# William Blair 2018 Growth Stock Conference

# Encompass Health Presentation

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## PARTICIPANTS

### Corporate Participants

**Matt Larew** – Analyst, William Blair & Co. LLC
**Mark J. Tarr** – President, Chief Executive Officer & Director, Encompass Health Corp.

## MANAGEMENT DISCUSSION SECTION

### Matt Larew, Analyst, William Blair & Co. LLC

Okay. Good morning. My name is Matt Larew. I'm the research analyst here at William Blair that covers Encompass Health. Just wanted to welcome everyone here to the 38th Annual Growth Stock Conference. Because of the first presentation there are a couple of remarks they've asked me to make, which I'll try to do. First our primary objective during these three days is to present a variety of interesting investment ideas from our research universe. These companies both those are – that are relatively new to our coverage like Encompass Health, as well as those that we have followed for many years, our great representation of our quality growth philosophy. We appreciate your attendance and hope you enjoy the conference.

Before we get started with Encompass I just want to run through a few logistical details. The small booklet you received at registration contains the final agenda, as well as room assignments for the formal presentations and breakouts. With the exception of the last presentation each day in which the breakout will be in the presentation room. Breakout sessions are located on the seventh floor and specific room locations will be announced at the end of the formal presentation. If you have any questions regarding the conference please inquire at the registration desk or ask any William Blair representative. Finally I'm required to inform you that for a complete list of disclosures you can go to williamblair.com.

So again my name is Matt Larew. I cover Encompass Health here and I'm very pleased to be joined by President and CEO, Mark Tarr; CFO, Doug Coltharp; and then of course Crissy Carlisle, who many of you may know from Investor Relations. Encompass Health is clear market leader in inpatient rehabilitation and has a network of home health and hospice agencies built around those IRFs. You know we believe Encompass is always positioned in this sweet spot of demographic growth, which should lead to accelerating demand over the next decade.

So again very pleased have Encompass Health here and given how much time I've already taken, I'll turn it over to Mark.

**Mark J. Tarr, President, Chief Executive Officer & Director, Encompass Health Corp.**

Thank you, Matt. It's great to be here today. We enjoy the opportunity to have a chance to tell you the Encompass Health story, probably more importantly be able to articulate a little bit more in terms of our growth plans for what we see for 2018 and the years to come.

For some of you that are already familiar with our company, this should serve as a good update, for those of you that may not be familiar with our company, this will give you a good background in terms of our industry as well as Encompass Health as a whole.

Before I get started, I want to make sure you know about our Safe Harbor statements as well as the fact that all of our SEC filings are available on our website should you want to see those out. Well, we started 2018 with a new name. We had moved away from the HealthSouth name, this is all tied to the multi-year rebranding initiative that we announced in July of 2017. In many ways the company had outgrown the HealthSouth name. First of all, our facilities and agencies were spread out across United States and they weren't just in the South. And then secondarily maybe even more important than that was the fact that we'd become an integrated post-acute provider with the largest ownership of inpatient rehabilitation facilities and the fourth largest home health agency in Encompass Home Health & Hospice.

So we were seeking for a name that better represented the company as a whole and our strategic approach moving forward. And we felt that the Encompass Health name had the opportunity to take legacy of both the HealthSouth with the Health and the Encompass from Encompass Home Health & Hospice to move forward with this initiative. The rebranding process from our fuel based assets started on April 1. We changed the name from our ticker symbol and at least in the Birmingham marketplace on January 1.

So this will be a two-year rollout. We'll have it rolled out, rebrand initiatives through all of our field based assets by the end of 2019.

The – as you'll see, we – our focus is on the integration of both our business segments having an inpatient rehabilitation facility segment of 127 hospitals, [indiscernible] (00:04:24) IRFs. We have 268 sites for home health and hospice. We have 36 states, plus we have two hospitals in Puerto Rico. We're committed to providing high quality cost effective care in an integrated manner, that is our focus and our strategy moving forward.

And you'll see that we're very proud of the fact that we're consistently rated as one of the best places to work this case in modern healthcare as well as Fortune 100 best companies. We feel that's very important for us to have an engaged workforce. It pays dividends longer term when you think about the opportunity to use this for both recruitment and retention of our workforce in a very competitive marketplace.

If you think about our two business segments. First our inpatient rehabilitation segment accounts for 80% of the revenues for the company. As we mentioned, this segment includes 127 inpatient rehabilitation facilities, 42 of those operate as joint ventures; joint ventures with acute care hospital systems. So that's a strategy that's not new to us. Our first joint venture arrangement was established in 1991. So we're very embedded in the process and the opportunities to operate collaboratively in a coordinated manner with acute care hospital systems. And we're also proud to say that we never had joint venture unwind in our history. So we know how to be a good partner. And those partnerships with acute care hospital systems range from large multi-location systems to academic systems, to more medium market level systems to more medium market level systems. So we can work well together with a lot of different, different systems.

From a share standpoint, we account for 22% of all licensed IRF beds and from a – we think about a share standpoint with Medicare population, 30% of all of the Medicare patients receiving care in inpatient rehabilitation hospital last year received it in an Encompass Health hospital. So we're very proud of that market share standpoint. The patients that we see in our rehabilitation hospitals present to us with very

significant physical and cognitive disabilities and complications. Their medical conditions are typically fragile. They have conditions such as strokes, hip fractures, debilitating neurological conditions. These are not discretionary type of cases, these are all non-discretionary where these patients are at a medical condition that they need to be in an inpatient facility. They don't have the option of going home without the intensive care that we provide in our hospitals. All of our rehabilitation hospitals are licensed as acute care hospitals, that's a specialty license within the acute care umbrella.

We don't do surgery, we don't have emergency departments in our hospitals but the intensity of care, providing 24/7 nursing care, we have a full complement of physicians, staff; we have nurses, therapists, we are quite different in terms of resource intensity from what you typically see in a skilled nursing facility, sometimes there's confusion in the marketplaces, typically when a skilled nursing facility may call itself a rehabilitation center, but there is a big difference between what we do and the degree of resources that we have in our hospitals and the intensity of the care that's provided in our hospitals than what you might see in a nursing home.

The second business segment that makes up the company is our home health and hospice, accounts for 20% of our revenues. The services included in our home-based setting are nursing, physical, occupational and speech therapy. We have medical social work and home health aides. Similar to our hospitals, we have highly developed clinical programs that we also work with patients in the home setting. Those include fall prevention, cardiopulmonary, diabetes management, orthopedics and chronic care management all in the home setting. With 56 locations, hospice locations that puts us as a top 25 hospice provider services for the terminally ill patients. We like the hospice service line, and we see this as an opportunity for growth. Going forward, when you look at the demographics, the aging population, we believe that there will be increased demand to provide hospice in the home setting. If you think about just societal norms then the increased acceptance of being cared for in the final days in the home setting, as well as the continued focus on the end of life costs. All of these are trends that we believe will make hospice a growing opportunity for us as we go out and grow the company.

A big strategic focus for us is creating these integrated marketplaces that we refer to as market overlap. And we look at market overlap as where we have both an inpatient rehabilitation hospital and a home health agency within a 30 mile radius that allows us to provide both a facility based setting and a home based setting. It is an area of focus as we look for acquisition opportunities on our home health segment. We will prioritize those marketplaces that we can create these overlap markets. And as you can see at the end of the first quarter approximately 60% of the marketplaces where we had an inpatient rehabilitation hospital, we also had an overlapping home health agency to go in that within a 30 mile radius. This map gives you an idea about where those marketplaces lie, as well as where we see as we have other potential to increase our [ph] market live (00:11:08) markets.

Clinical collaboration has been very important for us as we first got into the home health business, back in 2014 started looking for ways to make sure that we were doing everything we could at the transition point from the hospital setting to the home setting and all the factors that go into making sure that that collaboration was taking place. We first started looking at it closer in 2015. In 2016, we laid out a series of protocols and a process that would be applied in all of our overlap marketplaces and what we saw is that we had a – quite a distribution or varying levels of compliance within our various marketplaces and we had results ranging from high percentage collaboration rate to lower percentage collaboration rate. So we saw it as an opportunity to standardize the process. And whenever we have standardized something at our company, we give it the term TeamWorks initiative. And TeamWorks in its definition within our company is essentially where we look at something as an opportunity to develop what we call a playbook or a standardized list of protocols and processes, work with our own staff as well as an outside agency in the case of TeamWorks clinical collaboration, we use KPMG to help us work as a third party where they really focus on the process with our subject matter expert from both our hospitals and our home health agencies.

Helped us develop this playbook and then we ruled out these processes in all of our overlapped markets by the end of 2017. Ultimately with the goal of increasing the compliance with the collaboration and protocols and processes that we had put in place in all of these marketplaces, ultimately driving a higher

percentage of clinical collaboration with the ultimate goal of seeing an opportunity to show more consistent increase on our outcomes, as well as patient experience where patient and patient family saw that there was a nice smooth collaboration and transition from the facility base to the home base.

So you can see here as of the first quarter, we had grown over 460 basis points in Q1 of 2018, Q1 of 2017. Our near-term goal is 35% to 40%. So we're quickly closing in on the 35%, and once we reach that we will establish a new goal. But we're starting to see some traction in the first quarter outcomes as well as patient satisfaction. And those overlap marketplaces starting to see some trends where the quality indicators relative to our ability to have a higher percentage of patients go home to the home setting, when they're discharged from our rehabilitation hospitals. We started to see an increase on that. We saw a decrease in the number of patients that our hospitals had to send to a skilled nursing facility at the time of discharge.

Now we also saw a decline in the readmission to acute care hospitals in a number of those marketplaces. So there's only one quarter of time span there, but we believe that these are the establishing of trends that we would see on an ongoing basis because of this additional focus on clinical collaboration.

Our overall strategy for the company is to continue to expand our network, inpatient rehabilitation hospitals and home health and hospice. We want to strengthen these relationships with the acute care hospital systems, payors and other provider networks and increase the level and the connectivity of the patient care access across the entire continuum as well as to deliver – continuing to deliver our superior outcomes that we look in terms of relative to getting patients back home of the home setting and keeping them there.

When we think about quality, many of our quality metrics are in fact tied to whether or not we can get that patient home to the community to the home setting and can we keep them there safely so where they will not be readmitted back to the acute care hospital. That's really where the cost effectiveness comes into play within post-acute, can you successfully keep the patient safe, have great outcomes and keep them in the low cost setting, which is the home setting. So you can see here the comparison of both the results from our inpatient rehabilitation hospitals in the blue relative to the industry standard, relative to the discharge of the community, where we are 320 basis points better than the industry. On the home health side, you can see where the 30 day readmission is 90 basis points better than the industry average. So we see that we're starting to get really solid traction in both of those key metrics for quality in both of our segments.

We're also very focused on the opportunities to achieve additional certification of our clinical programs. The Joint Commission, which is the primary accrediting agency for hospitals, has a program, where you can qualify to have certified programs, it's called the Joint Commission is the major accrediting body and they certify programs that if you have achieved certain quality outcomes and criteria within these programs. We're proud to have had 280 of these certified programs in our inpatient rehabilitation hospitals, 103 of those are stroke programs, stroke is an area – diagnostic category that we put a big focus on that we see continued growth on and it's very important to us. On the home health side, we have proven the opportunity to go out and develop programs that are physician specific custom treatment programs, particularly with the high acuity patients, that allows us to treat certain kinds of patients in the home setting than perhaps other agencies cannot successfully treat.

We're very proud of our quality outcomes. And we're also very proud of the fact that we are the most cost effective provider out there with setting the leading physician in cost effectiveness in both of our segments. You can see here in blue the hospitals are 27% less than their average cost per discharge. The Encompass Home Health is 7.4% less on their average cost per visit. We do this in a number of different ways. One is we have centralized administrative functions in both our agencies and our hospitals. We have the opportunity to apply our vast degree of clinical best practices across our platform of agencies and our hospitals.

Our big focus is on maximizing staff productivity, and we happen to think that's a competitive advantage that we have put in place in both our hospitals and our home setting in terms of making sure that we are

adapting to the volume levels, making sure that the skillset of our staff is appropriate to the needs of the patients that we have out there. And the responsiveness as we have changes in volume. We have also applied opportunities within the supply chain to achieve these efficiencies that contribute to the cost advantages that you see here.

And the third area that we'll talk more about also is the opportunity to apply technology across each of these efforts from operating metrics standpoint with regard to maintaining our – and controlling our cost. When we think about technology, not only the clinical technology that we have in our hospitals, but we consider our IT initiatives that we put in place now for the past several years and the resources that we've applied to those has truly contributing to a competitive advantage that we have over other post-acute providers. I'll start out first with ACE-ITs. ACE-IT is the acronym that; we're big on acronyms. We have placed on our internal electronic clinical information system that we developed hand-in-hand with Cerner Corporation. Approximately eight years ago we made a committed with Cerner that we would work with them to develop an information system that is specific to what we do in rehabilitation hospital, as opposed to something that's off the shelf or what they may do in acute care hospital. We piloted it and ultimately rolled it out to our entire portfolio of rehabilitation hospitals over a five-year rollout period, that ended last year.

Beacon is the series of management reports that we have worked with our own IT group to help develop and support our managers both in the field and at the corporate level with information that used to be spread in a lot of different areas whether that was clinical information, operating information, financial information or at several different places where they'd have to search out different reports to get this type of information in a real-time manner. Our IT group worked together collaboratively, so that we now have a series reports that follow up under this Beacon initiative where they can go to one report, find this various levels of information that has all been pulled together as management tools, whether that's allowing them and supporting them in terms of managing staffing, so that they get real-time response and identifying the volume of patients that they have, the types of patients they have; so they can make staffing decisions. It includes information relative to our patient outcomes, discharge and community, patient satisfaction. So within Beacon, our managers at the local level, at the regional level and at the corporate level can access these reports online. So we can track and trend the productivity and the achievement of certain goals at all of our hospitals and our agencies.

Homecare Homebase is the gold standard for the IT systems used in the home health and hospice segments. We under April Anthony and her leadership team designed and started Homecare Homebase, so we are proud that we have a management team that are what we'd consider to be the super users of Homecare Homebase even though there are other providers in the homecare setting that use Homecare Homebase. We see significant advantage in the fact that our team helped design this. Know the ins and outs of it and probably apply it better than any other company that's out there in terms of the use of those IT services within Homecare Homebase.

And then finally last year, we announced the collaborative work on the Post-Acute Innovation Center with Cerner. And this will help us to go out on a market-to-market basis working with acute care hospital systems to help guide and navigate the best placement options for patients within the acute care sector in their marketplaces.

In this case, Cerner has a huge bulbous of information that we'll be able to tap into and pull from relative to data analytics information that they keep on the various providers in any given marketplace, whether that's the home health agencies, skilled nursing, inpatient rehabilitation, the full continuum. We'll be able to work with Cerner to develop these systems and then go out and offer these as tools working with whether they're our partnered acute care hospital systems or even non-partnered systems, working collaboratively using this information and these tools that we have developed with Cerner.

We are consistently being asked by acute care hospital systems now to help them with the post-acute setting, to help them make decisions on what the best setting is for their patients at the time of discharge. We use our clinical information systems and our vast data analytics capabilities given the information that we are now able to collect from ACE-IT, as well as Homecare Homebase in working with these acute care

hospital systems and better identifying at the time of placement whether patients are best suited to go to an IRF, go home with home health, maybe they're better suited to be in a convalescent type of setting and a skilled nursing facility. A good example where we have done this is we've done a pilot study in the Tyler, Texas marketplace with our joint venture partner in there, CHRISTUS Trinity Mother Frances is the name of the acute care hospital system there.

We worked with their team there and said, well why don't we think one specific diagnostic category, in this case, hip fractures, where we will work collaboratively with the discharge planners and the physicians in the acute care hospitals. We will help you identify what patients are most appropriate to go directly home, what patients may need to be in an IRF. What patients may not be expected to do well at the time of discharge and maybe better suited for a skilled nursing facility. But the early results have been very positive. We've had 40 of these hip fracture patients go through the system in the first quarter. The 40 represented an 18 patient increase for us in our inpatient rehabilitation hospitals and we're very proud of the outcomes, we've only one of those patients have to be returned back to the acute care hospital for an acute care readmission.

So that's just one example where we are applying the data analytic capabilities that we're now able to pull from as we have this information that we're extracting from the IT systems that we put in place and applying in the real world and working with and helping the acute care systems navigate through the various post-acute levels and finding the best place for the best outcomes for their patients.

One of the areas that IRF makes us very positive on the outlook for growth is the demographic tailwind that we see. The aging of the population out there as we all age, we will have more need for rehabilitative services and what we've seen here as you can see, the graph on the left hand side breaks it out from the various years 2014 through 2030. And then you can see, it's the year 2022 when the baby boomers will really start hitting the Medicare age and with the compound annual growth rate of 3%, but perhaps even more compelling is the table on the right hand side of the page.

Our average age patient is right at that 76, 77 number and when you look at the breakout of the age range of 70 to 74, the 75 to 79, there and you look at the age breakout or the year breakout between 2014 to 2018 and then on to 2022. You can see that the growth rate reaches 5% plus in those outgoing years. So we believe that we haven't even seen the start of the baby boomers that will need our ongoing services and this is an example of how we expect that as the population ages, as the baby boomers reach the age range of our typical patients, there'll be increased demand for the services that we provide in both our IRFs and the home setting.

We see our opportunities for growth multifaceted. One is taking market share and we have a strong history of taking market share in each of our segments, in both of our hospitals, as well as our home health agencies. We see the opportunities to continue to grow on our rehabilitation hospitals; whether that's through adding beds to existing hospitals that are running into capacity guidelines. Every year we'll add somewhere around 100 beds to our existing portfolio. All of our hospitals are designed and built so that we can add beds at some future point, as well as adding de novos and acquisitions that will complement our organic growth. It's the same story on our home health side where as we have acquired the agencies and they begin to mature with our systems and processes, whether that's on the sales and marketing side or from the clinical outcome side, we see them increasing as we – as those places mature.

The home health acquisitions and new store growth prioritized both in the IRF markets. We talked earlier about the overlap market opportunities and clinical collaboration, as well as the opportunity to build additional scale in hospice. I mentioned earlier that we're already a top 25 performer within hospice. And many of those same trends on this demographic or societal acceptance will continue to drive the need for hospice out there and create the opportunities for us to continue to grow.

This gives you an idea relative to growth of our hospitals for 2018 as well as 2019. We've listed the separate hospitals that are already on the board, some of those are up and running, some are still in the planning and construction phases. But you'll see in 2018, we expect to have 269 beds coming online throughout those hospitals, and in 2019 we'll have 270 beds with the expected 100-bed additions in

addition to the beds that will be coming out of the hospitals and new construction. We've broken those out between the de novos as well as the joint ventures that are listed here. So we're very excited about the next two years that we have in terms of the development and those hospitals that we've already announced or are in fact at some level development.

Home health and hospice is the same story. We believe that there are ample opportunities there. This segment the home health and hospice segment takes advantage of a marketplace that's very fragmented. So there are over 12,000 agencies out there in the U.S. Home Health & Hospice, 94% of those have annual revenues of less than $5 million. So you can see there are a lot of fragmentations, a lot of mom-and-pop agencies that are out there, those are all opportunities for us to go out and be the consolidator in the marketplace. We talked earlier about the hospice and the fact that we see that being more and more utilized by the Medicare population going forward.

Only 50% of the Medicare descendants utilize hospice services. Last year more than 25% died in the first seven days of care, even though hospice care is a 180-day benefit. So they were waiting till the very end before they took advantage of the hospice opportunities to them. So we see that as an opportunity, as society accepts hospice care more and more people want to spend their final days in a home setting and not in an acute care hospital. So those are all opportunities to expand and grow in hospice. And you'll see here that we've listed the Camellia Healthcare acquisition, which is the material acquisition that we're in the process of implementing, that included 18 hospice, 14 home health and two [ph] private buildings (00:32:59). So we completed that acquisition on May 1 of this year.

Historically, our company has been able to generate very strong levels of free cash flow. We see that continuing, and you'll see here, we estimate we'll have $340 million and $440 million of free cash flow this year, it gives us an opportunity to apply that to fund the high quality growth that we've talked about on the previous slides, we'll augment this with investments with shareholder distributions that you'll see here listed at the bottom. We're very proud of the fact that we feel that we have one of the strongest balance sheets in healthcare; our leverage will be or was at the end of the first quarter a three times. So we're very proud of that fact.

We also think that it's underappreciated the fact that we own approximately 70% of our real estate, we own 70% of our hospitals that rather there have a REIT own those operations, we prefer to own instead of them.

So in closing I hope you'll see that we feel that we have very strong business proposition with sustainable business fundamentals, attractive healthcare sector and a strong financial platform from which to pursue our growth. Thank you.