SandRidge Offshore, LLC
Form 424B3
September 17, 2008

Table of Contents

Filed pursuant to Rule 424(b)(3)
Registration No. 333-151899

PROSPECTUS

SandRidge Energy, Inc.

Offers to Exchange up to
$650,000,000 of 85/8% Senior Notes Due 2015
that have been registered under the Securities Act of 1933
for
$650,000,000 of 85/8% Senior Notes Due 2015
that have not been registered under the Securities Act of 1933
and
$350,000,000 of Senior Floating Rate Notes Due 2014
that have been registered under the Securities Act of 1933
for
$350,000,000 of Senior Floating Rate Notes Due 2014
that have not been registered under the Securities Act of 1933

Terms of the Exchange Offers

We are offering to exchange up to:

$650,000,000 aggregate principal amount of registered 85/8% Senior Notes Due 2015, for any and all of our $650,000,000 aggregate principal amount of unregistered 85/8% Senior Notes Due 2015; and

$350,000,000 aggregate principal amount of registered Senior Floating Rate Notes Due 2014, for any and all of our $350,000,000 aggregate principal amount of unregistered Senior Floating Rate Notes Due 2014.

We refer to the registered notes collectively as the exchange notes and the unregistered notes collectively as the outstanding notes. We refer to the exchange notes and the outstanding notes collectively as the notes. The exchange notes are being issued under the indenture pursuant to which we previously issued the outstanding notes. This prospectus also relates to up to approximately $205.6 million in aggregate principal amount of additional exchange notes that may be issued at our option as payment of interest on our Senior Notes Due 2015. We presently have no intention to issue any additional exchange notes as payment of interest.

We will exchange all outstanding notes that you validly tender and do not validly withdraw before the applicable exchange offer expires for an equal principal amount of exchange notes of the same series.

The terms of the exchange notes of each series are substantially identical to those of the outstanding notes of the same series, except that the transfer restrictions, registration rights and provisions for additional interest relating to the outstanding notes do not apply to the exchange notes.

The outstanding notes are, and the exchange notes will be, guaranteed by each of our existing and future domestic restricted subsidiaries.

Each exchange offer expires at 5:00 p.m., New York City time, on October 17, 2008, unless extended. We do not currently intend to extend the exchange offers.

Tenders of outstanding notes may be withdrawn at any time prior to the expiration of the applicable exchange offer.

The exchange of outstanding notes for exchange notes will not be a taxable event for U.S. federal income tax purposes.

This investment involves risks. Please read Risk Factors beginning on page 5 for a discussion of the risks that you should consider prior to tendering your outstanding notes in the exchange offers.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is September 17, 2008.

This prospectus incorporates important business and financial information about us that is not included in or delivered with this document. This information is available to you without charge upon written or oral request to: SandRidge Energy, Inc., 1601 N.W. Expressway, Suite 1600, Oklahoma City, Oklahoma 73118, Attention: Corporate Secretary, (405) 753-5500. The exchange offer is expected to expire on October 17, 2008 and you must make your exchange decision by the expiration date. To obtain timely delivery, you must request the information no later than October 9, 2008, or the date which is five business days before the expiration date of this exchange offer.

This prospectus is part of a registration statement we filed with the Securities and Exchange Commission, referred to in this prospectus as the SEC or the Commission. In making your investment decision, you should rely only on the information contained in this prospectus and in the accompanying letter of transmittal. We have not authorized anyone to provide you with any other information. If you received any unauthorized information, you must not rely on it. We are not making an offer to sell these securities in any state or jurisdiction where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front cover of this prospectus.

Each broker-dealer that receives exchange notes for its own account pursuant to an exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such exchange notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of exchange notes received in exchange for outstanding notes where such outstanding notes were acquired by such broker-dealer as a result of market-making activities or other trading activities. We have agreed that, for a period of 180 days after the consummation of an exchange offer, we will make this prospectus available to any broker-dealer for use in connection with any such resale. Please read Plan of Distribution.

TABLE OF CONTENTS

Table of Contents

PROSPECTUS SUMMARY

We have provided definitions for some of the natural gas and oil industry terms used in this prospectus in the Glossary of Natural Gas and Oil Terms included in this prospectus. In this prospectus, when we use the terms SandRidge, the Company, we, our, or us, we mean SandRidge Energy, Inc. and its subsidiaries on a consolidated basis, unless otherwise indicated or the context requires otherwise. SandRidge Tertiary refers to our wholly-owned subsidiary, SandRidge Tertiary LLC, formerly PetroSource Production Company, LLC, and Lariat refers to our wholly-owned subsidiary, Lariat Services, Inc.

Our Company

We are an independent natural gas and oil company headquartered in Oklahoma City, Oklahoma with our principal focus on exploration and production activities. We also own and operate natural gas gathering, marketing and processing facilities, CO_2 treating and transportation facilities, and tertiary oil recovery operations. In addition, we own and operate drilling rigs and a related oil field services business. We focus our exploration and production activities in West Texas, the Cotton Valley Trend in East Texas, the Gulf Coast, the Mid-Continent and the Gulf of Mexico.

Our principal executive offices are located at 1601 N.W. Expressway, Suite 1600, Oklahoma City, Oklahoma 73118 and our telephone number is (405) 753-5500. Our website is *http://www.sandridgeenergy.com*.

The Exchange Offers

On May 1, 2008, we issued the outstanding notes in a private placement. In connection with this issuance, we entered into a registration rights agreement in which we agreed, among other things, to deliver this prospectus to you and to use our best efforts to complete the exchange offer. The following is a summary of the exchange offer.

Outstanding notes	Our 85/8% Senior Notes Due 2015 and our Senior Floating Rate Notes Due 2014, which were issued on May 1, 2008.
Exchange notes	Our 85/8% Senior Notes Due 2015 and Senior Floating Rate Notes Due 2014. The terms of each series of exchange notes are substantially identical to those terms of the same series of outstanding notes, except that the transfer restrictions, the registration rights and provisions for additional interest relating to the outstanding notes do not apply to the exchange notes.
The exchange offers	We are offering to exchange upon the terms set forth in this prospectus and the accompanying letter of transmittal: up to $650,000,000 aggregate principal amount of our 85/8% Senior Notes Due 2015, that have been registered under the Securities Act of 1933, as amended (the Securities Act), in exchange for an equal outstanding principal amount of our 85/8% Senior Notes Due 2015 that have not been registered under the Securities Act; and

up to $350,000,000 aggregate principal amount of our Senior Floating Rate Notes Due 2014 that have been registered under the Securities Act in exchange for an equal outstanding principal amount of our Senior Floating Rate Notes Due 2014 that have not been registered under the Securities Act;

to satisfy our obligations under the registration rights agreement that we entered into when we issued the outstanding notes in transactions exempt from registration under the Securities Act. This prospectus

	also relates to additional exchange notes that may be issued at our option as payment of interest on our Senior Notes Due 2015.
Expiration date	Each exchange offer will expire at 5:00 p.m., New York City time, on October 17, 2008, unless we decide to extend it.
Conditions to the exchange offers	The registration rights agreement does not require us to accept outstanding notes for exchange if the applicable exchange offer or the making of any exchange by a holder of the outstanding notes would violate any applicable law or interpretation of the staff of the SEC. A minimum aggregate principal amount of outstanding notes being tendered is not a condition to either exchange offer.
Procedures for tendering outstanding notes	All of the outstanding notes are held in book-entry form through the facilities of The Depository Trust Company, or DTC. To participate in either exchange offer, you must follow the automatic tender offer program, or ATOP, procedures established by DTC for tendering notes held in book-entry form. The ATOP procedures require that the exchange agent receive, prior to the expiration date of the applicable exchange offer, a computer-generated message known as an agent s message that is transmitted through ATOP and that DTC confirm that DTC has received instructions to exchange your notes and you agree to be bound by the terms of the letter of transmittal in Annex A hereto. For more details, please read The Exchange Offers Terms of the Exchange and The Exchange Offers Procedures for Tendering.
Guaranteed delivery procedures	None.
Withdrawal of tenders	You may withdraw your tender of outstanding notes at any time prior to the expiration date of the applicable exchange offer. To withdraw, you must submit a notice of withdrawal to the exchange agent using ATOP procedures before 5:00 p.m., New York City time, on the expiration date of the applicable exchange offer. Please read The Exchange Offers Withdrawal Rights.
Acceptance of Outstanding Notes and Delivery of Exchange Notes	If you fulfill all conditions required for proper acceptance of outstanding notes, we will accept any and all outstanding notes that you properly tender in the applicable exchange offer before 5:00 p.m., New York City time, on the expiration date of the applicable exchange offer. We will return any outstanding note that we do not accept for exchange to you without expense promptly after the expiration date. We will deliver the exchange notes promptly after the expiration date and acceptance of the outstanding notes for exchange. Please read The Exchange Offers Terms of the Exchange Offers.
U.S. federal income tax considerations	The exchange of exchange notes for outstanding notes in the exchange offer will not be a taxable event for U.S. federal income tax purposes. Please read the discussion under the caption Certain U.S. Federal Tax

Considerations for more information regarding the tax consequences to you of the exchange offer.

Use of proceeds	The issuance of the exchange notes will not provide us with any new proceeds. We are making each exchange offer solely to satisfy our obligations under the registration rights agreement.
Fees and expenses	We will pay all of our expenses related to the exchange offers.
Exchange Agent	We have appointed Wells Fargo Bank, National Association as exchange agent for each exchange offer. You can find the address, telephone number and fax number of the exchange agent under the caption The Exchange Offers Exchange Agent.
Consequences of not exchanging your outstanding notes	If you do not exchange your outstanding notes in the applicable exchange offer, you will no longer be able to require us to register your outstanding notes under the Securities Act, except in the limited circumstances provided under the registration rights agreement. In addition, you will not be able to resell, offer to resell or otherwise transfer the outstanding notes unless we have registered the outstanding notes under the Securities Act, or unless you resell, offer to resell or otherwise transfer them under an exemption from the registration requirements of, or in a transaction not subject to, the Securities Act. For information regarding the consequences of not tendering your outstanding notes and our obligation to file a registration statement, please read The Exchange Offers Consequences of Failure to Exchange Outstanding Securities and Description of the Notes.

Description of the Exchange Notes

The terms of the exchange notes and those of the outstanding notes are substantially identical, except that the transfer restrictions, registration rights and provisions for additional interest relating to the outstanding notes do not apply to the exchange notes. As a result, the exchange notes will not bear legends restricting their transfer and will not have the benefit of the registration rights and additional interest provisions contained in the outstanding notes. The exchange notes represent the same debt as the outstanding notes for which they are being exchanged. Both the outstanding notes and the exchange notes are governed by the same indenture.

The following is a summary of the terms of the exchange notes. It may not contain all the information that is important to you. For a more detailed description of the exchange notes, please read Description of the Notes.

Issuer	SandRidge Energy, Inc.
Securities offered	\$650,000,000 aggregate principal amount of 85/8% Senior Notes Due 2015. \$350,000,000 aggregate principal amount of Senior Floating Rate Notes Due 2014. The exchange notes are being offered as additional debt securities under the indenture pursuant to which we previously issued the outstanding

	notes.
Maturity date of the 85/8% Senior Notes	April 1, 2015
Maturity date of the Senior Floating Rate Notes	April 1, 2014

3

Table of Contents

PIK interest	At our election, we may from time to time prior to April 30, 2011 upon notice elect to pay interest on the 85/8% Senior Notes in kind by the issuance of additional principal amount of 85/8% Senior Notes.
Interest payment dates	Interest on the 85/8% Senior Notes is payable semi-annually on each April 1 and October 1 of each year beginning on October 1, 2008. Interest on the Senior Floating Rate Notes is payable quarterly in cash in arrears on each January 1, April 1, July 1 and October 1 of each year beginning on July 1, 2008. Interest on the exchange notes will accrue from April 1, 2008 in the case of the 85/8% Senior Notes and from July 1, 2008 in the case of the Senior Floating Rate Notes.
Guarantees	The exchange notes are unconditionally guaranteed by our existing restricted subsidiaries and will be guaranteed by our future domestic restricted subsidiaries.
Use of proceeds	The issuance of the exchange notes will not provide us with any new proceeds. We are making this exchange offer solely to satisfy our obligations under our registration rights agreement.
Ranking	The exchange notes of each series are unsecured and rank equally in right of payment with the exchange notes of the other series and with all of our other existing and future senior indebtedness. The exchange notes are senior in right of payment to all our future subordinated indebtedness.
Transfer restrictions	The exchange notes generally will be freely transferable, but will also be new securities for which there will not initially be a market. There can be no assurance as to the development or liquidity of any market for the exchange notes.

Risk Factors

Investing in the exchange notes involves substantial risk. Please read Risk Factors beginning on page 5 for a discussion of certain factors you should consider in evaluating an investment in the exchange notes.

RISK FACTORS

An investment in the exchange notes involves a significant degree of risk. You should consider carefully these risks together with all of the other information included in this prospectus before deciding whether to participate in the exchange offers. All of the risks described below could materially and adversely affect our business prospects, financial condition, operating results and cash flows, which in turn could adversely affect our ability to satisfy our obligations under the exchange notes and the guarantees of the exchange notes.

Risks Related to Our Business

Natural gas and oil prices are volatile, and a decline in natural gas and oil prices can significantly affect our financial results and impede our growth.

Our revenue, profitability and cash flow depend upon the prices and demand for natural gas and oil. The markets for these commodities are very volatile. Even relatively modest drops in prices can significantly affect our financial results and impede our growth. Changes in natural gas and oil prices have a significant impact on the value of our reserves and on our cash flow. Prices for natural gas and oil may fluctuate widely in response to relatively minor changes in the supply of and demand for natural gas and oil and a variety of additional factors that are beyond our control, such as:

- the domestic and foreign supply of natural gas and oil;
- the price of foreign imports;
- worldwide economic conditions;
- political and economic conditions in oil producing countries, including the Middle East and South America;
- the ability of members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;
- the level of consumer product demand;
- weather conditions;
- technological advances affecting energy consumption;
- availability of pipeline infrastructure, treating, transportation and refining capacity;
- domestic and foreign governmental regulations and taxes; and
- the price and availability of alternative fuels.

Lower natural gas and oil prices may not only decrease our revenues on a per share basis, but also may reduce the amount of natural gas and oil that we can produce economically. This may result in our having to make substantial downward adjustments to our estimated proved reserves.

We have a substantial amount of indebtedness, which may adversely affect our cash flow and our ability to operate our business.

As of June 30, 2008, our total indebtedness was $1.8 billion, which represented approximately 46% of our total capitalization. Our substantial level of indebtedness increases the possibility that we may be unable to generate cash sufficient to pay, when due, the principal of, interest on or other amounts due in respect of our indebtedness. Our substantial indebtedness, combined with our lease and other financial obligations and contractual commitments, could have other important consequences to you. For example, it could:

- make us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in governmental regulation;

- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flows to fund working capital, capital expenditures, acquisitions and other general corporate purposes;

Table of Contents

- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- place us at a competitive disadvantage compared to our competitors that are less leveraged and, therefore, may be able to take advantage of opportunities that our leverage prevents us from pursuing; and
- limit our ability to borrow additional amounts for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy or other purposes.

Any of these above listed factors could materially adversely affect our business, financial condition and results of operations.

Our estimated reserves are based on many assumptions that may turn out to be inaccurate. Any significant inaccuracies in these reserve estimates or underlying assumptions could materially affect the quantities and present value of our reserves.

The process of estimating natural gas and oil reserves is complex and inherently imprecise. It requires interpretations of available technical data and many assumptions, including assumptions relating to production rates and economic factors such as natural gas and oil prices, taxes, drilling and operating expenses, capital expenditures and availability of funds. Any significant inaccuracies in these interpretations or assumptions could materially affect the estimated quantities and present value of reserves shown in this prospectus. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control.

The present value of future net cash flows from our proved reserves will not necessarily be the same as the current market value of our estimated natural gas and oil reserves.

We base the estimated discounted future net cash flows from our proved reserves on prices and costs in effect on the day of estimate. Actual future net cash flows from our natural gas and oil properties also will be affected by factors such as:

- actual prices we receive for natural gas and oil;
- actual cost of development and production expenditures;
- the amount and timing of actual production;
- supply of and demand for natural gas and oil; and
- changes in governmental regulations or taxation.

The timing of both our production and our incurrence of expenses in connection with the development and production of natural gas and oil properties will affect the timing of actual future net cash flows from proved reserves, and thus their actual present value. In addition, the 10% discount factor we use when calculating discounted future net cash flows may not be the most appropriate discount factor based on interest rates in effect from time to time and risks associated with us or the natural gas and oil industry in general.

Unless we replace our natural gas and oil reserves, our reserves and production will decline, which would adversely affect our business, financial condition and results of operations.

Our future natural gas and oil reserves and production, and therefore our cash flow and income, are highly dependent on our success in efficiently developing and exploiting our current reserves and economically finding or acquiring additional recoverable reserves. We may not be able to develop, find or acquire additional reserves to replace our current and future production at acceptable costs.

Our potential drilling location inventories are scheduled over several years, making them susceptible to uncertainties that could materially alter the occurrence or timing of their drilling.

As of June 30, 2008, approximately 1,000 of our 5,670 identified potential future well locations had proved undeveloped reserves. These potential drilling locations, including those without proved undeveloped reserves, represent a significant part of our growth strategy. Our ability to drill and develop these locations is subject to a number of uncertainties, including the availability of capital, seasonal conditions, regulatory approvals, natural gas and oil prices, costs and drilling results. Because of these uncertainties, we do not know if the numerous potential drilling locations we have will ever be drilled or if we will be able to produce natural gas or oil from these or any other potential drilling locations. As such, our actual drilling activities may materially differ from our current expectations, which could adversely affect our business.

We will not know conclusively prior to drilling whether natural gas or oil will be present in sufficient quantities to be economically viable.

We describe some of our current prospects and drilling locations and our plans to explore those prospects and drilling locations in this prospectus. A prospect is a property on which we have identified what our geoscientists believe, based on available seismic and geological information, to be indications of natural gas or oil. Our prospects and drilling locations are in various stages of evaluation, ranging from a prospect that is ready to drill to a prospect that will require substantial additional seismic data processing and interpretation.

The use of seismic data and other technologies and the study of producing fields in the same area will not enable us to know conclusively prior to drilling whether oil or natural gas will be present or, if present, whether oil or natural gas will be present in sufficient quantities to be economically viable. Even if sufficient amounts of oil or natural gas exist, we may damage the potentially productive hydrocarbon bearing formation or experience mechanical difficulties while drilling or completing the well, resulting in a reduction in production from the well or abandonment of the well. During 2007, we participated in drilling a total of 316 gross wells, of which eight have been identified as dry holes. During the six months ended June 30, 2008, we drilled 184 wells, one of which was identified as a dry hole. If we drill additional wells that we identify as dry holes in our current and future prospects, our drilling success rate may decline and materially harm our business. In sum, the cost of drilling, completing and operating any well is often uncertain, and new wells may not be productive.

Properties that we buy may not produce as projected, and we may be unable to determine reserve potential, identify liabilities associated with the properties or obtain protection from sellers against them.

Our reviews of properties we acquire are inherently incomplete because it generally is not feasible to review in depth every individual property involved in each acquisition. Even a detailed review of records and properties may not necessarily reveal existing or potential problems, nor will it permit a buyer to become sufficiently familiar with the properties to assess fully their deficiencies and potential. Inspections may not always be performed on every well, and environmental problems, such as soil or ground water contamination, are not necessarily observable even when an inspection is undertaken. Even when problems are identified, we often assume certain environmental and other risks and liabilities in connection with acquired properties, which risks and liabilities could have a material adverse effect on our results of operations and financial condition.

The development of the proved undeveloped reserves in the WTO and other areas of operation may take longer and may require higher levels of capital expenditures than we currently anticipate.

Approximately 53% of the estimated proved reserves that we own or have under lease in the WTO and 54% of our total proved reserves as of June 30, 2008 are proved undeveloped reserves. Development of these reserves may take longer and require higher levels of capital expenditures than we currently anticipate. Therefore, ultimate recoveries from these fields may not match current expectations. Delays in the development of our reserves or increases in costs to drill and develop such reserves will reduce the PV-10 value of our estimated proved undeveloped reserves and future net revenues estimated for such reserves.

Table of Contents

A significant portion of our operations are located in WTO, making us vulnerable to risks associated with operating in one major geographic area.

As of June 30, 2008, approximately 57% of our proved reserves and approximately 58% of our daily production were located in the West Texas Overthrust, or WTO. In addition, a substantial portion of our WTO natural gas contains a high concentration of CO_2 and requires treating. As a result, we may be disproportionately exposed to the impact of delays or interruptions of production from these wells caused by transportation and treatment capacity constraints, curtailment of production or treatment plant closures for scheduled maintenance or unanticipated occurrences.

Many of our prospects in the WTO may contain natural gas that is high in CO_2 content, which can negatively affect our economics.

The reservoirs of many of our prospects in the WTO may contain natural gas that is high in CO_2 content. The natural gas produced from these reservoirs must be treated for the removal of CO_2 prior to marketing. If we cannot obtain sufficient capacity at treatment facilities for our natural gas with a high CO_2 concentration, or if the cost to obtain such capacity significantly increases, we could be forced to delay production and development or experience increased production costs.

Furthermore, when we treat the gas for the removal of CO_2, some of the methane is used to run the treatment plant as fuel gas and other methane and heavier hydrocarbons, such as ethane, propane and butane, cannot be separated from the CO_2 and is lost. This is known as plant shrink. Historically our plant shrink has been approximately 12% in the WTO. We do not know the amount of CO_2 we will encounter in any well until it is drilled. As a result, sometimes we encounter CO_2 levels in our wells that are higher than expected. The amount of CO_2 in the gas produced affects the heating content of the gas. For example, if a well is 65% CO_2, the gas produced often has a heating content of between 300 and 350 MBtu per Mcf. Giving consideration for plant shrink, as many as four Mcf of high CO_2 gas must be produced to sell one MmBtu of natural gas. We report our volumes of natural gas reserves and production net of CO_2 volumes that are removed prior to sales.

Since the treatment expenses are incurred on an Mcf basis, we will incur a higher effective treating cost per MmBtu of natural gas sold for natural gas with a higher CO_2 content. As a result, high CO_2 gas wells must produce at much higher rates than low CO_2 gas wells to be economic, especially in a low natural gas price environment.

A significant decrease in natural gas production in our areas of midstream gas services operation, due to the decline in production from existing wells, depressed commodity prices or otherwise, would adversely affect our revenues and cash flow for our midstream gas services segment.

The profitability of our midstream business is materially impacted by the volume of natural gas we gather, transmit and process at our facilities. Most of the reserves backing up our midstream assets are operated by our exploration and production segment. A material decrease in natural gas production in our areas of operation would result in a decline in the volume of natural gas delivered to our pipelines and facilities for gathering, transmitting and processing. We have no control over many factors affecting production activity, including prevailing and projected energy prices, demand for hydrocarbons, the level of reserves, geological considerations, governmental regulation and the availability and cost of capital. Failure to connect new wells to our gathering systems would result in the amount of natural gas we gather, transmit and process being reduced substantially over time and could, upon exhaustion of the current wells, cause us to abandon our gathering systems and, possibly cease gathering, transmission and processing operations. Our ability to connect to new wells will be dependent on the level of drilling activity in our areas of operations and competitive market factors. The effect of any material decrease in the volume of natural gas handled by our midstream assets would be to reduce our revenues, operating income and our ability to make payments on the exchange notes.

8

Our use of 2-D and 3-D seismic data is subject to interpretation and may not accurately identify the presence of natural gas and oil. In addition, the use of such technology requires greater predrilling expenditures, which could adversely affect the results of our drilling operations.

A significant aspect of our exploration and development plan involves seismic data. Even when properly used and interpreted, 2-D and 3-D seismic data and visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators and do not enable the interpreter to know whether hydrocarbons are present in those structures. Other geologists and petroleum professionals, when studying the same seismic data, may have significantly different interpretations than our professionals.

In addition, the use of 2-D and 3-D seismic and other advanced technologies requires greater predrilling expenditures than traditional drilling strategies, and we could incur losses due to such expenditures. As a result, our drilling activities may not be geologically successful or economical, and our overall drilling success rate or our drilling success rate for activities in a particular area may not improve.

We often gather 2-D and 3-D seismic data over large areas. Our interpretation of seismic data delineates for us those portions of an area that we believe are desirable for drilling. Therefore, we may choose not to acquire option or lease rights prior to acquiring seismic data, and in many cases, we may identify hydrocarbon indicators before seeking option or lease rights in the location. If we are not able to lease those locations on acceptable terms, it would result in our having made substantial expenditures to acquire and analyze 2-D and 3-D data without having an opportunity to benefit from those expenditures.

Drilling for and producing natural gas and oil are high risk activities with many uncertainties that could adversely affect our business, financial condition or results of operations.

Our drilling and operating activities are subject to many risks, including the risk that we will not discover commercially productive reservoirs. Drilling for natural gas and oil can be unprofitable, not only from dry holes, but from productive wells that do not produce sufficient revenues to return a profit. In addition, our drilling and producing operations may be curtailed, delayed or canceled as a result of other factors, including:

- unusual or unexpected geological formations and miscalculations;
- pressures;
- fires;
- blowouts;
- loss of drilling fluid circulation;
- title problems;
- facility or equipment malfunctions;
- unexpected operational events;
- shortages of skilled personnel;
- shortages or delivery delays of equipment and services;

compliance with environmental and other regulatory requirements; and

adverse weather conditions.

Any of these risks can cause substantial losses, including personal injury or loss of life; damage to or destruction of property, natural resources and equipment; pollution; environmental contamination or loss of wells; and regulatory fines or penalties.

Insurance against all operational risks is not available to us. Additionally, we may elect not to obtain insurance if we believe that the cost of available insurance is excessive relative to the perceived risks presented. We do not carry environmental insurance, for example. We could incur losses for uninsurable or uninsured risks or in amounts in excess of existing insurance coverage. The occurrence of an event that is not covered in full or in part by insurance could have a material adverse impact on our business activities, financial condition, results of operations and our ability to make payments on the exchange notes.

Market conditions or operational impediments may hinder our access to natural gas and oil markets or delay our production.

Market conditions or a lack of satisfactory natural gas and oil transportation arrangements may hinder our access to natural gas and oil markets or delay our production. The availability of a ready market for our natural gas and oil production depends on a number of factors, including the demand for and supply of natural gas and oil and the proximity of reserves to pipelines and terminal facilities. Our ability to market our production depends in substantial part on the availability and capacity of gathering systems, pipelines and processing facilities. For example, we are currently experiencing capacity limitations on sour gas treating in the Piñon Field. Our failure to obtain such services on acceptable terms or expand our midstream assets could materially harm our business. We may be required to shut in wells for a lack of a market or because access to natural gas pipelines, gathering system capacity or processing facilities may be limited or unavailable. If that were to occur, then we would be unable to realize revenue from those wells until production arrangements were made to deliver the production to market.

Our development and exploration operations require substantial capital and we may be unable to obtain needed capital or financing on satisfactory terms, which could lead to a loss of properties and a decline in our natural gas and oil reserves.

The natural gas and oil industry is capital intensive. We make and expect to continue to make substantial capital expenditures in our business and operations for the exploration, development, production and acquisition of natural gas and oil reserves. To date, we have financed capital expenditures primarily with proceeds from the sale of equity, debt and cash generated by operations. We intend to finance our future capital expenditures with the sale of equity, asset sales, cash flow from operations and current and new financing arrangements. Our cash flow from operations and access to capital are subject to a number of variables, including:

- our proved reserves;
- the level of natural gas and oil we are able to produce from existing wells;
- the prices at which natural gas and oil are sold; and
- our ability to acquire, locate and produce new reserves.

If our revenues decrease as a result of lower natural gas and oil prices, operating difficulties, declines in reserves or for any other reason, we may have limited ability to obtain the capital necessary to sustain our operations at current levels. In order to fund our capital expenditures, we must seek additional financing. Our revolving credit facility and term loan contain covenants restricting our ability to incur additional indebtedness without the consent of the lenders. Our lenders may withhold this consent in their sole discretion.

In addition, we may not be able to obtain debt or equity financing on terms favorable to us, or at all. The failure to obtain additional financing could result in a curtailment of our operations relating to exploration and development of our prospects, which in turn could lead to a possible loss of properties and a decline in our natural gas and oil reserves.

The agreements governing our existing indebtedness have restrictions and financial covenants which could adversely affect our operations.

Our senior credit facility and the indentures governing the notes and our 8% Senior Notes Due 2018 restrict our ability to obtain additional financing, make investments, lease equipment, sell assets and engage in business combinations. We also are required to comply with certain financial covenants and ratios. Our ability to comply with these restrictions and covenants in the future is uncertain and will be affected by the levels of cash flow from our operations and events or circumstances beyond our control. Our failure to comply with any of the restrictions and covenants under the senior credit facility or indentures could result in a default under those agreements, which could cause all of our indebtedness to be immediately due and payable.

Our revolving credit facility limits the amounts we can borrow to a borrowing base amount. The borrowing base is subject to review semi-annually; however, the lenders reserve the right to have one additional redetermination of the borrowing base per calendar year. Unscheduled redeterminations may be made at our request, but are limited to two requests per year. The borrowing base is determined based on proved developed producing reserves, proved developed non-producing reserves and proved undeveloped reserves. Outstanding borrowings in excess of the borrowing base must be repaid immediately, or we must pledge other natural gas and oil properties as additional collateral. We do not currently have any substantial unpledged properties, and we may not have the financial resources in the future to make any mandatory principal prepayments required under the revolving credit facility.

If the indebtedness under our revolving credit facility and indentures were to be accelerated, our assets may not be sufficient to repay such indebtedness in full. In particular, holders of the exchange notes will be paid only if we have assets remaining after we pay amounts due on our secured indebtedness, including our revolving credit facility. We have pledged a significant portion of our assets as collateral under our revolving credit facility. Please see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Our derivative activities could result in financial losses or could reduce our earnings.

To achieve a more predictable cash flow and to reduce our exposure to adverse fluctuations in the prices of natural gas and oil, we currently, and may in the future, enter into derivative instruments for a portion of our natural gas and oil production, including collars and fixed-price swaps. We have not designated any of our derivative instruments as hedges for accounting purposes and record all derivative instruments on our balance sheet at fair value. Changes in the fair value of our derivative instruments are recognized in current earnings. Accordingly, our earnings may fluctuate significantly as a result of changes in fair value of our derivative instruments. Derivative instruments also expose us to the risk of financial loss in some circumstances, including when:

- production is less than expected;
- the counter-party to the derivative instrument defaults on its contract obligations; or
- there is a change in the expected differential between the underlying price in the derivative instrument and the actual prices received.

In addition, these types of derivative arrangements limit the benefit we would receive from increases in the prices for natural gas and oil.

Competition in the natural gas and oil industry is intense, which may adversely affect our ability to succeed.

The natural gas and oil industry is intensely competitive, and we compete with companies that have greater resources. Many of these companies not only explore for and produce natural gas and oil, but also carry on refining operations and market petroleum and other products on a regional, national or worldwide basis. These companies may be able to pay more for productive natural gas and oil properties and exploratory prospects or identify, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. In addition, these companies may have a greater ability to continue exploration activities during periods of low natural gas and oil market prices. Our larger competitors may be able to absorb the burden of present and future federal, state, local and other laws and regulations more easily than we can, which would adversely affect our competitive position. Our ability to acquire additional properties and to discover reserves in the future will be dependent upon our ability to evaluate and select suitable properties and to consummate transactions in a highly competitive environment. In addition, because we have fewer financial and human resources than many companies in our industry, we may be at a disadvantage in bidding for exploratory prospects and producing natural gas and oil properties.

Table of Contents

Downturns in natural gas and oil prices can result in decreased oil field activity which, in turn, can result in an oversupply of service providers and drilling rigs. This oversupply can result in severe reductions in prices received for oil field services or a complete lack of work for crews and equipment.

We are subject to complex federal, state, local and other laws and regulations that could adversely affect the cost, manner or feasibility of conducting our operations.

Our natural gas and oil exploration, production, transportation and treatment operations are subject to complex and stringent laws and regulations. In order to conduct our operations in compliance with these laws and regulations, we must obtain and maintain numerous permits, approvals and certificates from various federal, state and local governmental authorities. We may incur substantial costs in order to maintain compliance with these existing laws and regulations. In addition, our costs of compliance may increase if existing laws and regulations are revised or reinterpreted, or if new laws and regulations become applicable to our operations. For instance, we may be unable to obtain all necessary permits, approvals and certificates for proposed projects. Alternatively, we may have to incur substantial expenditures to obtain, maintain or renew authorizations to conduct existing projects. If a project is unable to function as planned due to changing requirements or public opposition, we may suffer expensive delays, extended periods of non-operation or significant loss of value in a project. All such costs may have a negative effect on our business and results of operations.

Our business is subject to federal, state and local laws and regulations as interpreted and enforced by governmental agencies and other bodies vested with much authority relating to the exploration for, and the development, production and transportation of, natural gas and oil. Failure to comply with such laws and regulations, as interpreted and enforced, could have a material adverse effect on us. For instance, the U.S. Department of the Interior s Minerals Management Service (MMS) may suspend or terminate our operations on federal leases for failure to pay royalties or comply with safety and environmental regulations.

Our operations expose us to potentially substantial costs and liabilities with respect to environmental, health and safety matters.

We may incur substantial costs and liabilities as a result of environmental, health and safety requirements applicable to us and our natural gas and oil exploration, development, production, transportation, treatment, and other activities. These costs and liabilities could arise under a wide range of environmental, health and safety laws that cover, among other things, emissions into the air and water, habitat and endangered species protection, the containment and disposal of hazardous substances, oil field waste and other waste materials, the use of underground injection wells, and wetlands protection. These laws and regulations are complex, change frequently and have tended to become increasingly strict over time. Failure to comply with environmental, health and safety laws or regulations may result in assessment of administrative, civil, and criminal penalties, imposition of cleanup and site restoration costs and liens, and the issuance of orders enjoining or limiting our current or future operations. Compliance with these laws and regulations also increases the cost of our operations and may prevent or delay the commencement or continuance of a given operation. Specifically, we may incur increased expenditures in the future in order to maintain compliance with laws and regulations governing emissions of air pollutants from our natural gas treatment plants.

Under certain environmental laws that impose strict, joint and several liability, we may be required to remediate our contaminated properties regardless of whether such contamination resulted from the conduct of others or from consequences of our own actions that were or were not in compliance with all applicable laws at the time those actions were taken. In addition, claims for damages to persons, property or natural resources may result from environmental and other impacts of our operations. Moreover, new or modified environmental, health or safety laws, regulations or enforcement policies could be more stringent and impose unforeseen liabilities or significantly increase compliance costs. Therefore, the costs to comply with environmental, health or safety laws or regulations or the liabilities incurred in connection with them could significantly and adversely affect our business, financial condition or results of operations. In addition, many countries as well as several states and regions of the U.S. have agreed to regulate emissions of greenhouse gases. Methane, a primary component of natural gas, and carbon dioxide, a byproduct of burning of natural gas and oil, are

Table of Contents

greenhouse gases. The carbon dioxide may be released or captured as part of our operations. Current or future regulation of greenhouse gases could adversely impact our financial condition and results of operations and demand for some of our services or products in the future.

If we fail to maintain an adequate system of internal control over financial reporting this could adversely affect our ability to accurately report our results.

We are not currently required to comply with Section 404 of the Sarbanes Oxley Act of 2002, and are therefore not required to make an assessment of the effectiveness of our internal controls over financial reporting for that purpose. Management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. A material weakness is a deficiency, or a combination of deficiencies, in our internal control over financial reporting that results in a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. Our efforts to develop and maintain our internal controls may not be successful, and we may be unable to maintain adequate controls over our financial processes and reporting in the future, including future compliance with the obligations under Section 404 of the Sarbanes-Oxley Act of 2002. We will be required to comply with Section 404 of the Sarbanes-Oxley Act of 2002 effective as of December 31, 2008. Any failure to develop or maintain effective controls, or difficulties encountered in their implementation or other effective improvement of our internal controls could harm our operating results. Ineffective internal controls could also cause investors to lose confidence in our reported financial information.

Risks Relating to the Notes and the Exchange Offers

If you fail to exchange outstanding notes, existing transfer restrictions will remain in effect and the market value of outstanding notes may be adversely affected because they may be more difficult to sell.

If you fail to exchange outstanding notes for exchange notes under the exchange offers, then you will continue to be subject to the existing transfer restrictions on the outstanding notes. In general, the outstanding notes may not be offered or sold unless they are registered or exempt from registration under the Securities Act and applicable state securities laws. Except in connection with these exchange offers or as required by the registration rights agreement, we do not intend to register resales of the outstanding notes.

The tender of outstanding notes under the exchange offers will reduce the principal amount of the currently outstanding notes. Due to the corresponding reduction in liquidity, this may have an adverse effect upon, and increase the volatility of, the market price of any currently outstanding notes that you continue to hold following completion of the exchange offers.

We may incur substantial additional indebtedness, including debt ranking equal to the notes.

Subject to the restrictions in the indenture governing the exchange notes and outstanding notes and in other instruments governing our other outstanding debt, we and our subsidiaries may be able to incur substantial additional debt in the future. Although the indenture governing the exchange notes and outstanding notes and the instruments governing certain of our other outstanding debt contain restrictions on the incurrence of additional debt, these restrictions are subject to a number of significant qualifications and exceptions, and debt incurred in compliance with these restrictions could be substantial. To the extent new debt is added to our current debt levels, the substantial leverage-related risks described above would increase.

If we or any of our subsidiaries that is a guarantor of the exchange notes and outstanding notes (a Guarantor) incur any additional debt that ranks equally with the notes (or with the guarantee thereof), including trade payables, the holders of that debt will be entitled to share ratably with holders of the notes in any proceeds distributed in connection with any insolvency, liquidation, reorganization, dissolution or other winding-up of us or such Guarantor. This may have the effect of reducing the amount of proceeds paid to holders of the notes in connection with such a distribution.

We may not be able to generate sufficient cash to service all of our indebtedness, including the notes, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may not be able to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness, including the notes.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness, including the notes. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. The terms of existing or future debt instruments and the indenture governing the notes may restrict us from adopting some of these alternatives. In addition, any failure to make payments of interest and principal on our outstanding indebtedness on a timely basis would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. Our senior credit facility and the indentures governing the notes and our other series of outstanding notes restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

Your right to receive payments on the exchange notes, like the outstanding notes, is effectively junior to the right of lenders who have a security interest in our assets to the extent of the value of those assets.

Our obligations under the exchange notes, like the outstanding notes, and the Guarantors obligations under their guarantees of the exchange notes, like the outstanding notes, are unsecured, but our obligations under our senior credit facility and each Guarantor s obligations under its guarantee of our senior credit facility are secured by a security interest in substantially all of our domestic tangible and intangible assets, including the stock of substantially all of our wholly-owned subsidiaries. If we are declared bankrupt or insolvent, or if we default under our senior credit facility, the funds borrowed thereunder, together with accrued interest, could become immediately due and payable. If we were unable to repay such indebtedness, the lenders under our senior credit facility could foreclose on the pledged assets to the exclusion of holders of the notes, even if an event of default exists under the indenture governing the notes at such time. Furthermore, if the lenders foreclose and sell the pledged equity interests in any Guarantor in a transaction permitted under the terms of the indenture governing the notes, then such Guarantor will be released from its guarantee of the notes automatically and immediately upon such sale. In any such event, because the notes will no longer be secured by any of such assets or by the equity interests in any such Guarantor, it is possible that there would be no assets remaining from which your claims could be satisfied or, if any assets remained, they might be insufficient to satisfy your claims in full. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

As of August 8, 2008, we had no borrowings outstanding under our senior credit facility, though, at that time, outstanding letters of credit reduced borrowing capacity under the senior credit facility by $22 million. As of

August 8, 2008, we had approximately $1.8 billion of outstanding secured long-term debt. Subject to the limits set forth in the indentures governing the notes and our 8% Senior Notes Due 2018, we may also incur additional secured debt.

Our ability to repay our debt, including the notes, is affected by the cash flow generated by our subsidiaries.

Our subsidiaries own some of our assets and conduct some of our operations. Accordingly, repayment of our indebtedness, including the notes, will be dependent on the generation of cash flow by our subsidiaries and their ability to make such cash available to us, by dividend, debt repayment or otherwise. Unless they are Guarantors, our subsidiaries will not have any obligation to pay amounts due on the notes or to make funds available for that purpose. Our subsidiaries may not be able to, or may not be permitted to, make distributions to enable us to make payments in respect of our indebtedness, including the notes. Each subsidiary is a distinct legal entity and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from our subsidiaries. While the indenture governing the notes limits the ability of our subsidiaries to incur consensual encumbrances or restrictions on their ability to pay dividends or make other intercompany payments to us, these limitations are subject to certain qualifications and exceptions. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness, including the notes.

Claims of holders of the exchange notes, like holders of outstanding notes, will be structurally subordinated to claims of creditors of certain of our subsidiaries that will not guarantee the exchange notes.

We conduct some of our operations through our subsidiaries, and certain of our immaterial domestic subsidiaries have not guaranteed the notes. Subject to certain limitations, the indenture governing the notes permits us to form or acquire additional subsidiaries that are not guarantors of the notes and to permit such non-guarantor subsidiaries to acquire additional assets and incur additional indebtedness. Holders of the exchange notes would not have any claim as a creditor against any of our non-guarantor subsidiaries to the assets and earnings of those subsidiaries. The claims of the creditors of those subsidiaries, including their trade creditors, banks and other lenders, would have priority over any of our claims or those of our other subsidiaries as equity holders of the non-guarantor subsidiaries. Consequently, in any insolvency, liquidation, reorganization, dissolution or other winding-up of any of the non-guarantor subsidiaries, creditors of those subsidiaries would be paid before any amounts would be distributed to us or to any of the Guarantors as equity, and thus be available to satisfy our obligations under the notes and other claims against us or the Guarantors.

For the six month period ended June 30, 2008, our non-guarantor subsidiaries accounted for approximately $10.1 million, or 1.6%, of our revenues. As of June 30, 2008, our non-guarantor subsidiaries accounted for approximately $31.9 million, or 0.7%, of our consolidated total assets and $11.2 million, or 0.5%, of our total liabilities, in each case after giving effect to intercompany eliminations. The indenture governing the notes permits these subsidiaries to incur certain additional debt and will not limit their ability to incur other liabilities that are not considered indebtedness under the indenture.

If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the notes.

Any default under the agreements governing our indebtedness, including a default under our senior credit facility, that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness, could prevent us from paying principal, premium, if any, and interest on the notes and substantially decrease the market value of the notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants in the instruments governing our indebtedness (including covenants in our senior credit facility and the indentures governing the notes and our 8% Senior Notes Due 2018), we could be in default under the terms of the agreements governing such indebtedness. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest;

the lenders under our senior credit facility could elect to terminate their commitments thereunder, cease making further loans and institute foreclosure proceedings against our assets; and

we could be forced into bankruptcy or liquidation.

If our operating performance declines, we may in the future need to obtain waivers from the required lenders under our senior credit facility to avoid being in default. If we breach our covenants under our senior credit facility and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under our senior credit facility, the lenders could exercise their rights, as described above, and we could be forced into bankruptcy or liquidation.

We may not be able to repurchase the notes upon a change of control.

Upon the occurrence of specific kinds of change of control events, we may be required to offer to repurchase all notes then outstanding at 101% of their principal amount plus accrued and unpaid interest, if any. The source of funds for any such purchase of the notes will be our available cash or cash generated from our operations or the operations of our subsidiaries or other sources, including borrowings, sales of assets or sales of equity. We may not be able to repurchase the notes upon a change of control because we may not have sufficient financial resources to purchase all of the exchange notes that are tendered upon a change of control. Our failure to repurchase the exchange notes upon a change of control would cause a default under the indenture governing the notes and could lead to a cross default under the indenture for our 8% Senior Notes Due 2018 or our senior credit facility.

Insolvency and fraudulent transfer laws and other limitations may preclude the recovery of payment under the notes and the guarantees.

Federal and state fraudulent transfer laws permit a court, if it makes certain findings, to avoid all or a portion of the obligations of the Guarantors pursuant to their guarantees of the notes, or to subordinate a Guarantor s obligations under such guarantee to claims of its other creditors, reducing or eliminating the holders of the notes ability to recover under such guarantees. Although laws differ among these jurisdictions, in general, under applicable fraudulent transfer or conveyance laws, the notes or guarantees could be voided as a fraudulent transfer or conveyance if (1) we or any of the Guarantors, as applicable, issued the notes or incurred the guarantees with the intent of hindering, delaying or defrauding creditors; or (2) we or any of the Guarantors, as applicable, received less than reasonably equivalent value or fair consideration in return for either issuing the notes or incurring the guarantees and, in the case of (2) only, one of the following is also true:

we or any of the Guarantors, as applicable, were insolvent or rendered insolvent by reason of the issuance of the notes or the incurrence of the guarantees or subsequently become insolvent for other reasons;

the issuance of the notes or the incurrence of the guarantees left us or any of the Guarantors, as applicable, with an unreasonably small amount of capital to carry on the business;

we or any of the Guarantors intended to, or believed that we or such Guarantor would, incur debts beyond our or such Guarantor s ability to pay such debts as they mature; or

we or any of the Guarantors was a defendant in an action for money damages, or had a judgment for money damages docketed against us or such Guarantor if, in either case, after final judgment, the judgment is unsatisfied.

Table of Contents

USE OF PROCEEDS

The exchange offers are intended to satisfy our obligations under the registration rights agreement we entered into in connection with the issuance of the outstanding notes. We will not receive any cash proceeds from the issuance of the exchange notes in the exchange offers. In consideration for issuing the exchange notes as contemplated in this prospectus, we will receive in exchange outstanding notes in like principal amount. We will cancel all outstanding notes surrendered in exchange for exchange notes in the exchange offers. As a result, the issuance of the exchange notes will not result in any increase or decrease in our indebtedness.

Table of Contents

RATIO OF EARNINGS TO FIXED CHARGES

We have computed our ratio of earnings to fixed charges for the six months ended June 30, 2008 and 2007 and for each of our fiscal years ended December 31, 2003, 2004, 2005, 2006 and 2007. The computation of earnings to fixed charges is set forth on Exhibit 12.1 to the registration statement of which this prospectus forms a part.

Ratio of earnings to fixed charges is calculated by dividing earnings by fixed charges from operations for the periods indicated. For purposes of calculating the ratio of earnings to fixed charges, (a) earnings represents pre-tax income from continuing operations plus fixed charges and (b) fixed charges represents interest expensed and capitalized, amortization of financing costs and required dividends on preference securities.

You should read the ratio information below in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and the notes thereto included elsewhere in this prospectus.

	For the Years Ended December 31,					For the Six Months Ended June 30,	
	2003	2004	2005	2006	2007	2007	2008
Ratio of earnings to fixed charges	19.4	12.2	6.3	2.2	1.7	1.4	(a)

(a) Due to our loss for the six months ended June 30, 2008, the ratio coverage was less than 1:1. We would have needed additional earnings of $118,353,000 to achieve coverage of 1:1.

THE EXCHANGE OFFERS

Purpose and Effect of the Exchange Offers

We issued the outstanding notes, which consist of $650,000,000 in aggregate principal amount of 85/8% Senior Notes Due 2015 and $350,000,000 in aggregate principal amount of Senior Floating Rate Notes Due 2014, in a private placement on May 1, 2008. The outstanding notes were issued to qualified institutional buyers pursuant to Section 4(2) of the Securities Act in exchange for debt outstanding under our senior unsecured credit agreement. Accordingly, the outstanding notes are subject to transfer restrictions. In general, you may not offer or sell the outstanding notes unless either the offer and sale thereof are registered under the Securities Act or are exempt from or not subject to registration under the Securities Act and applicable state securities laws.

In the registration rights agreement, we agreed to use our best efforts to cause an exchange offer registration statement to be declared effective by November 1, 2008. Now, to satisfy our obligations under the registration rights agreement, we are offering holders of the outstanding notes who are able to make certain representations described below the opportunity to exchange their outstanding notes for the exchange notes in the exchange offers. The exchange offers will be open for a period of at least 20 business days. During the exchange offer period, we will issue the exchange notes in exchange for all outstanding notes properly surrendered and not withdrawn before the expiration date. The exchange notes will be registered and the transfer restrictions, registration rights and provisions for additional interest relating to the outstanding notes will not apply to the exchange notes.

Terms of the Exchange Offers

Subject to the terms and conditions described in this prospectus and in the applicable letter of transmittal, we will accept for exchange any outstanding notes properly tendered and not withdrawn prior to 5:00 p.m., New York City time, on the expiration date of the applicable exchange offer. We will issue exchange notes in principal amount equal to the principal amount of outstanding notes surrendered in the exchange offers. Outstanding notes may be tendered only for exchange notes and only in denominations of $1,000 and integral multiples of $1,000 in excess of $1,000.

Neither exchange offer is conditioned upon any minimum aggregate principal amount of outstanding notes being tendered in such exchange offer. Each exchange offer will be conducted independently from the other exchange offer, and consummation of one exchange offer will not be conditioned upon consummation of the other.

As of the date of this prospectus, $650,000,000 in aggregate principal amount of 85/8% Senior Notes Due 2015 and $350,000,000 in aggregate principal amount of Senior Floating Rate Notes Due 2014 are outstanding. This prospectus is being sent to DTC, the sole registered holder of the outstanding notes, and to all persons whom we can identify as beneficial owners of the outstanding notes. There will be no fixed record date for determining registered holders of outstanding notes entitled to participate in the exchange offers.

We intend to conduct the exchange offers in accordance with the provisions of the registration rights agreement, the applicable requirements of the Securities Act and the Securities Exchange Act of 1934, as amended, or the Exchange Act, and the rules and regulations of the SEC. Outstanding notes not tendered for exchange in the exchange offers will remain outstanding and continue to accrue interest. These outstanding notes will be entitled to the rights and benefits such holders have under the indenture relating to the notes and the registration rights agreement.

We will be deemed to have accepted for exchange properly tendered outstanding notes when we have given oral or written notice of the acceptance to the exchange agent and complied with the applicable provisions of the registration rights agreement. The exchange agent will act as agent for the tendering holders for the purposes of receiving the exchange notes from us.

If you tender outstanding notes in the exchange offers, you will not be required to pay brokerage commissions or fees or, except to the extent indicated by the instructions to the letter of transmittal, transfer

Table of Contents

taxes with respect to the exchange of outstanding notes. We will pay all charges and expenses, other than certain applicable taxes described below, in connection with the exchange offer. Please read Fees and Expenses for more details regarding fees and expenses incurred in connection with the exchange offers. We will return any outstanding notes that we do not accept for exchange for any reason without expense to their tendering holders promptly after the expiration or termination of the applicable exchange offer.

Expiration, Extension and Amendment

Each exchange offer will expire at 5:00 p.m., New York City time, on October 17, 2008, unless, in our sole discretion, we extend it. We may extend one exchange offer without extending the other.

We expressly reserve the right, at any time or various times, to extend the period of time during which either exchange offer is open. We may delay acceptance of any outstanding notes by giving oral or written notice of such extension to their holders at any time until the exchange offer expires or terminates. During any such extensions, all outstanding notes previously tendered will remain subject to the exchange offer, and we may accept them for exchange.

To extend either exchange offer, we will notify the exchange agent orally or in writing of any extension. We will notify the registered holders of outstanding notes of the extension no later than 9:00 a.m. New York City time on the business day after the previously scheduled expiration date.

Procedures for Tendering

To participate in the exchange offers, you must properly tender your outstanding notes to the exchange agent as described below. We will only issue exchange notes in exchange for outstanding notes that you timely and properly tender. Therefore, you should allow sufficient time to ensure timely delivery of your outstanding notes, and you should follow carefully the instructions on how to tender your outstanding notes. It is your responsibility to properly tender your outstanding notes. We have the right to waive any defects. We are not, however, required to waive defects, and neither we nor the exchange agent is required to notify you of any defects in your tender.

If you have any questions or need help in exchanging your outstanding notes, please call the exchange agent whose address and phone number are described in the letter of transmittal included as Annex A to this prospectus.

All of the outstanding notes were issued in book-entry form, and all of the outstanding notes are currently represented by global certificates registered in the name of Cede & Co., the nominee of DTC. We have confirmed with DTC that the outstanding notes may be tendered using ATOP. The exchange agent will establish an account with DTC for purposes of each exchange offer promptly after the commencement of such exchange offer, and DTC participants may electronically transmit their acceptance of the exchange offer by causing DTC to transfer their outstanding notes to the exchange agent using the ATOP procedures. In connection with the transfer, DTC will send an agent s message to the exchange agent. The agent s message will state that DTC has received instructions from the participant to tender outstanding notes and that the participant agrees to be bound by the terms of the letter of transmittal.

By using the ATOP procedures to exchange outstanding notes, you will not be required to deliver a letter of transmittal to the exchange agent. You will, however, be bound by its terms just as if you had signed it.

There is no procedure for guaranteed late delivery of the outstanding notes.

Determinations Under the Exchange Offers

We will determine in our sole discretion all questions as to the validity, form, eligibility, time of receipt, acceptance of tendered outstanding notes and withdrawal of tendered outstanding notes. Our determination will be final and binding. We reserve the absolute right to reject any outstanding notes not properly tendered or any outstanding notes our acceptance of which would, in the opinion of our counsel, be unlawful. We also reserve the right to waive any defect, irregularities or conditions of tender as to particular outstanding notes.

Table of Contents

Our interpretation of the terms and conditions of the exchange offers, including the instructions in the letter of transmittal, will be final and binding on all parties. Unless waived, all defects or irregularities in connection with tenders of outstanding notes must be cured within such time as we shall determine. Although we intend to notify holders of defects or irregularities with respect to tenders of outstanding notes, neither we, the exchange agent nor any other person will incur any liability for failure to give such notification. Tenders of outstanding notes will not be deemed made until such defects or irregularities have been cured or waived. Any outstanding notes received by the exchange agent that are not properly tendered and as to which the defects or irregularities have not been cured or waived will be returned to the tendering holder as soon as practicable following the expiration date of the applicable exchange offer.

When We Will Issue Exchange Notes

In all cases, we will issue exchange notes for outstanding notes that we have accepted for exchange under the applicable exchange offer only after the exchange agent receives, prior to 5:00 p.m., New York City time, on the expiration date of such exchange offer,

A book-entry confirmation of such outstanding notes into the exchange agent s account at DTC; and

A properly transmitted agent s message.

Return of Outstanding Notes Not Accepted or Exchanged

If we do not accept tendered outstanding notes for exchange or if outstanding notes are submitted for a greater principal amount than you desire to exchange, the unaccepted or non-exchanged outstanding notes will be returned without expense to their tendering holder. Such non-exchanged outstanding notes will be credited to an account maintained with DTC. These actions will occur as promptly as practicable after the expiration or termination of the applicable exchange offer.

Valid Tender

By agreeing to be bound by the letter of transmittal, you will represent to us that, among other things:

Any exchange notes that you receive will be acquired in the ordinary course of your business;

You have no arrangement or understanding with any person or entity to participate in the distribution of the exchange notes;

You are not engaged in and do not intend to engage in the distribution of the exchange notes;

If you are a broker-dealer who will receive exchange notes for your own account in exchange for outstanding notes, you acquired those outstanding notes as a result of market-making activities or other trading activities and you will deliver this prospectus, as required by law, in connection with any resale of the exchange notes; and

You are not an affiliate, as defined in Rule 405 under the Securities Act, of us.

Withdrawal Rights

Except as otherwise provided in this prospectus, you may withdraw your tender at any time prior to 5:00 p.m., New York City time, on the expiration date of the exchange offer. For a withdrawal to be effective you must comply with the appropriate ATOP procedures. Any notice of withdrawal must specify the name and number of the account at DTC to be credited with withdrawn outstanding notes and otherwise comply with the ATOP procedures.

We will determine all questions as to the validity, form, eligibility and time of receipt of a notice of withdrawal. Our determination shall be final and binding on all parties. We will deem any outstanding notes so withdrawn not to have been validly tendered for exchange for purposes of the exchange offers.

Any outstanding notes that have been tendered for exchange but that are not exchanged for any reason will be credited to an account maintained with DTC for the outstanding notes. This return or crediting will take place as soon as practicable after withdrawal, rejection of tender, expiration or termination of the applicable exchange offer. You may retender properly withdrawn outstanding notes by following the procedures described under Procedures for Tendering above at any time on or prior to the expiration date of the applicable exchange offer.

Resales of Exchange Notes

Based on interpretations by the staff of the SEC, as described in no-action letters issued to third parties that are not related to us, we believe that exchange notes issued in the exchange offers in exchange for outstanding notes may be offered for resale, resold or otherwise transferred by holders of the exchange notes without compliance with the registration and prospectus delivery provisions of the Securities Act, if:

- The exchange notes are acquired in the ordinary course of the holder s business;
- The holders have no arrangement or understanding with any person to participate in the distribution of the exchange notes;
- The holders are not affiliates of ours within the meaning of Rule 405 under the Securities Act; and
- The holders are not broker-dealers who purchased outstanding notes directly from us for resale pursuant to Rule 144A or any other available exemption under the Securities Act.

However, the SEC has not considered the exchange offers described in this prospectus in the context of a no-action letter. The staff of the SEC may not make a similar determination with respect to the exchange offers as in the other circumstances. Each holder who wishes to exchange outstanding notes for exchange notes will be required to represent that it meets the above four requirements.

Any holder who is an affiliate of ours or who intends to participate in an exchange offer for the purpose of distributing exchange notes or any broker-dealer who purchased outstanding notes directly from us for resale pursuant to Rule 144A or any other available exemption under the Securities Act:

- Cannot rely on the applicable interpretations of the staff of the SEC mentioned above;
- Will not be permitted or entitled to tender its outstanding notes in the exchange offers; and
- Must comply with the registration and prospectus delivery requirements of the Securities Act in connection with any secondary resale transaction.

Each broker-dealer that receives exchange notes for its own account in exchange for outstanding notes must acknowledge that the outstanding notes were acquired by it as a result of market-making activities or other trading activities and agree that it will deliver a prospectus that meets the requirements of the Securities Act in connection with any resale of the exchange notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. Please read Plan of Distribution. A broker-dealer may use this prospectus, as it may be amended or supplemented from time to time, in connection with the resales of exchange notes received in exchange for outstanding notes that the broker-dealer acquired as a result of market-making or other trading activities. Any holder that is a broker-dealer participating in an exchange offer must notify the exchange agent at the telephone number set forth in the enclosed letter of transmittal and must comply with the procedures for broker-dealers participating in the exchange offer. We have not entered into any arrangement or understanding with any person to distribute the exchange notes to be received in the exchange offers.

Table of Contents

Exchange Agent

Wells Fargo Bank, National Association has been appointed as the exchange agent for the exchange offers. Questions and requests for assistance, requests for additional copies of this prospectus or of the letter of transmittal should be directed to the exchange agent addressed as follows:

Wells Fargo Bank, National Association

By Facsimile for Eligible Institutions:
(214) 777-4086
Attention: Patrick T. Giordano

By Registered and Certified Mail:
Wells Fargo Bank, NA
Corporate Trust Operations
MAC N9303-121
PO Box 1517
Minneapolis, MN 55480

By Regular Mail or Overnight Courier:
Wells Fargo Bank, NA
Corporate Trust Operations
MAC N9303-121

Sixth & Marquette Avenue
Minneapolis, MN 55479

In person by hand only:
Wells Fargo Bank, NA
12th Floor Northstar East Building
Corporate Trust Operations
608 Second Avenue South
Minneapolis, MN

Confirm by Telephone:
(214) 740-1573

Fees and Expenses

We will bear the expenses of soliciting tenders. The principal solicitation is being made by mail; however, we may make additional solicitation by telegraph, telephone or in person by our officers and regular employees and those of our affiliates.

We have not retained any dealer manager in connection with the exchange offers and will not make any payments to broker-dealers or others soliciting acceptances of the exchange offers. We will, however, pay the exchange agent reasonable and customary fees for its services and reimburse it for its related reasonable out of pocket expenses.

We will pay the cash expenses to be incurred in connection with the exchange offers. They include:

SEC registration fees;

Fees and expenses of the exchange agent and trustee;

Accounting and legal fees and printing costs; and

Related fees and expenses.

Transfer Taxes

We will pay all transfer taxes, if any, applicable to the exchange of outstanding notes under the exchange offers. Each tendering holder, however, will be required to pay any transfer taxes, whether imposed on the registered holder or any other person, if a transfer tax is imposed for any reason other than the exchange of outstanding notes under the exchange offers.

Table of Contents

Consequences of Failure to Exchange Outstanding Securities

If you do not exchange your outstanding notes for exchange notes under the applicable exchange offer, the outstanding notes you hold will continue to be subject to the existing restrictions on transfer. In general, you may not offer or sell the outstanding notes except under an exemption from, or in a transaction not subject to, the Securities Act and applicable state securities laws. We do not intend to register outstanding notes under the Securities Act unless the registration rights agreement requires us to do so.

Accounting Treatment

We will record the exchange notes in our accounting records at the same carrying value as the outstanding notes. This carrying value is the aggregate principal amount of the outstanding notes, as reflected in our accounting records on the date of exchange. Accordingly, we will not recognize any gain or loss for accounting purposes in connection with the exchange offers, other than the recognition of the fees and expenses of the offering as stated under Fees and Expenses.

Other

Participation in the exchange offers is voluntary, and you should consider carefully whether to accept. You are urged to consult your financial and tax advisors in making your own decision on what action to take.

We may in the future seek to acquire any untendered outstanding notes in open market or privately negotiated transactions, through subsequent exchange offers or otherwise. We have no present plans to acquire any outstanding notes that are not tendered in the applicable exchange offer or to file a registration statement to permit resales of any untendered outstanding notes.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS

Various statements contained in this prospectus, including those that express a belief, expectation, or intention, as well as those that are not statements of historical fact, are forward-looking statements. The forward-looking statements may include projections and estimates concerning the timing and success of specific projects and our future production, revenues, income and capital spending. Our forward-looking statements are generally accompanied by words such as estimate, project, predict, believe, expect, anticipate, potential, could, may, foresee, plan, goa
convey the uncertainty of future events or outcomes. The forward-looking statements in this prospectus speak only as of the date of this prospectus; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties relating to, among other matters, the risks discussed under the heading Risk Factors and the following:

- the volatility of natural gas and oil prices;
- discovery, estimation, development and replacement of natural gas and oil reserves;
- cash flow and liquidity;
- financial position;
- business strategy;
- amount, nature and timing of capital expenditures, including future development costs;
- availability and terms of capital;
- timing and amount of future production of natural gas and oil;
- availability of drilling and production equipment;
- timing of drilling rig fabrication and delivery;
- customer contracting of drilling rigs;
- availability of oil field labor;
- availability and regulation of CO_2;
- operating costs and other expenses;
- prospect development and property acquisitions;
- availability of pipeline infrastructure to transport natural gas production;

marketing of natural gas and oil;

competition in the natural gas and oil industry;

governmental regulation and taxation of the natural gas and oil industry; and

developments in oil-producing and natural gas-producing countries.

Table of Contents

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The following tables set forth selected historical consolidated financial data for the six months ended June 30, 2008 and 2007 and for the years ended December 31, 2007, 2006, 2005, 2004 and 2003. The historical financial data as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006 and 2005 are derived from our audited consolidated financial statements and the notes thereto included in this prospectus. The unaudited condensed consolidated balance sheet data and statement of operations data at June 30, 2007 and 2008 and for the six month periods ended June 30, 2007 and 2008 are derived from our unaudited condensed combined financial statements and the notes thereto included in this prospectus. The historical financial data as of December 31, 2005, 2004 and 2003 and for the years ended December 31, 2004 and 2003 are derived from our audited consolidated financial statements which are not included in this prospectus. The selected financial data should be read in conjunction with, and is qualified in its entirety by reference to, Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the notes thereto included elsewhere in this prospectus.

	Years Ended December 31,					Six Months Ended June 30,	
	2003(1)	2004(2)	2005	2006	2007	2007	2008
	(in thousands, except per share data)						
Statement of Operations Data:							
Revenues	$ 155,337	$ 175,995	$ 287,693	$ 388,242	$ 677,452	$ 308,127	$ 647,136
Expenses:							
Production	7,980	10,230	16,195	35,149	106,192	49,018	74,442
Production taxes	2,099	2,497	3,158	4,654	19,557	7,926	22,739
Drilling and services	13,847	26,442	52,122	98,436	44,211	24,126	12,235
Midstream marketing	94,620	96,180	141,372	115,076	94,253	46,747	105,151
Depreciation, depletion and amortization natural gas and crude oil	3,298	4,909	9,313	26,321	173,568	70,699	137,332
Depreciation, depletion and amortization other	5,284	7,765	14,893	29,305	53,541	22,263	33,745
General and administrative	3,705	6,554	11,908	55,634	61,780	25,360	47,197
Loss (gain) on derivative contracts	3,450	878	4,132	(12,291)	(60,732)	(15,981)	296,612
Loss (gain) on sale of assets	(1,284)	(210)	547	(1,023)	(1,777)	(659)	(7,711)
Total operating expenses	132,999	155,245	253,640	351,261	490,593	229,499	721,742
(Loss) income from operations	22,338	20,750	34,053	36,981	186,859	78,628	(74,606)

Other income (expense):							
Interest income	103	56	206	1,109	4,694	3,127	2,145
Interest expense	(1,208)	(1,678)	(5,277)	(16,904)	(117,185)	(60,108)	(47,395)
Other income (expense), net	960	(298)	(1,121)	671	5,377	2,506	1,503
Total other expense	(145)	(1,920)	(6,192)	(15,124)	(107,114)	(54,475)	(43,747)
(Loss) income before income taxes	22,193	18,830	27,861	21,857	79,745	24,153	(118,353)
Income tax (benefit) expense	7,585	6,433	9,968	6,236	29,524	9,082	(41,385)
Income from continuing operations	14,608	12,397	17,893	15,621	50,221	15,071	(76,968)
(Loss) income from discontinued operations, net of tax	(85)	451	229				
Cumulative effect of accounting change	(1,636)						
Extraordinary gain		12,544					
Net (loss) income	12,887	25,392	18,122	15,621	50,221	15,071	(76,968)
Preferred stock dividends and accretion				3,967	39,888	21,260	16,232
(Loss applicable) income available to common stockholders	$ 12,887	$ 25,392	$ 18,122	$ 11,654	$ 10,333	$ (6,189)	$ (93,200)

Table of Contents

	Historical						
	Years Ended December 31,					Six Months Ended June 30,	
	2003(1)	2004(2)	2005	2006	2007	2007	2008
	(In thousands except per share data)						
Earnings Per Share Information:							
Basic							
(Loss) income from continuing operations	$ 0.26	$ 0.22	$ 0.31	$ 0.21	$ 0.46	$ 0.15	$ (0.52)
Income from discontinued operations, net of income tax		0.01	0.01				
Extraordinary gain on acquisition		0.22					
Cumulative effect of change in accounting principle, net of income tax	(0.03)						
Preferred stock dividends				(0.05)	(0.37)	(0.21)	(0.11)
(Loss) income per share (applicable) available to common stockholders	$ 0.23	$ 0.45	$ 0.32	$ 0.16	$ 0.09	$ (0.06)	$ (0.63)
Weighted average number of shares outstanding(3):	56,312	56,312	56,559	73,727	108,828	100,025	148,124
Diluted							
(Loss) income from continuing operations	$ 0.26	$ 0.22	$ 0.31	$ 0.21	$ 0.46	$ 0.15	$ (0.52)
Income from discontinued operations, net of income tax		0.01	0.01				
Extraordinary gain on acquisition		0.22					
Cumulative effect of change in accounting principle, net of income tax	(0.03)						
Preferred stock dividends				(0.05)	(0.37)	(0.21)	(0.11)
	$ 0.23	$ 0.45	$ 0.32	$ 0.16	$ 0.09	$ (0.06)	$ (0.63)

(Loss) income per share (applicable) available to common stockholders							
Weighted average number of shares outstanding(3):	56,312	56,312	56,737	74,664	110,041	100,025	148,124

(1) We adopted the provisions of SFAS 143 Accounting for Retirement Obligations, resulting in a cumulative effect of change in accounting principal of $1.6 million.

(2) We recognized an extraordinary gain from the recognition of the excess of fair value over acquisition cost of $12.5 million related to an acquisition we made in 2004.

(3) The number of shares has been adjusted to reflect a 281.562-to-1 stock split in December 2005.

	As of December 31,					As of June 30,	
	2003	2004	2005	2006	2007	2007	2008
				(In thousands)			
Balance Sheet Data:							
Cash and cash equivalents	$ 176	$ 12,973	$ 45,731	$ 38,948	$ 63,135	$ 2,199	$ 275,888
Property, plant and equipment, net	$ 70,289	$ 114,818	$ 337,881	$ 2,134,718	$ 3,337,410	$ 2,542,460	$ 3,955,721
Total assets	$ 127,744	$ 197,017	$ 458,683	$ 2,388,384	$ 3,630,566	$ 2,765,348	$ 4,565,810
Long-term debt	$ 24,740	$ 59,340	$ 43,133	$ 1,066,831	$ 1,067,649	$ 1,066,656	$ 1,810,034
Redeemable convertible preferred stock	$	$	$	$ 439,643	$ 450,715	$ 449,998	
Total stockholders equity	$ 33,940	$ 59,330	$ 289,002	$ 649,818	$ 1,766,891	$ 950,821	$ 2,142,403
Total liabilities and stockholders equity	$ 127,744	$ 197,017	$ 458,683	$ 2,388,384	$ 3,630,566	$ 2,765,348	$ 4,565,810

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to help the reader understand our business, financial condition, results of operations, liquidity and capital resources. You should read this discussion in conjunction with our audited and unaudited consolidated financial statements and the related notes beginning on page F-1 of this prospectus.

The following discussion contains forward-looking statements that reflect our future plans, estimates, beliefs and expected performance. The forward-looking statements are dependent upon events, risks and uncertainties that may be outside our control. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, market prices for natural gas and crude oil, economic and competitive conditions, regulatory changes, estimates of proved reserves, potential failure to achieve production from development projects, capital expenditures and other uncertainties, as well as those factors discussed below and elsewhere in this prospectus. Please see Risk Factors and Cautionary Statements Regarding Forward-Looking Statements. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may not occur.

The financial information with respect to the six month periods ended June 30, 2008 and June 30, 2007 that is discussed below is unaudited. In the opinion of management, this information contains all adjustments, consisting only of normal recurring accruals, necessary to state fairly the unaudited condensed consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of the results of operations for the full fiscal year.

Overview of Our Company

We are a rapidly expanding independent natural gas and crude oil company concentrating on exploration, development and production activities. We are focused on continuing the exploration and exploitation of our significant holdings in the West Texas Overthrust, which we refer to as the WTO, a natural gas prone geological region where we have operated since 1986. The WTO includes the Piñon Field as well as the Allison Ranch, South Sabino, Thistle, Big Canyon, and McKay Creek exploration areas. We also own and operate drilling rigs and conduct related oil field services, and we own and operate interests in gas gathering, marketing and processing facilities and CO_2 gathering and transportation facilities.

On November 21, 2006, we acquired all of the outstanding membership interests in NEG Oil & Gas LLC (NEG) for total consideration of approximately $1.5 billion, excluding cash acquired. With core assets in the Val Verde and Permian Basins of West Texas, including overlapping or contiguous interests in the WTO, the NEG acquisition has dramatically increased our exploration and production segment operations. In addition to the NEG acquisition, we have completed numerous acquisitions of additional working interests in the WTO during the period from late 2005 through June 30, 2008. We also operate significant interests in the Cotton Valley Trend in East Texas, the Gulf Coast area, the Mid-Continent and the Gulf of Mexico.

During November 2007, we completed the initial public offering of our common stock. We used the proceeds from this offering to repay indebtedness outstanding under our senior credit facility as well as a note payable related to a 2007 acquisition and to fund the remainder of our 2007 capital expenditure program and a portion of our 2008 capital expenditure program.

Recent Events

Increase in Borrowing Base. In April 2008, our senior credit facility was increased to $1.75 billion from $750 million and our borrowing base was increased to $1.2 billion from $700.0 million. The $1.2 billion borrowing base contemplated a potential future fixed income transaction not to exceed $400.0 million. As a result of our May 2008 issuance of $750.0 million of senior notes, our borrowing base was reduced to $1.1 billion from $1.2 billion. The total committed amount of the Senior Credit facility remains at $1.75 billion.

Table of Contents

Exchange of Senior Term Loans. In May, 2008, we issued $650.0 million in principal amount of 85/8% Senior Notes Due 2015 in exchange for an equal outstanding principal amount of our fixed rate term loans and $350.0 million of our Senior Floating Rate Notes Due 2014 in exchange for an equal outstanding principal amount of our variable rate term loans. The exchange was made pursuant to a private placement that commenced on March 28, 2008 and expired on April 28, 2008. The newly issued senior notes have terms that are substantially identical to those of the exchanged senior term loans, except that the senior notes have been issued with registration rights.

Conversion of Redeemable Convertible Preferred Stock. In May 2008, we converted the remaining outstanding 1,844,464 shares of our redeemable convertible preferred stock into 18,810,260 shares of our common stock as permitted under the terms of the redeemable convertible preferred stock. This conversion resulted in a one-time charge to retained earnings of $6.1 million in accelerated accretion expense related to the remaining offering costs of the redeemable convertible preferred shares. Prorated dividends totaling $0.5 million for the period from May 2, 2008 to the date of conversion (May 7, 2008) were paid to the holders of the converted shares on May 7, 2008.

Sale of Colorado Assets. In May 2008, we completed the sale of all of our assets in the Piceance Basin of Colorado for net proceeds of approximately $147.2 million after closing adjustments. Assets sold included undeveloped acreage, working interests in wells, gathering and compression systems and other facilities related to natural gas and crude oil wells.

Issuance of 8.0% Senior Notes. In May 2008, we privately placed $750.0 million of our 8.0% Senior Notes due 2018. We used $478.0 million of the $735.0 million net proceeds received from the offering to repay the total balance outstanding on our senior credit facility. The remaining proceeds are expected to be used to fund a portion of our 2008 capital expenditures budget.

Production Shut-Ins. We experienced a fire at our Grey Ranch Plant located in Pecos County, Texas on June 27, 2008. While there were no injuries, we believe that the plant will be shut down for a minimum of 90 days from the date of the fire for repairs. As a result of the fire, our loss is approximately 16.5 MMcf per day of net methane production. In the Gulf Coast, an additional 8.5 MMcfe per day of net production was shut in during May 2008 due to major well work.

Century Plant Construction and Gas Treating and CO_2 Delivery Agreements. In June 2008, we entered into an agreement with a subsidiary of Occidental Petroleum Corporation (Occidental) to construct a CO_2 extraction plant (the Century Plant) located in Pecos County, Texas and associated compression and pipeline facilities for $800.0 million. Occidental will pay a minimum of 100% of the contract price (including any subsequent agreed-upon revisions) to us through periodic cost reimbursements based upon the percentage of the project completed. Upon start-up, the Century Plant will be owned and operated by Occidental for the purpose of extracting CO_2 from the delivered natural gas. We will deliver high CO_2 natural gas to the Century Plant pursuant to a 30-year treating agreement executed simultaneously with the construction agreement. Occidental will extract CO_2 from the delivered natural gas. Occidental will retain substantially all CO_2 extracted at the Century Plant and our other existing CO_2 extraction plants. We will retain all methane from the Century Plant and our other existing plants.

Potential Asset Sale. In July 2008, we announced our intent to offer certain properties for sale and to retain third parties to assist in the marketing efforts. Assets subject to the potential sale include our developed and undeveloped properties in East Texas and our undeveloped properties in North Louisiana.

SemGroup, L.P. Bankruptcy Filing. Our customer, SemGroup, L.P. and certain of its subsidiaries (SemGroup), filed for bankruptcy on July 22, 2008. On July 25, 2008, we offered to enter into supplier protection agreements with SemGroup under which we committed to continue to do business with SemGroup on the same terms and reasonably equivalent volume as before the bankruptcy filing in return for SemGroup s full payment for goods and services provided before the filing. As of June 30, 2008, SemGroup owed us a total of $1.2 million. In July 2008, we provided an additional $1.1 million of goods and services to SemGroup prior to its declaration of bankruptcy. Based upon the expected protection afforded by the terms of the supplier protection agreements, no allowance for doubtful recovery has been provided with respect to amounts outstanding from SemGroup.

Property Acquisitions. During July 2008, the Company purchased land, minerals, developed and undeveloped leasehold and interests in producing properties through various transactions at an aggregate purchase price of $67.6 million.

Segment Overview

We operate in four related business segments: exploration and production, drilling and oil field services, midstream gas services and other. Management evaluates the performance of our business segments based on operating income, which is defined as segment operating revenue less operating expenses and depreciation, depletion and amortization. These measurements provide important information to us about the activity and profitability of our lines of business. Set forth in the table below is financial information regarding each of our business segments.

	Year Ended December 31,			Six Months Ended June 30,	
	2007	2006	2005	2008	2007
Segment revenue:					
Exploration and production	$ 478,747	$ 106,413	$ 54,051	$ 500,350	$ 207,305
Drilling and oil field services	73,202	138,657	80,151	24,186	40,228
Midstream gas services	107,578	122,892	147,499	113,383	52,100
Other	17,925	20,280	5,992	9,217	8,494
Total revenues	677,452	388,242	287,693	647,136	308,127
Segment operating (loss) income:					
Exploration and production	198,913	17,069	14,886	(53,934)	76,463
Drilling and oil field services	10,473	32,946	18,295	2,496	8,876
Midstream gas services	6,783	3,528	4,096	6,585	2,301
Other	(29,310)	(16,562)	(3,224)	(29,753)	(9,012)
Total operating (loss) income	186,859	36,981	34,053	(74,606)	78,628
Interest income	5,423	1,109	206	2,145	3,127
Interest expense	(117,185)	(16,904)	(5,277)	(47,395)	(60,108)
Other (expense) income	4,648	671	(1,121)	1,503	2,506
(Loss) income before income taxes	$ 79,745	$ 21,857	$ 27,861	$ (118,353)	$ 24,153

Table of Contents

	Year Ended December 31,			Six Months Ended June 30,	
	2007	2006	2005	2008	2007
Production data:					
Natural gas (MMcf)	51,958	13,410	6,873	40,888	22,292
Crude oil (MBbls)(1)	2,042	322	72	1,231	906
Combined equivalent volumes (MMcfe)	64,211	15,342	7,305	48,274	27,728
Average daily combined equivalent volumes (MMcfe/d)	175.9	42.0	20.0	265	153
Average prices- as reported(2):					
Natural gas (per Mcf)	$ 6.51	$ 6.19	$ 6.54	$ 9.11	$ 6.90
Crude oil (per Bbl)(1)	$ 68.12	$ 56.61	$ 48.19	$ 101.55	$ 58.18
Combined equivalent (per Mcfe)	$ 7.45	$ 6.60	$ 6.63	$ 10.31	$ 7.45
Average prices- including impact of derivative contract settlements:					
Natural gas (per Mcf)	$ 7.18	$ 7.25	$ 6.54	$ 8.11	$ 6.86
Crude oil (per Bbl)(1)	$ 68.10	$ 56.61	$ 48.19	$ 93.74	$ 58.18
Combined equivalent (per Mcfe)	$ 7.98	$ 7.52	$ 6.63	$ 9.26	$ 7.42
Drilling and oil field services:					
Number of operational drilling rigs owned at end of period	25.0	25.0	19.0	26.7	27.0
Average number of operational drilling rigs owned during the period	26.0	21.9	14.3	28.0	25.5

(1) Includes natural gas liquids.

(2) Prices represent actual average prices for the periods presented and do not give effect to derivative transactions.

Exploration and Production Segment

We explore for, develop and produce natural gas and crude oil reserves, with a focus on our proved reserves and extensive undeveloped acreage positions in the WTO. We operate substantially all of our wells in our core areas and employ our drilling rigs and other drilling services, and contract for third party drilling, as needed, in the exploration and development of our operated wells and, to a lesser extent, on our non-operated wells.

The primary factors affecting the financial results of our exploration and production segment are the prices we receive for our natural gas and crude oil production, the quantity of our natural gas and crude oil production and changes in the fair value of derivative contracts we use to reduce the volatility of the prices we receive for our natural gas and crude oil production. Because we are vertically integrated, our exploration and production activities affect the results of our drilling and oil field services and midstream gas services segments. The NEG acquisition in 2006 substantially increased our revenues and operating income in our exploration and production segment. However, because our working interest in the Piñon Field increased to approximately 93%, there are greater intercompany eliminations that affect the consolidated financial results of our drilling and oil field services and midstream gas services segments.

Exploration and production segment revenues increased to $500.4 million in the six months ended June 30, 2008 from $207.3 million in the six months ended June 30, 2007, an increase of 141.4%, as a result of a 74.1% increase in combined production volumes and a 38.4% increase in the combined average price we received for the natural gas and crude oil we produced. In the six month period ended June 30, 2008 we increased natural gas production by 18.6 Bcf to 40.9 Bcf and increased crude oil production by 325 MBbls to 1,231 MBbls from the comparable period in 2007. The total combined 20.5 Bcfe increase in production was due primarily to an increase in our average working interest in the WTO from 83% at June 30, 2007 to 93% at June 30, 2008 and successful drilling in the WTO throughout 2007 and the first half of 2008. The Company had 1,884 producing wells at June 30, 2008 as compared to 1,469 producing wells at June 30, 2007.

Table of Contents

The average price we received for our natural gas production for the six month period ended June 30, 2008 increased 32.0%, or $2.21 per Mcf, to $9.11 per Mcf from $6.90 per Mcf in the comparable period in 2007. The average price received for our crude oil production increased 74.5%, or $43.37 per barrel, to $101.55 per barrel during the six months ended June 30, 2008 from $58.18 per barrel during the same period in 2007. Including the impact of derivative contract settlements, the effective price received for natural gas for the six month period ended June 30, 2008 was $8.11 per Mcf as compared to $6.86 per Mcf during the same period in 2007. Including the impact of derivative contract settlements, the effective price received for crude oil for the six month period ended June 30, 2008 was $93.74 per barrel. Our derivative contracts had no impact on effective oil prices during the six months ended June 30, 2007. During 2007 and continuing into 2008, we entered into derivatives contracts to mitigate the impact of commodity price fluctuations on our 2007, 2008 and 2009 production. Our derivative contracts are not designated as accounting hedges and, as a result, gains or losses on commodity derivative contracts are recorded as an operating expense. Internally, management views the settlement of such derivative contracts as adjustments to the price received for natural gas and crude oil production to determine effective prices.

For the six months ended June 30, 2008, we had a $53.9 million operating loss in our exploration and production segment, compared to $76.5 million in operating income for the same period in 2007. Our $293.0 million increase in exploration and production revenues was offset by a $296.6 million loss on our commodity derivative contracts of which $245.9 million was unrealized, a $25.4 million increase in production expenses, and a $66.9 million increase in depreciation, depletion and amortization, or DD&A, due to the increase in production. The increase in production expenses was attributable to the increase in number of operating wells we own and an increase in our average working interest in those wells. During the six month period ended June 30, 2008, the exploration and production segment reported a $296.6 million net loss on our commodity derivative positions ($50.7 million realized loss and $245.9 million unrealized loss) compared to a $16.0 million gain ($0.8 million realized loss and $16.8 million unrealized gain) in the comparable period in 2007. During 2007 and 2008, we entered into natural gas and oil swaps and natural gas basis swaps in order to mitigate the effects of fluctuations in prices received for our production. Given the long term nature of our investment in the WTO development program and the relatively high level of natural gas prices compared to our budgeted prices, management believes it prudent to enter into natural gas and crude oil swaps and natural gas basis swaps for a portion of our production. Unrealized gains or losses on derivative contracts represent the change in fair value of open derivative positions during the period. The change in fair value is principally measured based on period end prices as compared to the contract price. The unrealized loss on natural gas and crude oil derivative contracts recorded in the six month period ended June 30, 2008 was attributable to an increase in average natural gas and crude oil prices at June 30, 2008 as compared to the average natural gas and crude oil prices at December 31, 2007 or the contract price for contracts entered into during the period. Future volatility in natural gas and crude oil prices could have an adverse effect on the operating results of our exploration and production segment.

Exploration and production segment revenues increased to $478.7 million in the year ended December 31, 2007 from $106.4 million in 2006, an increase of 350%, as a result of a 320% increase in production volumes and a 13% increase in the average price we received for the natural gas and oil we produced. During 2007, we increased natural gas production by 38.5 Bcf to 52.0 Bcf and increased crude oil production by 1,720 MBbls to 2,042 MBbls. The total combined 48.9 Bcfe increase in production was due primarily to acquisitions and successful drilling in the WTO.

The average price we received for our natural gas production for the year ended December 31, 2007 increased 5%, or $0.32 per Mcf, to $6.51 per Mcf from $6.19 per Mcf in 2006. The average price received for our crude oil production increased to $68.12 from $56.61 per Bbl in 2006. Including the impact of derivative contract settlements, the effective price received for natural gas for the year ended December 31, 2007 was $7.18 per Mcf as compared to $7.25 per Mcf during the comparable period in 2006. Our oil derivative contract settlements decreased our effective price received for oil by $0.02 per Bbl to $68.10 per Bbl for the year ended December 31, 2007. Our derivative contracts had no impact on effective oil prices during the year ended December 31, 2006.

33

For the year ended December 31, 2007, we had $198.9 million in operating income in our exploration and production segment, compared to $17.1 million in operating income in 2006. The $372.4 million increase in exploration and production segment revenues was partially offset by a $71.0 million increase in production expenses and a $147.2 million increase in depreciation, depletion and amortization, or DD&A. The increase in production expenses was attributable to the additional properties acquired in the NEG acquisition and operating expenses on our new wells. During the year ended December 31, 2007, the exploration and production segment reported a $60.7 million net gain on our derivative positions ($34.5 million realized gains and $26.2 million unrealized gains) compared to a $12.3 million net gain ($14.2 million realized gains and $1.9 million unrealized losses) in the comparable period in 2006. During 2007, we selectively entered into natural gas swaps and basis swaps by capitalizing on what we perceived as spikes in the price of natural gas or favorable basis differences between the NYMEX price and natural gas prices at our principal West Texas pricing point of Waha Hub. Unrealized gains or losses on derivative contracts represent the change in fair value of open derivative positions during the period. The change in fair value is principally measured based on period end prices as compared to the contract price. Future volatility in natural gas and oil prices could have an adverse effect on the operating results of our exploration and production segment.

For the year ended December 31, 2006, exploration and production segment revenues increased to $106.4 million from $54.1 million in 2005. The increase in 2006 compared to 2005 was attributable to increased production due to successful drilling activity and approximately 40 days of production from the NEG acquisition effective November 21, 2006. NEG contributed approximately $36.9 million of revenues in the 2006 period. Production volumes increased to 15,342 Mmcfe in 2006 from 7,305 Mmcfe in 2005, representing an 8,037 Mmcfe, or 110% increase. Approximately 4,902 Mmcfe, or 61%, of the increase was attributable to NEG production for the period from November 21, 2006 to December 31, 2006. Average combined prices were essentially unchanged at $6.60 per Mcfe as compared to $6.63 per Mcfe in 2005.

Exploration and production segment operating income increased $2.2 million in 2006 to $17.1 million from $14.9 million in 2005. The increase was primarily attributable to the increased production revenues described above, approximately $12.3 million in derivative gains (including a $1.9 million unrealized loss) in 2006 as compared to a $4.1 million derivative loss (including a $1.3 million unrealized loss) in 2005, and the addition of NEG for the period from November 21, 2006 to December 31, 2006. The increase in exploration and production segment income was substantially offset by a $20.5 million, or 106%, increase in production costs, a $26.7 million, or 380%, increase in general and administrative expenses and a $19.3 million increase in DD&A. Approximately $7.0 million of the increase in production costs was attributable to the NEG acquisition with the remainder of the increase attributable to the increase in the number of wells operated in 2006 as compared to 2005. The increase in DD&A for our exploration and production segment was attributable to higher production and the increase in the full-cost pool due to the NEG acquisition.

As of December 31, 2007, we had 1,516.2 Bcfe of estimated net proved reserves with a PV-10 of $3,550.5 million, while at December 31, 2006 we had 1,001.8 Bcfe of estimated net proved reserves with a PV-10 of $1,734.3 million. Our Standardized Measure of Discounted Future Net Cash Flows was $2,718.5 million at December 31, 2007 as compared to $1,440.2 million at December 31, 2006 and $499.2 million at December 31, 2005. For a discussion of PV-10 and a reconciliation to Standardized Measure of Discounted Net Cash Flows, see Business Our Business and Primary Operations Exploration and Production Proved Reserves. The increase in 2007 was primarily attributable to revisions of our previous estimates due to performance and results of our drilling activity. The increase in 2006 was primarily related to the addition of the NEG reserves which was partially offset by a decrease in the price of natural gas to $5.32 per Mcf at December 31, 2006 from $8.40 per Mcf at December 31, 2005.

Estimates of net proved reserves are inherently imprecise. In order to prepare our estimates, we must analyze available geological, geophysical, production and engineering data and project production rates and the timing of development expenditures. The process also requires economic assumptions about matters such as natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and the availability of funds. We may adjust estimates of proved reserves to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control.

Approximately 97% of our year-end reserve estimates are prepared by independent petroleum reserve engineers.

Over the past several years, higher natural gas and oil prices have led to higher demand for drilling rigs, operating personnel and field supplies and services. Higher prices have also caused increases in the costs of those goods and services. To date, the higher sales prices have more than offset the higher field costs. Our ownership of drilling rigs has also assisted us in stabilizing our overall cost structure. Given the inherent volatility of natural gas and oil prices that are influenced by many factors beyond our control, we plan our activities and budget based on conservative sales price assumptions, which generally were lower than the average sales prices received in 2007. We focus our efforts on increasing natural gas reserves and production while controlling costs at a level that is appropriate for long-term operations. Our future earnings and cash flows are dependent on our ability to manage our overall cost structure to a level that allows for profitable production.

Like all exploration and production companies, we face the challenge of natural production declines. As initial reservoir pressures are depleted, natural gas and oil production from a given well naturally decreases. Thus, a natural gas and oil exploration and production company depletes part of its asset base with each unit of oil or natural gas it produces. We attempt to overcome this natural decline by drilling and acquiring more reserves than we produce. Our future growth will depend on our ability to continue to add reserves in excess of production. We will maintain our focus on managing the costs associated with adding reserves through drilling and acquisitions as well as the costs associated with producing such reserves. Our ability to add reserves through drilling is dependent on our capital resources and can be limited by many factors, including our ability to timely obtain drilling permits and regulatory approvals. In the WTO, this has not posed a problem. However, in other areas, the permitting and approval process has been more difficult in recent years due to increased activism from environmental and other groups. This has increased the time it takes to receive permits in some locations.

Drilling and Oil Field Services Segment

We drill for our own account primarily in the WTO through our drilling and oil field services subsidiary, Lariat Services, Inc., or LSI. We also drill wells for other natural gas and crude oil companies, primarily located in the West Texas region. As of June 30, 2008, our drilling rig fleet consisted of 41 operational rigs, 30 we owned directly and 11 owned by Larclay, L.P., a limited partnership in which we have a 50% interest. We also own one rig that is currently being retrofitted. Our oil field services business conducts operations that complement our drilling services operations. These services include providing pulling units, trucking, rental tools, location and road construction and roustabout services to ourselves and to third parties. Additionally, we provide under-balanced drilling systems only for our own account.

In 2006, we and Clayton Williams Energy, Inc., or CWEI, formed Larclay, L.P., which acquired twelve sets of rig components and other related equipment to assemble into completed land drilling rigs. The drilling rigs were to be used for drilling on CWEI s prospects, our prospects or for contracting to third parties on daywork drilling contracts. All of these rigs have been delivered, although one rig has not been assembled. CWEI was responsible for securing financing and the purchase of the rigs. The partnership financed 100% of the acquisition cost of the rigs utilizing a guarantee by CWEI. We operate the rigs owned by the partnership. The partnership and CWEI are responsible for all costs related to the initial construction and equipping of the drilling rigs. In the event of an operating shortfall within the partnership, we, along with CWEI, are responsible to fund the shortfall through loans to the partnership. In April 2008, LSI and CWEI each made loans of $2.5 million to Larclay under promissory notes. The notes bear interest at a floating rate based on a London Interbank Offered Rate (LIBOR) average plus 3.25% (5.75% at June 30, 2008) as provided in the partnership agreement. In June 2008, Larclay executed a $15.0 million revolving promissory note with each LSI and CWEI. Amounts drawn under each revolving promissory note bear interest at a floating rate based on a LIBOR average plus 3.25% (5.75% at June 30, 2008) as provided in the partnership agreement. Amounts advanced to Larclay by LSI under the revolving promissory note during 2008 were $1.5 million. Larclay s current cash shortfall is a result of principal payments pursuant to its rig loan agreement. We account for Larclay as an equity investment.

The financial results of our drilling and oil field services segment depend on many factors, particularly the demand for and the price we can charge for our services. We provide drilling services for our own account and for others, generally on a daywork, and less often on a turnkey, contract basis. We generally assess the complexity and risk of operations, the on-site drilling conditions, the type of equipment to be used, the anticipated duration of the work to be performed and the prevailing market rates in determining the contract terms we offer.

Daywork Contracts. Under a daywork drilling contract, we provide a drilling rig with required personnel to our customer who supervises the drilling of the well. We are paid based on a negotiated fixed rate per day while the rig is used. Daywork drilling contracts specify the equipment to be used, the size of the hole and the depth of the well. Under a daywork drilling contract, the customer bears a large portion of the out-of-pocket drilling costs, and we generally bear no part of the usual risks associated with drilling, such as time delays and unanticipated costs. As of June 30, 2008, 29 of our rigs were operating under daywork contracts and 27 of these were working for our account. As of June 30, 2008, the 11 operational rigs owned by Larclay were operating under daywork contracts and four of these were working for our account. The remaining seven operational Larclay rigs were working for CWEI as of June 30, 2008.

Turnkey Contracts. Under a typical turnkey contract, a customer will pay us to drill a well to a specified depth and under specified conditions for a fixed price, regardless of the time required or the problems encountered in drilling the well. We provide most of the equipment and drilling supplies required to drill the well. We subcontract for related services such as the provision of casing crews, cementing and well logging. Generally, we do not receive progress payments and are paid only after the well is drilled. We enter into turnkey contracts in areas where our experience and expertise permit us to drill wells more profitably than under a daywork contract. As of June 30, 2008, none of our rigs were operating under a turnkey contract.

Drilling and oil field services segment revenue decreased to $24.2 million in the six month period ended June 30, 2008 from $40.2 million in the six month period ended June 30, 2007. This resulted in operating income of $2.5 million in the six month period ended June 30, 2008 compared to operating income of $8.9 million in the same period in 2007. The decline in revenues and operating income is primarily attributable to an increase in the number of our rigs operating on our properties and an increase in our ownership interest in our natural gas and crude oil properties. Our drilling and oil field services segment records revenues and operating income only on wells drilled for or on behalf of third parties. The portion of drilling costs incurred by our drilling and oil field services segment relating to our ownership interest are capitalized as part of our full-cost pool. During the six months ended June 30, 2008, 25 of the 28 operational rigs we owned were working for our account, as compared to 17 of our 26 operational rigs working for our account at June 30, 2007. As a result, during the six month period ended June 30, 2008, approximately 87.2%, or $164.4 million, of our drilling and oil field service revenues were generated by work performed on our own account and eliminated in consolidation as compared to approximately 66%, or $77.9 million, for the comparable period in 2007. The average daily rate we received per rig working for third parties declined to an average of $14,000 per rig per working day during the first six months of 2008 from an average of $24,500 per rig per working day during the first six months of 2007. During the six months ended June 30, 2007, two of our rigs working for third parties were operating under turnkey contracts, which resulted in higher average revenues earned per day compared to revenues earned per day by rigs working under dayrate contracts. None of our rigs operated under turnkey contracts during the six months ended June 30, 2008.

Drilling and oil field services segment revenue decreased to $73.2 million for the year ended December 31, 2007 from $138.7 million for the year ended December 31, 2006. Operating income decreased to $10.5 million during 2007 from $32.9 million in the same period in 2006. The decline in revenues and operating income is primarily attributable to an increase in the number of rigs operating on our properties and an increase in our ownership interest in our natural gas and oil properties. As of December 31, 2007, with the NEG acquisition and other WTO property acquisitions, our average working interest was approximately 93% in the wells we operate in the WTO, and the third-party interest has declined to less than 20%. During the year ended December 31, 2007, approximately 72% of drilling and oil field service segment revenue was generated by work performed on our own account and eliminated in consolidation as compared to approximately 34% for the comparable period in 2006. The number of drilling rigs we owned increased 19%

to an average of 26 rigs during 2007 from an average of 21.9 rigs in 2006. The average daily rate we received per rig of $17,177, excluding revenues for related rental equipment and before intercompany eliminations, was essentially unchanged from 2006. Our rig utilization rate was 90%, representing 1,095 stacked rig days in 2007. The decline in operating income was principally attributable to the increase in the number and working interest ownership in wells drilled for our own account.

During 2006, our drilling and oil field services segment reported $138.7 million in revenues, an increase of $58.5 million, or 73%, from 2005. Operating income increased to $32.9 million in 2006 from $18.3 million in 2005. The increase in revenue and operating income was primarily attributable to an increase in the number of rigs we owned and an increase in the average revenue per rig per day we earned from the rigs. The number of rigs we owned increased 32% to 25 rigs as of December 31, 2006 and the average revenue we received per rig, excluding revenues for related rental equipment, increased 48% (before intercompany eliminations) to $17,034 per day from $11,503 per day. Our margins increased primarily due to our rig rates increasing faster than our operating costs.

We believe our ownership of drilling rigs and related oil field services will continue to be a major catalyst of our growth. As of December 31, 2007, our drilling fleet consisted of 44 rigs, including the twelve rigs owned by Larclay. As of December 31, 2007, 29 of our rigs are working on properties that we operate; six of our rigs are drilling on a contract basis for third parties; three are being retrofitted and six are idle or being repaired.

Midstream Gas Services Segment

We provide gathering, compression, processing and treating services of natural gas in West Texas, primarily through our wholly owned subsidiary, SandRidge Midstream, Inc. (formerly known as ROC Gas Company, Inc.). Through our gas marketing subsidiary, Integra Energy LLC, we buy and sell natural gas produced from our operated wells as well as third-party operated wells. Gas marketing revenue is one of our largest revenue components; however, it is a very low margin business. On a consolidated basis, natural gas purchases and other costs of sales include the total value we receive from third parties for the natural gas we sell and the amount we pay for natural gas, which are reported as midstream and marketing expense. The primary factors affecting our midstream gas services are the quantity of natural gas we gather, treat and market and the prices we pay and receive for natural gas.

Midstream gas services segment revenue for the six months ended June 30, 2008 was $113.4 million compared to $52.1 million in the comparable period of 2007. The increase in midstream gas services revenues is attributable to larger third-party volumes transported and marketed through our gathering systems during the six months ended June 30, 2008 as compared to the same period in 2007 as well as an overall increase in natural gas prices from the 2007 period to the 2008 period. We generally charge a flat fee per unit transported and charge a percentage of sales for marketed volumes.

Midstream gas services segment revenue for the year ended December 31, 2007 was $107.6 million compared to $122.9 million in 2006. The decrease in midstream gas services revenues is attributable to the increase in our working interest in the WTO as a result of the NEG and other acquisitions.

Midstream gas services segment revenue decreased $24.6 million for the year ended December 31, 2006 from $147.5 million in 2005 to $122.9 million in 2006. The NEG acquisition significantly decreased our midstream gas services revenue as more gas was transported for our own account. We do not record midstream gas revenue for transportation, treating and processing of our own gas. Prior to the NEG acquisition, transportation, treating and processing of gas for NEG was recorded as midstream gas services revenue. Operating income increased $3.3 million in 2007 to $6.8 million due to lower gas prices paid and an increase in marketing and transportation for our own account. Operating income decreased to $3.5 million in 2006 from $4.1 million in the 2005 period, primarily due to the NEG acquisition and start-up operating expenses for our Sagebrush processing plant in 2006. The Sagebrush plant was placed into full operation during May 2007. We have the contractual right to periodically increase fees we receive for transportation and processing based on certain indexes.

Table of Contents

Other Segment

Our other segment consists primarily of our CO_2 gathering and sales operations, corporate operations and other investments. We conduct our CO_2 gathering and sales operations through our wholly owned subsidiary, SandRidge CO_2, LLC (formerly operated through PetroSource Energy Company, LLC). SandRidge CO_2 gathers CO_2 from natural gas treatment plants located in West Texas and transports and sells this CO_2 for use in our and third parties tertiary oil recovery operations. The operating loss in the other segment was $29.8 million for the six months ended June 30, 2008 as compared to a loss of $9.0 million during the same period in 2007. The increase is primarily attributable to significant increases in corporate and support staff throughout 2007 and the first half of 2008.

Results of Operations

Six months ended June 30, 2008 compared to the six months ended June 30, 2007

Revenues. Total revenues increased 110.0% to $647.1 million for the six months ended June 30, 2008 from $308.1 million in the same period in 2007. This increase was due to a $291.2 million increase in natural gas and crude oil sales. Lower drilling and services revenues partially offset the increase in midstream and marketing revenues.

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	$ Change	% Change
	(In thousands)			
Revenues:				
Natural gas and crude oil	$ 497,621	$ 206,450	$ 291,171	141.0%
Drilling and services	24,291	40,244	(15,953)	(39.6)%
Midstream and marketing	115,897	52,101	63,796	122.4%
Other	9,327	9,332	(5)	(0.1)%
Total revenues	$ 647,136	$ 308,127	$ 339,009	110.0%

Total natural gas and crude oil revenues increased $291.2 million to $497.6 million for the six months ended June 30, 2008 compared to $206.5 million for the same period in 2007, primarily as a result of the increases in our natural gas and crude oil production volumes and prices received for our production. Total natural gas production increased 83.4% to 40,888 MMcf in the 2008 period compared to 22,292 MMcf in the 2007 period, while crude oil production increased 35.9% to 1,231 MBbls in the 2008 period from 906 MBbls in the 2007 period. The average price received, excluding the impact of derivative contracts, for our natural gas and crude oil production increased 38.4% in the 2008 period to $10.31 per Mcfe compared to $7.45 per Mcfe in the 2007 period.

Drilling and services revenues decreased 39.6% to $24.3 million for the six months ended June 30, 2008 compared to $40.2 million in the same period in 2007. The decline in revenues is due to an increase in the number of company-owned rigs operating on company-owned natural gas and crude oil properties and the increase in working interest in these properties from the first six months of 2007 to the first six months of 2008. Additionally, the average daily revenue per rig working for third parties declined to approximately $14,000 per rig per day worked during the six months ended June 30, 2008 compared to an average of approximately $24,500 per rig per day worked during the same period in 2007. During the six months ended June 30, 2007, two of our rigs working for third parties were operating under turnkey contracts which resulted in higher average revenues earned per day compared to revenues earned per day by rigs working under daywork contracts. None of our rigs operated under turnkey contracts during the six months ended June 30, 2008.

Midstream and marketing revenues increased $63.8 million, or 122.4%, with revenues of $115.9 million in the six-month period ended June 30, 2008 compared to $52.1 million in the six-month period ended June 30, 2007 due to the larger third-party production volumes transported and marketed, during the six months ended

June 30, 2008 compared to the same period in 2007. Higher natural gas prices prevalent during the six months ended June 30, 2008 compared to the first six months of 2007 also contributed to the increase.

Operating Costs and Expenses. Total operating costs and expenses increased to $721.7 million for the six months ended June 30, 2008 compared to $229.5 million for the same period in 2007 due to a $296.6 million loss on derivative contracts, increases in production-related costs, general and administrative expenses and depreciation, depletion and amortization. These increases were partially offset by a decrease in expenses attributable to our drilling and services.

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	$ Change	% Change
	(In thousands)			
Operating costs and expenses:				
Production	$ 74,442	$ 49,018	$ 25,424	51.9%
Production taxes	22,739	7,926	14,813	186.9%
Drilling and services	12,235	24,126	(11,891)	(49.3)%
Midstream and marketing	105,151	46,747	58,404	124.9%
Depreciation, depletion, and amortization natural gas and crude oil	137,332	70,699	66,633	94.2%
Depreciation, depletion and amortization other	33,745	22,263	11,482	51.6%
General and administrative	47,197	25,360	21,837	86.1%
Loss (gain) on derivative contracts	296,612	(15,981)	312,593	(1,956.0)%
Gain on sale of assets	(7,711)	(659)	(7,052)	1,070.1%
Total operating costs and expenses	$ 721,742	$ 229,499	$ 492,243	214.5%

Production expenses increased $25.4 million primarily due to the increase from June 30, 2007 to June 30, 2008 in the number of producing wells in which we have a working interest. Production taxes increased $14.8 million, or 186.9%, to $22.7 million as a result of the increase in production and the increased prices received for production during the six months ended June 30, 2008.

Drilling and services expenses decreased 49.3% to $12.2 million for the six months ended June 30, 2008 compared to $24.1 million for the same period in 2007 primarily due to the increase in the number and working interest ownership of the wells we drilled for our own account.

Midstream and marketing expenses increased $58.4 million, or 124.9%, to $105.2 million due to the larger production volumes transported and marketed during the six months ended June 30, 2008 on behalf of third parties than during the same period in 2007.

DD&A for our natural gas and crude oil properties increased to $137.3 million for the six months ended June 30, 2008 from $70.7 million in the same period in 2007. Our DD&A per Mcfe increased $0.30 to $2.85 in the first six months of 2008 from $2.55 in the same period in 2007. The increase is primarily attributable to the increase in our depreciable properties, higher future development costs and increased production. Our production increased 74.1% to 48.3 Bcfe in the 2008 period from 27.7 Bcfe in the 2007 period.

DD&A for other assets increased to $33.7 million for the six months ended June 30, 2008 from $22.3 million for the comparable period of 2007 due to the higher average carrying costs of our drilling rigs and gathering and compression facilities during the 2008 period compared to the 2007 period.

General and administrative expenses increased $21.8 million to $47.2 million for the six months ended June 30, 2008 from $25.4 million for the same period in 2007. The increase was principally attributable to a $21.2 million increase in corporate salaries and wages due to the significant increase in corporate and support staff. General and administrative expenses include non-cash stock compensation expense of $7.3 million for the six months ended June 30, 2008 compared to $2.3 million for the same period in 2007. The increases in salaries and wages as well as stock compensation were partially offset by $7.5 million in capitalized general and administrative expenses for the six months ended June 30, 2008. There were no general and administrative expenses capitalized during the six months ended June 30, 2007.

For the six-month period ended June 30, 2008, we recorded a loss of $296.6 million ($245.9 million unrealized loss and $50.7 million realized loss) on our derivative contracts compared to a $16.0 million gain ($16.8 million unrealized gain and $0.8 million realized loss) for the same period in 2007. The unrealized loss recorded in the six-month period ended June 30, 2008 resulted primarily from increases in natural gas and crude oil commodity prices from December 31, 2007 to June 30, 2008.

Gain on sale of assets increased to $7.7 million in the six months ended June 30, 2008 compared to $0.7 million in the same period in 2007, primarily due to the gain associated with our sale of assets located in the Piceance Basin of Colorado in May 2008.

Other Income (Expense). Total net other expense decreased to $43.7 million in the six-month period ended June 30, 2008 from $54.5 million in the six-month period ended June 30, 2007. The decrease is reflected in the table below.

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007	$ Change	% Change
	(In thousands)			
Other income (expense):				
Interest income	$ 2,145	$ 3,127	$ (982)	(31.4)%
Interest expense	(47,395)	(60,108)	12,713	(21.2)%
Minority interest	(851)	(157)	(694)	442.0%
Income from equity investments	1,415	2,164	(749)	(34.6)%
Other income, net	939	499	440	88.2%
Total other expense, net	(43,747)	(54,475)	10,728	(19.7)%
(Loss) income before income tax (benefit) expense	(118,353)	24,153	(142,506)	(590.0)%
Income tax (benefit) expense	(41,385)	9,082	(50,467)	(555.7)%
Net (loss) income	$ (76,968)	$ 15,071	$ (92,039)	(610.7)%

Interest income was $2.1 million for the six months ended June 30, 2008 compared to $3.1 million in the same period in 2007. This decrease generally was due to lower excess cash levels during the six months ended June 30, 2008 compared to the same period in 2007.

Interest expense decreased to $47.4 million, net of $0.4 million of capitalized interest, for the six months ended June 30, 2008 from $60.1 million, net of $0.9 million of capitalized interest, for the same period in 2007. This decrease was attributable to the expensing of unamortized debt issuance costs related to our senior bridge facility during March 2007 and a $10.4 million unrealized gain related to our interest rate swap. These decreases were partially offset by increased interest expense during the six months ended June 30, 2008 due to higher average debt balances outstanding during that period compared to the same period in 2007.

Year Ended December 31, 2007 Compared to the Year Ended December 31, 2006

Impact of the NEG Acquisition. The results of operations for the year ended December 31, 2006 include the results of NEG from November 21, 2006. The results of operations for the year ended December 31, 2007 include the NEG acquisition for the full year. While NEG was principally an exploration and production company, the acquisition affected several of our revenue and expense categories. Revenues and expenses related to our natural gas and crude oil operations increased due to increased production from the acquired NEG properties. Revenues and expenses relating to our drilling and services and midstream and marketing operations decreased due to increased intercompany eliminations as more services were provided on company-owned properties. General and administrative expenses increased due to the addition of new staff. Interest expense increased due to the additional borrowings incurred in conjunction with the NEG acquisition.

Revenue. Total revenue increased 75% to $677.5 million for the year ended December 31, 2007 from $388.2 million in 2006. This increase was due to a $376.4 million increase in natural gas and oil sales and was partially offset by lower revenues in our other segments.

	Year Ended December 31,			
	2007	2006 (In thousands)	$ Change	% Change
Revenue:				
Natural gas and crude oil	$ 477,612	$ 101,252	$ 376,360	371.7%
Drilling and services	73,197	139,049	(65,852)	(47.4)%
Midstream and marketing	107,765	122,896	(15,131)	(12.3)%
Other	18,878	25,045	(6,167)	(24.6)%
Total revenues	$ 677,452	$ 388,242	$ 289,210	74.5%

Total natural gas and crude oil revenues increased $376.4 million to $477.6 million for the year ended December 31, 2007, compared to $101.3 million in 2006, primarily as a result of an increase in natural gas and crude oil production volumes. Total natural gas production increased 287% to 51,958 Mmcf in 2007 compared to 13,410 Mmcf in 2006, while crude oil production increased 534% to 2,042 MBbls in 2007 from 322 MBbls in 2006. The increase was due to the NEG acquisition and our successful drilling in the WTO. The average price received for our natural gas and crude oil production increased 13% in 2007 to $7.45 per Mcfe compared to $6.60 per Mcfe in 2006, excluding the impact of derivative contracts.

Drilling and services revenue decreased 47% to $73.2 million in 2007 compared to $139.0 million in 2006. The decline in revenues is primarily attributable to an increase in the number of rigs operating on our properties and an increase in our ownership interest in our natural gas and oil properties. The number of rigs we owned increased to 26.0 (average for the year ended December 31, 2007) in 2007 compared to 21.9 in 2006, an increase of 19%, and the average daily revenue per rig, after considering the effect of the elimination of intercompany usage, was essentially unchanged at $17,177 per day.

Midstream and marketing revenue decreased $15.1 million, or 12%, with revenues of $107.8 million for the year ended December 31, 2007, as compared to $122.9 million in 2006. The NEG acquisition significantly decreased our midstream gas services revenues as more gas was transported for our own account. Prior to the acquisition, transportation, treating and processing of gas for NEG was recorded as midstream gas services revenue. We have the contractual right to periodically increase fees we receive for transportation and processing based on certain indexes.

Other revenue decreased to $18.9 million during 2007 from $25.0 million in 2006. The decrease was primarily due to the sale of various non-energy related assets to our former President and Chief Operating Officer. Revenues related to these assets are included in the 2006 period prior to their sale in August 2006. This decrease was slightly offset by an increase in revenues generated by our CO_2 operations.

Operating Costs and Expenses. Total operating costs and expenses increased to $490.6 million during 2007, compared to $351.3 million in 2006, primarily due to increases in our production-related costs as well as an increase in corporate staff. These increases were partially offset by decreases in costs attributable to our drilling and services and midstream and marketing operations as well as increased gains on derivative instruments.

	Year Ended December 31, 2007	2006 (In thousands)	$ Change	% Change
Operating costs and expenses:				
Production	$ 106,192	$ 35,149	$ 71,043	202.1%
Production taxes	19,557	4,654	14,903	320.2%
Drilling and services	44,211	98,436	(54,225)	(55.1)%
Midstream and marketing	94,253	115,076	(20,823)	(18.1)%
Depreciation, depletion, and amortization natural gas and crude oil	173,568	26,321	147,247	559.4%
Depreciation, depletion and amortization other	53,541	29,305	24,236	82.7%
General and administrative	61,780	55,634	6,146	11.0%
Gain on derivative instruments	(60,732)	(12,291)	(48,441)	(394.1)%
Gain on sale of assets	(1,777)	(1,023)	(754)	(73.7)%
Total operating costs and expenses	$ 490,593	$ 351,261	$ 139,332	39.7%

Production expense includes the costs associated with our exploration and production activities, including, but not limited to, lease operating expense and processing costs. Production expenses increased $71.0 million due to increased production from our 2007 drilling activity and the addition of the NEG properties. The remainder of the increase was due to an increase in lease operating expenses due to an increase in the number of wells we operate. Production taxes increased $14.9 million, or 320%, to $19.6 million primarily due to increased gas production as a result of our 2007 drilling activity and the addition of the NEG properties in 2006.

Drilling and services and midstream and marketing expenses decreased 55% and 18% respectively, during 2007 as compared to 2006 primarily because of the increase in the number and working interest ownership of the wells we drilled for our own account.

DD&A for our natural gas and crude oil properties increased to $173.6 million during 2007 from $26.3 million in 2006. Our DD&A per Mcfe increased $0.98 to $2.70 from $1.72 in 2006. The increase is primarily attributable to our 2007 capital expenditures and the NEG acquisition, which increased our depreciable properties by the purchase price plus future development costs and increased production. Our production increased 320% to 64.2 Bcfe from 15.3 Bcfe in 2006.

DD&A for our other assets consists primarily of depreciation of our drilling rigs, natural gas plants and other equipment. The $24.2 million increase in DD&A other was due primarily to our increased investments in rigs, other oilfield services equipment and midstream assets. During 2006 and 2007, capital expenditures for drilling rigs, other oilfield services equipment and midstream assets were $293 million on a combined basis. We calculate depreciation of property and equipment using the straight-line method over the estimated useful lives of the assets, which range from three to 25 years. Our drilling rigs and related oil field services equipment are depreciated over an average seven-year useful life.

General and administrative expenses increased 11% to $61.8 million during 2007 from $55.6 million in 2006. The increase was principally attributable to a $17.3 million increase in corporate salaries and wages which was due to a significant increase in corporate and support staff. As of December 31, 2007 we had 2,227 employees as compared to

1,443 at December 31, 2006. The increase in corporate salaries and wages was partially offset by $4.6 million in capitalized general and administrative expenses, a $5.5 million decrease due to a legal settlement recorded in 2006 and a $1.6 million decrease in stock compensation expense. In accordance with the full-cost method of accounting, we capitalize internal costs that can be directly identified with our acquisition, exploration and development activities and do not include any costs related to production, general corporate overhead or similar activities. During 2006 we settled a legal dispute resulting in an additional loss on the settlement of $5.5 million. As part of a severance package for certain executive officers,

Table of Contents

the Board of Directors approved the acceleration of vesting of certain stock awards resulting in increased compensation expense recognized during 2006.

For the year ended December 31, 2007, we recorded a gain of $60.7 million ($26.2 million unrealized gain and $34.5 million realized gain) on our derivatives instruments compared to a $12.3 million gain ($1.9 million unrealized loss and $14.2 million realized gain) in 2006. During 2007, we selectively entered into natural gas swaps and basis swaps by capitalizing on what we perceived as spikes in the price of natural gas or favorable basis differences between the NYMEX price and natural gas prices at our principal West Texas pricing point of Waha Hub. Unrealized gains or losses on derivatives contracts represent the change in fair value of open derivatives positions during the period. The change in fair value is principally measured based on period end prices as compared to the contract price. The unrealized gain recorded during 2007 was attributable to a decrease in average natural gas prices at December 31, 2007 as compared to the average natural gas prices at the various contract dates.

Other Income (Expense). Total other expense increased to $107.1 million for the year ended December 31, 2007 from $15.1 million in 2006. The increase is reflected in the table below.

	Year Ended December 31, 2007	2006	$ Change	% Change
		(In thousands)		
Other income (expense):				
Interest income	$ 5,423	$ 1,109	$ 4,314	389.0%
Interest expense	(117,185)	(16,904)	(100,281)	593.2%
Minority interest	276	(296)	572	193.2%
Income from equity investments	4,372	967	3,405	352.1%
Total other expense	(107,114)	(15,124)	(91,990)	(608.2)%
Income before income taxes	79,745	21,857	57,888	264.8%
Income tax expense	29,524	6,236	23,288	373.4%
Net income	$ 50,221	$ 15,621	$ 34,600	221.5%

Interest income increased to $5.4 million in 2007 from $1.1 million in 2006. This increase was due to interest income from investment of excess cash after the repayment of debt.

Interest expense increased to $117.2 million during 2007, from $16.9 million in 2006. This increase was attributable to increased average debt balances. To finance the NEG acquisition, we entered into a $750 million senior credit facility, which had an initial borrowing base of $300 million, and an $850 million senior bridge facility. In March 2007, we entered into a $1.0 billion senior term loan and sold 17.8 million shares of common stock in a private placement. A portion of the proceeds from the senior unsecured term loan was used to repay the bridge loan. Please read Liquidity and Capital Resources.

The minority interest is derived from Cholla Pipeline, LP, Sagebrush Pipeline, LLC and Integra. We acquired the remaining minority interest in Integra in the fourth quarter of 2007.

During the year ended December 31, 2007 we reported income from equity investments of $4.4 million as compared to $1.0 million in 2006. Approximately $1.9 million of the increase was attributable to income from our interest in the Grey Ranch processing plant which has experienced increased profitability due to higher levels of utilization in 2007 as compared to 2006. Approximately $1.5 million of the increase was attributable to income from Larclay as all of Larclay s rigs have now been delivered and all but one rig are operational.

We reported an income tax expense of $29.5 million for the year ended December 31, 2007 as compared to an expense of $6.2 million in 2006. The current period income tax expense represents an effective income tax rate of 37.0% as compared to 28.5% in 2006. The lower effective income tax rate in 2006 was attributable to favorable percentage depletion deductions during that period.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenue. Total revenue increased to $388.2 million in 2006 from $287.7 million in 2005, which is further explained by the categories below.

	Year Ended December 31,			
	2006	2005	$ Change	% Change
		(In thousands)		
Revenue:				
Natural gas and crude oil	$ 101,252	$ 49,987	$ 51,265	102.6%
Drilling and services	139,049	80,343	58,706	73.1%
Midstream and marketing	122,896	147,133	(24,237)	(16.5)%
Other	25,045	10,230	14,815	144.8%
Total revenues	$ 388,242	$ 287,693	$ 100,549	35.0%

Natural gas and crude oil revenue increased $51.3 million to $101.3 million in 2006 from $50.0 million in 2005. This was primarily a result of an increase in natural gas production volumes. Total natural gas production almost doubled to 13,410 Mmcf in 2006 compared to 6,873 Mmcf in 2005. Natural gas prices decreased $0.35, or 5%, in the 2006 period to $6.19 per Mcf compared to $6.54 per Mcf in 2005.

Drilling and services revenue increased 73% to $139.0 million for the year ended December 31, 2006 compared to $80.3 million in the same period in 2005, primarily due to an increase in the number of drilling rigs we owned and to an increase in the average daily revenue per rig. The number of rigs we owned increased to 25 (21.9 average for the year) as of December 31, 2006 compared to 19 (14.3 average for the year) in 2005, an increase of 32%, and the average daily revenue per rig, after considering the effect of the elimination of intercompany usage, increased 48% to $17,034 in 2006 compared to $11,503 in 2005. Additionally, the revenue from our heavy hauling trucking subsidiary increased $7.8 million during the comparison period due to an expansion of our trucking services. The revenue from our pulling unit operations increased $7.7 million because of an increase in the demand for these oil field services and an increase in the rate we charge.

Midstream and marketing revenue decreased $24.2 million from 2005 with revenues of $122.9 million during the year ended December 31, 2006 as compared to $147.1 million in 2005. We do not record midstream and marketing revenues for marketing, transportation, treating and processing of our own gas. The NEG acquisition significantly decreased our midstream gas services revenues as more gas was transported and marketed for our own account. Prior to the NEG acquisition, transportation, treating and processing of gas for NEG was recorded as midstream and marketing revenue. We have the contractual right to periodically increase fees we receive for transportation and processing based on certain indexes.

Other revenues increased $14.8 million to $25.0 million in 2006 from $10.2 million in 2005. The increase was primarily attributable to an increase of $12.0 million in CO_2 and tertiary oil recovery revenues. In December 2005, we acquired an additional equity interest in PetroSource which increased our ownership interest to 86.5%, resulting in the consolidation of PetroSource commencing in the fourth quarter of 2005. We recorded PetroSource revenues for the full year in 2006. The remainder of the increase was attributable to additional administration fees collected from operating natural gas and oil wells and lease acreage income received as a result of an increase in the number of wells, an increase in overhead rates and an increase in leasing activities. Approximately $0.9 million of the increase was related to an increase of revenue from a shopping center that was sold in 2006.

Operating Costs and Expenses. Total operating costs and expenses increased $97.6 million to $351.3 million in 2006 from $253.6 million in 2005, which is further explained by the categories below.

Table of Contents

	Year Ended December 31, 2006	2005 (In thousands)	$ Change	% Change
Operating costs and expenses:				
Production	$ 35,149	$ 16,195	$ 18,954	117.0%
Production taxes	4,654	3,158	1,496	47.4%
Drilling and services	98,436	52,122	46,314	88.9%
Midstream and marketing	115,076	141,372	(26,296)	(18.6)%
Depreciation, depletion and amortization-natural gas and oil	26,321	9,313	17,008	182.6%
Depreciation, depletion and amortization-other	29,305	14,893	14,412	96.8%
General and administrative	55,634	11,908	43,726	367.2%
Loss (gain) on derivative instruments	(12,291)	4,132	(16,423)	(397.5)%
Loss (gain) on sale of assets	(1,023)	547	(1,570)	(287.0)%
Total operating costs and expenses	$ 351,261	$ 253,640	$ 97,621	38.5%

Production expense increased to $35.1 million in 2006 from $16.2 million in 2005 primarily due to the increase in the number of wells operated in 2006 as compared to 2005, the addition of NEG for the period from November 21, 2006 to December 31, 2006 and the addition of PetroSource for the full year in 2006 as compared to one quarter in 2005. Approximately $7.5 million of the increase was attributable to the NEG acquisition and approximately $3.2 million of the increase was attributable to PetroSource with the remainder of the increase due to an increase in the number of wells we operate.

Production taxes increased $1.5 million, or 47%, to $4.7 million due to the increase in natural gas production, which was partially offset by a decline in realized natural gas prices. Production taxes are generally assessed at the wellhead and are based on the volumes produced times the price received.

Drilling and services expenses increased 89% to $98.4 million in 2006 from $52.1 million in 2005, primarily due to an increase in oil field services operating expense. Oil field services operating expenses, including fuel, repairs and maintenance, increased $14.2 million due to an increase in the number of drilling rigs we owned as well as work we performed on a turnkey and footage basis rather than a day rate basis.

Midstream and marketing expenses decreased $26.3 million, or 19%, to $115.1 million in 2006 as compared to $141.4 million in 2005 due to a decrease in the average price paid for natural gas that we market and a decrease in natural gas purchased from third parties as we focused our marketing efforts more on our own production.

DD&A relating to our natural gas and oil properties increased 183% to $26.3 million in 2006 from $9.3 million in 2005. The increase was primarily attributable to a 110% increase in year-over-year production and a 37% increase in DD&A per unit of production. The average DD&A per Mcfe was $1.68 for the year ended December 31, 2006 as compared to $1.23 in 2005. The increase in the DD&A rate was attributable to the NEG acquisition which added significantly higher reserves at a higher cost per Mcfe.

DD&A related to other property, plant and equipment increased $14.4 million, or 97%, primarily due to our investment in additional drilling rigs and oil field service equipment.

General and administrative expense increased $43.7 million to $55.6 million in 2006 from $11.9 million in 2005, due in part to an increase in expense related to salaries and wages as we added a significant amount of staff to accommodate our acquisitions and our increased drilling activities, a $5 million dispute settlement, a $3.6 million increase in property and franchise taxes, higher administrative costs associated with our increase in staff including rent, utilities, insurance and office equipment and supplies, a $2.5 million increase in bad debt expense and an increase in legal and professional expenses. Legal and professional fees increased $4.7 million due primarily to an increase in legal fees relating to two legal issues and increased audit fees.

Table of Contents

For the year ended December 31, 2006, we recorded a gain on derivative instruments of $12.3 million compared to a loss of $4.1 million in 2005. We enter into collars and fixed-price swaps to mitigate the effect of price fluctuations of natural gas and oil. We use natural gas basis swaps to mitigate the risk of fluctuations in pricing differentials between our natural gas well head prices and benchmark spot prices. We have not designated any of these derivative contracts as hedges for accounting purposes. We record derivatives contracts at fair value on the balance sheet, and gains or losses resulting from changes in the fair value of our derivative contracts (unrealized) are recognized as a component of operating costs and expenses. Unrealized gains or losses are realized upon settlement. During the first eleven months of 2006, we settled or terminated all of our natural gas derivative contracts and realized a net gain of approximately $14.2 million. Offsetting the 2006 net realized gain on the settlement or early termination of our derivative instruments was a net unrealized loss of $1.9 million which represented the change in fair value of our derivatives instruments from the purchase date in early December 2006 to December 31, 2006. Generally, we record unrealized gains on our swaps and fixed-price swaps when natural gas and oil commodity prices decrease and record unrealized losses as natural gas and oil prices increase. We record unrealized gains on our basis swaps if the pricing differential increases and unrealized losses as the pricing differential decreases. Gains or losses on derivatives contracts are realized upon settlement. During 2005 we did not terminate any derivatives positions and realized a loss of $2.8 million due to normal settlements. Future volatility in natural gas and oil prices could have an adverse effect on the operating results of our exploration and production segment.

Other Income (Expense). Total other expense increased to $15.1 million in 2006 from $6.2 million in 2005. The increase is detailed in the table below.

	Year Ended December 31, 2006	2005 (In thousands)	$ Change	% Change
Other income (expense):				
Interest income	$ 1,109	$ 206	$ 903	438.3%
Interest expense	(16,904)	(5,277)	(11,627)	(220.3)%
Minority interest	(296)	(737)	441	59.8%
Income (loss) from equity investments	967	(384)	1,351	351.8%
Total other expense	(15,124)	(6,192)	(8,932)	(144.3)%
Income before income taxes	21,857	27,861	(6,004)	(21.5)%
Income tax expense	6,236	9,968	(3,732)	(37.4)%
Income from discontinued operations, net of tax		229	(229)	(100.0)%
Net income	$ 15,621	$ 18,122	$ (2,501)	(13.8)%

Interest income increased to $1.1 million in 2006 from $0.2 million in 2005. This increase was due to interest income recognized in 2006 related to excess cash balances with various financial institutions.

Interest expense increased to $16.9 million in 2006 from $5.3 million in 2005. This increase was due to the additional debt that we incurred to finance our purchase of NEG.

We recorded income from equity investments of $1.0 million in 2006 as compared to a $0.4 million loss in 2005. The 2005 loss was primarily due to PetroSource. We accounted for PetroSource under the equity method during the first nine months of 2005.

Income tax expense decreased to $6.2 million in 2006 from $10.0 million in 2005 primarily due to a decrease in our effective income tax rate. During 2006, we realized a $3.5 million reduction in tax expense from our percentage depletion deduction, which was partially offset by $1.3 million in additional state income taxes.

Liquidity and Capital Resources

Summary

Our operating cash flow is influenced mainly by the prices that we receive for our natural gas and crude oil production; the quantity of natural gas we produce and, to a lesser extent, the quantity of crude oil we produce; the success of our development and exploration activities; the demand for our drilling rigs and oil field services and the rates we receive for these services; and the margins we obtain from our natural gas and CO_2 gathering and processing contracts.

On November 9, 2007, we completed the initial public offering of our common stock. We sold 32,379,500 shares of our common stock, including 4,170,000 shares sold directly to an entity controlled by our Chairman and Chief Executive Officer, Tom L. Ward. After deducting underwriting discounts of approximately $44.0 million and offering expenses of approximately $3.1 million, we received net proceeds of approximately $794.7 million. The net proceeds were utilized as follows (in millions):

Repayment of outstanding balance and accrued interest on senior credit facility	$ 515.9
Repayment of note payable and accrued interest incurred in connection with recent acquisition	49.1
Excess cash to fund capital expenditures	229.7
Total	$ 794.7

As of June 30, 2008, our cash and cash equivalents were $275.9 million, and we had approximately $1.1 billion available under our senior credit facility. There were no amounts outstanding under our senior credit facility at June 30, 2008. As of June 30, 2008, we had $1.8 billion in total debt outstanding.

Capital Expenditures

We make and expect to continue to make substantial capital expenditures in the exploration, development, production and acquisition of natural gas and crude oil reserves.

Our capital expenditures by segment were:

	Year Ended December 31,			Six Months Ended June 30,	
	2007	2006	2005	2008	2007
			(In thousands)		
Capital Expenditures:					
Exploration and production	$ 1,046,552	$ 170,872	$ 61,227	$ 813,900	$ 377,120
Drilling and oil field services	123,232	89,810	43,730	35,791	83,913
Midstream gas services	63,828	16,975	25,904	69,429	23,130
Other	47,236	28,884	3,735	15,181	7,981
	1,280,848	306,541	134,596	934,301	492,144

Capital expenditures, excluding acquisitions					
Acquisitions	116,650	1,054,075	21,247		
Total	$ 1,397,498	$ 1,360,616	$ 155,843	$ 934,301	$ 492,144

We estimate that our total capital expenditures for 2008, excluding acquisitions, will be approximately $2.0 billion. As in 2007, our 2008 capital expenditures for our exploration and production segment will be focused on growing and developing our reserves and production on our existing acreage and acquiring additional leasehold interests, primarily in the WTO. Of our total $2.0 billion capital expenditure budget, approximately $1.8 billion is budgeted for exploration and production activities. Included in our 2008 exploration and production capital expenditure budget is $1.1 billion for drilling in the WTO, including the Piñon field, and $305.0 million for land and seismic. We plan to drill approximately 268 gross wells in the WTO in 2008.

During 2008, we completed our rig fleet expansion program that we started in 2005. Final delivery of all of the rigs ordered from Chinese manufacturers occurred in 2007, and all such rigs had been retrofitted and joined our fleet by the second quarter of 2008. We are also continuing to upgrade and modernize our rig fleet. Approximately $64.0 million of our 2008 capital expenditure budget will be spent on our drilling and oil field services segment.

We anticipate spending approximately $159 million in capital expenditures in our midstream gas services and other segments as we expand our network of gas gathering lines and plant and compression capacity.

We believe that our cash flows from operations, current cash and investments on hand, availability under our senior credit facility, and anticipated proceeds from the sale of our East Texas and Louisiana properties will be sufficient to meet our capital expenditure budget for the next twelve months. The majority of our capital expenditures will be discretionary and could be curtailed if our cash flows decline from expected levels or we are unable to obtain capital on attractive terms; however, we have various sources of capital in the form of our revolving credit facility, potential asset sales, the incurrence of additional long-term debt or the issuance of equity.

Cash Flows from Continuing Operations

Our cash flows from continuing operations are as follows:

	Year Ended December 31,			Six Months Ended June 30,	
	2007	**2006**	**2005**	**2008**	**2007**
			(In thousands)		
Cash Flows from Operations:					
Cash flows provided by operating activities	$ 357,452	$ 67,349	$ 63,297	$ 296,834	$ 180,844
Cash flows used in investing activities	(1,385,581)	(1,340,567)	(155,826)	(785,891)	(493,310)
Cash flows provided by financing activities	1,052,316	1,266,435	126,413	701,810	275,717
Net increase (decrease) in cash and cash equivalents	$ 24,187	$ (6,783)	$ 33,884	$ 212,753	$ (36,749)

Operating Activities. Net cash provided by operating activities for the six months ended June 30, 2008 and 2007 were $296.8 million and $180.8 million, respectively. The increase in cash provided by operating activities from 2007 to 2008 was primarily due to our 74.1% increase in production volumes as a result of our drilling success in the WTO as well as various acquisitions throughout 2007 and the first six months of 2008. Also, contributing to this increase was a 38.4% increase in the combined average prices we received for the natural gas and crude oil produced. These increases were partially offset by increases in general and administrative costs, such as salaries and wages.

Net cash provided by operating activities for the years ended December 31, 2007 and 2006 were $357.5 million and $67.3 million, respectively. The increase in cash provided by operating activities from 2006 to 2007 was primarily due to our $34.6 million increase in net income as a result of our 320% increase in production volumes as a result of the NEG and various other acquisitions as well as our drilling success. Also, contributing to this increase was

$34.5 million in realized gains on our derivative contracts. These increases were partially offset by increases in general and administrative costs such as salaries and wages.

Cash flows provided by operating activities increased $4.0 million to $67.3 million in 2006 from $63.3 million in 2005 primarily due to an increase in non-cash DD&A of $31.4 million and an increase in non-cash stock-based compensation expense of $8.3 million as net income decreased approximately $2.5 million in 2006 over 2005. The increases were substantially offset by changes in operating assets and liabilities.

Investing Activities. Cash flows used in investing activities increased to $785.9 million in the six month period ended June 30, 2008 from $493.3 million in the comparable 2007 period as we continued to ramp up our capital expenditure program. For the six month period ended June 30, 2008, our capital expenditures were $813.9 million in our exploration and production segment, $35.8 million for drilling and oil field services, $69.4 million for midstream gas services and $15.2 million for other capital expenditures. During the same period in 2007, capital expenditures were $377.1 million in our exploration and production segment, $83.9 million for drilling and oil field services, $23.1 million for midstream gas services and $8.0 million for other capital expenditures.

Cash flows used in investing activities increased to $1,385.6 million during 2007 from $1,340.6 million in 2006. During 2006, we acquired NEG for $990.4 million, net of cash received and $231.2 million in common stock. Capital expenditures for property, plant and equipment during 2007 were $1,280.8 million as compared to $306.5 million in 2006 as we continued to ramp up our capital expenditure program. During 2007 our capital expenditures were $1,046.6 million in our exploration and production segment, $123.2 million for drilling and oil field services, $63.8 million for midstream gas services and $47.2 million for other capital expenditures.

Cash flows used in investing activities increased to $1,340.6 million for the year ended December 31, 2006 from $155.8 million in 2005. During 2006, our cash flows used in investing activities included acquisitions of $1,054 million, including the NEG acquisition described above. During the comparison period, exploration and production capital expenditures increased to $170.9 million in 2006 from $61.2 million in 2005, primarily because of the additional wells that were drilled in the Piñon Field in 2006 and 2005. Capital expenditures for drilling and oil field services increased to $89.8 million in 2006 from $43.7 million in 2005, due to an increase in the number of drilling rigs. Proceeds from the sale of assets increased to $19.7 million in 2006 from $3.3 million in 2005.

Financing Activities. Since December 2005, we have used equity issuances, borrowings and, to a lesser extent, our cash flows from operations to fund our rapid growth. Proceeds from borrowings increased to $1,408.0 million for the six months ended June 30, 2008, and we repaid approximately $665.6 million leaving net borrowings during the period of approximately $742.4 million. Our financing activities provided $701.8 million in cash for the six month period ended June 30, 2008 compared to $275.7 million in the comparable period in 2007.

During 2007 we raised $1.1 billion in equity issuances and had net cash repayments of $0.7 million of debt. Our equity issuances included the November 2007 initial public offering of our common stock yielding net proceeds of $794.7 million and a March 2007 private placement of our common stock which provided net proceeds of approximately $318.7 million. Proceeds from borrowings were $1,331.5 million during 2007 and we repaid approximately $1,332.2 million leaving net cash repayments during 2007 of approximately $0.7 million. We used the net proceeds from our term loan and the common stock issuances to repay our senior bridge facility and all of the outstanding borrowings under our senior credit facility as well as to fund a portion of our capital expenditure program. Our financing activities provided $1,052.3 million in cash during 2007 compared to $1,266.4 million in 2006.

During the year ended December 31, 2006, we incurred net borrowings of $743.0 million, raised $100.8 million from issuances of common stock and raised $439.5 million from an issuance of redeemable convertible preferred stock. Our net borrowings, common stock issuances and issuance of redeemable preferred stock in 2006 were primarily used to finance the NEG acquisition as well as our 2006 capital expenditure program. Most of our borrowings in 2005 funded the acquisition of drilling rigs, our exploration and production activities and the expansion of our gathering and treating assets. In December 2005, we received $173.1 million in net proceeds from a private placement of common stock, which was primarily used to reduce outstanding borrowings and to increase our interest in SandRidge Tertiary and SandRidge CO_2.

Table of Contents

Credit Facilities and Other Indebtedness

Senior Credit Facility. On November 21, 2006, we entered into a new $750.0 million senior secured revolving credit facility (the senior credit facility) with Bank of America, N.A., as Administrative Agent. The senior credit facility matures on November 21, 2011 and is available to be drawn on and repaid without restriction so long as we are in compliance with its terms, including certain financial covenants. The initial proceeds of the senior credit facility were used to (i) partially finance the NEG acquisition, (ii) refinance our existing senior secured revolving credit facility and NEG s existing credit facility, and (iii) pay fees and expenses related to the NEG acquisition and our existing credit facility.

The senior credit facility contains various covenants that limit our and certain of our subsidiaries ability to grant certain liens; make certain loans and investments; make distributions; redeem stock; redeem or prepay debt; merge or consolidate with or into a third party; or engage in certain asset dispositions, including a sale of all or substantially all of our assets. Additionally, the senior credit facility limits our and certain of our subsidiaries ability to incur additional indebtedness.

The senior credit facility also contains financial covenants, including maintenance of agreed upon levels for (i) the ratio of total funded debt to EBITDAX (as defined in the senior credit facility), which may not exceed 4.5:1.0 calculated using the last fiscal quarter on an annualized basis as of the end of fiscal quarters ending on or before September 30, 2008 and calculated using the last four completed fiscal quarters thereafter, (ii) the ratio of EBITDAX to interest expense plus current maturities of long-term debt, which must be at least 2.5:1.0 calculated using the last four completed fiscal quarters, and (iii) the current ratio, which must be at least 1.0:1.0. As of June 30, 2008, we were in compliance with all of the covenants under the senior credit facility.

Net increase in cash and cash equivalents

19,281

53,788

19,281

53,788

Cash and cash equivalents at beginning of period	3,354	14,435	3,354	14,435
Cash and cash equivalents at end of period	$ 22,635	$ 68,223		

$

22,635

$

68,223

Supplemental Cash Flow Information

Cash paid for interest

$	59,937
$	92,928
$	59,937
$	92,928
Cash paid for taxes	
$	55,905
$	59,937
$	55,905
$	59,937

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

Table of Contents

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 September 30, 2016, and for the three and nine month periods ended September 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 nine months ended September 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 August 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2016-15*, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments,* which addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2017. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In March 2016, the FASB issued 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 currently evaluating the standard to determine the impact it will have 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 to determine the impact it will have on its consolidated financial statements.

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

9

Table of Contents

adoption of the standard and approximately $38.0 million of unamortized debt issuance costs were reclassified to be a direct reduction of debt, rather than a component of other assets.

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 $406.3 million, 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 nine months ended September 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		92,981
Identifiable intangible assets		32,484
Goodwill		319,145
Total assets		456,950
Total liabilities		35,792
Acquired non-controlling interests		2,514
Net assets acquired		418,644
Less: Cash and cash equivalents acquired		(12,340)
Net cash paid	$	406,304

Table of Contents

Goodwill of $319.1 million has been 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.

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.

Table of Contents

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 September 30, 2016, Concentra contributed net revenue of $258.5 million and net income of approximately $0.9 million, which are reflected in the Company s consolidated statements of operations. For the nine months ended September 30, 2016, Concentra contributed net revenue of $764.3 million and net income of approximately $7.9 million, which are reflected in the Company s consolidated statements of operations.

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 Company s results of operations for the three months ended September 30, 2016 include 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 September 30,		For the Nine Months Ended September 30,			
	2015		2015		2016	
	(in thousands, except per share amounts)					
Net revenue	$	1,099,857	$	3,350,131	$	3,293,286
Net income attributable to Holdings		26,277		88,502		93,407
Income per common share:						
Basic	$	0.20	$	0.67	$	0.71
Diluted	$	0.20	$	0.67	$	0.71

12

The pro forma financial information is based on the preliminary allocation of the purchase price of the Physiotherapy acquisition, and is 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 nine months ended September 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 nine months ended September 30, 2016 were adjusted to exclude approximately $3.2 million of Physiotherapy acquisition costs.

Other Acquisitions

In addition to the acquisition of Physiotherapy, the Company completed other acquisitions consisting of hospital, clinic, and center businesses during the nine months ended September 30, 2016. The specialty hospital transactions were conducted principally through either the exchange of nonmonetary assets or issuance of equity interests. Assets transferred and equity interests issued for these acquisitions consisted of $7.6 million in cash payments, net of cash received, $17.7 million for specialty hospitals exchanged, and issuance of $38.3 million of equity interests. The specialty hospital exchange transaction resulted in a non-operating gain totaling $6.5 million due, in part, to a bargain purchase because the fair values of the identifiable assets received in the exchange transaction exceeded the fair values of the transferred hospitals. The assets received in these acquisitions consisted principally of cash, real property, and goodwill, of which $46.2 million, $0.9 million, and $4.1 million of goodwill was recognized in our specialty hospital, outpatient rehabilitation, and Concentra reporting units, respectively.

4. Sale of Businesses

The Company recognized non-operating gains totaling $42.1 million for the nine months ended September 30, 2016, principally as the result of the sale of its contract therapy businesses for $65.0 million, resulting in a non-operating gain of $33.9 million. Additionally, the Company sold nine outpatient rehabilitation clinics to an entity in which the Company holds a non-controlling interest, resulting in a non-operating gain of $1.7 million.

5. Equity Investment Events

During the nine months ended September 30, 2016, an entity in which the Company owned a non-controlling interest was sold, which resulted in a non-operating loss of $5.1 million.

Table of Contents

6. Intangible Assets

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

	December 31, 2015	September 30, 2016
	(in thousands)	
Goodwill	$ 2,314,624	$ 2,674,623
Identifiable intangibles Indefinite lived assets:		
Trademarks	162,609	166,698
Certificates of need	13,022	13,070
Accreditations	2,045	2,045
Identifiable intangibles Finite lived assets:		
Customer relationships	132,751	122,095
Favorable leasehold interests	8,248	11,227
Non-compete agreements		23,085
Total identifiable intangibles	$ 2,633,299	$ 3,012,843

The Company s customer relationships and non-compete agreement assets amortize over their estimated useful lives. Amortization expense was $4.1 million and $3.0 million for the three months ended September 30, 2016 and 2015, respectively. Amortization expense was $12.2 million and $4.4 million for the nine months ended September 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 $16.3 million.

In addition, the Company has recognized unfavorable leasehold interests which are recorded as liabilities. The net carrying value of unfavorable leasehold interests was $4.0 million and $3.0 million as of September 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 September 30, 2016 and $0.5 million for the nine months ended September 30, 2016.

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

Table of Contents

The changes in the carrying amount of goodwill for the Company s reportable segments for the nine months ended September 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		46,205		358,153		4,115		408,473
Measurement period adjustment				(38,148)		4,825		(33,323)
Disposed		(6,758)		(8,393)				(15,151)
Balance as of September 30, 2016	$	1,396,826	$	618,207	$	659,590	$	2,674,623

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		September 30, 2016
		(in thousands)		
Select 6.375% senior notes(1)	$	700,867	$	702,124
Select credit facilities:				
Select revolving facility		295,000		175,000
Select term loans(2)		743,071		1,121,655
Other Select		11,987		22,802
Total Select debt		1,750,925		2,021,581
Less: Select current maturities		222,905		7,268
Select long-term debt maturities	$	1,528,020	$	2,014,313
Concentra credit facilities:				
Concentra revolving facility	$	5,000	$	
Concentra term loans(3)		624,659		627,262
Other Concentra		5,312		5,962
Total Concentra debt		634,971		633,224
Less: Concentra current maturities		2,261		5,422
Concentra long-term debt maturities	$	632,710	$	627,802
Total current maturities	$	225,166	$	12,690
Total long-term debt maturities		2,160,730		2,642,115

Total debt	$	2,385,896	$	2,654,805

(1) Includes unamortized premium of $1.2 million and $1.1 million at December 31, 2015 and September 30, 2016, respectively. Includes unamortized debt issuance costs of $10.4 million and $8.9 million at December 31, 2015 and September 30, 2016, respectively.

(2) Includes unamortized discounts of $2.8 million and $12.9 million at December 31, 2015 and September 30, 2016, respectively. Includes unamortized debt issuance costs of $7.4 million and $14.8 million at December 31, 2015 and September 30, 2016, respectively.

(3) Includes unamortized discounts of $2.9 million at both December 31, 2015 and September 30, 2016. Includes unamortized debt issuance costs of $20.2 million and $13.7 million at December 31, 2015 and September 30, 2016, respectively.

Maturities of Long-Term Debt and Notes Payable

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

	Select	Concentra (in thousands)	Total
October 1, 2016 December 31, 2016	$ 4,236	$ 2,160	$ 6,396
2017	16,731	7,890	24,621
2018	706,426	6,617	713,043
2019	18,084	6,636	24,720
2020	6,303	6,656	12,959
2021 and beyond	1,305,337	619,873	1,925,210
Total principal	2,057,117	649,832	2,706,949
Unamortized discounts and premiums	(11,811)	(2,905)	(14,716)
Unamortized debt issuance costs	(23,725)	(13,703)	(37,428)
Total	$ 2,021,581	$ 633,224	$ 2,654,805

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) provided for the lenders named therein to make available an aggregate of $625.0 million of Series F Tranche B Term Loans, (ii) extended the financial covenants through March 3, 2021, (iii) added 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) made certain other technical amendments to the Select credit facilities. The Series F Tranche B Term Loans 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 B Term Loans is 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 nine months ended September 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.

Concentra Credit Facilities

On September 26, 2016, Concentra entered into Amendment No. 1 (the Concentra Credit Agreement Amendment) to its first lien credit agreement (the Concentra first lien credit agreement) dated June 1, 2015. The Concentra first lien credit agreement initially provided for $500.0 million in first lien credit facilities composed of $450.0 million, seven-year term loans (Concentra first lien term loan) and a $50.0 million, five-year revolving credit facility (Concentra revolving facility).

The Concentra Credit Agreement Amendment provided an additional $200.0 million of first lien term loans due June 1, 2022, the proceeds of which were used to prepay in full Concentra s second lien term loan due June 1, 2023; and also amended certain restrictive covenants to give Concentra greater operational flexibility.

The Concentra first lien term loan continues to bear interest at a rate equal to Adjusted LIBO (as defined in the Concentra first lien credit agreement) plus 3.00% (subject to an Adjusted LIBO floor of 1.00%), or Alternate Base Rate (as defined in the Concentra first lien credit agreement) plus 2.00% (subject to an Alternate Base Rate floor of 2.00%). The Concentra first lien term loan amortizes in equal quarterly installments of $1.6 million through March 31, 2022, with the remaining unamortized aggregate principal due on the maturity date.

The reacquisition price of the second lien term loans was $202.0 million. The premium plus the expensing of unamortized deferred financing costs and original issuance discount resulted in a loss on early retirement of debt of $10.9 million during the three months ended September 30, 2016.

17

Table of Contents

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.

	December 31, 2015			September 30, 2016		
	Face Value	Carrying Value	Fair Value	Face Value	Carrying Value	Fair Value
	(in thousands)					
Select 6.375% senior notes(1)	$ 710,000	$ 700,867	$ 623,948	$ 710,000	$ 702,124	$ 698,853
Select credit facilities(2)	1,048,277	1,038,071	1,023,616	1,324,315	1,296,655	1,318,943
Concentra credit facilities(3)	652,750	629,659	645,392	643,870	627,262	642,260

(1) The carrying value includes unamortized premium of $1.2 million and $1.1 million at December 31, 2015 and September 30, 2016, respectively, and unamortized debt issuance costs of $10.4 million and $8.9 million at December 31, 2015 and September 30, 2016, respectively.

(2) The carrying value includes unamortized discounts of $2.8 million and $12.9 million at December 31, 2015 and September 30, 2016, respectively, and unamortized debt issuance costs of $7.4 million and $14.8 million at December 31, 2015 and September 30, 2016, respectively.

(3) The carrying value includes unamortized discounts of $2.9 million at both December 31, 2015 and September 30, 2016 and unamortized debt issuance costs of $20.2 million and $13.7 million at December 31, 2015 and September 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.

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 shared 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.

Table of Contents

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 September 30, 2015				
	Specialty Hospitals	Outpatient Rehabilitation	Concentra	Other	Total
			(in thousands)		
Net operating revenues	$ 562,328	$ 199,593	$ 258,969	$ 233	$ 1,021,123
Adjusted EBITDA	53,656	23,807	25,584	(18,536)	84,511
Total assets	2,333,049	541,435	1,332,975	106,946	4,314,405
Capital expenditures	27,494	4,023	9,640	3,923	45,080

	Three Months Ended September 30, 2016				
	Specialty Hospitals	Outpatient Rehabilitation(1)	Concentra	Other	Total
			(in thousands)		
Net operating revenues	$ 544,491	$ 250,710	$ 258,507	$ 87	$ 1,053,795
Adjusted EBITDA	48,264	31,995	40,888	(23,070)	98,077
Total assets	2,461,751	977,431	1,327,438	78,785	4,845,405
Capital expenditures	24,378	6,234	2,720	4,670	38,002

	Nine Months Ended September 30, 2015				
	Specialty Hospitals	Outpatient Rehabilitation	Concentra(2)	Other	Total
			(in thousands)		
Net operating revenues	$ 1,753,445	$ 603,831	$ 345,798	$ 457	$ 2,703,531
Adjusted EBITDA	241,575	74,662	36,783	(54,672)	298,348
Total assets	2,333,049	541,435	1,332,975	106,946	4,314,405
Capital expenditures	81,329	11,048	13,494	8,121	113,992

	Nine Months Ended September 30, 2016				
	Specialty Hospitals	Outpatient Rehabilitation(1)	Concentra	Other	Total
			(in thousands)		
Net operating revenues	$ 1,729,261	$ 745,720	$ 764,252	$ 523	$ 3,239,756
Adjusted EBITDA	217,759	99,006	118,080	(66,696)	368,149
Total assets	2,461,751	977,431	1,327,438	78,785	4,845,405
Capital expenditures	79,366	15,032	10,647	13,215	118,260

Table of Contents

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

	Three Months Ended September 30, 2015				
	Specialty Hospitals	Outpatient Rehabilitation	Concentra (in thousands)	Other	Total
Adjusted EBITDA	$ 53,656	$ 23,807	$ 25,584	$ (18,536)	
Depreciation and amortization	(13,782)	(3,247)	(13,316)	(1,127)	
Stock compensation expense			(811)	(4,014)	
Income (loss) from operations	$ 39,874	$ 20,560	$ 11,457	$ (23,677)	$ 48,214
Non-operating gain					29,647
Equity in earnings of unconsolidated subsidiaries					6,348
Interest expense					(33,052)
Income before income taxes					$ 51,157

	Three Months Ended September 30, 2016				
	Specialty Hospitals	Outpatient Rehabilitation (1)	Concentra (in thousands)	Other	Total
Adjusted EBITDA	$ 48,264	$ 31,995	$ 40,888	$ (23,070)	
Depreciation and amortization	(14,317)	(6,159)	(15,278)	(1,411)	
Stock compensation expense			(193)	(4,557)	
Income (loss) from operations	$ 33,947	$ 25,836	$ 25,417	$ (29,038)	$ 56,162
Non-operating loss					(1,028)
Loss on early retirement of debt					(10,853)
Equity in earnings of unconsolidated subsidiaries					5,268
Interest expense					(44,482)
Income before income taxes					$ 5,067

	Nine Months Ended September 30, 2015				
	Specialty Hospitals	Outpatient Rehabilitation	Concentra(2) (in thousands)	Other	Total
Adjusted EBITDA	$ 241,575	$ 74,662	$ 36,783	$ (54,672)	
Depreciation and amortization	(40,409)	(9,564)	(17,510)	(3,185)	
Stock compensation expense			(811)	(9,664)	
Concentra acquisition costs			(4,715)		
Income (loss) from operations	$ 201,166	$ 65,098	$ 13,747	$ (67,521)	$ 212,490
Non-operating gain					29,647
Equity in earnings of unconsolidated subsidiaries					12,788
Interest expense					(79,728)
Income before income taxes					$ 175,197

Table of Contents

	Nine Months Ended September 30, 2016				
	Specialty Hospitals	Outpatient Rehabilitation(1)	Concentra (in thousands)	Other	Total
Adjusted EBITDA	$ 217,759	$ 99,006	$ 118,080	$ (66,696)	
Depreciation and amortization	(42,022)	(16,397)	(45,570)	(3,898)	
Stock compensation expense			(577)	(12,347)	
Physiotherapy acquisition costs				(3,236)	
Income (loss) from operations	$ 175,737	$ 82,609	$ 71,933	$ (86,177)	$ 244,102
Non-operating gain					37,094
Loss on early retirement of debt					(11,626)
Equity in earnings of unconsolidated subsidiaries					14,466
Interest expense					(127,662)
Income before income taxes					$ 156,374

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

(2) 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.

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:

Table of Contents

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2016	2015	2016
	(in thousands, except per share amounts)			
Numerator:				
Net income attributable to Select Medical Holdings Corporation	$ 29,406	$ 6,471	$ 101,409	$ 95,239
Less: Earnings allocated to unvested restricted stockholders	923	209	2,925	2,852
Net income available to common stockholders	$ 28,483	$ 6,262	$ 98,484	$ 92,387
Denominator:				
Weighted average shares basic	127,386	127,848	127,541	127,659
Effect of dilutive securities:				
Stock options	263	141	303	145
Weighted average shares diluted	127,649	127,989	127,844	127,804
Basic income per common share	$ 0.22	$ 0.05	$ 0.77	$ 0.72
Diluted income per common share	$ 0.22	$ 0.05	$ 0.77	$ 0.72

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 & 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.

Table of Contents

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.

Evansville Litigation. 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, from 2006 until April 2012, 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 District Court of its decision not to intervene in the case, and the District Court thereafter approved a case management plan imposing certain deadlines.

In December 2015, the defendants filed a Motion to Dismiss the Second Amended Complaint on multiple grounds. One basis for the Motion to Dismiss was the False Claims Act s public disclosure bar, which disqualifies qui tam actions that are based on fraud already publicly disclosed through enumerated sources, unless the relator is an original source. The Affordable Care Act, enacted on March 23, 2010, altered the public disclosure bar language of the False Claims Act by, among other things, giving the United States the right to oppose dismissal of a case based on the public disclosure bar. In their Motion to Dismiss, the defendants contended that the public disclosure bar applies because substantially the same conduct as the plaintiff-relators have alleged had previously been publicly disclosed, including in a New York Times article and a prior qui tam case. A second basis for the defendants Motion to Dismiss was that the plaintiff-relators did not plead their claims with sufficient particularity, as required by the Federal Rules of Civil Procedure.

Then, based on the Affordable Care Act s changes to the public disclosure bar language of the False Claims Act, the United States filed a notice asserting a veto of the defendants use of the public disclosure bar for claims arising from conduct from and after March 23, 2010. The defendants filed briefs challenging the United States contention that the statutory changes gives it an unfettered right to veto the applicability of the public disclosure bar. On September 30, 2016, the District Court partially granted and partially denied the defendants Motion to Dismiss. It ruled that the plaintiff-relators alleged substantially the same conduct as had been publicly disclosed and that the plaintiff relators are not original sources, so that the public disclosure bar requires dismissal of all non-retaliation claims arising from conduct before March 23, 2010. The District Court also ruled that the statutory changes to the public disclosure bar gave the United States the power to veto its applicability to claims arising from conduct on and after March 23, 2010, and therefore did not dismiss those claims based on the public disclosure bar. However, the District Court ruled that the plaintiff-relators did not

23

Table of Contents

plead certain of their claims relating to interrupted stay manipulation and premature discharging of patients with the requisite particularity, and dismissed those claims. The District Court declined to dismiss the plaintiff-relators claims arising from conduct from and after March 23, 2010 relating to delayed discharging of patients and upcoding and the plaintiff-relators retaliation claims.

On October 17, 2016, the defendants filed a Motion seeking certification to file an interlocutory appeal with the United States Court of Appeals for the Seventh Circuit of the District Court s ruling that the United States has the power to veto the application of the public disclosure bar to the defendants conduct from and after March 23, 2010. 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.

Knoxville Litigation. 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.

In November 2015, the defendants filed a Motion to Dismiss the Complaint on multiple grounds. The defendants first argued that False Claims Act s first-to-file bar required dismissal of plaintiff-relator s claims. Under the first-to-file bar, if a qui tam case is pending, no person may bring a related action based on the facts underlying the first action. The defendants asserted that the plaintiff-relator s claims were based on the same underlying facts as were asserted in the Evansville litigation, discussed above. The defendants also argued that the plaintiff-relator s claims must be dismissed under the public disclosure bar, and because the plaintiff-relator did not plead his claims with sufficient particularity.

In June 2016, the District Court granted the defendants Motion to Dismiss and dismissed the plaintiff-relator s lawsuit in its entirety. The District Court ruled that the first-to-file bar precludes all but one of the plaintiff-relator s claims, and that the remaining claim must also be dismissed because the plaintiff-relator failed to plead it with sufficient particularity. In July 2016, the plaintiff-relator filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. Then, on October 11, 2016, the plaintiff-relator filed a Motion to Remand the case to the District Court for further proceedings, arguing that the September 30, 2016 decision in the Evansville litigation, discussed above, undermines the basis for the District Court s dismissal. 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.

Construction Commitments

At September 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

$16.2 million.

Table of Contents

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 September 30, 2016 and for the three and nine months ended September 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

September 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	$ 71	$ 4,692	$ 4,140	$ 59,320	$	$ 68,223
Accounts receivable, net		385,135	91,629	120,516	(4,569)(e)	592,711
Current deferred tax asset	13,208	23,273	4,023	10,143		50,647
Intercompany receivables		2,177,863	175,638		(2,353,501)(a)	
Prepaid income taxes	5,076			6,398		11,474
Other current assets	11,674	34,134	11,784	25,088		82,680
Total Current Assets	30,029	2,625,097	287,214	221,465	(2,358,070)	805,735
Property and equipment, net	45,241	580,519	45,701	192,024		863,485
Investment in affiliates	4,587,985	90,815			(4,678,800)(b) (c)	
Goodwill		2,015,033		659,590		2,674,623
Other identifiable intangibles, net		103,511		234,709		338,220
Non-current deferred tax asset	15,215				(15,215)(d)	
Other assets	7,723	81,266	54,703	19,650		163,342
Total Assets	$ 4,686,193	$ 5,496,241	$ 387,618	$ 1,327,438	$ (7,052,085)	$ 4,845,405
Liabilities and Equity						
Current Liabilities:						
Bank overdrafts	$ 20,151	$	$	$	$	$ 20,151
Current portion of long-term debt and notes payable	4,836	469	1,963	5,422		12,690
Accounts payable	10,206	72,890	17,329	13,756		114,181
Intercompany payables	2,177,863	175,638			(2,353,501)(a)	
Accrued payroll	13,877	75,189	11,502	37,522		138,090
Accrued vacation	3,286	46,583	15,809	13,098		78,776
Accrued interest	31,387	4	4	1,569		32,964
Accrued other	44,347	55,704	9,671	32,709		142,431
Due to third party payors		15,634			(4,569)(e)	11,065
Total Current Liabilities	2,305,953	442,111	56,278	104,076	(2,358,070)	550,348
Long-term debt, net of current portion	2,004,106	599	9,607	627,803		2,642,115
Subordinate debt	(641,466)	524,292	117,174			
Non-current deferred tax liability		110,989	9,852	104,374	(15,215)(d)	210,000
Other non-current liabilities	48,559	51,248	4,563	32,157		136,527
Total Liabilities	3,717,152	1,129,239	197,474	868,410	(2,373,285)	3,538,990

Redeemable non-controlling interests			10,639	235,790		246,429
Stockholder s Equity:						
Common stock	0					0
Capital in excess of par	921,069					921,069
Retained earnings (accumulated deficit)	47,972	1,290,294	(37,700)	1,730	(1,254,324)(c)	47,972
Subsidiary investment		3,076,708	129,833	217,935	(3,424,476)(b)	
Total Select Medical Corporation Stockholder s Equity	969,041	4,367,002	92,133	219,665	(4,678,800)	969,041
Non-controlling interest			87,372	3,573		90,945
Total Equity	969,041	4,367,002	179,505	223,238	(4,678,800)	1,059,986
Total Liabilities and Equity	$ 4,686,193	$ 5,496,241	$ 387,618	$ 1,327,438	$ (7,052,085)	$ 4,845,405

(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.

(e) Reclass of accounts receivable, net to report a net due to third party payor liability in consolidation.

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Operations

For the Three Months Ended September 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	$ 85	$ 654,966	$ 140,237	$ 258,507	$	$ 1,053,795
Costs and expenses:						
Cost of services	626	540,053	162,594	212,430		915,703
General and administrative	26,967	121				27,088
Bad debt expense		9,671	2,624	5,382		17,677
Depreciation and amortization	1,411	17,363	3,113	15,278		37,165
Total costs and expenses	29,004	567,208	168,331	233,090		997,633
Income (loss) from operations	(28,919)	87,758	(28,094)	25,417		56,162
Other income and expense:						
Intercompany interest and royalty fees	(1,613)	(26,871)	28,484			
Intercompany management fees	33,693	(25,728)	(7,965)			
Loss on early retirement of debt				(10,853)		(10,853)
Equity in earnings of unconsolidated subsidiaries		5,238	30			5,268
Non-operating gain (loss)	(6,963)	5,935				(1,028)
Interest expense	(24,353)	(8,013)	(1,952)	(10,164)		(44,482)
Income (loss) from operations before income taxes	(28,155)	38,319	(9,497)	4,400		5,067
Income tax expense (benefit)	5,701	(7,365)	1,565	1,174		1,075
Equity in earnings of subsidiaries	40,327	(6,347)			(33,980)(a)	
Net income (loss)	6,471	39,337	(11,062)	3,226	(33,980)	3,992
Less: Net income (loss) attributable to non-controlling interests			(4,810)	2,331		(2,479)
Net income (loss) attributable to Select Medical Corporation	$ 6,471	$ 39,337	$ (6,252)	$ 895	$ (33,980)	$ 6,471

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Operations

For the Nine Months Ended September 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	$ 522	$ 2,086,884	$ 388,098	$ 764,252	$	$ 3,239,756
Costs and expenses:						
Cost of services	1,576	1,689,064	431,796	632,514		2,754,950
General and administrative	81,198	28				81,226
Bad debt expense		30,634	6,722	14,235		51,591
Depreciation and amortization	3,898	49,744	8,675	45,570		107,887
Total costs and expenses	86,672	1,769,470	447,193	692,319		2,995,654
Income (loss) from operations	(86,150)	317,414	(59,095)	71,933		244,102
Other income and expense:						
Intercompany interest and royalty fees	(4,203)	(76,817)	81,020			
Intercompany management fees	127,832	(107,532)	(20,300)			
Loss on early retirement of debt	(773)			(10,853)		(11,626)
Equity in earnings of unconsolidated subsidiaries		14,384	82			14,466
Non-operating gain	33,932	3,162				37,094
Interest expense	(70,243)	(21,332)	(5,442)	(30,645)		(127,662)
Income (loss) from operations before income taxes	395	129,279	(3,735)	30,435		156,374
Income tax expense	13,840	24,620	2,172	10,953		51,585
Equity in earnings of subsidiaries	108,684	(4,053)			(104,631)(a)	
Net income (loss)	95,239	100,606	(5,907)	19,482	(104,631)	104,789
Less: Net income (loss) attributable to non-controlling interests			(2,082)	11,632		9,550
Net income (loss) attributable to Select Medical Corporation	$ 95,239	$ 100,606	$ (3,825)	$ 7,850	$ (104,631)	$ 95,239

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 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 (loss)	$ 95,239	$ 100,606	$ (5,907)	$ 19,482	$ (104,631)(a)	$ 104,789
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:						
Distributions from unconsolidated subsidiaries		70	16,075			16,145
Depreciation and amortization	3,898	49,744	8,675	45,570		107,887
Amortization of leasehold interests		58		399		457
Provision for bad debts		30,634	6,722	14,235		51,591
Equity in earnings of unconsolidated subsidiaries		(14,384)	(82)			(14,466)
Loss on early retirement of debt	773			10,853		11,626
Loss (gain) on disposal of assets	225	(107)	185	(21)		282
Gain on sale of assets and businesses	(33,932)	(8,260)				(42,192)
Gain on sale of equity method investment		(241)				(241)
Impairment on equity investment		5,339				5,339
Stock compensation expense	12,347			577		12,924
Amortization of debt discount, premium and issuance costs	9,289			2,556		11,845
Deferred income taxes	(902)			(12,186)		(13,088)
Changes in operating assets and liabilities, net of effects from acquisition of businesses:						
Equity in earnings of subsidiaries	(108,684)	4,053			104,631(a)	
Accounts receivable		3,772	(25,450)	(19,098)		(40,776)
Other current assets	(1,153)	9,685	(6,053)	9,615		12,094
Other assets	(3,881)	53,125	(54,044)	9,489		4,689
Accounts payable	(239)	(22,374)	332	4,529		(17,752)
Accrued expenses	19,692	22,231	13,606	(2,533)		52,996
Due to third party payors		15,634	(4,569)			11,065
Income taxes	2,716			2,317		5,033
Net cash provided by (used in) operating activities	(4,612)	249,585	(50,510)	85,784		280,247
Investing activities						

Purchases of property and equipment	(13,315)	(58,441)	(35,857)	(10,647)		(118,260)
Proceeds from sale of assets and businesses	63,418	7,964	6			71,388
Investment in businesses		(3,140)				(3,140)
Proceeds from sale of equity investment		1,241				1,241
Acquisition of businesses, net of cash acquired	(406,305)	(3,523)		(4,403)		(414,231)
Net cash used in investing activities	(356,202)	(55,899)	(35,851)	(15,050)		(463,002)
Financing activities						
Borrowings on revolving facilities	420,000					420,000
Payments on revolving facilities	(540,000)			(5,000)		(545,000)
Net proceeds from term loans	600,127			195,217		795,344
Payments on term loans	(228,962)			(205,880)		(434,842)
Borrowings of other debt	8,748		12,237	2,816		23,801
Principal payments on other debt	(10,971)	(528)	(1,813)	(2,165)		(15,477)
Dividends paid to Holdings	(1,939)					(1,939)
Equity investment by Holdings	1,488					1,488
Intercompany	116,274	(190,878)	74,604			
Proceeds from issuance of non-controlling interest			11,846			11,846
Repayments of bank overdrafts	(8,464)					(8,464)
Tax benefit from stock based awards	514					514
Purchase of non-controlling interests		(1,294)	(236)			(1,530)
Distributions to non-controlling interests			(6,762)	(2,436)		(9,198)
Net cash provided by (used in) financing activities	356,815	(192,700)	89,876	(17,448)		236,543
Net increase (decrease) in cash and cash equivalents	(3,999)	986	3,515	53,286		53,788
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	$ 71	$ 4,692	$ 4,140	$ 59,320	$	$ 68,223

(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 (in thousands)	Eliminations	Consolidated Select Medical Corporation
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
Retained earnings (accumulated deficit)	(45,122)	1,189,688	(8,932)	(6,120)	(1,174,636)(c)	(45,122)
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.

30

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Operations

For the Three Months Ended September 30, 2015

(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Eliminations	Consolidated Select Medical Corporation
			(in thousands)			
Net operating revenues	$ 233	$ 644,458	$ 117,463	$ 258,969	$	$ 1,021,123
Costs and expenses:						
Cost of services	581	568,272	102,400	229,696		900,949
General and administrative	22,169	32				22,201
Bad debt expense		12,002	1,785	4,500		18,287
Depreciation and amortization	1,128	14,338	2,690	13,316		31,472
Total costs and expenses	23,878	594,644	106,875	247,512		972,909
Income (loss) from operations	(23,645)	49,814	10,588	11,457		48,214
Other income and expense:						
Intercompany interest and royalty fees	(355)	347	8			
Intercompany management fees	(1,967)	7,955	(5,988)			
Non-operating gain		29,647				29,647
Equity in earnings of unconsolidated subsidiaries		6,319	29			6,348
Interest expense	(15,029)	(6,091)	(1,577)	(10,355)		(33,052)
Income (loss) from operations before income taxes	(40,996)	87,991	3,060	1,102		51,157
Income tax expense (benefit)	(13,708)	32,841	(346)	(440)		18,347
Equity in earnings of subsidiaries	56,694	1,226			(57,920)(a)	
Net income	29,406	56,376	3,406	1,542	(57,920)	32,810
Less: Net income attributable to non-controlling interests		10	2,121	1,273		3,404
Net income attributable to Select Medical Corporation	$ 29,406	$ 56,366	$ 1,285	$ 269	$ (57,920)	$ 29,406

(a) Elimination of equity in earnings of subsidiaries.

31

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Operations

For the Nine Months Ended September 30, 2015

(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Eliminations	Consolidated Select Medical Corporation
			(in thousands)			
Net operating revenues	$ 457	$ 1,994,703	$ 362,573	$ 345,798	$	$ 2,703,531
Costs and expenses:						
Cost of services	1,591	1,693,968	309,206	304,448		2,309,213
General and administrative	63,387	(185)		4,715		67,917
Bad debt expense		30,737	7,128	5,378		43,243
Depreciation and amortization	3,186	42,020	7,952	17,510		70,668
Total costs and expenses	68,164	1,766,540	324,286	332,051		2,491,041
Income (loss) from operations	(67,707)	228,163	38,287	13,747		212,490
Other income and expense:						
Intercompany interest and royalty fees	(952)	933	19			
Intercompany management fees	37,320	(18,911)	(18,409)			
Non-operating gain		29,647				29,647
Equity in earnings of unconsolidated subsidiaries		12,718	70			12,788
Interest expense	(43,210)	(18,177)	(4,617)	(13,724)		(79,728)
Income (loss) from operations before income taxes	(74,549)	234,373	15,350	23		175,197
Income tax expense (benefit)	(25,644)	93,461	(1,634)	(1,135)		65,048
Equity in earnings of subsidiaries	150,314	9,536			(159,850)(a)	
Net income	101,409	150,448	16,984	1,158	(159,850)	110,149
Less: Net income attributable to non-controlling interests		41	7,402	1,297		8,740
Net income (loss) attributable to Select Medical Corporation	$ 101,409	$ 150,407	$ 9,582	$ (139)	$ (159,850)	$ 101,409

(a) Elimination of equity in earnings of subsidiaries.

Table of Contents

Select Medical Corporation

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 30, 2015

(unaudited)

	Select (Parent Company Only)	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Non-Guarantor Concentra	Eliminations	Consolidated Select Medical Corporation
			(in thousands)			
Operating activities						
Net income	$ 101,409	$ 150,448	$ 16,984	$ 1,158	$ (159,850)(a)	$ 110,149
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Distributions from unconsolidated subsidiaries		11,737	77			11,814
Depreciation and amortization	3,186	42,020	7,952	17,510		70,668
Provision for bad debts		30,737	7,128	5,378		43,243
Equity in earnings of unconsolidated subsidiaires		(12,718)	(70)			(12,788)
Gain on sale of assets and businesses		(1,257)	(6)	(1)		(1,264)
Gain on sale of equity investment		(29,647)				(29,647)
Stock compensation expense	8,433			811		9,244
Amortization of debt discount, premium and issuance costs	5,500			1,246		6,746
Deferred income taxes	(6,925)					(6,925)
Changes in operating assets and liabilities, net of effects from acquisition of businesses:						
Equity in earnings of subsidiaries	(150,314)	(9,536)			159,850(a)	
Accounts receivable		(35,725)	(6,085)	(6,968)		(48,778)
Other current assets	(2,090)	(2,006)	(12)	(472)		(4,580)
Other assets	5,833	(1,546)	253			4,540
Accounts payable	(572)	8,139	(2,011)	(2,509)		3,047
Accrued expenses	12,541	15,433	2,713	2,029		32,716
Income taxes	18,410			(3,164)		15,246
Net cash provided by (used in) operating activities	(4,589)	166,079	26,923	15,018		203,431
Investing activities						
Purchases of property and equipment	(8,119)	(87,070)	(5,309)	(13,494)		(113,992)
Proceeds from sale of assets		1,519	9	14		1,542
Investment in businesses		(826)	(877)			(1,703)
Proceeds from sale of equity investment		33,096				33,096
Acquisition of businesses, net of cash acquired			(2,686)	(1,047,186)		(1,049,872)
	(8,119)	(53,281)	(8,863)	(1,060,666)		(1,130,929)

Net cash used in investing activities						
Financing activities						
Borrowings on revolving facilities	830,000			10,000		840,000
Payments on revolving facilities	(665,000)			(10,000)		(675,000)
Net proceeds from term loans				623,575		623,575
Payments on term loans	(26,884)					(26,884)
Borrowings of other debt	6,486		1,547	3,008		11,041
Principal payments on other debt	(8,800)	(1,313)	(796)	(2,258)		(13,167)
Dividends paid to Holdings	(26,751)					(26,751)
Equity investment by Holdings	1,604					1,604
Proceeds from issuance of non-controlling interests				217,065		217,065
Proceeds from bank overdrafts	2,353					2,353
Tax benefit from stock based awards	383					383
Intercompany	(95,683)	(109,796)	(12,456)	217,935		
Distributions to non-controlling interests			(6,470)	(970)		(7,440)
Net cash provided by (used in) financing activities	17,708	(111,109)	(18,175)	1,058,355		946,779
Net increase (decrease) in cash and cash equivalents	5,000	1,689	(115)	12,707		19,281
Cash and cash equivalents at beginning of period	70	2,454	830			3,354
Cash and cash equivalents at end of period	$ 5,070	$ 4,143	$ 715	$ 12,707	$	$ 22,635

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

Table of Contents

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;

- 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.

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 September 30, 2016, we operated 123 specialty hospitals in 27 states and 1,603 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 September 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 September 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 $3,239.8 million for the nine months ended September 30, 2016. Of this total, we earned approximately 53% of our net operating revenues from our specialty hospitals segment, approximately 23% from our outpatient rehabilitation segment, and approximately 24% 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

Table of Contents

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

Non-GAAP Measure Reconciliation

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(in thousands)			
Net income	$ 32,810	$ 3,992	$ 110,149	$ 104,789
Income tax expense	18,347	1,075	65,048	51,585
Interest expense	33,052	44,482	79,728	127,662
Non-operating loss (gain)	(29,647)	1,028	(29,647)	(37,094)
Equity in earnings of unconsolidated subsidiaries	(6,348)	(5,268)	(12,788)	(14,466)
Loss on early retirement of debt		10,853		11,626
Income from operations	$ 48,214	$ 56,162	$ 212,490	$ 244,102
Stock compensation expense:				
Included in general and administrative	3,433	3,932	8,073	10,771
Included in cost of services	1,392	818	2,402	2,153
Depreciation and amortization	31,472	37,165	70,668	107,887
Physiotherapy acquisition costs				3,236
Concentra acquisition costs			4,715	
Adjusted EBITDA	$ 84,511	$ 98,077	$ 298,348	$ 368,149

Summary Financial Results

Consolidated Operating Results for the Three Months Ended September 30, 2016

For the three months ended September 30, 2016, our net operating revenues increased 3.2% to $1,053.8 million, compared to $1,021.1 million for the three months ended September 30, 2015. We had income from operations of $56.2 million for the three months ended September 30, 2016, compared to $48.2 million for the three months ended September 30, 2015. Net income was $4.0 million for the three months ended September 30, 2016, which includes a pre-tax non-operating loss of $1.0 million and a pre-tax loss on early retirement of debt of $10.9 million. Net income was $32.8 million for the three months ended September 30, 2015, which includes a pre-tax non-operating gain of $29.6 million. Our Adjusted EBITDA for the three months ended September 30, 2016 increased 16.1% to $98.1 million, compared to $84.5 million for the three months ended September 30, 2015, and our Adjusted EBITDA margin was 9.3% for the three months ended September 30, 2016, compared to 8.3% for the three months ended September 30, 2015.

Consolidated Operating Results for the Nine Months Ended September 30, 2016

For the nine months ended September 30, 2016, our net operating revenues increased 19.8% to $3,239.8 million, compared to $2,703.5 million for the nine months ended September 30, 2015. We had income from operations of $244.1 million for the nine months ended September 30, 2016, compared to $212.5 million for the nine months ended September 30, 2015. Net income was $104.8 million for the nine months ended September 30, 2016, which includes a pre-tax non-operating gain of $37.1 million and a pre-tax loss on early retirement of debt of $11.6 million. Net income was $110.1 million for the nine months ended September 30, 2015, which includes a pre-tax non-operating gain of $29.6 million. Our Adjusted EBITDA for the nine months ended September 30, 2016 increased 23.4% to $368.1 million, compared to $298.3 million for the nine months ended

Table of Contents

September 30, 2015, and our Adjusted EBITDA margin was 11.4% for the nine months ended September 30, 2016, compared to 11.0% for the nine months ended September 30, 2015.

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 September 30, 2016, all of our 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 $9.0 million for the three months ended September 30, 2016, compared to $3.1 million for the three months ended September 30, 2015. Adjusted EBITDA losses for start-up hospitals were $19.4 million for the nine months ended September 30, 2016, compared to $11.9 million for the nine months ended September 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 $42.1 million for the nine months ended September 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 $6.5 million and $1.7 million, respectively.

Indebtedness

On September 26, 2016, Concentra entered into the Concentra Credit Agreement Amendment to the Concentra first lien credit agreement. The amended agreement provided an additional $200.0 million of first lien term loans due June 1, 2022, the net proceeds of which, together with cash on hand, were used to prepay in full Concentra s second lien term loan due June 1, 2023. The reacquisition price of the second lien term loans was $202.0 million, and the prepayment resulted in a loss on early retirement of debt of $10.9 million during the three months ended September 30, 2016.

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

Table of Contents

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 nine months ended September 30, 2016, we recognized a loss on early retirement of debt of $0.8 million.

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

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 30% of our consolidated net operating revenues for the nine months ended September 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.

Table of Contents

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 22, 2016, CMS published 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.

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 a 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.

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 became effective for each LTCH at different points in time over the twelve month period that began on October 1, 2015. As of September 30, 2016, all of our LTCHs were operating under the new payment rules.

41

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. 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 periods of time, commencing on or after July 1, 2016. In the third quarter 2016, 6 of our LTCHs became subject to the new payment limits. During the fourth quarter of 2016, and the first, second, and third quarters of 2017, 14, 36, 16, and 31 of our LTCHs will become subject to the new payment limits, respectively. The effect on our net operating revenues for the third quarter of 2016 was immaterial. We expect the effect on our net operating revenues in the fourth quarter of 2016 to be immaterial. We currently project that our net operating revenue for 2017 may be adversely affected by approximately $12.0 million if we are unable to mitigate the effects of the new payment limits.

For discharges that occurred 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 expired 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 expired 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 a given referring hospital would be determined during settlement of a cost report by dividing the LTCH s total number of Medicare discharges in the 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 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 Medicare, Medicaid, SCHIP Extension Act of 2007 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

42

Table of Contents

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.

Fiscal Year 2017. On August 5, 2016, CMS published 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

Table of Contents

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 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.

Table of Contents

Operating Statistics

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 September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Specialty Hospitals Data(1):				
Number of hospitals owned - start of period	119	116	120	118
Number of hospitals acquired		1	1	4
Number of hospital start-ups		1	1	2
Number of hospitals closed/sold	(1)	(3)	(4)	(9)
Number of hospitals owned - end of period	118	115	118	115
Number of hospitals managed - end of period	9	8	9	8
Total number of hospitals (all) - end of period	127	123	127	123
Long term acute care hospitals	110	104	110	104
Rehabilitation hospitals	17	19	17	19
Available licensed beds (2)	5,150	5,208	5,150	5,208
Admissions (2)	13,927	12,586	42,352	39,541
Patient days (2)	338,412	296,202	1,034,166	951,292
Average length of stay (days) (2)	24	24	24	24
Net revenue per patient day (2)(3)	$ 1,522	$ 1,642	$ 1,563	$ 1,651
Occupancy rate (2)	71%	62%	72%	67%
Percent patient days - Medicare (2)	59%	53%	60%	55%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Outpatient Rehabilitation Data:				
Number of clinics owned - start of period	881	1,435	880	896
Number of clinics acquired		3	7	546
Number of clinic start-ups	11	7	19	20
Number of clinics closed/sold	(2)	(8)	(16)	(25)
Number of clinics owned - end of period	890	1,437	890	1,437
Number of clinics managed - end of period	143	166	143	166
Total number of clinics (all) - end of period	1,033	1,603	1,033	1,603
Number of visits (2)	1,306,637	2,052,678	3,879,409	5,751,562
Net revenue per visit (2)(4)	$ 103	$ 102	$ 103	$ 102

(Operating statistics by business segment and related footnotes are continued next page)

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Concentra Data:				
Number of centers owned - start of period	300	301		300
Number of centers acquired		1	300	3
Number of centers start-ups				
Number of centers closed/sold		(1)		(2)
Total number of centers - end of period	300	301	300	301
Number of visits (5)	1,980,496	1,906,242	2,654,330	5,642,305
Net revenue per visit (5)(6)	$ 114	$ 119	$ 114	$ 118

---

(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.

Table of Contents

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Net operating revenues	100.0%	100.0%	100.0%	100.0%
Cost of services(1)	88.2	86.9	85.4	85.0
General and administrative	2.2	2.6	2.5	2.5
Bad debt expense	1.8	1.7	1.6	1.6
Depreciation and amortization	3.1	3.5	2.6	3.4
Income from operations	4.7	5.3	7.9	7.5
Loss on early retirement of debt		(1.0)		(0.4)
Equity in earnings of unconsolidated subsidiaries	0.6	0.5	0.5	0.5
Non-operating gain (loss)	2.9	(0.1)	1.1	1.1
Interest expense	(3.2)	(4.2)	(3.0)	(3.9)
Income before income taxes	5.0	0.5	6.5	4.8
Income tax expense	1.8	0.1	2.4	1.6
Net income	3.2	0.4	4.1	3.2
Net income (loss) attributable to non-controlling interests	0.3	(0.2)	0.3	0.3
Net income attributable to Holdings and Select	2.9%	0.6%	3.8%	2.9%

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

Table of Contents

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

	For the Three Months Ended September 30, 2015	2016	% Change	For the Nine Months Ended September 30, 2015	2016	% Change
Net operating revenues:						
Specialty hospitals	$ 562,328	$ 544,491	(3.2)%	$ 1,753,445	$ 1,729,261	(1.4)%
Outpatient rehabilitation(1)	199,593	250,710	25.6	603,831	745,720	23.5
Concentra(2)	258,969	258,507	(0.2)	345,798	764,252	N/M
Other(3)	233	87	(62.7)	457	523	14.4
Total company	$ 1,021,123	$ 1,053,795	3.2%	$ 2,703,531	$ 3,239,756	19.8%
Income (loss) from operations:						
Specialty hospitals	$ 39,874	$ 33,947	(14.9)%	$ 201,166	$ 175,737	(12.6)%
Outpatient rehabilitation(1)	20,560	25,836	25.7	65,098	82,609	26.9
Concentra(2)	11,457	25,417	121.8	13,747	71,933	N/M
Other(3)	(23,677)	(29,038)	(22.6)	(67,521)	(86,177)	(27.6)
Total company	$ 48,214	$ 56,162	16.5%	$ 212,490	$ 244,102	14.9%
Adjusted EBITDA:						
Specialty hospitals	$ 53,656	$ 48,264	(10.0)%	$ 241,575	$ 217,759	(9.9)%
Outpatient rehabilitation(1)	23,807	31,995	34.4	74,662	99,006	32.6
Concentra(2)	25,584	40,888	59.8	36,783	118,080	N/M
Other(3)	(18,536)	(23,070)	(24.5)	(54,672)	(66,696)	(22.0)
Total company	$ 84,511	$ 98,077	16.1%	$ 298,348	$ 368,149	23.4%
Adjusted EBITDA margin:						
Specialty hospitals	9.5%	8.9%		13.8%	12.6%	
Outpatient rehabilitation(1)	11.9	12.8		12.4	13.3	
Concentra(2)	9.9	15.8		10.6	15.5	
Other(3)	N/M	N/M		N/M	N/M	
Total company	8.3%	9.3%		11.0%	11.4%	
Purchases of property and equipment:						
Specialty hospitals	$ 27,494	$ 24,378		$ 81,329	$ 79,366	
Outpatient rehabilitation(1)	4,023	6,234		11,048	15,032	
Concentra(2)	9,640	2,720		13,494	10,647	
Other(3)	3,923	4,670		8,121	13,215	
Total company	$ 45,080	$ 38,002		$ 113,992	$ 118,260	

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

Table of Contents

	As of September 30, 2015	As of September 30, 2016
	(in thousands)	
Total assets:		
Specialty hospitals	$ 2,333,049	$ 2,461,751
Outpatient rehabilitation	541,435	977,431
Concentra(2)	1,332,975	1,327,438
Other(3)	106,946	78,785
Total company	$ 4,314,405	$ 4,845,405

N/M Not Meaningful

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

(2) Concentra s operating results are consolidated with Select s effective June 1, 2015.

(3) Other includes our corporate services and certain other non-consolidating joint ventures and minority investments in other healthcare related businesses

Three Months Ended September 30, 2016, Compared to Three Months Ended September 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 3.2% to $1,053.8 million for the three months ended September 30, 2016, compared to $1,021.1 million for the three months ended September 30, 2015, principally due to the acquisition of Physiotherapy on March 4, 2016.

Specialty Hospitals. Our specialty hospitals segment net operating revenues declined 3.2% to $544.5 million for the three months ended September 30, 2016, compared to $562.3 million for the three months ended September 30, 2015. The primary reason for this decrease was a decline in our patient days which decreased 12.5% to 296,202 days for the three months ended September 30, 2016, compared to 338,412 days for the three months ended September 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 during the three months ended September 30, 2016 due to changes we implemented at our LTCHs operating under the new Medicare patient criteria regulations, and specialty hospital closures and sales. 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 7.9% to $1,642 for the three months ended September 30, 2016, compared to $1,522 for the three months ended September 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 62% for the three months ended September 30, 2016, compared to 71% for the three months ended September 30, 2015.

Outpatient Rehabilitation. Our outpatient rehabilitation segment net operating revenues increased 25.6% to $250.7 million for the three months ended September 30, 2016, compared to $199.6 million for three months ended September 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 2,052,678 for the three months ended September 30, 2016, compared to 1,306,637 for the three months ended September 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 September 30, 2016, compared to $103 for the three months ended September 30, 2015.

Concentra Segment. Net operating revenues were $258.5 million for the three months ended September 30, 2016, compared to $259.0 million for the three months ended September 30, 2015. Net revenue per visit was $119 and visits were 1,906,242 in the centers for the three months ended September 30, 2016, compared to net revenue per visit of $114 and 1,980,496 visits in the centers for the three months ended September 30, 2015. This decrease in visits was primarily driven by declines in consumer health and employer services. Visits related to workers compensation services were comparable in both periods. The decline in consumer health visits has resulted from our decision to emphasize our efforts on workers compensation services. The increase in revenue per visit was principally due to an increase per visit for workers compensation services.

Operating Expenses

Our operating expenses include our cost of services, general and administrative expense, and bad debt expense. Our operating expenses increased to $960.5 million, or 91.1% of net operating revenues, for the three months ended September 30, 2016, compared to $941.4 million, or 92.2% of net operating revenues, for the three months ended September 30, 2015. The increase in operating expenses is principally due to the acquisition of Physiotherapy on March 4, 2016. Our cost of services, a major component of which is labor expense, was $915.7 million, or 86.9% of net operating revenues, for the three months ended September 30, 2016, compared to $900.9 million, or 88.2% of net operating revenues, for the three months ended September 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 $58.5 million for the three months ended September 30, 2016, compared to $47.1 million for the three months ended September 30, 2015. General and administrative expenses were $27.1 million for the three months ended September 30, 2016, compared to $22.2 million for the three months ended September 30, 2015. Our bad debt expense was $17.7 million, or 1.7% of net operating revenues, for the three months ended September 30, 2016, compared to $18.3 million, or 1.8% of net operating revenues, for the three months ended September 30, 2015.

Adjusted EBITDA

Specialty Hospitals. Adjusted EBITDA for our specialty hospitals was $48.3 million for the three months ended September 30, 2016, compared to $53.7 million for the three months ended September 30, 2015. Our Adjusted EBITDA margin for the segment was 8.9% for the three months ended September 30, 2016, compared to 9.5% for the three months ended September 30, 2015. The reduction in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment was principally attributable to Adjusted EBITDA losses resulting from start-up specialty hospitals, Adjusted EBITDA losses on newly acquired specialty hospitals, and specialty hospital closures. Start-up specialty hospitals incurred $9.0 million of Adjusted

Table of Contents

EBITDA losses in the three months ended September 30, 2016, compared to $3.1 million for the three months ended September 30, 2015, as discussed under *Summary Financial Results* above.

Outpatient Rehabilitation. Adjusted EBITDA for our outpatient rehabilitation segment increased 34.4% to $32.0 million for the three months ended September 30, 2016, compared to $23.8 million for the three months ended September 30, 2015. The increase in Adjusted EBITDA for our outpatient rehabilitation segment was principally attributable to clinics acquired during the year. Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 12.8% for the three months ended September 30, 2016, compared to 11.9% for the three months ended September 30, 2015. The margin increase was principally due to the sale of our contract therapy businesses, which historically operated at lower Adjusted EBITDA margins.

Concentra Segment. Adjusted EBITDA for our Concentra segment was $40.9 million for the three months ended September 30, 2016, compared to $25.6 million for the three months ended September 30, 2015. Our Adjusted EBITDA margin for the Concentra segment was 15.8% for the three months ended September 30, 2016, compared to 9.9% for the three months ended September 30, 2015. The increases in Adjusted EBITDA and Adjusted EBITDA margins were principally due to cost reductions we have implemented.

Other. Adjusted EBITDA loss was $23.1 million for the three months ended September 30, 2016, compared to an Adjusted EBITDA loss of $18.5 million for the three months ended September 30, 2015.

Depreciation and Amortization

For the three months ended September 30, 2016, depreciation and amortization expense was $37.2 million, compared to $31.5 million for the three months ended September 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 September 30, 2016, we had income from operations of $56.2 million, compared to $48.2 million for the three months ended September 30, 2015. The increase was principally due to the cost saving initiatives in our Concentra segment and the acquisition of Physiotherapy on March 4, 2016.

Loss on Early Retirement of Debt

On September 26, 2016, Concentra prepaid the second lien term loan under the Concentra credit facilities. The premium plus the expensing of unamortized deferred financing costs and original issuance discount resulted in a loss on early retirement of debt of $10.9 million during the three months ended September 30, 2016.

Equity in Earnings of Unconsolidated Subsidiaries

For the three months ended September 30, 2016, we had equity in earnings of unconsolidated subsidiaries of $5.3 million, compared to equity in earnings of unconsolidated subsidiaries of $6.3 million for the three months ended September 30, 2015. The decrease in our equity in earnings of unconsolidated subsidiaries was principally due to the sale of a start-up company in which we owned a non-controlling interest.

Table of Contents

Non-Operating Gain (Loss)

For the three months ended September 30, 2016, we had a non-operating loss of $1.0 million. For the three months ended September 30, 2015, we had a non-operating gain of $29.6 million on the sale of an equity investment. The equity investment was a start-up company investment in which we owned a non-controlling interest.

Interest Expense

Interest expense was $44.5 million for the three months ended September 30, 2016, compared to $33.1 million for the three months ended September 30, 2015. The increase in interest expense was principally the result of increases in our indebtedness used to finance the acquisition of Physiotherapy on March 4, 2016, and increases in our interest rates associated with amendments of Select s credit facilities in the fourth quarter of 2015 and the first quarter of 2016.

Income Taxes

We recorded income tax expense of $1.1 million for the three months ended September 30, 2016, which represented an effective tax rate of 21.2%. We recorded income tax expense of $18.3 million for the three months ended September 30, 2015, which represented an effective tax rate of 35.9%.

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.

Non-controlling Interests

Net losses attributable to non-controlling interests were $2.5 million for the three months ended September 30, 2016, compared to net income attributable to non-controlling interests of $3.4 million for the three months ended September 30, 2015. The decrease is principally due to losses at start-up specialty hospitals as discussed under *Summary Financial Results* above. These amounts represent the minority owner s share of income and losses for these consolidated entities.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 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

Our net operating revenues increased by 19.8% to $3,239.8 million for the nine months ended September 30, 2016, compared to $2,703.5 million for the nine months ended September 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 1.4% to $1,729.3 million for the nine months ended September 30, 2016, compared to $1,753.4 million for the nine months ended September 30, 2015. The primary reason for this decrease was a decline in our patient days which decreased

8.0% to 951,292 days for the nine months ended September 30, 2016, compared to 1,034,166 days for the nine months ended September 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 and sales. 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 5.6% to $1,651 for the nine months ended September 30, 2016, compared to $1,563 for the nine months ended September 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 67% for the nine months ended September 30, 2016, compared to 72% for the nine months ended September 30, 2015.

Outpatient Rehabilitation. Our outpatient rehabilitation segment net operating revenues increased 23.5% to $745.7 million for the nine months ended September 30, 2016, compared to $603.8 million for nine months ended September 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 nine months ended September 30, 2016, compared to $103 for the nine months ended September 30, 2015.

Concentra Segment. Net operating revenues were $764.3 million for the nine months ended September 30, 2016, compared to $345.8 million for the nine months ended September 30, 2015, which includes results beginning June 1, 2015. Net revenue per visit was $118 and visits were 5,642,305 in the centers for the nine months ended September 30, 2016, compared to net revenue per visit of $114 and 2,654,330 visits in the centers for the nine months ended September 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 $2,887.8 million, or 89.1% of net operating revenues, for the nine months ended September 30, 2016, compared to $2,420.4 million, or 89.5% of net operating revenues, for the nine months ended September 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 $2,755.0 million, or 85.0% of net operating revenues, for the nine months ended September 30, 2016, compared to $2,309.2 million, or 85.4% of net operating revenues, for the nine months ended September 30, 2015. The decrease 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. Facility rent expense, a component of cost of services, was $167.5 million for the nine months ended September 30, 2016, compared to $118.2 million for the nine months ended September 30, 2015. General and administrative expenses were $81.2 million for the nine months ended September 30, 2016, which included $3.2 million of Physiotherapy acquisition costs, compared to $67.9 million for the nine months ended September 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 both the nine months ended September 30, 2016 and September 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 $51.6 million, or 1.6% of net operating revenues, for the nine months ended September 30, 2016, compared to $43.2 million, or 1.6% of net operating revenues, for the nine months ended September 30, 2015.

Table of Contents

Adjusted EBITDA

Specialty Hospitals. Adjusted EBITDA for our specialty hospitals was $217.8 million for the nine months ended September 30, 2016, compared to $241.6 million for the nine months ended September 30, 2015. Our Adjusted EBITDA margin for the segment was 12.6% for the nine months ended September 30, 2016, compared to 13.8% for the nine months ended September 30, 2015. The reduction in Adjusted EBITDA and Adjusted EBITDA margin for our specialty hospitals segment was principally attributable to Adjusted EBITDA losses resulting from start-up hospitals, Adjusted EBITDA losses of newly acquired specialty hospitals, and specialty hospital closures. Start-up specialty hospitals incurred $19.4 million of Adjusted EBITDA losses in the nine months ended September 30, 2016, compared to $11.9 million for the nine months ended September 30, 2015, as discussed under *Summary Financial Results* above. We also experienced a decline in Adjusted EBITDA in our LTCHs as a result of a decrease in patient days as discussed above under *Net Operating Revenues*.

Outpatient Rehabilitation. Adjusted EBITDA for our outpatient rehabilitation segment increased 32.6% to $99.0 million for the nine months ended September 30, 2016, compared to $74.7 million for the nine months ended September 30, 2015. This increase was principally due to the acquisition of Physiotherapy on March 4, 2016. Our Adjusted EBITDA margin for the outpatient rehabilitation segment was 13.3% for the nine months ended September 30, 2016, compared to 12.4% for the nine months ended September 30, 2015. The increase was principally due to the sale of our contract therapy businesses, which historically operated at lower Adjusted EBITDA margins.

Concentra Segment. Adjusted EBITDA for our Concentra segment was $118.1 million for the nine months ended September 30, 2016, compared to $36.8 million for the nine months ended September 30, 2015, which includes results beginning June 1, 2015. Our Adjusted EBITDA margin for the Concentra segment was 15.5% for the nine months ended September 30, 2016, compared to 10.6% for the nine months ended September 30, 2015. The increases in Adjusted EBITDA and Adjusted EBITDA margins were principally due to cost reductions we have implemented.

Other. Adjusted EBITDA loss was $66.7 million for the nine months ended September 30, 2016, compared to an Adjusted EBITDA loss of $54.7 million for the nine months ended September 30, 2015.

Depreciation and Amortization

For the nine months ended September 30, 2016, depreciation and amortization expense was $107.9 million, compared to $70.7 million for the nine months ended September 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 nine months ended September 30, 2016, we had income from operations of $244.1 million, compared to $212.5 million for the nine months ended September 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 prepaid the Series D Tranche B Term Loans under the Select credit facilities, which resulted in the recognition of approximately a $0.8 million loss on early retirement of debt. On September 26, 2016, Concentra prepaid the second lien term loan under the Concentra credit facilities. The premium plus the expensing of unamortized deferred financing costs and original issuance discount resulted in a loss on early retirement of debt of approximately $10.9 million.

Equity in Earnings of Unconsolidated Subsidiaries

For the nine months ended September 30, 2016, we had equity in earnings of unconsolidated subsidiaries of $14.5 million, compared to equity in earnings of unconsolidated subsidiaries of $12.8 million for the nine months ended September 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

The Company recognized a non-operating gain of $42.1 million for the nine months ended September 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 $6.5 million and $1.7 million, respectively, as discussed above under *Significant Events*. Additionally, during the nine months ended September 30, 2016, an entity in which the Company owned a non-controlling interest was sold, which resulted in a non-operating loss of $5.1 million.

For the nine months ended September 30, 2015, we had a non-operating gain of $29.6 million on the sale of an equity investment. The equity investment was a start-up company investment in which we owned a non-controlling interest.

Interest Expense

Interest expense was $127.7 million for the nine months ended September 30, 2016, compared to $79.7 million for the nine months ended September 30, 2015. The increase in interest expense was principally the result of increases in our indebtedness used to finance the acquisitions of Concentra on June 1, 2015 and Physiotherapy on March 4, 2016, and increases in our interest rates associated with amendments of Select s credit facilities in the fourth quarter of 2015 and the first quarter of 2016.

Income Taxes

We recorded income tax expense of $51.6 million for the nine months ended September 30, 2016, which represented an effective tax rate of 33.0%. We recorded income tax expense of $65.0 million for the nine months ended September 30, 2015, which represented an effective tax rate of 37.1%.

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 nine months ended September 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 nine months ended September 30, 2016 resulted from the effects of the two discrete tax events discussed above.

Table of Contents

Non-Controlling Interests

Non-controlling interests in consolidated earnings were $9.6 million for the nine months ended September 30, 2016, compared to $8.7 million for the nine months ended September 30, 2015. The increase is principally due to the acquisition of Concentra, offset in part by the minority interest owners share of losses from new specialty hospitals.

Liquidity and Capital Resources

Cash Flows for the Nine Months Ended September 30, 2016 and Nine Months Ended September 30, 2015

	For the Nine Months Ended September 30, 2015	For the Nine Months Ended September 30, 2016
	(in thousands)	
Cash provided by operating activities	$ 203,431	$ 280,247
Cash used in investing activities	(1,130,929)	(463,002)
Cash provided by financing activities	946,779	236,543
Increase in cash and equivalents	19,281	53,788
Cash and equivalents at beginning of period	3,354	14,435
Cash and equivalents at end of period	$ 22,635	$ 68,223

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 $280.2 million of cash flows for the nine months ended September 30, 2016, compared to $203.4 million of cash flows provided for the nine months ended September 30, 2015. The increase in operating cash flows for the nine months ended September 30, 2016 compared to the nine months ended September 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, and cash distributions we received from unconsolidated investments in which we are minority owners.

Our days sales outstanding were 52 days at September 30, 2016, compared to 53 days at December 31, 2015 and 52 days at September 30, 2015. Our days sales outstanding will fluctuate based upon variability in our collection cycles. Our days sales outstanding at September 30, 2016, December 31, 2015 and September 30, 2015 all fall within our expected range.

Investing activities used $463.0 million of cash flow for the nine months ended September 30, 2016, principally due to the acquisition of Physiotherapy. Investing activities also included $118.3 million for purchases of property and equipment, offset in part by proceeds from the sale of businesses of $71.4 million. Investing activities used $1,130.9 million of cash flow for the nine months ended September 30, 2015, principally due to $1,047.2 million related to the Concentra acquisition and $114.0 million for purchases of property and equipment.

Financing activities for Select provided $236.5 million of cash flow for the nine months ended September 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 $125.0 million of net repayments under the Select and Concentra revolving facilities.

Financing activities provided $946.8 million of cash flow for the nine months ended September 30, 2015. The principal sources of cash for financing activities were $165.0 million of net borrowings under the Select revolving facility, $646.9 million borrowed under the Concentra credit facilities, and $217.1 million attributable to a non-consolidating interest in Group Holdings.

Capital Resources

Working capital - We had net working capital of $255.4 million at September 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 early retirement 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 nine months ended September 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.

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) provided for the lenders named therein to make available an aggregate of $625.0 million of Series F Tranche B Term Loans, (ii) extended the financial covenants through March 3, 2021, (iii) added 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) made certain other technical amendments to the Select credit facilities. The Series F Tranche B Term Loans 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 B Term Loans is 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%.

Table of Contents

At September 30, 2016, Select had outstanding borrowings under the Select credit facilities of $1,149.3 million of Select term loans (excluding unamortized discounts and debt issuance costs of $27.7 million) and borrowings of $175.0 million (excluding letters of credit) under the Select revolving facility. After giving effect to $39.7 million of outstanding letters of credit at September 30, 2016, Select had $235.3 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 September 30, 2016, Select was required to maintain its leverage ratio at less than 5.75 to 1.00. Select s leverage ratio was 5.11 to 1.00 as of September 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.

On September 26, 2016, Concentra entered into Amendment No. 1 (the Concentra Credit Agreement Amendment) to its first lien credit agreement (the Concentra first lien credit agreement) dated June 1, 2015. The Concentra first lien credit agreement initially provided for $500.0 million in first lien credit facilities composed of $450.0 million, seven-year term loans (Concentra first lien term loan) and a $50.0 million, five-year revolving credit facility (Concentra revolving facility).

The Concentra Credit Agreement Amendment provided an additional $200.0 million of first lien term loans due June 1, 2022, the proceeds of which were used to prepay in full Concentra s second lien term loan due June 1, 2023; and also amended certain restrictive covenants to give Concentra greater operational flexibility.

The Concentra first lien term loan continues to bear interest at a rate equal to Adjusted LIBO (as defined in the Concentra first lien credit agreement) plus 3.00% (subject to an Adjusted LIBO floor of 1.00%), or Alternate Base Rate (as defined in the Concentra first lien credit agreement) plus 2.00% (subject to an Alternate Base Rate floor of 2.00%). The Concentra first lien term loan amortizes in equal quarterly installments of $1.6 million through March 31, 2022, with the remaining unamortized aggregate principal due on the maturity date.

At September 30, 2016, Concentra had outstanding borrowings of $643.9 million under the Concentra term loans (excluding unamortized discounts and debt issuance costs of $16.6 million). Concentra did not have any borrowings under the Concentra revolving facility. After giving effect to $6.6 million of outstanding letters of credit at September 30, 2016, Concentra had $43.4 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 has been extended until December 31, 2017 and will remain in effect until then, unless further 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 nine months ended September 30, 2016. Since the inception of the program through September 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.

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 August 2016, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*, which addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2017. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

In March 2016, the FASB issued 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 currently evaluating the standard to determine the impact it will have 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

Table of Contents

beginning after December 15, 2016. Early adoption is permitted. The Company is currently evaluating the standard to determine the impact it will have on its consolidated financial statements.

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 were reclassified to be a direct reduction of debt, rather than a component of other assets.

Table of Contents

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 September 30, 2016, Select had $1,149.3 million (excluding unamortized discounts and debt issuance costs) in term loans outstanding under the Select credit facilities and $175.0 million in revolving borrowings outstanding under the Select credit facilities, which bear interest at variable rates.

As of September 30, 2016, Concentra had outstanding borrowings under the Concentra credit facilities of $643.9 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 September 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 $527.4 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 $621.9 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 $643.9 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%.

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 September 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%	2,230.7
0.50%	7,151.1
0.75%	12,071.6
1.00%	16,992.1

Table of Contents

(1) Based on the 3-month LIBOR rate of 0.85% as of September 30, 2016, a change in interest rates of up to 0.15% 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 0.15% as of September 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 September 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.

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 third quarter ended September 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.

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.

Evansville Litigation. 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, from 2006 until April 2012, 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

63

not to intervene. On June 19, 2015, the U.S. Department of Justice notified the District Court of its decision not to intervene in the case, and the District Court thereafter approved a case management plan imposing certain deadlines.

In December 2015, the defendants filed a Motion to Dismiss the Second Amended Complaint on multiple grounds. One basis for the Motion to Dismiss was the False Claims Act s public disclosure bar, which disqualifies qui tam actions that are based on fraud already publicly disclosed through enumerated sources, unless the relator is an original source. The Affordable Care Act, enacted on March 23, 2010, altered the public disclosure bar language of the False Claims Act by, among other things, giving the United States the right to oppose dismissal of a case based on the public disclosure bar. In their Motion to Dismiss, the defendants contended that the public disclosure bar applies because substantially the same conduct as the plaintiff-relators have alleged had previously been publicly disclosed, including in a New York Times article and a prior qui tam case. A second basis for the defendants Motion to Dismiss was that the plaintiff-relators did not plead their claims with sufficient particularity, as required by the Federal Rules of Civil Procedure.

Then, based on the Affordable Care Act s changes to the public disclosure bar language of the False Claims Act, the United States filed a notice asserting a veto of the defendants use of the public disclosure bar for claims arising from conduct from and after March 23, 2010. The defendants filed briefs challenging the United States contention that the statutory changes gives it an unfettered right to veto the applicability of the public disclosure bar. On September 30, 2016, the District Court partially granted and partially denied the defendants Motion to Dismiss. It ruled that the plaintiff-relators alleged substantially the same conduct as had been publicly disclosed and that the plaintiff relators are not original sources, so that the public disclosure bar requires dismissal of all non-retaliation claims arising from conduct before March 23, 2010. The District Court also ruled that the statutory changes to the public disclosure bar gave the United States the power to veto its applicability to claims arising from conduct on and after March 23, 2010, and therefore did not dismiss those claims based on the public disclosure bar. However, the District Court ruled that the plaintiff-relators did not plead certain of their claims relating to interrupted stay manipulation and premature discharging of patients with the requisite particularity, and dismissed those claims. The District Court declined to dismiss the plaintiff-relators claims arising from conduct from and after March 23, 2010 relating to delayed discharging of patients and upcoding and the plaintiff-relators retaliation claims.

On October 17, 2016, the defendants filed a Motion seeking certification to file an interlocutory appeal with the United States Court of Appeals for the Seventh Circuit of the District Court s ruling that the United States has the power to veto the application of the public disclosure bar to the defendants conduct from and after March 23, 2010. 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.

Knoxville Litigation. 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.

Table of Contents

In November 2015, the defendants filed a Motion to Dismiss the Complaint on multiple grounds. The defendants first argued that False Claims Act s first-to-file bar required dismissal of plaintiff-relator s claims. Under the first-to-file bar, if a qui tam case is pending, no person may bring a related action based on the facts underlying the first action. The defendants asserted that the plaintiff-relator s claims were based on the same underlying facts as were asserted in the Evansville litigation, discussed above. The defendants also argued that the plaintiff-relator s claims must be dismissed under the public disclosure bar, and because the plaintiff-relator did not plead his claims with sufficient particularity.

In June 2016, the District Court granted the defendants Motion to Dismiss and dismissed the plaintiff-relator s lawsuit in its entirety. The District Court ruled that the first-to-file bar precludes all but one of the plaintiff-relator s claims, and that the remaining claim must also be dismissed because the plaintiff-relator failed to plead it with sufficient particularity. In July 2016, the plaintiff-relator filed a Notice of Appeal to the United States Court of Appeals for the Sixth Circuit. Then, on October 11, 2016, the plaintiff-relator filed a Motion to Remand the case to the District Court for further proceedings, arguing that the September 30, 2016 decision in the Evansville litigation, discussed above, undermines the basis for the District Court s dismissal. 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.

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 has been extended until December 31, 2017 and will remain in effect until then, unless further 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 September 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 September 30, 2016:

	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publically Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under Plans or Programs
July 1 - July 31, 2016		$		$ 185,249,408
August 1 - August 31, 2016				185,249,408

September 1 - September 30, 2016	116,975		12.26		185,249,408
Total	116,975	$	12.26	$	185,249,408

Table of Contents

(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.

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 68 hereof.

Table of Contents

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: November 3, 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)

Dated: November 3, 2016

EXHIBIT INDEX

Exhibit	Description
10.1	Third Amendment to the Lease Agreement, dated September 19, 2016, between Old Gettysburg II, LP and Select Medical Corporation.
10.2	Amendment No. 1, dated as of September 26, 2016, among Concentra Inc., Concentra Holdings, Inc., JP Morgan Chase Bank, N.A, as the administrative agent, collateral agent and lender and the additional lenders named therein, incorporated herein by reference to Exhibit 10.1 of the Current Report on Form 8-K of Select Medical Holdings Corporation and Select Medical Corporation filed on September 28, 2016 (Reg. Nos. 001-34405 and 001-31441).
10.3	Office Lease Agreement, dated as of October 28, 2016, between Select Medical Corporation and Old Gettysburg Associates V, L.P.
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 September 30, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015, (ii) Condensed Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015, (iv) Condensed Consolidated Statements of Changes in Equity and Income for the nine months ended September 30, 2016 and (v) Notes to Condensed Consolidated Financial Statements.