 | 79,177 | 8,358 | 39,448 | | 135,552 |
| Accrued vacation | 3,352 | 49,989 | 15,191 | 12,542 | | 81,074 |
| Accrued interest | 13,933 | 2 | 7 | 2,985 | | 16,927 |
| Accrued other | 39,267 | 55,732 | 9,109 | 29,977 | | 134,085 |
| Income taxes payable | 1,040 | | | 11,274 | | 12,314 |
| Total Current Liabilities | 2,172,011 | 427,934 | 46,638 | 116,419 | (2,227,642) | 535,360 |
| Long-term debt, net of current portion | 1,467,920 | 491,355 | 120,914 | 627,122 | | 2,707,311 |
| Non-current deferred tax liability | | 106,571 | 8,969 | 101,173 | (15,175)(d) | 201,538 |
| Other non-current liabilities | 46,467 | 49,000 | 4,391 | 31,841 | | 131,699 |
| Total Liabilities | 3,686,398 | 1,074,860 | 180,912 | 876,555 | (2,242,817) | 3,575,908 |
| Redeemable non-controlling interests | | | 11,328 | 234,456 | | 245,784 |
| Stockholder s Equity: | | | | | | |
| Common stock | 0 | | | | | 0 |

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| | | | | | | |
|---|---------------------|---------------------|-------------------|---------------------|-----------------------|---------------------|
| Capital in excess of par | 913,058 | | | | | 913,058 |
| Retained earnings (accumulated deficit) | 43,019 | 1,250,956 | (16,937) | 835 | (1,234,854)(c) | 43,019 |
| Subsidiary investment | | 3,077,282 | 84,009 | 217,935 | (3,379,226)(b) | |
| Total Select Medical Corporation Stockholder s Equity | 956,077 | 4,328,238 | 67,072 | 218,770 | (4,614,080) | 956,077 |
| Non-controlling interest | | | 57,068 | 3,512 | | 60,580 |
| Total Equity | 956,077 | 4,328,238 | 124,140 | 222,282 | (4,614,080) | 1,016,657 |
| Total Liabilities and Equity | \$ 4,642,475 | \$ 5,403,098 | \$ 316,380 | \$ 1,333,293 | \$ (6,856,897) | \$ 4,838,349 |

(a) Elimination of intercompany.

(b) Elimination of investments in consolidated subsidiaries.

(c) Elimination of investments in consolidated subsidiaries earnings.

(d) Reclass of non-current deferred tax asset to report net non-current deferred tax liability in consolidation.

Table of Contents**Select Medical Corporation****Condensed Consolidating Statement of Operations****For the Three Months Ended June 30, 2016****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|---------------------------------------|------------------------------------|---------------------|--|
| | (in thousands) | | | | | |
| Net operating revenues | \$ 20 | \$ 720,404 | \$ 122,339 | \$ 254,868 | \$ | \$ 1,097,631 |
| Costs and expenses: | | | | | | |
| Cost of services | 606 | 571,001 | 138,496 | 206,882 | | 916,985 |
| General and administrative | 25,844 | 26 | | | | 25,870 |
| Bad debt expense | | 10,265 | 2,113 | 5,139 | | 17,517 |
| Depreciation and amortization | 1,276 | 17,184 | 2,829 | 14,916 | | 36,205 |
| Total costs and expenses | 27,726 | 598,476 | 143,438 | 226,937 | | 996,577 |
| Income (loss) from operations | (27,706) | 121,928 | (21,099) | 27,931 | | 101,054 |
| Other income and expense: | | | | | | |
| Intercompany interest and royalty fees | (1,532) | (50,979) | 52,511 | | | |
| Intercompany management fees | 38,783 | (32,280) | (6,503) | | | |
| Equity in earnings of unconsolidated subsidiaries | | 4,519 | 27 | | | 4,546 |
| Non-operating gain | 10,463 | 2,572 | | | | 13,035 |
| Interest expense | (25,544) | (6,685) | (1,851) | (10,252) | | (44,332) |
| Income (loss) from operations before income taxes | (5,536) | 39,075 | 23,085 | 17,679 | | 74,303 |
| Income tax expense (benefit) | (473) | 26,370 | 672 | 6,881 | | 33,450 |
| Equity in earnings of subsidiaries | 38,998 | 21,526 | | | (60,524)(a) | |
| Net income | 33,935 | 34,231 | 22,413 | 10,798 | (60,524) | 40,853 |
| Less: Net income attributable to non-controlling interests | | | 842 | 6,076 | | 6,918 |
| Net income attributable to Select Medical Corporation | \$ 33,935 | \$ 34,231 | \$ 21,571 | \$ 4,722 | \$ (60,524) | \$ 33,935 |

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents**Select Medical Corporation****Condensed Consolidating Statement of Operations****For the Six Months Ended June 30, 2016****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|---------------------------------------|------------------------------------|---------------------|--|
| | (in thousands) | | | | | |
| Net operating revenues | \$ 437 | \$ 1,431,918 | \$ 247,861 | \$ 505,745 | \$ | \$ 2,185,961 |
| Costs and expenses: | | | | | | |
| Cost of services | 950 | 1,149,011 | 269,202 | 420,084 | | 1,839,247 |
| General and administrative | 54,231 | (93) | | | | 54,138 |
| Bad debt expense | | 20,963 | 4,098 | 8,853 | | 33,914 |
| Depreciation and amortization | 2,487 | 32,381 | 5,562 | 30,292 | | 70,722 |
| Total costs and expenses | 57,668 | 1,202,262 | 278,862 | 459,229 | | 1,998,021 |
| Income (loss) from operations | (57,231) | 229,656 | (31,001) | 46,516 | | 187,940 |
| Other income and expense: | | | | | | |
| Intercompany interest and royalty fees | (2,590) | (49,946) | 52,536 | | | |
| Intercompany management fees | 94,139 | (81,804) | (12,335) | | | |
| Equity in earnings of unconsolidated subsidiaries | | 9,146 | 52 | | | 9,198 |
| Loss on early retirement of debt | (773) | | | | | (773) |
| Non-operating gain (loss) | 40,895 | (2,773) | | | | 38,122 |
| Interest expense | (45,890) | (13,319) | (3,490) | (20,481) | | (83,180) |
| Income from operations before income taxes | 28,550 | 90,960 | 5,762 | 26,035 | | 151,307 |
| Income tax expense | 8,139 | 31,985 | 607 | 9,779 | | 50,510 |
| Equity in earnings of subsidiaries | 68,357 | 2,294 | | | (70,651)(a) | |
| Net income | 88,768 | 61,269 | 5,155 | 16,256 | (70,651) | 100,797 |
| Less: Net income attributable to non-controlling interests | | | 2,728 | 9,301 | | 12,029 |
| Net income attributable to Select Medical Corporation | \$ 88,768 | \$ 61,269 | \$ 2,427 | \$ 6,955 | \$ (70,651) | \$ 88,768 |

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents**Select Medical Corporation****Condensed Consolidating Statement of Cash Flows****For the Six Months Ended June 30, 2016****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|---------------------------------------|------------------------------------|---------------------|--|
| | (in thousands) | | | | | |
| Operating activities | | | | | | |
| Net income | \$ 88,768 | \$ 61,269 | \$ 5,155 | \$ 16,256 | \$ (70,651)(a) | \$ 100,797 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | | | | |
| Distributions from unconsolidated subsidiaries | | 12,000 | 39 | | | 12,039 |
| Depreciation and amortization | 2,487 | 32,381 | 5,562 | 30,292 | | 70,722 |
| Amortization of leasehold interests | | 34 | | 261 | | 295 |
| Provision for bad debts | | 20,963 | 4,098 | 8,853 | | 33,914 |
| Equity in earnings of unconsolidated subsidiaries | | (9,146) | (52) | | | (9,198) |
| Loss on early retirement of debt | 773 | | | | | 773 |
| Loss from disposal of assets | | 37 | 12 | 6 | | 55 |
| Gain on sale of businesses | (40,895) | (2,566) | | | | (43,461) |
| Impairment of equity investment | | 5,339 | | | | 5,339 |
| Stock compensation expense | 7,790 | | | 384 | | 8,174 |
| Amortization of debt discount, premium and issuance costs | 5,371 | | 2 | 1,704 | | 7,077 |
| Deferred income taxes | 997 | | | (14,283) | | (13,286) |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | | | |
| Equity in earnings of subsidiaries | (68,357) | (2,294) | | | 70,651(a) | |
| Accounts receivable | | (22,202) | (10,405) | (11,489) | | (44,096) |
| Other current assets | (2,938) | 7,029 | (960) | 7,880 | | 11,011 |
| Other assets | (4,268) | (291) | (508) | 9,280 | | 4,213 |
| Accounts payable | (2,241) | (17,885) | (3,181) | 7,455 | | (15,852) |
| Accrued expenses | (10,175) | 24,534 | 9,113 | (2,840) | | 20,632 |
| Income taxes | 8,832 | | | 19,989 | | 28,821 |
| Net cash provided by (used in) operating activities | (13,856) | 109,202 | 8,875 | 73,748 | | 177,969 |
| Investing activities | | | | | | |
| Purchases of property and equipment | (8,545) | (41,851) | (21,935) | (7,927) | | (80,258) |
| Proceeds from sale of assets and business | 63,418 | 7,942 | 6 | | | 71,366 |
| Investment in businesses | | (1,590) | | | | (1,590) |
| Acquisition of businesses, net of cash acquired | (408,654) | (605) | (8,395) | (3,865) | | (421,519) |
| Net cash used in investing activities | (353,781) | (36,104) | (30,324) | (11,792) | | (432,001) |

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| Financing activities | | | | | | |
|---|-----------|----------|----------|-----------|-------|-----------|
| Borrowings on revolving facilities | 320,000 | | | | | 320,000 |
| Payments on revolving facilities | (375,000) | | (5,000) | | | (380,000) |
| Net proceeds from Select term loans | 600,127 | | | | | 600,127 |
| Payments on term loans | (227,399) | | (2,250) | | | (229,649) |
| Borrowings of other debt | 9,765 | | 9,500 | | 2,817 | 22,082 |
| Principal payments on other debt | (7,278) | (385) | (876) | (1,387) | | (9,926) |
| Dividends paid to Holdings | (506) | | | | | (506) |
| Equity investment by Holdings | 657 | | | | | 657 |
| Proceeds from issuance of non-controlling interest | | | 3,103 | | | 3,103 |
| Repayments of bank overdrafts | (2,138) | | | | | (2,138) |
| Intercompany | 49,141 | (67,014) | 17,873 | | | |
| Tax benefit from stock based awards | 269 | | | | | 269 |
| Purchase of non-controlling interests | | (1,294) | | | | (1,294) |
| Distributions to non-controlling interests | | | (3,402) | (1,306) | | (4,708) |
| Net cash provided by (used in) financing activities | 367,638 | (68,693) | 26,198 | (7,126) | | 318,017 |
| Net increase in cash and cash equivalents | 1 | 4,405 | 4,749 | 54,830 | | 63,985 |
| Cash and cash equivalents at beginning of period | 4,070 | 3,706 | 625 | 6,034 | | 14,435 |
| Cash and cash equivalents at end of period | \$ 4,071 | \$ 8,111 | \$ 5,374 | \$ 60,864 | \$ | \$ 78,420 |

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

Table of Contents**Select Medical Corporation****Condensed Consolidating Balance Sheet****December 31, 2015**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|---------------------------------------|------------------------------------|---------------------|--|
| | (in thousands) | | | | | |
| Assets | | | | | | |
| Current Assets: | | | | | | |
| Cash and cash equivalents | \$ 4,070 | \$ 3,706 | \$ 625 | \$ 6,034 | \$ | \$ 14,435 |
| Accounts receivable, net | | 419,554 | 68,332 | 115,672 | | 603,558 |
| Current deferred tax asset | 11,556 | 6,733 | 4,761 | 5,638 | | 28,688 |
| Intercompany receivables | | 1,974,229 | 127,373 | | (2,101,602)(a) | |
| Prepaid income taxes | 7,979 | | | 8,715 | | 16,694 |
| Other current assets | 10,521 | 34,887 | 5,731 | 34,640 | | 85,779 |
| Total Current Assets | 34,126 | 2,439,109 | 206,822 | 170,699 | (2,101,602) | 749,154 |
| Property and equipment, net | 38,872 | 548,820 | 61,126 | 215,306 | | 864,124 |
| Investment in affiliates | 4,111,682 | 66,015 | | | (4,177,697)(b) (c) | |
| Goodwill | | 1,663,974 | | 650,650 | | 2,314,624 |
| Other identifiable intangibles, net | | 72,776 | | 245,899 | | 318,675 |
| Non-current deferred tax asset | 12,297 | | | | (12,297)(d) | |
| Other assets | 3,842 | 108,524 | 659 | 29,076 | | 142,101 |
| Total Assets | 4,200,819 | 4,899,218 | 268,607 | 1,311,630 | (6,291,596) | \$ 4,388,678 |
| Liabilities and Equity | | | | | | |
| Current Liabilities: | | | | | | |
| Bank overdrafts | \$ 28,615 | \$ | \$ | \$ | \$ | \$ 28,615 |
| Current portion of long-term debt and notes payable | 221,769 | 197 | 939 | 2,261 | | 225,166 |
| Accounts payable | 10,445 | 101,156 | 16,997 | 8,811 | | 137,409 |
| Intercompany payables | 1,974,229 | 127,373 | | | (2,101,602)(a) | |
| Accrued payroll | 22,970 | 66,908 | 3,916 | 27,195 | | 120,989 |
| Accrued vacation | 6,406 | 50,254 | 9,363 | 7,954 | | 73,977 |
| Accrued interest | 6,315 | 3 | | 3,083 | | 9,401 |
| Accrued other | 38,883 | 42,939 | 9,866 | 42,040 | | 133,728 |
| Total Current Liabilities | 2,309,632 | 388,830 | 41,081 | 91,344 | (2,101,602) | 729,285 |
| Long-term debt, net of current portion | 984,744 | 452,417 | 90,860 | 632,709 | | 2,160,730 |
| Non-current deferred tax liability | | 114,394 | 9,239 | 107,369 | (12,297)(d) | 218,705 |
| Other non-current liabilities | 47,190 | 41,904 | 4,798 | 39,328 | | 133,220 |
| Total Liabilities | 3,341,566 | 997,545 | 145,978 | 870,750 | (2,113,899) | 3,241,940 |
| Redeemable non-controlling interests | | 870 | 11,224 | 226,127 | | 238,221 |
| Stockholder s Equity: | | | | | | |
| Common stock | 0 | | | | | 0 |
| Capital in excess of par | 904,375 | | | | | 904,375 |
| | (45,122) | 1,189,688 | (8,932) | (6,120) | (1,174,636)(c) | (45,122) |

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| | | | | | | | |
|---|--------------|--------------|------------|--------------|----------------|--------------|--|
| Retained earnings (accumulated deficit) | | | | | | | |
| Subsidiary investment | | 2,711,115 | 74,011 | 217,935 | (3,003,061)(b) | | |
| Total Select Medical Corporation Stockholder s Equity | 859,253 | 3,900,803 | 65,079 | 211,815 | (4,177,697) | 859,253 | |
| Non-controlling interest | | | 46,326 | 2,938 | | 49,264 | |
| Total Equity | 859,253 | 3,900,803 | 111,405 | 214,753 | (4,177,697) | 908,517 | |
| Total Liabilities and Equity | \$ 4,200,819 | \$ 4,899,218 | \$ 268,607 | \$ 1,311,630 | \$ (6,291,596) | \$ 4,388,678 | |

(a) Elimination of intercompany.

(b) Elimination of investments in consolidated subsidiaries.

(c) Elimination of investments in consolidated subsidiaries earnings.

(d) Reclass of non-current deferred tax asset to report net non-current deferred tax liability in consolidation.

Table of Contents**Select Medical Corporation****Condensed Consolidating Statement of Operations****For the Three Months Ended June 30, 2015****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries (in thousands) | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|--|------------------------------------|---------------------|--|
| Net operating revenues | \$ 105 | \$ 676,146 | \$ 123,985 | \$ 86,829 | \$ | \$ 887,065 |
| Costs and expenses: | | | | | | |
| Cost of services | 574 | 564,390 | 104,163 | 74,752 | | 743,879 |
| General and administrative | 19,467 | (141) | | 4,715 | | 24,041 |
| Bad debt expense | | 9,252 | 2,156 | 878 | | 12,286 |
| Depreciation and amortization | 1,073 | 13,908 | 2,673 | 4,194 | | 21,848 |
| Total costs and expenses | 21,114 | 587,409 | 108,992 | 84,539 | | 802,054 |
| Income (loss) from operations | (21,009) | 88,737 | 14,993 | 2,290 | | 85,011 |
| Other income and expense: | | | | | | |
| Intercompany interest and royalty fees | (311) | 306 | 5 | | | |
| Intercompany management fees | (2,167) | 8,418 | (6,251) | | | |
| Equity in earnings of unconsolidated subsidiaries | | 3,828 | 20 | | | 3,848 |
| Interest expense | (14,280) | (6,083) | (1,556) | (3,369) | | (25,288) |
| Income (loss) from operations before income taxes | (37,767) | 95,206 | 7,211 | (1,079) | | 63,571 |
| Income tax expense (benefit) | (13,338) | 38,574 | (1,024) | (695) | | 23,517 |
| Equity in earnings of subsidiaries | 61,369 | 5,159 | | | (66,528) (a) | |
| Net income (loss) | 36,940 | 61,791 | 8,235 | (384) | (66,528) | 40,054 |
| Less: Net income attributable to non-controlling interests | | 13 | 3,077 | 24 | | 3,114 |
| Net income (loss) attributable to Select Medical Corporation | \$ 36,940 | \$ 61,778 | \$ 5,158 | \$ (408) | \$ (66,528) | \$ 36,940 |

(a) Elimination of equity in earnings of subsidiaries.

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Select Medical Corporation
Condensed Consolidating Statement of Operations
For the Six Months Ended June 30, 2015
(unaudited)

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries (in thousands) | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---------------------------------|--------------------------|---|----------------------------|---------------|---|
| Net operating revenues | \$ 224 | \$ 1,350,245 | \$ 245,110 | \$ 86,829 | \$ | \$ 1,682,408 |
| Costs and expenses: | | | | | | |
| Cost of services | 1,010 | 1,125,696 | 206,806 | 74,752 | | 1,408,264 |
| General and administrative | 41,218 | (217) | | 4,715 | | 45,716 |
| Bad debt expense | | 18,735 | 5,343 | 878 | | 24,956 |
| Depreciation and amortization | 2,058 | 27,682 | 5,262 | 4,194 | | 39,196 |
| Total costs and expenses | 44,286 | 1,171,896 | 217,411 | 84,539 | | 1,518,132 |
| Income (loss) from operations | (44,062) | 178,349 | 27,699 | 2,290 | | 164,276 |
| Other income and expense: | | | | | | |
| Intercompany interest and royalty fees | (597) | 586 | 11 | | | |
| Intercompany management fees | 39,287 | (26,866) | (12,421) | | | |
| Equity in earnings of unconsolidated subsidiaries | | 6,399 | 41 | | | 6,440 |
| Interest expense | (28,181) | (12,086) | (3,040) | (3,369) | | (46,676) |
| Income (loss) from operations before income taxes | (33,553) | 146,382 | 12,290 | (1,079) | | 124,040 |
| Income tax expense (benefit) | (11,936) | 60,620 | (1,288) | (695) | | 46,701 |
| Equity in earnings of subsidiaries | 93,620 | 8,310 | | | (101,930) (a) | |
| Net income (loss) | 72,003 | 94,072 | 13,578 | (384) | (101,930) | 77,339 |
| Less: Net income attributable to non-controlling interests | | 31 | 5,281 | 24 | | 5,336 |
| Net income (loss) attributable to Select Medical Corporation | \$ 72,003 | \$ 94,041 | \$ 8,297 | \$ (408) | \$ (101,930) | \$ 72,003 |

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents**Select Medical Corporation****Condensed Consolidating Statement of Cash Flows****For the Six Months Ended June 30, 2015****(unaudited)**

| | Select (Parent Company Only) | Subsidiary Guarantors | Non-Guarantor Subsidiaries (in thousands) | Non-Guarantor Concentra | Eliminations | Consolidated Select Medical Corporation |
|---|---|----------------------------------|--|------------------------------------|---------------------|--|
| Operating activities | | | | | | |
| Net income (loss) | \$ 72,003 | \$ 94,072 | \$ 13,578 | \$ (384) | \$ (101,930)(a) | \$ 77,339 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | | | | |
| Distributions from unconsolidated subsidiaries | | | 52 | | | 52 |
| Depreciation and amortization | 2,058 | 27,682 | 5,262 | 4,194 | | 39,196 |
| Provision for bad debts | | 18,735 | 5,343 | 878 | | 24,956 |
| Equity in earnings of unconsolidated subsidiaries | | (6,399) | (41) | | | (6,440) |
| Loss on disposal of assets | | 251 | | | | 251 |
| Stock compensation expense | 5,794 | | | | | 5,794 |
| Amortization of debt discount, premium and issuance costs | 3,717 | | | 310 | | 4,027 |
| Deferred income taxes | (4,428) | | | | | (4,428) |
| Changes in operating assets and liabilities, net of effects from acquisition of businesses: | | | | | | |
| Equity in earnings of subsidiaries | (93,620) | (8,310) | | | 101,930(a) | |
| Accounts receivable | | (73,409) | (19,744) | 3,888 | | (89,265) |
| Other current assets | (4,916) | 1,416 | 1,481 | (6,019) | | (8,038) |
| Other assets | 3,453 | (96) | 211 | | | 3,568 |
| Accounts payable | (846) | 7,731 | (2,198) | 4,238 | | 8,925 |
| Accrued expenses | (4,099) | 2,899 | 1,907 | | | 707 |
| Income taxes | 19,111 | | | (695) | | 18,416 |
| Net cash provided by (used in) operating activities | (1,773) | 64,572 | 5,851 | 6,410 | | 75,060 |
| Investing activities | | | | | | |
| Purchases of property and equipment | (4,525) | (56,763) | (3,770) | (3,854) | | (68,912) |
| Investment in businesses | | (855) | | | | (855) |
| Acquisition of businesses, net of cash acquired | | | (2,686) | (1,045,311) | | (1,047,997) |
| Net cash used in investing activities | (4,525) | (57,618) | (6,456) | (1,049,165) | | (1,117,764) |
| Financing activities | | | | | | |
| Borrowings on revolving facilities | 650,000 | | | 10,000 | | 660,000 |
| Payments on revolving facilities | (390,000) | | | (10,000) | | (400,000) |
| | | | | 623,575 | | 623,575 |

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| | | | | | |
|--|-----------|----------|---------|-----------|-----------|
| Net proceeds from Concentra term loans | | | | | |
| Payments on term loans | (26,884) | | | | (26,884) |
| Borrowings of other debt | 6,486 | | 96 | 3,008 | 9,590 |
| Principal payments on other debt | (6,591) | (1,296) | (393) | (40) | (8,320) |
| Dividends paid to Holdings | (13,129) | | | | (13,129) |
| Equity investment by Holdings | 1,325 | | | | 1,325 |
| Proceeds from issuance of non-controlling interests | | | | 217,065 | 217,065 |
| Proceeds from bank overdrafts | 5,590 | | | | 5,590 |
| Tax benefit from stock based awards | 11 | | | | 11 |
| Intercompany | (217,509) | (5,170) | 4,744 | 217,935 | |
| Distributions to non-controlling interests | | | (4,282) | | (4,282) |
| Net cash provided by (used in) financing activities | 9,299 | (6,466) | 165 | 1,061,543 | 1,064,541 |
| Net increase (decrease) in cash and cash equivalents | | | | | |
| | 3,001 | 488 | (440) | 18,788 | 21,837 |
| Cash and cash equivalents at beginning of period | | | | | |
| | 70 | 2,454 | 830 | | 3,354 |
| Cash and cash equivalents at end of period | | | | | |
| | \$ 3,071 | \$ 2,942 | \$ 390 | \$ 18,788 | \$ 25,191 |

(a) Elimination of equity in earnings of consolidated 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 our unaudited condensed consolidated financial statements and accompanying notes.

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:

- changes in government reimbursement for our services due to the implementation of healthcare reform legislation, deficit reduction measures, and/or new payment policies (including, for example, the expiration of the moratorium limiting the full application of the 25 Percent Rule that would reduce our Medicare payments for those patients admitted to a long term acute care hospital from a referring hospital in excess of an applicable percentage admissions threshold) may result in a reduction in net operating revenues, an increase in costs and a reduction in profitability;
- the impact of the Bipartisan Budget Act of 2013 (BBA of 2013), which establishes new payment limits for Medicare patients who do not meet specified criteria, may result in a reduction in net operating revenues and profitability of our long term acute care hospitals (LTCHs);
- 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;

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- our plans and expectations related to the Concentra and Physiotherapy acquisitions and our inability to realize anticipated synergies;
- private third-party payors for our services may undertake future cost containment initiatives that could limit our future net operating revenues and profitability;
- 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, therapists, physicians, or other licensed providers could increase our operating costs significantly or limit our ability to staff our facilities;
- 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 SEC, including factors discussed under the section entitled, **Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2015 as such risk factors may be updated from time to time in our periodic filings with the SEC.

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.

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Overview

We began operations in 1997, and we believe that we are one of the largest operators of specialty hospitals and outpatient rehabilitation clinics in the United States based on number of facilities. On March 4, 2016, we acquired Physiotherapy, a national provider of outpatient physical rehabilitation care, which operated 574 clinics nationwide. As of June 30, 2016, we operated 124 specialty hospitals in 26 states and 1,600 outpatient rehabilitation clinics in 37 states and the District of Columbia. Concentra, which is operated through a joint venture subsidiary, provides occupational medicine, consumer health, physical therapy, and veteran's healthcare services throughout the United States. As of June 30, 2016, Concentra operated 301 medical centers in 38 states. Concentra also provides contract services at employer worksites and operates Department of Veterans Affairs community-based outpatient clinics (CBOCs). On March 31, 2016, we sold our contract therapy businesses. As of June 30, 2016, we had operations in 46 states and the District of Columbia.

We manage our Company through three business segments: specialty hospitals, outpatient rehabilitation, and the Concentra segment. We had net operating revenues of \$2,186.0 million for the six months ended June 30, 2016. Of this total, we earned approximately 54% of our net operating revenues from our specialty hospitals segment, approximately 23% from our outpatient rehabilitation segment, and approximately 23% from our Concentra segment. Our specialty hospitals segment consists of hospitals designed to serve the needs of long term acute care 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 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 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. Our Concentra segment consists of medical centers and contract services provided at employer worksites and Department of Veterans Affairs CBOCs that deliver occupational medicine, consumer health, physical therapy, and veteran's healthcare services.

Non-GAAP Measure

We believe that the presentation of Adjusted EBITDA income (loss) (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 (GAAP). 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, income from operations, 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 GAAP and is thus susceptible to varying calculations, Adjusted EBITDA as presented may not be comparable to other similarly titled measures of other companies.

We define Adjusted EBITDA as earnings excluding interest, income taxes, depreciation and amortization, gain (loss) on early retirement of debt, stock compensation expense, Concentra acquisition costs, Physiotherapy acquisition costs, non-operating gain (loss), and equity in earnings (losses) of unconsolidated subsidiaries. We will refer to Adjusted EBITDA throughout the remainder of Management's Discussion and Analysis of Financial Condition and Results of Operations. You should refer to the following table which reconciles the

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relationship of net income and income from operations to Adjusted EBITDA, whenever we refer to Adjusted EBITDA:

Non-GAAP Measure Reconciliation

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|------------|---------------------------|------------|
| | 2015 | 2016 | 2015 | 2016 |
| | (in thousands) | | | |
| Net income | \$ 40,054 | \$ 40,853 | \$ 77,339 | \$ 100,797 |
| Income tax expense | 23,517 | 33,450 | 46,701 | 50,510 |
| Interest expense | 25,288 | 44,332 | 46,676 | 83,180 |
| Non-operating gain | | (13,035) | | (38,122) |
| Equity in earnings of unconsolidated subsidiaries | (3,848) | (4,546) | (6,440) | (9,198) |
| Loss on early retirement of debt | | | | 773 |
| Income from operations | \$ 85,011 | \$ 101,054 | \$ 164,276 | \$ 187,940 |
| Stock compensation expense: | | | | |
| Included in general and administrative | 2,749 | 3,399 | 4,640 | 6,839 |
| Included in cost of services | 574 | 799 | 1,010 | 1,335 |
| Depreciation and amortization | 21,848 | 36,205 | 39,196 | 70,722 |
| Physiotherapy acquisition costs | | | | 3,236 |
| Concentra acquisition costs | 4,715 | | 4,715 | |
| Adjusted EBITDA | \$ 114,897 | \$ 141,457 | \$ 213,837 | \$ 270,072 |

Summary Financial Results***Consolidated Operating Results for the Three Months Ended June 30, 2016***

For the three months ended June 30, 2016, our net operating revenues increased 23.7% to \$1,097.6 million, compared to \$887.1 million for the three months ended June 30, 2015. We had income from operations of \$101.1 million for the three months ended June 30, 2016, compared to \$85.0 million for the three months ended June 30, 2015. Net income was \$40.9 million for the three months ended June 30, 2016, compared to \$40.1 million for the three months ended June 30, 2015. Our Adjusted EBITDA for the three months ended June 30, 2016 increased 23.1% to \$141.5 million, compared to \$114.9 million for the three months ended June 30, 2015, and our Adjusted EBITDA margin was 12.9% for the three months ended June 30, 2016, compared to 13.0% for the three months ended June 30, 2015.

Consolidated Operating Results for the Six Months Ended June 30, 2016

For the six months ended June 30, 2016, our net operating revenues increased 29.9% to \$2,186.0 million, compared to \$1,682.4 million for the six months ended June 30, 2015. We had income from operations of \$187.9 million for the six months ended June 30, 2016, compared to \$164.3 million for the six months ended June 30, 2015. Net income was \$100.8 million for the six months ended June 30, 2016, compared to \$77.3 million for the six months ended June 30, 2015. Our Adjusted EBITDA for the six months ended June 30, 2016 increased 26.3% to \$270.1 million, compared to \$213.8 million for the six months ended June 30, 2015 and our Adjusted EBITDA margin was 12.4% for the six months

ended June 30, 2016, compared to 12.7% for the six months ended June 30, 2015.

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Medicare Reimbursement of LTCH Services Patient Criteria

As discussed below under *Regulatory Changes Medicare Reimbursement of LTCH Services Patient Criteria*, new Medicare regulations, which establish new payment limits for Medicare patients discharged from an LTCH who do not meet specified patient criteria, began to be phased in to our LTCHs in the fourth quarter of 2015. As of June 30, 2016, 72 of our 105 owned LTCHs are now operating under the new payment rules.

New Specialty Hospitals

Select's development of new specialty hospitals can result in start-up costs exceeding net operating revenues, if any, causing Adjusted EBITDA losses during the start-up period. Adjusted EBITDA losses for start-up hospitals were \$6.6 million for the three months ended June 30, 2016, compared to \$3.3 million for the three months ended June 30, 2015. Adjusted EBITDA losses for start-up hospitals were \$10.5 million for the six months ended June 30, 2016, compared to \$8.8 million for the six months ended June 30, 2015.

Significant Events

Physiotherapy Acquisition

On March 4, 2016, Select consummated the acquisition of 100% of the issued and outstanding equity securities of Physiotherapy. Select financed the acquisition using a combination of cash on hand and a portion of the proceeds from the Series F Tranche B Term Loans under the Select credit facilities, as discussed below. Acquisition costs of \$3.2 million were recognized as part of general and administrative expense on the consolidated statements of operations.

Sale of Businesses

The Company recognized a non-operating gain of \$43.4 million for the six months ended June 30, 2016. The Company sold its contract therapy businesses for \$65.0 million, resulting in a non-operating gain of \$33.9 million. The Company also transferred five specialty hospitals in an exchange transaction and sold nine outpatient rehabilitation clinics, to a non-consolidating subsidiary, which resulted in non-operating gains of \$7.8 million and \$1.7 million, respectively.

Indebtedness

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On March 4, 2016, Select entered into an additional credit extension amendment to the Select credit facilities, which among other changes, provided for the lenders named therein to make available an aggregate of \$625.0 million of Series F Tranche B Term Loans. Select used the proceeds of the Series F Tranche B Term Loans and cash on hand to (i) refinance in full the Series D Tranche B Term Loans due December 20, 2016, (ii) consummate the acquisition of Physiotherapy, and (iii) pay fees and expenses incurred in connection with the transactions. During the six months ended June 30, 2016, we recognized a loss on early retirement of debt of \$0.8 million.

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Regulatory Changes

Our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on February 26, 2016, contains a detailed discussion of the regulations that affect our business in Part I Business Government Regulations. The following is a discussion of recent regulatory changes that have affected our results of operations in 2015 and 2016 or may have an effect on our future results of operations. The information below should be read in conjunction with the more detailed discussion of regulations contained in our Form 10-K.

Medicare Reimbursement Generally

The Medicare program reimburses healthcare providers for services furnished to Medicare beneficiaries, which are generally persons age 65 and older, those who are chronically disabled, and those suffering from end stage renal disease. The program is governed by the Social Security Act of 1965 and is administered primarily by the Department of Health and Human Services and CMS. Net operating revenues generated directly from the Medicare program represented approximately 31% of our consolidated net operating revenues for the six months ended June 30, 2016 and 37% of our consolidated net operating revenues for the year ended December 31, 2015. The principal causes of the decrease in Medicare net operating revenues as a percentage of our total net operating revenues are the acquisitions of Concentra on June 1, 2015, and Physiotherapy on March 4, 2016, which both have a significantly lower relative percentage of Medicare net operating revenues as compared to our historical business prior to the acquisitions. Since the percentage of net operating revenues generated directly from the Medicare program have been historically higher in our specialty hospitals segment as compared to our outpatient rehabilitation and Concentra segments, we anticipate that the percentage of net operating revenues generated directly from the Medicare program will continue to decrease to the extent growth in our outpatient rehabilitation and Concentra segments outpaces growth in our specialty hospitals segment.

The Medicare program reimburses our LTCHs, inpatient rehabilitation facilities (IRFs) and outpatient rehabilitation providers, using different payment methodologies.

The Medicare Access and CHIP Reauthorization Act of 2015, enacted on April 16, 2015, reforms Medicare payment policy for services paid under the Medicare physician fee schedule, including our outpatient rehabilitation services. The law repeals the sustainable growth rate (the SGR) formula effective January 1, 2015, and establishes a new payment framework consisting of specified updates to the Medicare physician fee schedule, a new Merit-Based Incentive Payment System (MIPS), and incentives for participation in alternative payment models (APMs). To finance these provisions, the Medicare Access and CHIP Reauthorization Act of 2015 reduces market basket updates for post-acute care providers, including LTCHs and IRFs, among other Medicare payment cuts. As noted below, the law sets the annual prospective payment system update for fiscal year 2018 at 1% for LTCHs and IRFs, as well as skilled nursing facilities, home health agencies, and hospices. The law also extends the exceptions process for outpatient therapy caps through December 31, 2017.

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Medicare Reimbursement of LTCH Services

There have been significant regulatory changes affecting LTCHs that have affected our net operating revenues and, in some cases, caused us to change our operating models and strategies. We have been subject to regulatory changes that occur through the rulemaking procedures of CMS. All Medicare payments to our LTCHs are made in accordance with long-term care hospital prospective payment system (LTCH-PPS). Proposed rules specifically related to LTCHs are generally published in April or May, finalized in August and effective on October 1st of each year.

The following is a summary of significant changes to the Medicare prospective payment system for LTCHs which have affected our results of operations, as well as proposed policy and payment rate changes that may affect our future results of operations.

Fiscal Year 2015. On August 22, 2014, CMS published the final rule updating policies and payment rates for LTCH-PPS for fiscal year 2015 (affecting discharges and cost reporting periods beginning on or after October 1, 2014 through September 30, 2015). The standard federal rate was set at \$41,044, an increase from the standard federal rate applicable during fiscal year 2014 of \$40,607. The update to the standard federal rate for fiscal year 2015 included a market basket increase of 2.9%, less a productivity adjustment of 0.5%, less a reduction of 0.2% mandated by the Affordable Care Act (ACA), and less a budget neutrality adjustment of 1.266%. The fixed-loss amount for high cost outlier cases was set at \$14,972, an increase from the fixed-loss amount in the 2014 fiscal year of \$13,314.

Fiscal Year 2016. On August 17, 2015, CMS published the final rule updating policies and payment rates for the LTCH-PPS for fiscal year 2016 (affecting discharges and cost reporting periods beginning on or after October 1, 2015 through September 30, 2016). The standard federal rate was set at \$41,763, an increase from the standard federal rate applicable during fiscal year 2015 of \$41,044. The update to the standard federal rate for fiscal year 2016 includes a market basket increase of 2.4%, less a productivity adjustment of 0.5%, and less a reduction of 0.2% mandated by the ACA. The fixed-loss amount for high cost outlier cases paid under LTCH-PPS was set at \$16,423, an increase from the fixed-loss amount in the 2015 fiscal year of \$14,972. The fixed-loss amount for high cost outlier cases paid under the site-neutral payment rate described below was set at \$22,538.

Fiscal Year 2017. On August 2, 2016, CMS released an advanced copy of the final rule updating policies and payment rates for the LTCH-PPS for fiscal year 2017 (affecting discharges and cost reporting periods beginning on or after October 1, 2016 through September 30, 2017). The standard federal rate was set at \$42,476, an increase from the standard federal rate applicable during fiscal year 2016 of \$41,763. The update to the standard federal rate for fiscal year 2017 includes a market basket increase of 2.8%, less a productivity adjustment of 0.3%, and less a reduction of 0.75% mandated by the ACA. The fixed-loss amount for high cost outlier cases paid under LTCH-PPS was set at \$21,943, an increase from the fixed-loss amount in the 2016 fiscal year of \$16,423. The fixed-loss amount for high cost outlier cases paid under the site-neutral payment rate was set at \$23,570, an increase from the fixed-loss amount in the 2016 fiscal year of \$22,538.

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Medicare Market Basket Adjustments

The ACA instituted a market basket payment adjustment to LTCHs. In fiscal years 2017 through 2019, the market basket update will be reduced by 0.75%. The Medicare Access and CHIP Reauthorization Act of 2015 sets the annual update for fiscal year 2018 at 1% after taking into account the market basket payment reduction of 0.75% mandated by the ACA. The ACA specifically allows these market basket reductions to result in less than a 0% payment update and payment rates that are less than the prior year. For fiscal year 2017, CMS is rebasing the LTCH-specific market basket by replacing the 2009-based LTCH-specific market basket with a 2013-based LTCH-specific market basket that is based on Medicare cost report data from cost reporting periods beginning on or after October 1, 2012 and before October 1, 2013.

Patient Criteria

The BBA of 2013, enacted December 26, 2013, establishes new payment limits for Medicare patients discharged from an LTCH who do not meet specified criteria. Specifically, for Medicare patients discharged in cost reporting periods beginning on or after October 1, 2015, LTCHs will be reimbursed under LTCH-PPS only if, immediately preceding the patient's LTCH admission, the patient was discharged from a general acute care hospital paid under IPPS and the patient's stay included at least three days in an intensive care unit (ICU) or coronary care unit (CCU) or the patient is assigned to an Medicare severity diagnosis-related group for LTCHs (MS-LTC-DRG) for cases receiving at least 96 hours of ventilator services in the LTCH. In addition, to be paid under LTCH-PPS the patient's discharge from the LTCH may not include a principal diagnosis relating to psychiatric or rehabilitation services. For any Medicare patient who does not meet the new criteria, the LTCH will be paid a lower site-neutral payment rate, which will be the lower of (1) the inpatient prospective payment system (IPPS) comparable per-diem payment rate capped at the Medicare severity diagnosis-related group (MS-DRG) including any outlier payments, or (2) 100 percent of the estimated costs for services.

The BBA of 2013 provides for a transition to the site-neutral payment rate for those patients not paid under LTCH-PPS. During the transition period (cost reporting periods beginning on or after October 1, 2015 through September 30, 2017), a blended rate will be paid for Medicare patients not meeting the new criteria. The blended rate will comprise half the site-neutral payment rate and half the LTCH-PPS payment rate. For discharges in cost reporting periods beginning on or after October 1, 2017, only the site-neutral payment rate will apply for Medicare patients not meeting the new criteria.

In addition, for cost reporting periods beginning on or after October 1, 2019, qualifying discharges from an LTCH will continue to be paid at the LTCH-PPS payment rate, unless the number of discharges for which payment is made under the site-neutral payment rate is greater than 50% of the total number of discharges from the LTCH. If the number of discharges for which payment is made under the site-neutral payment rate is greater than 50%, then beginning in the next cost reporting period all discharges from the LTCH will be reimbursed at the site-neutral payment rate. The BBA of 2013 requires CMS to establish a process for an LTCH subject to the site-neutral payment rate to re-qualify for payment under LTCH-PPS.

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Payment adjustments, including the interrupted stay policy and the 25 Percent Rule (discussed below), apply to LTCH discharges regardless of whether the case is paid at the LTCH-PPS payment rate or the site-neutral payment rate. However, short stay outlier payment adjustments do not apply to cases paid at the site-neutral payment rate after the transition period. Beginning in fiscal year 2016, CMS calculates the annual recalibration of the MS-LTC-DRG relative payment weighting factors using only data from LTCH discharges that meet the criteria for exclusion from the site-neutral payment rate. In addition, beginning in fiscal year 2016, CMS applies the IPPS fixed-loss amount to site-neutral cases, rather than the LTCH PPS fixed-loss amount. CMS calculates the LTCH-PPS fixed-loss amount using only data from cases paid at the LTCH-PPS payment rate, excluding cases paid at the site-neutral rate.

Each of our LTCHs has their own unique annual cost reporting period. As a result, the new payment limits will become effective for each of our LTCHs at different points in time over a twelve month period that began on October 1, 2015. As of June 30, 2016, 72 of our owned LTCHs were operating under the new payment rules. The remaining 33 LTCHs have cost reporting periods commencing during the third quarter of 2016.

25 Percent Rule

The 25 Percent Rule is a downward payment adjustment that applies if the percentage of Medicare patients discharged from LTCHs who were admitted from a referring hospital (regardless of whether the LTCH or LTCH satellite is co-located with the referring hospital) exceeds the applicable percentage admissions threshold during a particular cost reporting period. As more fully described under business Government Regulations, various legislation has limited or deferred the full application of the 25 Percent Rule. These regulatory changes will have an adverse financial impact on the net operating revenues and profitability of many of our LTCHs for cost reporting periods beginning on or after July 1, 2016.

For discharges occurring prior to October 1, 2016, the 25 Percent Rule payment adjustments are found in two Medicare regulations, one that applies to Medicare patients admitted from a co-located referring hospital and one that applies to Medicare patients admitted from a referring hospital not co-located with the LTCH. After October 1, 2016, a single consolidated 25 Percent Rule applies to all LTCH discharges that occur in the LTCH's cost reporting period that begins after the statutory moratoria on the full implementation of the 25 Percent Rule expires. The moratorium on the full application of the 25 Percent Rule applicable to co-located hospitals expires beginning with LTCH cost reporting periods beginning on or after July 1, 2016, while the moratorium on the full application of the 25 Percent Rule applicable to LTCHs not co-located with a referring hospital expires beginning with LTCH cost reporting periods beginning on or after October 1, 2016. Consequently, LTCHs that are subject to both Medicare regulations will continue to be subject to the moratorium on the full application of the 25 Percent Rule applicable to co-located hospitals until their cost reports beginning on or after October 1, 2016.

Under the single consolidated 25 Percent Rule, CMS calculates the percentage of LTCH discharges referred from any hospital on a provider number basis only. An LTCH's percentage of Medicare discharges from all locations of given referring hospital would be determined during settlement of a cost report by dividing the LTCH's total number of Medicare discharges in the

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cost reporting period (based on the CMS Certification Number (CCN) on the claims) that were admitted directly from a given referring hospital (again determined by the CCN on the referring hospital's claims) by the LTCH's total number of Medicare discharges in the cost reporting period. LTCH discharges that reach high cost outlier status at the referring hospital are not be subject to the 25 Percent Rule payment adjustment (that is, such discharges would only be included in an LTCH's total Medicare discharges and would not count as having been admitted from that referring hospital), and to the extent the LTCH is exclusively located in an MSA-dominant area or rural area, the LTCH would have an increased applicable threshold under proposed special treatment for exclusively MSA-dominant or exclusively rural LTCHs.

Moratorium on New LTCHs, LTCH Satellite Facilities and LTCH Beds

The SCHIP Extension Act imposed a moratorium on the establishment and classification of new LTCHs, LTCH satellite facilities and LTCH beds in existing LTCHs or satellite facilities subject to certain exceptions through December 28, 2012. The BBA of 2013, as amended by the PAMA, reinstated the moratorium on the establishment and classification of new LTCHs or LTCH satellite facilities, and on the increase of LTCH beds in existing LTCHs or satellite facilities beginning April 1, 2014 through September 30, 2017 with certain exceptions to the moratorium that are applicable to the establishment and classification of new LTCHs or LTCH satellite facilities under development prior to April 1, 2014.

Medicare Reimbursement of Inpatient Rehabilitation Facility Services

The following is a summary of significant changes to the Medicare prospective payment system for IRFs which have affected our results of operations during the periods presented in this report, as well as the policies and payment rates for fiscal year 2016 which affect our patient discharges and cost reporting periods beginning on or after October 1, 2015.

Fiscal Year 2015. On August 6, 2014, CMS published the final rule updating policies and payment rates for IRF-PPS for fiscal year 2015 (affecting discharges and cost reporting periods beginning on or after October 1, 2014 through September 30, 2015). The standard payment conversion factor for discharges for fiscal year 2015 was set at \$15,198, an increase from the standard payment conversion factor applicable during fiscal year 2014 of \$14,846. The update to the standard payment conversion factor for fiscal year 2015 included a market basket increase of 2.9%, less a productivity adjustment of 0.5%, and less a reduction of 0.2% mandated by the ACA. CMS decreased the outlier threshold amount for fiscal year 2015 to \$8,848 from \$9,272 established in the final rule for fiscal year 2014.

Fiscal Year 2016. On August 6, 2015, CMS published the final rule updating policies and payment rates for IRF-PPS for fiscal year 2016 (affecting discharges and cost reporting periods beginning on or after October 1, 2015 through September 30, 2016). The standard payment conversion factor for discharges for fiscal year 2016 was set at \$15,478, an increase from the standard payment conversion factor applicable during fiscal year 2015 of \$15,198. The update to the standard payment conversion factor for fiscal year 2016 includes a market basket increase of 2.4%, less a productivity adjustment of 0.5%, and less a reduction of 0.2% mandated by the ACA. CMS decreased the outlier threshold amount for fiscal year 2016 to \$8,658 from \$8,848 established in the final rule for fiscal year 2015.

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Fiscal Year 2017. On July 29, 2016, CMS released an advanced copy of the final rule updating policies and payment rates for the IRF-PPS for fiscal year 2017 (affecting discharges and cost reporting periods beginning on or after October 1, 2016 through September 30, 2017). The standard payment conversion factor for discharges for fiscal year 2017 was set at \$15,708, an increase from the standard payment conversion factor applicable during fiscal year 2016 of \$15,478. The update to the standard payment conversion factor for fiscal year 2017 includes a market basket increase of 2.7%, less a productivity adjustment of 0.3%, and less a reduction of 0.75% mandated by the ACA. CMS decreased the outlier threshold amount for fiscal year 2017 to \$7,984 from \$8,658 established in the final rule for fiscal year 2016.

Medicare Market Basket Adjustments

The ACA instituted a market basket payment adjustment for IRFs. In fiscal years 2017 through 2019, the market basket update will be reduced by 0.75%. The Medicare Access and CHIP Reauthorization Act of 2015 sets the annual update for fiscal year 2018 at 1% after taking into account the market basket payment reduction of 0.75% mandated by the ACA. The ACA specifically allows these market basket reductions to result in less than a 0% payment update and payment rates that are less than the prior year.

Medicare Reimbursement of Outpatient Rehabilitation Services

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare physician fee schedule. Historically, the Medicare physician fee schedule rates have updated annually based on the SGR formula. The SGR formula has resulted in automatic reductions in rates every year since 2002; however, for each year through March 31, 2015, CMS or Congress has taken action to prevent the SGR formula reductions. The Medicare Access and CHIP Reauthorization Act of 2015 repeals the SGR formula effective for services provided on or after January 1, 2015, and establishes a new payment framework consisting of specified updates to the Medicare physician fee schedule, a new MIPS, and APMs. For services provided between January 1, 2015 and June 30, 2015, a 0% payment update was applied to the Medicare physician fee schedule payment rates. For services provided between July 1, 2015 and December 31, 2015, a 0.5% update was applied to the fee schedule payment rates. For services provided in 2016 through 2019, a 0.5% update will be applied each year to the fee schedule payment rates, subject to MIPS adjustment beginning in 2019. For services provided in 2020 through 2025, a 0.0% percent update will be applied each year to the fee schedule payment rates, subject to MIPS and APM adjustments. Finally, in 2026 and subsequent years eligible professionals participating in APMs that meet certain criteria would receive annual updates of 0.75%, while all other professionals would receive annual updates of 0.25%.

The Medicare Access and CHIP Reauthorization Act of 2015 requires that payments under the fee schedule be adjusted starting in 2019 based on performance in MIPS, which will consolidate the three existing incentive programs focused on quality, resource use, and meaningful use of electronic health records. The law requires the Secretary of Health and Human Services to establish the MIPS requirements under which a provider's performance is assessed according to established performance standards and used to determine an adjustment factor that is then applied to the professional's payment for a year. Each year from 2019-2024 professionals who receive a significant share of their revenues through an APM (such as accountable care

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organizations or bundled payment arrangements) that involves risk of financial losses and a quality measurement component will receive a 5% bonus. The bonus payment for APM participation is intended to encourage participation and testing of new APMs and promotes the alignment of incentives across payors. The specifics of the MIPS and APM adjustments beginning in 2019 and 2020, respectively, will be subject to future notice and comment rule-making. For the year ended December 31, 2015, we received approximately 11% of our outpatient rehabilitation net operating revenues from Medicare.

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The following tables set forth operating statistics for each of our operating segments for each of the periods presented. The operating statistics reflect data for the period of time we managed these operations:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|----------|---------------------------|----------|
| | 2015 | 2016 | 2015 | 2016 |
| Specialty Hospitals Data(1): | | | | |
| Number of hospitals owned - start of period | 120 | 118 | 120 | 118 |
| Number of hospitals acquired | | 3 | 1 | 3 |
| Number of hospital start-ups | 1 | 1 | 1 | 1 |
| Number of hospitals closed/sold | (2) | (6) | (3) | (6) |
| Number of hospitals owned - end of period | 119 | 116 | 119 | 116 |
| Number of hospitals managed - end of period | 9 | 8 | 9 | 8 |
| Total number of hospitals (all) - end of period | 128 | 124 | 128 | 124 |
| Long term acute care hospitals | 111 | 106 | 111 | 106 |
| Rehabilitation hospitals | 17 | 18 | 17 | 18 |
| Available licensed beds (2) | 5,187 | 5,154 | 5,187 | 5,154 |
| Admissions (2) | 14,024 | 13,094 | 28,425 | 26,955 |
| Patient days (2) | 343,515 | 317,119 | 695,754 | 655,090 |
| Average length of stay (days) (2) | 24 | 24 | 25 | 24 |
| Net revenue per patient day (2)(3) | \$ 1,590 | \$ 1,680 | \$ 1,583 | \$ 1,655 |
| Occupancy rate (2) | 71% | 68% | 72% | 70% |
| Percent patient days - Medicare (2) | 60% | 55% | 61% | 56% |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2015 | 2016 | 2015 | 2016 |
| Outpatient Rehabilitation Data: | | | | |
| Number of clinics owned - start of period | 883 | 1,441 | 880 | 896 |
| Number of clinics acquired | | | 7 | 543 |
| Number of clinic start-ups | 5 | 7 | 8 | 13 |
| Number of clinics closed/sold | (7) | (13) | (14) | (17) |
| Number of clinics owned - end of period | 881 | 1,435 | 881 | 1,435 |
| Number of clinics managed - end of period | 147 | 165 | 147 | 165 |
| Total number of clinics (all) - end of period | 1,028 | 1,600 | 1,028 | 1,600 |
| Number of visits (2) | 1,336,284 | 2,122,330 | 2,572,772 | 3,698,884 |
| Net revenue per visit (2)(4) | \$ 103 | \$ 102 | \$ 103 | \$ 102 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-----------|---------------------------|-----------|
| | 2015 | 2016 | 2015 | 2016 |
| Concentra Data: | | | | |
| Number of centers owned - start of period | | 301 | | 300 |
| Number of centers acquired | 300 | | 300 | 2 |
| Number of centers start-ups | | | | |
| Number of centers closed/sold | | | | (1) |
| Total number of centers - end of period | 300 | 301 | 300 | 301 |
| Number of visits (5) | 673,834 | 1,890,348 | 673,834 | 3,736,063 |
| Net revenue per visit (5)(6) | \$ 112 | \$ 118 | \$ 112 | \$ 118 |

(Operating statistics footnotes are continued next page)

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- (1) Specialty hospitals consist of LTCHs and IRFs.
- (2) Data excludes specialty hospitals and outpatient clinics managed by the Company.
- (3) Net revenue per patient day is calculated by dividing specialty hospitals direct patient service revenues by the total number of patient days.
- (4) Net revenue per visit is calculated by dividing outpatient rehabilitation clinic direct patient service revenue by the total number of visits and excludes contract therapy revenue for all periods presented.
- (5) Data excludes onsite clinics and CBOCs.
- (6) Net revenue per visit is calculated by dividing center direct patient service revenue by the total number of center visits.

Results of Operations

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|--------|---------------------------|--------|
| | 2015 | 2016 | 2015 | 2016 |
| Net operating revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of services(1) | 83.9 | 83.5 | 83.7 | 84.1 |
| General and administrative | 2.7 | 2.4 | 2.7 | 2.5 |
| Bad debt expense | 1.4 | 1.6 | 1.5 | 1.6 |
| Depreciation and amortization | 2.4 | 3.3 | 2.3 | 3.2 |
| Income from operations | 9.6 | 9.2 | 9.8 | 8.6 |
| Loss on early retirement of debt | | | | 0.0 |
| Equity in earnings of unconsolidated subsidiaries | 0.4 | 0.4 | 0.4 | 0.4 |
| Non-operating gain | | 1.2 | | 1.7 |
| Interest expense | (2.8) | (4.0) | (2.8) | (3.8) |
| Income before income taxes | 7.2 | 6.8 | 7.4 | 6.9 |
| Income tax expense | 2.7 | 3.1 | 2.8 | 2.3 |
| Net income | 4.5 | 3.7 | 4.6 | 4.6 |
| Net income attributable to non-controlling interests | 0.3 | 0.6 | 0.3 | 0.5 |

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| | | | | |
|--|------|------|------|------|
| Net income attributable to Holdings and Select | 4.2% | 3.1% | 4.3% | 4.1% |
|--|------|------|------|------|

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

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

| | For the Three Months Ended June 30, | | | For the Six Months Ended June 30, | | |
|---|-------------------------------------|--------------|----------|-----------------------------------|--------------|----------|
| | 2015 | 2016 | % Change | 2015 | 2016 | % Change |
| (in thousands) | | | | | | |
| Net operating revenues: | | | | | | |
| Specialty hospitals | \$ 592,336 | \$ 585,816 | (1.1)% | \$ 1,191,117 | \$ 1,184,770 | (0.5)% |
| Outpatient rehabilitation(2) | 207,795 | 256,928 | 23.6 | 404,238 | 495,010 | 22.5 |
| Concentra(3) | 86,829 | 254,868 | N/M | 86,829 | 505,745 | N/M |
| Other(1) | 105 | 19 | (81.9) | 224 | 436 | 94.6 |
| Total company | \$ 887,065 | \$ 1,097,631 | 23.7% | \$ 1,682,408 | \$ 2,185,961 | 29.9% |
| Income (loss) from operations: | | | | | | |
| Specialty hospitals | \$ 78,043 | \$ 68,927 | (11.7)% | \$ 161,292 | \$ 141,790 | (12.1)% |
| Outpatient rehabilitation(2) | 25,545 | 31,930 | 25.0 | 44,538 | 56,773 | 27.5 |
| Concentra(3) | 2,290 | 27,931 | N/M | 2,290 | 46,516 | N/M |
| Other(1) | (20,867) | (27,734) | (32.9) | (43,844) | (57,139) | (30.3) |
| Total company | \$ 85,011 | \$ 101,054 | 18.9% | \$ 164,276 | \$ 187,940 | 14.4% |
| Adjusted EBITDA: | | | | | | |
| Specialty hospitals | \$ 91,447 | \$ 82,739 | (9.5)% | \$ 187,919 | \$ 169,495 | (9.8)% |
| Outpatient rehabilitation(2) | 28,722 | 38,132 | 32.8 | 50,855 | 67,011 | 31.8 |
| Concentra(3) | 11,199 | 43,039 | N/M | 11,199 | 77,192 | N/M |
| Other(1) | (16,471) | (22,453) | (36.3) | (36,136) | (43,626) | (20.7) |
| Total company | \$ 114,897 | \$ 141,457 | 23.1% | \$ 213,837 | \$ 270,072 | 26.3% |
| Adjusted EBITDA margin: | | | | | | |
| Specialty hospitals | 15.4% | 14.1% | | 15.8% | 14.3% | |
| Outpatient rehabilitation(2) | 13.8 | 14.8 | | 12.6 | 13.5 | |
| Concentra(3) | 12.9 | 16.9 | | 12.9 | 15.3 | |
| Other(1) | N/M | N/M | | N/M | N/M | |
| Total company | 13.0% | 12.9% | | 12.7% | 12.4% | |
| Purchases of property and equipment: | | | | | | |
| Specialty hospitals | \$ 31,042 | \$ 21,313 | | \$ 53,835 | \$ 54,988 | |
| Outpatient rehabilitation(2) | 3,103 | 3,825 | | 7,025 | 8,798 | |
| Concentra(3) | 3,854 | 4,716 | | 3,854 | 7,927 | |
| Other(1) | 3,065 | 3,636 | | 4,198 | 8,545 | |
| Total company | \$ 41,064 | \$ 33,490 | | \$ 68,912 | \$ 80,258 | |

(Selected financial data by business segment and related footnotes are continued next page)

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

| | 2015 | As of June 30, (in thousands) | 2016 |
|---------------------------|------|----------------------------------|--------------|
| Total assets: | | | |
| Specialty hospitals | \$ | 2,372,723 | \$ 2,448,390 |
| Outpatient rehabilitation | | 538,586 | 984,140 |
| Concentra(3) | | 1,320,941 | 1,333,293 |
| Other(1) | | 109,085 | 72,526 |
| Total company | \$ | 4,341,335 | \$ 4,838,349 |

N/M Not Meaningful

- (1) Other includes our corporate services and certain other non-consolidating joint ventures and minority investments in other healthcare related businesses
- (2) The outpatient rehabilitation segment includes the operating results of contract therapy businesses through March 31, 2016 and Physiotherapy beginning March 4, 2016.
- (3) Concentra's operating results are consolidated with Select's effective June 1, 2015.

Three Months Ended June 30, 2016, Compared to Three Months Ended June 30, 2015

In the following, we discuss our results of operations related to net operating revenues, operating expenses, Adjusted EBITDA, depreciation and amortization, income from operations, equity in earnings of unconsolidated subsidiaries, non-operating gain (loss), interest expense, income taxes, and non-controlling interest, which, in each case, are the same for Holdings and Select.

Net Operating Revenues

Our net operating revenues increased by 23.7% to \$1,097.6 million for the three months ended June 30, 2016, compared to \$887.1 million for the three months ended June 30, 2015, principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016.

Specialty Hospitals. Our specialty hospitals segment net operating revenues declined 1.1% to \$585.8 million for the three months ended June 30, 2016, compared to \$592.3 million for the three months ended June 30, 2015. The primary reason for this decrease was a decline in our patient days which decreased 7.7% to 317,119 days for the three months ended June 30, 2016, compared to 343,515 days for the three months ended June 30, 2015. As discussed above under *Regulatory Changes Medicare Reimbursement of LTCH Services Patient Criteria*, new Medicare regulations, which establish new payment limits for Medicare patients discharged from an LTCH who do not meet specified patient criteria, began to be phased in to our LTCHs in the fourth quarter of 2015. We experienced fewer Medicare patient days due to changes we implemented at LTCHs operating under the new Medicare patient criteria regulations and specialty hospital closures. This decrease in patient days was offset in part by increases in our Medicare net revenue per patient day. Our average net revenue per patient day for all of our specialty hospitals increased 5.7% to \$1,680 for the three months ended June 30, 2016, compared to \$1,590 for the three months ended June 30, 2015, principally as a result of increases in our Medicare net revenue per patient day. The increase in our Medicare net revenue per patient day resulted primarily from the increase in patient acuity at LTCHs now operating under the Medicare patient criteria

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regulations. Our occupancy percentage declined to 68% for the three months ended June 30, 2016, compared to 71% for the three months ended June 30, 2015.

Outpatient Rehabilitation. Our outpatient rehabilitation segment net operating revenues increased 23.6% to \$256.9 million for the three months ended June 30, 2016, compared to \$207.8 million for three months ended June 30, 2015. This increase resulted from growth in our outpatient rehabilitation clinics, offset in part by the sale of our contract therapy businesses. Patient visits in our outpatient clinics were 2,122,330 for the three months ended June 30, 2016, compared to 1,336,284 for the three months ended June 30, 2015. This increase resulted principally from our newly acquired outpatient rehabilitation clinics, as well as growth in our existing owned outpatient rehabilitation clinics. Net revenue per visit in our owned outpatient rehabilitation clinics was \$102 for the three months ended June 30, 2016, compared to \$103 for the three months ended June 30, 2015.

Concentra Segment. Net operating revenues were \$254.9 million for the three months ended June 30, 2016, compared to \$86.8 million for the three months ended June 30, 2015, which includes results beginning June 1, 2015. Net revenue per visit was \$118 and visits were 1,890,348 in the centers for the three months ended June 30, 2016, compared to net revenue per visit of \$112 and 673,834 visits in the centers for the three months ended June 30, 2015, which includes results beginning June 1, 2015.

Operating Expenses

Our operating expenses include our cost of services, general and administrative expense, and bad debt expense. Our operating expenses increased to \$960.4 million, or 87.5% of net operating revenues, for the three months ended June 30, 2016, compared to \$780.2 million, or 88.0% of net operating revenues, for the three months ended June 30, 2015. The increase in operating expenses is principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016. Our cost of services, a major component of which is labor expense, was \$917.0 million, or 83.5% of net operating revenues, for the three months ended June 30, 2016, compared to \$743.9 million, or 83.9% of net operating revenues, for the three months ended June 30, 2015. The decrease in cost of services as a percentage of net operating revenues resulted principally from a decrease in expenses relative to revenues at our Concentra segment as a result of cost saving initiatives we have implemented. Facility rent expense, a component of cost of services, was \$57.0 million for the three months ended June 30, 2016, compared to \$37.7 million for the three months ended June 30, 2015. General and administrative expenses were \$25.9 million for the three months ended June 30, 2016, compared to \$24.0 million for the three months ended June 30, 2015, which included \$4.7 million of Concentra acquisition costs. General and administrative expenses as a percentage of net operating revenues were 2.4% for the three months ended June 30, 2016, compared to 2.7% for the three months ended June 30, 2015. Our general and administrative function includes our shared services activities which have grown and expanded as a result of our significant business acquisitions. Our bad debt expense was \$17.5 million, or 1.6% of net operating revenues, for the three months ended June 30, 2016, compared to \$12.3 million, or 1.4% of net operating revenues, for the three months ended June 30, 2015.

Adjusted EBITDA

Specialty Hospitals. Adjusted EBITDA for our specialty hospitals was \$82.7 million for the three months ended June 30, 2016, compared to \$91.4 million for the three months ended June 30, 2015. Our Adjusted EBITDA margin for the segment was 14.1% for the three months ended June 30, 2016, compared to 15.4% for the three months ended June 30, 2015. The reduction in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment was attributable to a decline in Adjusted EBITDA in our LTCHs, which was principally the result of a decrease in Medicare patient days as discussed above under *Net Operating Revenues*. We also experienced a decline in Adjusted EBITDA and Adjusted EBITDA margin

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resulting from start-up specialty hospitals which incurred \$6.6 million of Adjusted EBITDA losses in the three months ended June 30, 2016, as discussed under *Summary Financial Results* above.

Outpatient Rehabilitation. Adjusted EBITDA for our outpatient rehabilitation segment increased 32.8% to \$38.1 million for the three months ended June 30, 2016, compared to \$28.7 million for the three months ended June 30, 2015. Our contract therapy businesses, sold on March 31, 2016, contributed \$2.7 million of Adjusted EBITDA to the outpatient rehabilitation segment for the three months ended June 30, 2015. The increase in Adjusted EBITDA for our outpatient rehabilitation segment was attributable to growth at our existing clinics and from clinics acquired during the year. Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 14.8% for the three months ended June 30, 2016, compared to 13.8% for the three months ended June 30, 2015. The increase was principally due to the sale of our contract therapy businesses.

Concentra Segment. Adjusted EBITDA for our Concentra segment was \$43.0 million for the three months ended June 30, 2016, compared to \$11.2 million for the three months ended June 30, 2015, which includes results beginning June 1, 2015. Our Adjusted EBITDA margin for the Concentra segment was 16.9% for the three months ended June 30, 2016, compared to 12.9% for the three months ended June 30, 2015, which was principally due to cost reductions.

Other. Adjusted EBITDA loss was \$22.5 million for the three months ended June 30, 2016, compared to an Adjusted EBITDA loss of \$16.5 million for the three months ended June 30, 2015.

Depreciation and Amortization

For the three months ended June 30, 2016, depreciation and amortization expense was \$36.2 million, compared to \$21.8 million for the three months ended June 30, 2015. The increase was principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016.

Income from Operations

For the three months ended June 30, 2016, we had income from operations of \$101.1 million, compared to \$85.0 million for the three months ended June 30, 2015. The increase was principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016.

Equity in Earnings of Unconsolidated Subsidiaries

For the three months ended June 30, 2016, we had equity in earnings of unconsolidated subsidiaries of \$4.5 million, compared to equity in earnings of unconsolidated subsidiaries of \$3.8 million for the three months ended June 30, 2015. The increase in our equity in earnings of unconsolidated subsidiaries resulted from increased earnings associated with several of our inpatient rehabilitation joint ventures in which we own a non-controlling interest.

Non-Operating Gain

For the three months ended June 30, 2016, we had a non-operating gain of \$13.0 million. The non-operating gain was principally due to the sale of nine outpatient rehabilitation clinics and the transfer of five specialty hospitals in an exchange transaction, as discussed above under *Significant Events*.

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Interest Expense

Interest expense was \$44.3 million for the three months ended June 30, 2016, compared to \$25.3 million for the three months ended June 30, 2015. The increase in interest expense was principally due to increases in our indebtedness as a result of the acquisition of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016.

Income Taxes

We recorded income tax expense of \$33.5 million for the three months ended June 30, 2016. The expense represented an effective tax rate of 45.0%. We recorded income tax expense of \$23.5 million for the three months ended June 30, 2015. The expense represented an effective tax rate of 37.0%.

Our quarterly effective income tax rate is derived from our full year estimated effective income tax rate and can be impacted by discrete items specific to a particular quarter and quarterly changes in our full year tax provision estimate. During the three months ended June 30, 2016, we exchanged five specialty hospitals in a hospital swap transaction. For tax purposes, the exchange was treated as a discrete tax event particular to the quarter ended June 30, 2016. Our tax basis in the five specialty hospitals was less than our book basis and resulted in a tax gain exceeding our book gain. The additional tax resulting from this gain was the principal cause of the increase in the effective tax rate.

Non-controlling Interests

Non-controlling interests in consolidated earnings were \$6.9 million for the three months ended June 30, 2016, compared to \$3.1 million for the three months ended June 30, 2015. The increase is principally due to the acquisition of Concentra. These amounts represent the minority owner's share of income and losses for these consolidated entities.

Six Months Ended June 30, 2016 Compared to Six Months Ended June 30, 2015

In the following, we discuss our results of operations related to net operating revenues, operating expenses, Adjusted EBITDA, depreciation and amortization, income from operations, loss on early retirement of debt, equity in earnings of unconsolidated subsidiaries, non-operating gain (loss), interest expense, income taxes, and non-controlling interest, which, in each case, are the same for Holdings and Select.

Net Operating Revenues

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Our net operating revenues increased by 29.9% to \$2,186.0 million for the six months ended June 30, 2016, compared to \$1,682.4 million for the six months ended June 30, 2015, principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016.

Specialty Hospitals. Our specialty hospitals segment net operating revenues declined 0.5% to \$1,184.8 million for the six months ended June 30, 2016, compared to \$1,191.1 million for the six months ended June 30, 2015. The primary reason for this decrease was a decline in our patient days which decreased 5.8% to 655,090 days for the six months ended June 30, 2016, compared to 695,754 days for the six months ended June 30, 2015. As discussed above under *Regulatory Changes Medicare Reimbursement of LTCH Services Patient Criteria*, new Medicare regulations, which establish new payment limits for Medicare patients discharged from an LTCH who do not meet specified patient criteria, began to be phased in to our LTCHs in the fourth quarter of 2015. We experienced fewer Medicare patient days due to changes we implemented at LTCHs operating under the new Medicare patient criteria regulations and specialty hospital closures.

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This decrease in patient days was offset in part by increases in our Medicare net revenue per patient day. Our average net revenue per patient day for all of our specialty hospitals increased 4.5% to \$1,655 for the six months ended June 30, 2016, compared to \$1,583 for the six months ended June 30, 2015, principally as a result of increases in our Medicare net revenue per patient day. The increase in our Medicare net revenue per patient day resulted primarily from the increase in patient acuity at LTCHs now operating under the Medicare patient criteria regulations. Our occupancy percentage declined to 70% for the six months ended June 30, 2016, compared to 72% for the six months ended June 30, 2015.

Outpatient Rehabilitation. Our outpatient rehabilitation segment net operating revenues increased 22.5% to \$495.0 million for the six months ended June 30, 2016, compared to \$404.2 million for six months ended June 30, 2015. This increase was due to an increase in visits resulting principally from our newly acquired outpatient rehabilitation clinics and growth in our existing owned outpatient rehabilitation clinics. Net revenue per visit in our owned outpatient rehabilitation clinics was \$102 for the six months ended June 30, 2016, compared to \$103 for the six months ended June 30, 2015.

Concentra Segment. Net operating revenues were \$505.7 million for the six months ended June 30, 2016, compared to \$86.8 million for the six months ended June 30, 2015, which includes results beginning June 1, 2015. Net revenue per visit was \$118 and visits were 3,736,063 in the centers for the six months ended June 30, 2016, compared to net revenue per visit of \$112 and 673,834 visits in the centers for the six months ended June 30, 2015, which includes results beginning June 1, 2015.

Operating Expenses

Our operating expenses include our cost of services, general and administrative expense, and bad debt expense. Our operating expenses increased to \$1,927.3 million, or 88.2% of net operating revenues, for the six months ended June 30, 2016, compared to \$1,478.9 million, or 87.9% of net operating revenues, for the six months ended June 30, 2015. The increase in operating expenses is principally due to the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016. Our cost of services, a major component of which is labor expense, was \$1,839.2 million, or 84.1% of net operating revenues, for the six months ended June 30, 2016, compared to \$1,408.3 million, or 83.7% of net operating revenues, for the six months ended June 30, 2015. The increase in cost of services as a percentage of net operating revenues resulted principally from Concentra and an increase in expenses relative to revenues at our specialty hospitals. Our specialty hospitals labor costs increased as a result of higher labor costs associated with the increased patient acuity and higher wage rates for clinicians we are experiencing at our LTCHs now operating under the Medicare patient criteria regulations. We also maintained certain staffing levels at our specialty hospitals, even though we experienced declines in patient volumes during the six months ended June 30, 2016, due to the difficulties in rehiring staff should patient volumes increase. Facility rent expense, a component of cost of services, was \$109.0 million for the six months ended June 30, 2016, compared to \$71.1 million for the six months ended June 30, 2015. General and administrative expenses were \$54.1 million for the six months ended June 30, 2016, which included \$3.2 million of Physiotherapy acquisition costs, compared to \$45.7 million for the six months ended June 30, 2015, which included \$4.7 million of Concentra acquisition costs. General and administrative expenses as a percentage of net operating revenues were 2.5% for the six months ended June 30, 2016 and 2.7% for the six months ended June 30, 2015. Our general and administrative function includes our shared services activities which have grown and expanded as a result of our significant business acquisitions. Our bad debt expense was \$33.9 million, or 1.6% of net operating revenues, for the six months ended June 30, 2016, compared to \$25.0 million, or 1.5% of net operating revenues, for the six months ended June 30, 2015.

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Adjusted EBITDA

Specialty Hospitals. Adjusted EBITDA for our specialty hospitals was \$169.5 million for the six months ended June 30, 2016, compared to \$187.9 million for the six months ended June 30, 2015. Our Adjusted EBITDA margin for the segment was 14.3% for the six months ended June 30, 2016, compared to 15.8% for the six months ended June 30, 2015. The reduction in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment was attributable to a decline in Adjusted EBITDA in our LTCHs, which was principally the result of a decrease in patient days as discussed above under *Net Operating Revenues* and increases in our cost of services as discussed above under *Operating Expenses*. We also experienced a decline in Adjusted EBITDA and Adjusted EBITDA margin resulting from start-up hospitals which incurred \$10.5 million of Adjusted EBITDA losses in the six months ended June 30, 2016, compared to \$8.8 million for the six months ended June 30, 2015, as discussed under *Summary Financial Results* above.

Outpatient Rehabilitation. Adjusted EBITDA for our outpatient rehabilitation segment increased 31.8% to \$67.0 million for the six months ended June 30, 2016, compared to \$50.9 million for the six months ended June 30, 2015. Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 13.5% for the six months ended June 30, 2016, compared to 12.6% for the six months ended June 30, 2015. The increase was principally due to the sale of our contract therapy businesses.

Concentra Segment. Adjusted EBITDA for our Concentra segment was \$77.2 million for the six months ended June 30, 2016, compared to \$11.2 million for the six months ended June 30, 2015, which includes results beginning June 1, 2015. Our adjusted EBITDA margin for the Concentra segment was 15.3% for the six months ended June 30, 2016, compared to 12.9% for the six months ended June 30, 2015.

Other. Adjusted EBITDA loss was \$43.6 million for the six months ended June 30, 2016, compared to an Adjusted EBITDA loss of \$36.1 million for the six months ended June 30, 2015.

Depreciation and Amortization

For the six months ended June 30, 2016, depreciation and amortization expense was \$70.7 million, compared to \$39.2 million for the six months ended June 30, 2015. The increase was principally due to the acquisitions of Concentra on June 1, 2015, and Physiotherapy on March 4, 2016.

Income from Operations

For the six months ended June 30, 2016, we had income from operations of \$187.9 million, compared to \$164.3 million for the six months ended June 30, 2015. The increase was principally due to the acquisitions of Concentra on June 1, 2015, and Physiotherapy on March 4, 2016.

Loss on Early Retirement of Debt

On March 4, 2016, we repaid the Series D Tranche B Term Loans under the Select credit facilities. During the six months ended June 30, 2016, we recognized a loss on early retirement of debt of \$0.8 million.

Equity in Earnings of Unconsolidated Subsidiaries

For the six months ended June 30, 2016, we had equity in earnings of unconsolidated subsidiaries of \$9.2 million, compared to equity in earnings of unconsolidated subsidiaries of \$6.4 million for the six months

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ended June 30, 2015. The increase in our equity in earnings of unconsolidated subsidiaries resulted from increased earnings associated with several of our inpatient rehabilitation joint ventures in which we own a non-controlling interest.

Non-Operating Gain

For the six months ended June 30, 2016, we had a non-operating gain of \$38.1 million. The non-operating gain was principally due to the sale of our contract therapy businesses during the first quarter, the sale of nine outpatient rehabilitation clinics, and the transfer of five specialty hospitals in an exchange transaction during the second quarter, as discussed above under *Significant Events*. Additionally, we recognized an impairment loss of \$5.3 million during the first quarter on an investment in which we were a minority owner.

Interest Expense

Interest expense was \$83.2 million for the six months ended June 30, 2016, compared to \$46.7 million for the six months ended June 30, 2015. The increase in interest expense was principally due to increases in our indebtedness as a result of the acquisition of Concentra and Physiotherapy.

Income Taxes

We recorded income tax expense of \$50.5 million for the six months ended June 30, 2016. The expense represented an effective tax rate of 33.4%. We recorded income tax expense of \$46.7 million for the six months ended June 30, 2015. The expense represented an effective tax rate of 37.7%.

Our effective income tax rate is derived from our full year estimated effective income tax rate and can be impacted by discrete items specific to a particular quarter and quarterly changes in our full year tax provision estimate. On March 31, 2016, we sold our contract therapy businesses. For tax purposes, the sale was treated as a discrete tax event particular to the first quarter of 2016. Our tax basis in our contract therapy businesses exceeded our selling price. As a result, we had no tax expense from the sale. Additionally, during the three months ended June 30, 2016, we exchanged five specialty hospitals in a hospital swap transaction. For tax purposes, the exchange was treated as a discrete tax event particular to the second quarter of 2016. Our tax basis in the five specialty hospitals was less than our book basis and resulted in a tax gain exceeding our book gain. The lower effective tax rate for the six months ended June 30, 2016 resulted from the effects of the two discrete tax events discussed above.

Non-Controlling Interests

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Non-controlling interests in consolidated earnings were \$12.0 million for the six months ended June 30, 2016, compared to \$5.3 million for the six months ended June 30, 2015. The increase is principally due to the acquisition of Concentra. These amounts represent the minority owner's share of income and losses for these consolidated entities.

Table of Contents**Liquidity and Capital Resources***Cash Flows for the Six Months Ended June 30, 2016 and Six Months Ended June 30, 2015*

| | For the Six Months Ended June 30, | |
|---|--|-------------|
| | 2015 | 2016 |
| | (in thousands) | |
| Cash provided by operating activities | \$ 75,060 | \$ 177,969 |
| Cash used in investing activities | (1,117,764) | (432,001) |
| Cash provided by financing activities | 1,064,541 | 318,017 |
| Increase in cash and equivalents | 21,837 | 63,985 |
| Cash and equivalents at beginning of period | 3,354 | 14,435 |
| Cash and equivalents at end of period | \$ 25,191 | \$ 78,420 |

In the following, we discuss cash flows from operating activities, investing activities, and financing activities, which, in each case, are the same for Holdings and Select.

Operating activities provided \$178.0 million of cash flows for the six months ended June 30, 2016, compared to \$75.1 million of cash flows provided for the six months ended June 30, 2015. The increase in operating cash flows for the six months ended June 30, 2016 compared to the six months ended June 30, 2015 is principally due to cash flows provided from Concentra which was acquired on June 1, 2015, Physiotherapy which was acquired on March 4, 2016, an increase in the turnover of our accounts receivable, and cash distributions we received from unconsolidated investments in which we are minority owners.

Our days sales outstanding were 51 days at June 30, 2016, compared to 53 days at December 31, 2015 and 55 days at June 30, 2015. Our days sales outstanding will fluctuate based upon variability in our collection cycles. Our days sales outstanding at June 30, 2016, December 31, 2015 and June 30, 2015 all fall within our expected range.

Investing activities used \$432.0 million of cash flow for the six months ended June 30, 2016, principally due to the acquisition of Physiotherapy. Investing activities also included \$80.3 million for purchases of property and equipment, offset in part by proceeds from the sale of businesses of \$71.4 million. Investing activities used \$1,117.8 million of cash flow for the six months ended June 30, 2015, principally due to \$1,045.0 million related to the Concentra acquisition and \$68.9 million for purchases of property and equipment.

Financing activities for Select provided \$318.0 million of cash flow for the six months ended June 30, 2016. The principal source of cash was the issuance of \$625.0 million aggregate principal amount of Series F Tranche B Term Loans under the Select credit facilities, resulting in net proceeds of \$600.1 million, offset by \$215.7 million of cash used to repay the Series D Tranche B Term Loans under the Select credit facilities and \$60.0 million of net repayments under the Select revolving facility

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Financing activities provided \$1,064.5 million of cash flow for the six months ended June 30, 2015. The principal sources of cash for financing activities were \$260.0 million of net borrowings under the Select revolving facility, \$623.6 million borrowed under the Concentra credit facilities, and \$217.1 million attributable to a non-consolidating interest in Group Holdings.

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Capital Resources

Working capital - We had net working capital of \$289.7 million at June 30, 2016 compared to net working capital of \$19.9 million at December 31, 2015. The increase in net working capital is primarily due to the extinguishment of Series D Tranche B Term Loans, which were classified as a current liability at December 31, 2015, and an increase in cash over the six months ended June 30, 2016.

Select credit facilities - On March 2, 2016, Select made a principal prepayment of \$10.2 million associated with the Select term loans in accordance with the provision in the Select credit facilities that requires mandatory prepayments of the Select term loans as a result of annual excess cash flow as defined in the Select credit facilities.

At June 30, 2016, Select had outstanding borrowings under the Select credit facilities of \$1,150.9 million of Select term loans (excluding unamortized discounts and debt issuance costs of \$29.8 million) and borrowings of \$240.0 million (excluding letters of credit) under the Select revolving facility. After giving effect to \$39.7 million of outstanding letters of credit at June 30, 2016, Select had \$170.3 million of availability under the Select revolving facility.

The Select credit facilities require Select to maintain certain leverage ratios (as defined in the Select credit facilities). For the quarter ended June 30, 2016, Select was required to maintain its leverage ratio at less than 5.75 to 1.00. Select's leverage ratio was 5.00 to 1.00 as of June 30, 2016.

Concentra credit facilities - Select and Holdings are not parties to the Concentra credit facilities and are not obligors with respect to Concentra's debt under such agreements. While this debt is non-recourse to Select, it is included in Select's consolidated financial statements.

At June 30, 2016, Concentra had outstanding borrowings of \$645.5 million under the Concentra term loans (excluding unamortized discounts and debt issuance costs of \$21.4 million). Concentra did not have any borrowings under the Concentra revolving facility. After giving effect to \$7.8 million of outstanding letters of credit at June 30, 2016, Concentra had \$42.2 million of availability under its revolving facility.

Stock Repurchase Program - Holdings' board of directors has authorized a common stock repurchase program to repurchase up to \$500.0 million worth of shares of its common stock. The program will remain in effect until December 31, 2016, unless extended or earlier terminated 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 Holdings deems appropriate. Holdings is funding this program with cash on hand and borrowings under Select's revolving credit facility. Holdings did not repurchase shares during the six months ended June 30, 2016. Since the inception of the program through June 30, 2016, Holdings has repurchased 35,924,128 shares at a cost of approximately

\$314.7 million, or \$8.76 per share, which includes transaction costs.

Liquidity - We believe our internally generated cash flows and borrowing capacity under the Select and Concentra credit facilities will be sufficient to finance operations over the next twelve months. 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.

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Use of Capital Resources - We may from time to time pursue opportunities to develop new joint venture relationships with significant health systems and other healthcare providers, 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 business through opportunistic acquisitions.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2016-09, *Compensation-Stock Compensation*, which simplifies various aspects of accounting for share-based payments to employees. The areas for simplification involve several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2016. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. This ASU includes a lessee accounting model that recognizes two types of leases; finance and operating. This ASU requires that a lessee recognize on the balance sheet assets and liabilities for all leases with lease terms of more than twelve months. Lessees will need to recognize almost all leases on the balance sheet as a right-of-use asset and a lease liability. For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or finance. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as finance or operating lease. For short-term leases of twelve months or less, lessees are permitted to make an accounting election by class of underlying asset not to recognize right-of-use assets or lease liabilities. If the alternative is elected, lease expense would be recognized generally on the straight-line basis over the respective lease term.

The amendments in ASU 2016-02 will take effect for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted as of the beginning of an interim or annual reporting period. A modified retrospective approach is required for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the adoption methodology and the impact of this update on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes*, which changes the presentation of deferred income taxes. The intent is to simplify the presentation of deferred income taxes through the requirement that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The revised guidance is effective for annual fiscal periods beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the standard.

In May 2014, March 2016, and April 2016 the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, ASU 2016-08, *Revenue from Contracts with Customers, Principal versus Agent Considerations*, ASU 2016-10, *Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing*, and ASU 2016-12, *Revenue from Contracts with Customers, Narrow Scope Improvements and Practical Expedients*, respectively, which supersede most of the current revenue recognition requirements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be

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entitled in exchange for those goods or services. New disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. The original standards were effective for fiscal years beginning after December 15, 2016; however, in July 2015, the FASB approved a one-year deferral of these standards, with a new effective date for fiscal years beginning after December 15, 2017. The standards require the selection of a modified retrospective or cumulative effect transition method for retrospective application. The Company is currently evaluating the standards to determine the impact they will have on its consolidated financial statements.

Recently Adopted Accounting Pronouncements

In April and August 2015, the FASB issued ASU 2015-03 and ASU 2015-15, each titled *Interest- Imputation of Interest*, to simplify the presentation of debt issuance costs. The standard requires debt issuance costs be presented in the balance sheet as a direct deduction from the carrying value of the debt liability. The FASB clarified that debt issuance costs related to line-of-credit arrangements can be presented as an asset and amortized over the term of the arrangement. The Company adopted the standard at the beginning of the first quarter of 2016. The balance sheet as of December 31, 2015 was retrospectively conformed to reflect the adoption of the standard and approximately \$38.0 million of unamortized debt issuance costs are now classified as a direct reduction of debt, rather than a component of other assets.

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 variable rate long-term indebtedness. Our principal interest rate exposure relates to the loans outstanding under the Select credit facilities and Concentra credit facilities.

As of June 30, 2016, Select had \$1,150.9 million (excluding unamortized discounts and debt issuance costs) in term loans outstanding under the Select credit facilities and \$240.0 million in revolving borrowings outstanding under the Select credit facilities, which bear interest at variable rates.

As of June 30, 2016, Concentra had outstanding borrowings under the Concentra credit facilities of \$645.5 million (excluding unamortized discounts and debt issuance costs) of term loans, which bear interest at variable rates. Concentra did not have any outstanding revolving borrowings. Certain of Select's and Concentra's outstanding borrowings that bear interest at variable rates were effectively fixed as of June 30, 2016 based upon then current interest rates because the Adjusted LIBO Rate did not then exceed the applicable Adjusted LIBO Rate floors for such borrowings:

- Select's aggregate \$527.5 million in Series E Tranche B Term Loans are subject to an Adjusted LIBO Rate floor of 1.00%. Therefore, until the Adjusted LIBO Rate exceeds 1.00%, Select's interest rate on this indebtedness is effectively fixed at 6.00%.

- Select's aggregate \$623.4 million in Series F Tranche B Term Loans are subject to an Adjusted LIBO Rate floor of 1.00%. Therefore, until the Adjusted LIBO Rate exceeds 1.00%, Select's interest rate on this indebtedness is effectively fixed at 6.00%.

- the \$445.5 million Concentra first lien term loan is subject to an Adjusted LIBO Rate floor of 1.00%. Therefore, until the Adjusted LIBO Rate exceeds 1.00%, Concentra's interest rate on this indebtedness is effectively fixed at 4.00%.

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- the \$200.0 million Concentra second lien term loan is subject to an Adjusted LIBO Rate floor of 1.00%. Therefore, until the Adjusted LIBO Rate exceeds 1.00%, Concentra's interest rate on this indebtedness is effectively fixed at 9.00%.

However, the Select and Concentra revolving borrowings are not subject to an Adjusted LIBO Rate floor.

The following table summarizes the impact of hypothetical increases in market interest rates as of June 30, 2016 on our consolidated interest expense over the subsequent twelve month period:

| Increase in Market Interest Rate | Interest Rate Expense Increases Per Annum (in thousands)(1) |
|--|---|
| 0.25% \$ | 600.0 |
| 0.50% \$ | 3,894.6 |
| 0.75% \$ | 8,985.5 |
| 1.00% \$ | 14,076.5 |

(1) Based on the 3-month LIBOR rate of 0.65% as of June 30, 2016, a change in interest rates of up to 0.35% would only increase interest expense with respect to the Select and Concentra revolving borrowings, which are not subject to an Adjusted LIBO Rate floor. Increases in interest rates greater than 0.35% as of June 30, 2016 would impact the interest rate paid on all of Select's and Concentra's variable rate debt, as indicated in the table above.

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 June 30, 2016 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.

Physiotherapy Acquisition

On March 4, 2016, Select consummated the acquisition of Physiotherapy. SEC guidance permits management to omit an assessment of an acquired business' internal control over financial reporting from management's assessment of internal control over financial reporting for a period not to exceed one year from the date of the acquisition.

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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 second quarter ended June 30, 2016 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.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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 the Company 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 address claims arising out of the Company's operations, 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, as well as the cost and possible lack of available insurance, 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 is and 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.

On October 19, 2015, the plaintiff-relators filed a Second Amended Complaint in United States of America, ex rel. Tracy Conroy, Pamela Schenk and Lisa Wilson v. Select Medical Corporation, Select Specialty Hospital - Evansville, LLC ("SSH-Evansville"), Select Employment Services, Inc., and Dr. Richard Sloan. The case is a civil action filed in the United States District Court for the Southern District of Indiana by private plaintiff-relators on behalf of the United States under the federal False Claims Act. The plaintiff-relators are the former CEO and two former case managers at SSH-Evansville, and the defendants currently include the Company, SSH-Evansville, a subsidiary of the Company serving as common paymaster for its employees, and a physician who practices at SSH-Evansville. The plaintiff-relators allege that SSH-Evansville discharged patients too early or held patients too long, improperly discharged patients to and readmitted them from short stay hospitals, up-coded diagnoses at admission, and admitted patients for whom long-term acute care was not medically necessary. They also allege that the defendants engaged in retaliation in violation of federal and state law. The Second Amended Complaint replaces a prior complaint that was filed under seal on September 28, 2012 and served on the Company on February 15, 2013, after a federal magistrate judge unsealed it on January 8, 2013. All deadlines in the case had been stayed after the seal was lifted in order to allow the government time to complete its investigation and to decide whether or not to intervene. On June 19, 2015, the U.S. Department

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of Justice notified the court of its decision not to intervene in the case, and the court thereafter approved a case management plan imposing certain deadlines. The defendants filed a Motion to Dismiss the Second Amended Complaint in December 2015. The Company intends to vigorously defend this action, but at this time the Company is unable to predict the timing and outcome of this matter.

On July 13, 2015, the federal District Court for the Eastern District of Tennessee unsealed a qui tam Complaint in Armes v. Garman, et al, No. 3:14-cv-00172-TAV-CCS, which named as defendants Select, Select Specialty Hospital Knoxville, Inc. (SSH-Knoxville), Select Specialty Hospital North Knoxville, Inc. and ten current or former employees of these facilities. The Complaint was unsealed after the United States and the State of Tennessee notified the court on July 13, 2015 that each had decided not to intervene in the case. The Complaint is a civil action that was filed under seal on April 29, 2014 by a respiratory therapist formerly employed at SSH-Knoxville. The Complaint alleges violations of the federal False Claims Act and the Tennessee Medicaid False Claims Act based on extending patient stays to increase reimbursement and to increase average length of stay; artificially prolonging the lives of patients to increase Medicare reimbursements and decrease inspections; admitting patients who do not require medically necessary care; performing unnecessary procedures and services; and delaying performance of procedures to increase billing. The Complaint was served on some of the defendants during October 2015. The defendants filed a Motion to Dismiss such Complaint in November 2015, and the court approved such Motion and dismissed the lawsuit in June 2016. In July 2016, the plaintiff filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. The Company intends to vigorously defend this action if the relators pursue it, but 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, 2015.

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

Purchases of Equity Securities by the Issuer

Holdings board of directors has authorized a common stock repurchase program to repurchase up to \$500.0 million worth of shares of its common stock. The program will remain in effect until December 31, 2016, unless extended or earlier terminated 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 Holdings deems appropriate. Holdings did not repurchase shares during the three months ended June 30, 2016 under the authorized common stock repurchase program.

The following table provides information regarding repurchases of our common stock during the three months ended June 30, 2016:

| Total Number of Shares Purchased(1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly | Approximate Dollar Value of Shares that May Yet Be |
|-------------------------------------|------------------------------|--|--|
|-------------------------------------|------------------------------|--|--|

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| | | | Announced Plans or Programs | | Purchased Under Plans or Programs |
|--------------------------|--------|----|--------------------------------|--|--------------------------------------|
| April 1 - April 30, 2016 | 5,579 | \$ | 13.59 | | \$ 185,249,408 |
| May 1 - May 31, 2016 | 32,467 | | 13.24 | | 185,249,408 |
| June 1 - June 30, 2016 | | | | | 185,249,408 |
| Total | 38,046 | \$ | 13.29 | | \$ 185,249,408 |

(1) Represents shares of common stock surrendered to us to satisfy tax withholding obligations associated with the vesting of restricted shares issued to employees, pursuant to the provisions of our equity incentive plans.

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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 61 hereof.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this Report to be signed on their behalf by the undersigned, thereunto duly authorized.

SELECT MEDICAL CORPORATION

By: */s/* Martin F. Jackson
Martin F. Jackson
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer)

By: */s/* Scott A. Romberger
Scott A. Romberger
Senior Vice President, Chief Accounting Officer and
Controller
(Principal Accounting Officer)

Dated: August 4, 2016

SELECT MEDICAL HOLDINGS CORPORATION

By: */s/* Martin F. Jackson
Martin F. Jackson
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer)

By: */s/* Scott A. Romberger
Scott A. Romberger
Senior Vice President, Chief Accounting Officer and
Controller
(Principal Accounting Officer)

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EXHIBIT INDEX

| Exhibit | Description |
|----------------|---|
| 10.1 | Second Amendment to the Lease Agreement, dated June 1, 2016, between Old Gettysburg II, LP and Select Medical Corporation. |
| 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 June 30, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2016 and 2015, (ii) Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015, (iv) Condensed Consolidated Statements of Changes in Equity and Income for the six months ended June 30, 2016 and (v) Notes to Condensed Consolidated Financial Statements. |