Encompass Health

Post Q1 2019 Earnings Call

April 26, 2019

PARTICIPANTS

Corporate Participants

Crissy Buchanan Carlisle – Chief Investor Relations Officer, Encompass Health Corp.
Mark J. Tarr – President, Chief Executive Officer & Director, Encompass Health Corp.
Douglas E. Coltharp – Executive Vice President & Chief Financial Officer, Encompass Health Corp.
Barbara A. Jacobsmeyer – Executive Vice President, President Inpatient Hospitals, Encompass Health Corp.
April K. Anthony – Chief Executive Officer, Home Health and Hospice, Encompass Health Corp.

Other Participants

Matt Larew – Analyst, William Blair & Co. LLC
Brian Gil Tanquilut – Analyst, Jefferies LLC
A.J. Rice – Analyst, Credit Suisse Securities (USA) LLC
Frank George Morgan – Analyst, RBC Capital Markets LLC
Joanna Gajuk – Analyst, Bank of America Merrill Lynch
Dana Hambly – Analyst, Stephens, Inc.
Nathan Leiphardt – Analyst, UBS Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Encompass Health's First Quarter 2019 Earnings Conference Call. At this time, I would like to inform all participants that their lines will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] You will be limited to one question and one follow-up question. Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

I'll now turn the call over to Crissy Carlisle, Encompass Health's Chief Investor Relations Officer.

Crissy Buchanan Carlisle, Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator, and good morning, everyone. Thank you for joining Encompass Health's first quarter 2019 earnings call. With me on the call in Birmingham today are: Mark Tarr, President and Chief Executive Officer; Doug Coltharp, Chief Financial Officer; Barb Jacobsmeyer, President, Inpatient Rehabilitation Hospitals; Patrick Darby, General Counsel and Corporate Secretary; Andy Price, Chief Accounting Officer; Ed Fay, Treasurer; and Julie Duck, Senior Vice President of Financial Operations. April Anthony, Chief Executive Officer of our Home Health and Hospice segment also is participating in today's call via phone.

Before we begin, if you do not already have a copy, the first quarter earnings release, supplemental information and related Form 8-K filed with the SEC are available on our website at

encompasshealth.com. On page 2 of the supplemental information, you will find the safe harbor statements which are also set forth in greater detail on the last page of the earnings release.

During the call, we will make forward-looking statements which are subject to risk and uncertainties, many of which are beyond our control. Certain risk and uncertainties that could cause actual results to differ materially from our projections, estimates and expectations are discussed in the company's SEC filings, including the earnings release and related Form 8-K, the Form 10-K for the year ended December 31, 2018, and the Form 10-Q for the quarter ended March 31, 2019 when filed. We encourage you to read them.

You are cautioned not to place undue reliance on the estimates, projections, guidance and other forward-looking information presented which are based on current estimates of future events and speak only as of today. We do not undertake a duty to update these forward-looking statements.

Our supplemental information and discussion on this call will include certain non-GAAP financial measures. For such measures, reconciliation to the most directly comparable GAAP measure is available at the end of the supplemental information, at the end of the related press release and as part of the Form 8-K filed yesterday with the SEC, all of which are available on our website.

Before I turn it over to Mark, I would like to remind everyone that we will adhere to the one question and one follow-up question rule to allow everyone to submit a question. If you have additional questions, please feel free to put yourself back in the queue.

With that, I'll turn the call over to Mark.

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

Thank you, Crissy, and good morning to everyone joining today's call. The first quarter was a good start to 2019 with consolidated revenue increasing 7.5%, consolidated adjusted EBITDA increasing 8.8% and adjusted EPS increasing 11.8%. We also made significant progress in the first quarter on our strategic and operational priorities.

We recently signed a definitive agreement to acquire Alacare Home Health and Hospice, with 23 home health and 23 hospice locations across Alabama, this acquisition is consistent with our objectives of creating new overlap markets adding density in existing home health markets and building scale in our hospice business. The Alacare acquisition will result in three new overlap markets, Gadsden, Huntsville and Montgomery allowing us to bring the benefits of clinical collaborations to patients in these areas. We expect to close this transaction in June.

We continue to make progress on clinical collaboration and achieved a 36% clinical collaboration rate in the first quarter of 2019, a 250 basis point increase over the first quarter of 2018. This marks the first quarter our clinical collaboration rate exceeded 35% and we've revised our near-term objective to 40%. We are also showing progress in our initiative to build stroke market share. In the first quarter of 2019, we officially launched our three year strategic sponsorship with the American Heart Association/American Stroke Association. This sponsorship allows us to bolster stroke awareness through provider, patient, and community education highlighting the AHA, ASA guidance that strongly recommend stroke patients to be treated in an inpatient rehabilitation hospital rather than a skilled nursing facility.

Thus far, we've completed the Life After Stroke Guide to bring awareness and guidance about Life After Stroke to individuals and their families. This guide has been distributed to our patients and is available for anyone to download electronically from the American Stroke Association's website. This jointly branded guide between Encompass Health and the AHA/ASA has been visited more than 7,500 times on the ASA websites and has been downloaded nearly 1,900 times since the end of January 2019. We've also completed 8 of 20 Go Red for Women luncheons across the country where over 4,700 attendees have received cobranded educational information. In addition five Encompass Health stroke patient stories

have been shared as part of the AHA/ASA support network and promoted via social media posts on each of the American Stroke Association's channels.

We've also continued our development of post-acute solutions that focus on improving patient outcomes and lowering cost of care by reducing hospital readmissions across the entire episode of care. In the first quarter of 2019, we continue to refine our 90-day post-acute readmission prediction model and in April we launched a pilot project that combines this model with several other existing tools in the Houston market.

Moving now to the regulatory front. On April 17, 2019 CMS released its fiscal year 2020 proposed rule for inpatient rehabilitation facilities. Recall that the 2019 final rule included changes to the patient assessment and case mix system for inpatient rehabilitation hospitals in fiscal year 2020, referred to as the transition to the CARE Tool payment system.

CMS is moving forward with this transition and the proposed rule for 2020 included an updated CMG table incorporating a second year of data and reflecting several other provisions stemming from dialogue with the provider community. This implemented as proposed, we estimate the rule would result in Medicare reimbursement rates for our company in fiscal year 2020, which begins October 1, 2019 that would be flat to down 0.25%. Additional information regarding how each component of the proposed rule is estimated to impact our company can be found on page 26 of the supplemental information that accompanied our earnings release.

We appreciate CMS releasing an FAQ document last August to clarify information under the new system. Since we received that information from CMS, we have focused on working with our hospitals to improve the documentation that captures each patient's functional abilities under the new care elements and we are seeing improved interrater reliability across our hospital portfolio.

We also want to thank CMS for being open to provide our feedback on the potential effects of care assessment measures on CMG's relative weights and length of stay. Notably CMS is now proposing to weight the functional assessment items to produce a weighted functional score whereas the fiscal year 2019 proposal did not weight the assessment items. This initial attempt by CMS to implement a weighted functional score reflects the views of stakeholders that the various functional activities correlate differently to the burden of care and provider costs.

The proposed weighting methodology is new, not yet fully understood. The comment period will help stakeholders to begin examining the clinical technical aspects of the proposed weighting methodology and to develop questions and other relevant input for CMS' consideration. We plan to continue engaging in constructive dialogue with CMS as a company and as part of our industry trade groups during proposed rules comment period.

In home health, CMS is replacing their current home health prospective payment system with the Patient-Driven Groupings Model or PDGM. Among other changes, this system will revise the current 60-day episodic payment to a 30-day payment period. Reimbursement under this new system also relies more heavily on a patient's clinical characteristics and eliminates therapy service-use thresholds. In addition to achieve budget neutrality, CMS assumed behavioral changes will offset a 6.4% reduction in the base rate. Our preparation for these changes includes the continued use of technology to generate objective evidence-based care plans and to drive incremental efficiencies in administrative support functions.

We are working with Medalogix to further refine our care plans for all home health patients we serve. And we're working with Homecare Homebase on key system enhancements to ensure the increased billing frequency PDGM will require as part of its move from 60-day payment periods to 30-day payment periods, does not result in a doubling of our billing related costs. Also as part of the continuing investments we've made in our care transitions program, we're seeing an increase in admissions from acute care hospitals which is driving our expected impact from PDGM to be less negative than we had previously estimated.

We were also encouraged by the support we are receiving from Congress as evidenced by the Bipartisan Senate Bill 433 and we are hopeful, we will soon have a companion bill in the House also with Bipartisan support. Bipartisan support is rare in this day and we believe the support home health is receiving shows the value of homecare is widely appreciated by both parties as not only a low cost setting, but also as the preferred setting for care for many of America's seniors. We expect to provide updated estimates on the impact of PDGM to our revenue after the proposed home health rule for calendar year 2020 is released this summer.

As a reminder neither of the proposed new payment systems changes the long-term outlook for our company, which is predicated on the demographic trend driving increasing demand for the services we provide. We believe we are well-positioned as a company to work through these changes and we have a proven track record of being able to do so. We have successfully managed through economic recessions, regulatory changes, sequestrations and Medicare payment freezes and cuts, growing adjusted EBITDA in 40 of the last 41 quarters. We provide necessary services to an aging population and consistently produce high quality patient outcomes in a cost-effective manner. As the population continues to age, the demand for our facility and home-based services will grow, and we will meet that demand with enhanced capabilities and expanded capacity.

Our home health segment is also preparing for the start of the Review Choice Demonstration or RCD in June. Following the pause of their Pre-Claim Review Demonstration or PCRD two years ago, CMS work to revise the pre-claim review program to offer more flexibility and choice for providers. Earlier this month, CMS announced RCD will begin in June 1, 2019 in Illinois, where we have three home health agencies. We are well prepared for this program, and will apply the learnings from our Illinois locations that successfully navigated PCRD with an affirmation rate in excess of 90%.

I'll conclude my comments with a discussion of our 2019 guidance. As a result of our strong start to 2019 and our current expectations for the remainder of 2019, included the impact of the 2020 proposed rule for inpatient rehabilitation hospitals on the fourth quarter of 2019, we are reiterating our full year guidance. We continue to expect net operating revenues in a range of $4.5 billion to $4.6 billion, adjusted EBITDA in a range of $925 million to $945 million, and adjusted EPS in a range of $3.71 to $3.85 per share. This guidance does not include our planned acquisition of Alacare, which is expected to close in June.

With that, I'll turn it over to Doug.

Douglas E. Coltharp, Executive Vice President & Chief Financial Officer, Encompass Health Corp.

Thank you, Mark, and good morning everyone. As Mark stated at the beginning of his comments, Q1 was a strong start to the year with solid revenue and adjusted EBITDA gains in both business segments and operating leverage achieved against our G&A expenses. Our consolidated revenues for Q1 increased 7.5% to $1.124 billion. Consolidated adjusted EBITDA rose 8.8% to $242.9 million and adjusted EPS increased 11.8% to $1.04 per diluted share.

We continue to generate significant levels of free cash flow. Adjusted free cash flow for Q1 was $127.8 million in line with our expectations and was used to fund $59 million in capacity additions to our business lines, $28.3 million in common dividends and $11 million in common stock repurchases. We ended the quarter with our leverage ratio at 2.8 times consistent with year-end 2018, in spite of an approximately $55 million increase in debt solely attributable to the adoption of the new lease accounting standard. We have more than sufficient liquidity and balance sheet capacity to fund the $217.5 million purchase of Alacare, which we expect to close in June and to continue to pursue our other capital deployment strategies.

Moving to the results by business segments, IRF revenues for Q1 increased 3.5% driven by discharge growth of 1.1% and a 2.6% increase in revenue per discharge. Discharge growth in Q1 was attributable to new stores as same-store discharges declined by 20 basis points. We faced our toughest same-store comparison in Q1 as we've posted same-store growth of 4.8% in Q1 2018. Recall that Q1 2018 including

an estimated 100 basis points to 200 basis points related to the severe flu season and an additional 50 basis points related to the timing of Easter and Passover. Moreover, same-store growth in Q1 2019 was negatively impacted by approximately 20 basis points stemming from the continued disruption in the Panama City market resulting from Hurricane Michael.

Revenue for discharge in Q1 increased 2.6%, which was above our expectations and resulted from rate increases across all major payer classes and improvements in discharge destination, specifically a decrease in discharges to SNFs and an increase in discharges to community. These factors were partially offset by a 30 basis point increase in revenue reserves related to bad debt. Revenue reserves related to bad debt were 1.4% in Q1.

As can be seen on page 24 of the supplemental slides, new prepayment claims denials in Q1 declined on both a year-over-year and sequential basis. However, collections of previously denied claims also declined. During the quarter, we experienced favorable resolution rates on claims subjected to the TPE process. But once again, we saw little to no progress on substantial backlog of claims awaiting adjudication at the ALJ level.

IRF segment adjusted EBITDA for Q1 was $230 million, an increase of 2.8% over the prior year period. The 60 basis point increase in SWB as a percent of revenue to 51.1% was below our expectations owing to a lower than anticipated increase in benefits costs and continued improvements in labor productivity. We continue to expect benefits costs to increase 6% to 8% in 2019. Supply's expense in Q2 declined 20 basis points as a percent of revenue due primarily to the increased utilization of generic pharmaceuticals.

Other income in Q1 2019 of $2.8 million included approximately $1.6 million related to a quarterly mark-to-market on our nonqualified 401(k) plan. There is a corresponding offsetting entry within general and administrative expenses such that this mark-to-market activity has no impact on consolidated adjusted EBITDA.

Turning now to our home health and hospice segment, revenue increased 23.4% in Q1 with 18.5% growth in home health and 68.6% increase in hospice. Segment revenue growth for the quarter benefited from the inclusion of the former Camellia Healthcare locations which were acquired on May 1, 2018. Home health revenue growth was driven by both volume and pricing gains, admissions were up 12.1%, 6.4% on a same-store basis and episodes increased 12.3%, 5.4% on a same-store basis. Revenue per episode in Q1 increased 4.2% aided by the receipt in the quarter of an approximately $1 million BPCI reconciliation payment. And as a reminder revenue per episode for Q1 2018 was negatively impacted by an approximate $4 million ZPIC reserve.

The scale of our hospice business continues to increase. Hospice revenue growth in Q1 was primarily driven by acquisitions, but also included same-store admission growth of 13.7%. Q1 hospice ADC of 2,656 increased 67% over Q1 2018. Home health and hospice segment adjusted EBITDA for Q1 was $46.3 million, an increase of 38.2% over the prior year period and again benefited from the inclusion of the former Camellia locations.

Growth in adjusted EBITDA was also driven by lower cost of services as a percent of revenue owing to our continued focus on caregiver optimization and productivity. Specifically our cost per visit in Q1 2019 decreased to $74.8 from $75.3 in Q1 2018. While visits per episode declined to 17.7 from 17.9 in the prior year period.

Finally as can be seen on page 11 of the supplemental slides, our general and administrative expenses for Q1 declined both in absolute dollars and as a percent of revenue, compared to Q1, 2018. The decline was primarily attributable to year-over-year reduction and expenses related to our rebranding initiative.

And now, we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Matt Larew of William Blair.

<A – Doug Coltharp – Encompass Health Corp.>: Good morning, Matt.

<A – Mark Tarr – Encompass Health Corp.>: Hey, Matt.

<Q – Matt Larew – William Blair & Co. LLC>: Hi, good morning guys. I wanted to ask the first question on IRF pricing and maybe first just get your insights into the sort of education and training that maybe gives you the confidence in providing that bracket for the impact from FIM to CARE Tool here in 2020. And then part two would be on the private side. Doug in your comments you alluded to revenue per discharge being affected by all payers increasing. So if you could maybe give us a sense for number one, how you arrived at that bracket for FIM to CARE Tool and then part two, how things are trending with the private payers on IRF side?

<A – Mark Tarr – Encompass Health Corp.>: Yeah. Hey, Matt. This is Mark. I'm going to give a couple comments first on the overall education, turn it to Barb Jacobsmeyer for additional details and then turn to Doug for your second part of your question. But as we started discussing last year, we were seeking out to clarify a number of the details from CMS with the new CARE Tool. There was additional clarification that came out in a Q&A in August which gave us a lot of additional insights into questions that we had. Once we had those clarified, we were able to develop a standardized education that then we could roll out to all of our hospitals and really increase our interrater reliability, so as we looked at one hospital compared to another and look at their program mix that we would see consistencies in the scoring process and all of that leads to this greater need and demand to get in and work with our therapist and nurses so that they had a good understanding of the CARE Tool. Recall that the FIM tool has been in use literally for entire generation or more of therapists and nurses in our industry, really started back in the mid to late 1990s when FIM scores started meaning something. So this has been a big transition and under Barb's leadership they've done a lot of work to help educate our staff. I'll ask Barb to weigh in on this.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Right. So as Mark mentioned you know we've got a clarification as late as August of 2018 and there is a big difference and FIM has always taken the lowest score of the patient's performance within those first 48 hours whereas the CARE Tool uses what is defined as the most usual. So there's been a lot of clarification that we've needed from CMS on how that should be interpreted, so that we could provide that education to the field. We did do a crosswalk, so that we could see the progress that was being made from our hospitals. And it's one of the reasons that we use quarter one of 2019 to really base what we were projecting because we saw the progress as we move from quarter four to quarter one and we really feel that that is not only sustainable, but what we have probably some more work to be done. So we continue to educate our staff and the good news is that on October 1 we'll be able to stop thinking about and performing two separate assessments which should allow for additional focus on the interrater reliability, focusing specifically on the CARE Tool.

<A – Doug Coltharp – Encompass Health Corp.>: Matt, this is Doug. Let me address your question on the pricing side. I mentioned that we had good pricing increases across all major payer classifications, just to add some additional color on that. Pricing for Medicare Advantage in the quarter was up 5.3%, Managed Care, which excludes Medicare Advantage, so the other private pay component was up 2.7%. And Medicaid was up 12.5%. To start with a little bit more of an explanation on Medicare Advantage, what we're benefiting from there are both contractual rate increases and increase in the stroke and neuro penetration and this is something that is consistent across all payer classifications, which carries a higher reimbursement. And an increase with the number of MA contracts that are based on the CMG and not on a per deal. And in aggregate also for the quarter, Medicare Advantage was our strongest volume growth increase with a 14.3% increase. On the Managed Care side, again the 2.7% increase really reflects both the contractual rate increases that we were able to negotiate as these payers become increasingly aware of our value proposition and an increase in the patient mix towards stroke and neuro, and the same were held true for Medicaid which was predominantly based on the patient mix.

<Q – Matt Larew – William Blair & Co. LLC>: Okay. Thanks for all those comments, very helpful. And then the second maybe would be obviously at Alacare closing here in June, but I noticed that you're still targeting separately an additional $50 million of M&A. And so just wondering what you're seeing out there in terms of disconnects or maybe agreement in terms of buyer and seller related to PDGM. And then if there is a preference with that $50 million in terms of home health or hospice at this point? Thanks.

<A – Doug Coltharp – Encompass Health Corp.>: I think our priorities for home health and hospice acquisitions remain the same and both Camellia Healthcare and Alacare service is great examples of that. Our first priority is to create incremental overlap markets so that we can bring clinical collaboration to new areas into new groups of patients. The second is to build density in home healthcare and the third is to build scale in hospice. If there's any change I would say that they are probably more equally weighted today than they were say two years ago. But we continue to see good opportunities to grow the business that solve for one or more of those priorities.

Out of that $50 million, I think we closed on about $11 million were in the first quarter. And so, we believe that even though we'll be focused predominantly on closing an integrated Alacare that we're going to continue to pick up some of these bolt-on or fill-in acquisitions depending on how you want to describe those. And we're not having a real issue with price discovery. I think there's more clarity around the potential impact of PDGM, right now than there was when we were going to the HHGM predecessor model. There is a little bit of consternation about what ultimately happens with the behavioral adjustment. As Mark alluded to in his comments, we're cautiously optimistic about that maybe being resolved legislatively, but on the whole, we're not having a difficulty coming to I think a reasonable basis for adjusting out regulatory risk as we look at the home health and hospice acquisition opportunities.

Operator: Your next question comes from the line of Brian Tanquilut of Jefferies.

<Q – Brian Tanquilut – Jefferies LLC>: Hey, good morning, guys.

<A – Mark Tarr – Encompass Health Corp.>: Good morning.

<Q – Brian Tanquilut – Jefferies LLC>: Mark, just given that you have a little bit more visibility now into the IRF reimbursement for next year and it sounds like PDGM you're getting a better feel for that as well and the M&A that you've done with Alacare. So would you be able to say that you still feel confident that you can grow EBITDA dollars next year given where we are today?

<A – Mark Tarr – Encompass Health Corp.>: The answer is yes. We're taking a lot of review on that, I'll ask Doug go into details, but yeah given the strong demand for both of the services and our business segments, we do believe that we can continue to grow EBITDA.

<A – Doug Coltharp – Encompass Health Corp.>: Hey, Brain, I think it's helpful if you kind of break it down into its pieces. So the 2020 rule for the IRF segment hits the first three quarters of 2020 with the estimated flat to down 0.25% Medicare fee-for-service reimbursement update. We expect a normalized rate update in the fourth quarter based on the 2021 rule, which will actually take the calendar 2020 Medicare fee-for-service reimbursement from modestly positive.

As we just talked about with regard to the other payer classes, we'll have rate increases in those pay categories which will add to the aggregate price increase. We will have IRF volume growth from three sources organic, new IRFs, we've got four hospitals that will open in 2019 and bed expansion. Recall that we are anticipating approximately 150 beds coming online in 2019 and those are skewed towards the back half. Within the IRF segment some expense categories will deleverage such as SWB, but others will leverage like occupancy. Home health and hospice will continue with strong volume growth, organic in the 2019 acquisitions including Alacare. PDGM does remain a little bit of an uncertainty, but if the behavioral adjustments go away or reduced, we think we can be able to manage down to probably a flat on the Medicare fee-for-service reimbursement. And then we take those segment results and believe that

corporate G&A should grow only very modestly next year and that should translate into consolidated EBITDA growth in 2020.

<Q – Brian Tanquilut – Jefferies LLC>: No, I really appreciate that, Doug. I guess my follow-up, as I think about the margin performance for the quarter was strong, revenue per discharge was stronger during the quarter and then home health margins cost per day was at $75. How sustainable do you think these numbers are and should we think about revenue per discharge maintaining that level?

<A – Doug Coltharp – Encompass Health Corp.>: Well, again, as we pointed out in our comments in pricing in both segments, you had some favorable tailwinds and then you had the comparisons to last year as well. Most notably on the home health side with the ZPIC reserve impacting last year. We think that the trends that are identified on the IRF segment within the other payer classes in general skewing towards higher acuity will continue, that's been our focus. But I think the pricing considerations for both business segments that we've included in our business outlook are our best guide to our expected future performance for this time being.

Operator: Your next question comes from the line of A.J. Rice of Credit Suisse.

<Q – A.J. Rice – Credit Suisse Securities (USA) LLC>: Hi, everybody. Just my question is around this year's guidance. I guess the – obviously you got more clarity on the IRF rule and the impact that will have potentially later in the year, but that seemed to be the main change. You're well-ahead of the consensus numbers that may be different than your own numbers, I don't know. But what's your thinking about your guidance range and potentially moving up or adjusting that in light of the strong quarter and the trajectory you're on now? What are some thoughts there?

<A – Doug Coltharp – Encompass Health Corp.>: A.J., it's Doug I think it's safe to say that we would have been reporting or would have been talking about a significant increase in the guidance range had it not been for the impact of the IRF rule that dropped same time. So the overachievement we got in Q1 was essentially offset almost dollar for dollar by the expected impact of the IRF rule against the previous assumption of the 2.4% Medicare fee-for-service increase in Q4. And then as you noticed the rest of the guidance considerations have not changed its Q1, have made those expectations beginning of the year, we're 3 months into a 12 month period. And so we just don't have enough clarity on the other things that we've cited within the guidance considerations to make any changes there yet.

<Q – A.J. Rice – Credit Suisse Securities (USA) LLC>: Okay. And then just my follow up would be the capital deployment decisions you're making this year. I believe early next year the home health ownership it's outside of Encompass. You have an opportunity to proactively buy that in obviously they could always put it to you as well. Is that affecting your capital deployment decisions in any way for the remainder of the year or what's your thinking on that?

<A – Doug Coltharp – Encompass Health Corp.>: The home health management team has done a phenomenal job building the business both prior to our partnership and since the partnership to the extent that they elect to exercise their put options and exercise their SARs, we're glad to increase our ownership of the segment and to have them receive those rewards which are very just. We'd like to see the management team continue as equity owners in that business for a more lengthy period of time.

All of that said should the put options be exercised or should we choose ourselves after 2020 to exercise any portion of our call option, our balance sheet has substantial capacity and we have more than ample liquidity to be able to do that without crowding out any of our other capital deployment opportunities be those related to the capacity expansions in our core business or continuingly shareholder distributions. We're in the fortunate position given the strength of our balance sheet and the consistency of our free cash flow that when it comes to capital deployment, we remain an and story and not at or story.

Operator: Your next question comes from the line of Frank Morgan of RBC Capital Markets.

<A – Doug Coltharp – Encompass Health Corp.>: Hi there, Frank.

<A – Mark Tarr – Encompass Health Corp.>: Hello, Frank.

<Q – Frank Morgan – RBC Capital Markets LLC>: Good morning. Hey thanks for the color around the rate outlook in the fourth quarter under the new rule. Just curious when you think about mitigation steps just from a volume perspective, do you envision any kind of change in volume assumptions, I mean it's an opportunity to focus more on a different type of patient. I know you talked about the stroke program but [ph] that didn't sound (00:38:34) like that has anything to do with this rule. But just curious is there anything – is the assumption that nothing changes in terms of just volume and utilization and the only thing that happens is rate from a revenue perspective.

And then if that's the case is there anything you can do on the – in terms of [indiscernible] (00:38:55) management, is there anything that could change there that may help you on the cost side? And then the second question was just on the home healthcare side you called out this kind of pleasant surprise, you've now seen from more hospital based admissions and that that will produce a better outcome under the new rule. Could you quantify that maybe and how big a deal is that on the positive and any other things out there that we should be looking for in that area? Thanks.

<A – Mark Tarr – Encompass Health Corp.>: Yeah, Frank, I'll make a quick comment and then turn it over to Barb Jacobsmeyer. But relative to our clinical programs in our IRFs, we remain committed to stroke, neuro and those programs that typically require a higher acuity level of care. That is an area that we have transitioned into now for the past almost decade now as we moved out an orthopedic focus into more of the neuro focused, but it continues to show a lot of demand for our services particularly in those product lines. So we've remained committed to those as well, and I'll let Barb to comment on our cobranding initiative with the Stroke Association as part of that.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Yeah. So we continue to focus on the stroke, the exposure that we're getting with the Heart and Stroke Association is really strong as far as it relates to education to healthcare providers, but also to patients and caregivers on making sure that they really know where the best side of care is for stroke patients who get the best recovery. We also, as Doug mentioned, we've seen the growth on the MA side. And it's really showing that value proposition of even though IRF maybe more expensive on the frontend, when we can take care of those patients and get them home and prevent those costly readmissions, that value proposition is really starting to be understood. So those are the things that we will continue to focus on as we look to continue to grow.

<A – Mark Tarr – Encompass Health Corp.>: Frank I may ask April to weigh in on your home health question.

<A – April Anthony – Encompass Health Corp.>: Yeah. Regarding the increase in hospital admissions, I think we've put a well-concerted effort to making sure that we have good sales and marketing presence covering the various hospitals that we serve, the acute care hospitals as well as our partner inpatient rehab hospitals, as well as other post-acute care facilities, but they are not part of the Encompass Health family and that effort [indiscernible] (00:41:20) increasing our proportion of non-Medicare – our non-community based discharges. And under the new PDGM rule institutional discharges that come to home health have a higher reimbursement rate. So it's a strategy that we have been pursuing really since the beginning of our partnership five – four-and-a-half almost years ago now. And it's something that we continue to see gains in, we don't know specifically yet as we wait until July the next round of PDGM communication to come out, we'll know exactly the impact that that's going to make on our total expectations [indiscernible] (00:41:56). But we're pleased with the progress that we're making in institutional based discharges. Currently only 37% of our admissions are non-institutional. So we've been able to increase that institutional admission rate 67%.

Operator: Your next question comes from the line of Kevin Fischbeck of Bank of America.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Good morning. Actually this is Joanna Gajuk filling in for Kevin. Thanks for taking the question.

<A – Mark Tarr – Encompass Health Corp.>: How are you Gajuk?

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: I'm good thank you. How are you? So in terms of the follow-up here on the comments on the very strong pricing in the inpatient rehab segment. So you talk about the strength across all payers. But also at the same time I noticed that in your slide deck, on page 26 at the bottom you show expected pricing for the bucket, the Medicare Advantage and Managed Care, bucket and actually for 2020 you kind of expect deceleration from 2% to 4% growth in 2019 to 1% to 3% growth in 2020. Is it because of the cost or anything is changed because I've noticed that previously you kind of have this 2% to 4% growth every year? But now I guess it seems like something might have changed in terms of the outlook in out years.

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. That's almost solely attributable to revised expectations for Medicare Advantage and that relates to a trend that we've talked about on many of our previous quarterly calls and that is, we've been very successful in negotiating a movement for many of our Medicare Advantage contracts from a per diem basis to CMG basis and the [ph] CMJ (00:43:39) is tied to Medicare fee-for-service CMGs.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Right.

<A – Doug Coltharp – Encompass Health Corp.>: So when we get a reduction in Medicare fee-for-service, it also impacts that portion of our Medicare Advantage book of business and CMGs now account for about 75% of our Medicare and Managed book of business. And that was the sole adjustment we made to that expectation.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: Okay. Yeah, that's what I was expecting. I just want to confirm that. That's helpful. And the second follow-up on pricing, but within home health, so you flagged obviously there's some year-over-year comparison differences to the $4 million [indiscernible] (00:44:15) last year and there is I guess the $1 million benefit this year from BPCI. So if I exclude both, it's still pretty good number 1.2% increase. So that's obviously much better than declines last year in 2018. So is it a good way to think about it that this should be sort of your expectation I guess going forward for 2019?

<A – Doug Coltharp – Encompass Health Corp.>: I think trend wise, it is a good way to look at it. It will be altered when we close on Alacare, because there's a different patient mix. Because what's driving that normalized increase this year is our patient mix, which includes a higher portion of therapy than we currently have in place at Alacare. And then also the success that we've had more recently establishing our value proposition with Managed Care players and Medicare Advantage within our home health segment.

<Q – Joanna Gajuk – Bank of America Merrill Lynch>: And actually yes, on Alacare was my question. I appreciate that you did not include it in the guidance as of now but it's closing in June. So you disclosed some of the metrics in terms of the purchase price and revenues. But can you talk about the margin and sort of profile of that asset and also how do you expect this to play out once the deal closes? Because my question is, is it going to look similar to Camellia where initially we're talking about this not being as accretive because there's some – there were some costs and investments initially, but then accretive afterwards, so any color you can give us would be helpful? Thank you.

<A – Doug Coltharp – Encompass Health Corp.>: Sure. And Joanna, I think you know it's our policy we don't provide updated guidance and we don't comment in depth on expected performance until we've actually closed on an acquisition. Again we're anticipating that that will be in June of this year. That said there will be some similarities to the Camellia Healthcare acquisition. There's always going to be a ramp up period. Alacare is a very well-run organization that has been providing great services to home health and hospice patients in the State of Alabama. But there are things that we do certain way at our home health segment that are proven to be very effective and really industry leading. And so, we'll take some time in the back half of the year to help the team adjust to our operating standards and then hopefully

those will be fully in place by January 1st of next year and will enjoy the benefits of a full year EBITDA contribution from that business.

Operator: [Operator Instructions] Your next question comes from the line of Dana Hambly of Stephens.

<A – Doug Coltharp – Encompass Health Corp.>: Hello, Dana.

<A – Mark Tarr – Encompass Health Corp.>: Good morning, Dana.

<Q – Dana Hambly – Stephens, Inc.>: Hey, good morning, thanks for taking the questions. Doug I want to go back to a comment or an answer to Brian's question earlier about if the behavioral adjustments go away that you might be able to get a flat home health reimbursements in 2020, is that correct? And does that compare to – you are using a negative 3.8% in your business outlook on page 26 right now?

<A – Doug Coltharp – Encompass Health Corp.>: That is what I said I'm making big promises on April's behalf.

<Q – Dana Hambly – Stephens, Inc.>: Okay. All right, just wanted to clarify that. And then the follow-up Mark or Barb just for the uninformed which includes myself. Just trying to understand the importance of going to a weighted functional score from an un-weighted functional score in the IRF proposed rule.

<A – Mark Tarr – Encompass Health Corp.>: It is a big change. And once again I mentioned that we appreciated the willingness to CMS to listen from stakeholders. We were a big part of that, very proud of the contributions our team made in terms of their point of expertise and feeding that back to CMS. I'm going to let Barb comment on that. Barb is actually trained as a physical therapist. So she's actually done some of this type of marking with the tools.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: So the CARE Tool does weight things differently than did. And to be honest we actually requested additional information from CMS on the data analytics that they use to determine the weighting and the CMG, so that we can have a better understanding as we prepare our comments, because there are some that are similar to the weightings, the way it was with FIM, but there are some that are very different. And at this point we don't really understand how they determine some of those weightings.

<Q – Dana Hambly – Stephens, Inc.>: Thank you.

Operator: Your next question comes from the line of Kevin Ellich of Craig-Hallum.

<A – Doug Coltharp – Encompass Health Corp.>: Hello, Kevin.

<Q>: Hi, guys.

<A – Mark Tarr – Encompass Health Corp.>: Hey, Kevin.

<Q>: Hey. This is actually [ph] Ryan (00:49:06) on for Kevin.

<A – Mark Tarr – Encompass Health Corp.>: All right.

<A – Doug Coltharp – Encompass Health Corp.>: All right.

<Q>: Hey, most of my questions have been touched on, so just some housekeeping stuff. Could you talk a little bit about the timing of the $3 million to $5 million in strategic investments in post-acute solutions? And apologies if it's been mentioned before, but are those operating costs, and if so is it in G&A or other operating?

<A – Doug Coltharp – Encompass Health Corp.>: So the $3 million to $5 million will be 100% operating cost. It's all going to be – I'd say all of it – probably 80% of it's going to be in corporate G&A, there may be some piece that just slips into IRF segment because it's hard for us to not involve folks from the IRF side, but we wouldn't necessarily pull their cost out. It was a little bit light in the first quarter. And I would expect the balance of it to be pretty ratable over the rest of the three quarters of this year.

<Q>: Okay. And then just my follow-up, how much will be funded by revolver versus cash as it relates to the Alacare deal and how quickly do you guys want to pay that down?

<A – Doug Coltharp – Encompass Health Corp.>: Cash is fungible. So I don't know exactly what our cash balance will be on June 1, but if I were doing some modeling I probably would plug it all in under the revolver. And then in terms of paying it down, it'll go into our cash allocation model. But this again is a business that is at a relatively low degree of financial leverage and generating a lot of cash. So I don't – and in addition to that, if you look at the composition of our debt capital, we have a lot of flexibility, we have very little with regard to principal amortization, and our maturities are pushed out in widespread. So I wouldn't feel any pressure to trying to reduce the revolver balance even after funding healthcare as a prioritization of free cash flow.

<Q>: All right. Thanks guys and congrats on the quarter.

<A – Mark Tarr – Encompass Health Corp.>: Thank you.

Operator: Your next question comes from the line of Nathan Leiphardt of UBS.

<A – Mark Tarr – Encompass Health Corp.>: Hi, Nathan.

<A – Doug Coltharp – Encompass Health Corp.>: Good morning.

<Q – Nathan Leiphardt – UBS Securities LLC>: Good morning. Thanks, on for Whit Mayo. Just on the joint marketing with the American Stroke Association, American Heart Association, I know you gave some numbers around downloads and whatnot with that initiative is. And you called out some increased stroke mix, but wondering if there's been any measurable volume benefits from that initiative yet? When we might start to see some of those?

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. I think we are seeing, first of all, when we look at our own measure of stroke market share and you've got to pick a way to try to measure it. We look at the stroke incidence that is published by the American Heart Association/American Stroke Association on an annual basis is a little bit of a lag to that data. We removed the mortality rate which is updated more frequently. And then we just look at our stroke discharge as the numerator in that equation and what we see is continued growth in our stroke market share. And in addition to that if you look over the last three years, we've had a CAGR in our stroke discharge that is in the 7% to 8% range. So, certainly within – now the specific partnership with ASA/AHA only started on January 1st of this year. So it's really only quarter that we can say has benefited at all from that initiative although there was a bit of a ramp-up. But certainly we think this is highly complementary to the things we've already been doing with regard to clinical programs and stroke certifications and so forth and that the opportunities that remains to serve stroke patients is still very vast.

<Q – Nathan Leiphardt – UBS Securities LLC>: And then I just had a clarification, you rattled off some numbers earlier by payer in the IRF segment in terms of pricing growth and volume growth, was that same-store or total and I was also hoping if you could give the Medicaid and the commercial volume growth, I know you gave the Medicare Advantage?

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. That was for total not same-store and in terms of volume growth Medicaid was up 3.9% and Managed Care was down slightly.

<Q – Nathan Leiphardt – UBS Securities LLC>: Great. Thanks.

Operator: Thank you. I will now return the call to Crissy Carlisle for closing comments.

Crissy Buchanan Carlisle, Chief Investor Relations Officer, Encompass Health Corp.

If anyone has any additional questions, please call me at 205-970-5860. Thank you again for joining today's call.

Operator: Thank you. That does conclude Encompass Health's first quarter 2019 earnings conference call. You may now disconnect your lines, and have a wonderful day.