Company Name: Encompass Health Corporation (EHC)
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<<Matt Larew, Analyst, William Blair & Co.>>

[Call Starts Abruptly] and thank you for joining us for the Encompass Health management presentation. My name is Matt Larew. I cover healthcare delivery and services here at William Blair. I'm pleased to be joined this morning by President and CEO, Mark Tarr; and CFO, Doug Coltharp.

Just briefly here, Encompass Health is the clear market leader in inpatient rehabilitation and has a growing network of home health and hospice agencies built around its rehab hospitals. Encompass really is positioned in the sweet spot of demographic growth, which should lead to accelerating demand over the next decade. Due to the companies consistent investments in quality and technology, Encompass treats higher acuity patients at a lower cost while delivering higher quality outcomes than its competition.

So two quick items before I turn the podium over. One, the breakout session is on the second floor, in the Burnham B Room, immediately following the presentation; and then second, I'm required to inform you that for a complete list of research disclosures for potential conflict of interest, please visit our website at williamblair.com.

So with that, I'll turn it over to Mark.

<<Mark J. Tarr, President and Chief Executive Officer>>

Thank you, Matt. It's great to be back at the conference, again, this year. Let's start with the forward-looking statements disclosure statement. If you have any further questions on this, you can tap into our website that provides additional data. And for those of you that aren't familiar with Encompass Health, we are industry leader in post-acute care solutions and patient care. We're broken up into two operating segments: one, facility base, as you can see here, with 130 IRFs or inpatient rehabilitation hospitals.

We have – the second operating segment is the home- based segment with 221 home health locations, 59 hospice locations. We have a very broad geographic distributions across 37 states and two locations in Puerto Rico. Our facilities are noted for their high quality of care and superior outcomes as our ability to provide integrated care in the marketplaces particularly where we have both business segments. And also we are able to do this in a very cost-effective and a cost-efficient manner and are the industry leader in terms of our cost data and low-cost provider.

We're also very proud of the fact that we are seen as being a good employer. As noted here, the Fortune 100 Best Companies to work for, to achieve the Great Place to Work for. We take this very serious, work very hard at it. We're going to retain our good staff, and we don't have the

turnover and the expenses affiliated with that. So we're very proud of being named to these lists on a regular basis.

The first segment is the inpatient segment. It accounts for about 80% of our consolidated revenues. From a market share perspective, we're the largest owner operator in this segment of IRFs. We have 22% of the licensed beds that are out there. Almost one in every three Medicare patients served in an IRF this year will be serving in an Encompass Health Hospital. Our business model has 45. Almost third of our total number of hospitals are partnership setup with acute care hospital systems. That is a business model we've had now in place for almost 30 years, very proud of the fact that we've never had one of our partnerships unwind.

Each one of our hospitals have very clear, defined and developed clinical programs as evidenced here by the fact that we have 115 hospitals that hold one or more disease-specific certification from the Joint Commission, which is the major accrediting agency for hospitals, both acute and inpatient rehabilitation. The type of patients that we see in our hospitals: we have 40% of our patients fall into neuro category between those who suffer from stroke, about 18% of our dischargers are stroke patients. We have – the remainder of that 40% are what we call other neurological types of cases. Those patients that have some sort of neuropathy, typically that would fall into that category. We have a number of hip fracture patients. We have patients that have suffered from traumatic injuries, such as brain injuries and spinal cords, and typically those patients are those types of debilities that will be associated with the geographic population.

Second operating segment is home health and hospice, which accounts for the remaining approximately 20% of our consolidated revenues. We are the fourth largest provider of Medicare skilled home services. As you can see here with 221 locations, with 59 hospice locations that puts us as a top 20 hospice provider in the United States. We have very defined programs, once again, clinical programs in our home health and hospice segments, similar to what we have in our rehabilitation hospital segment. And once again, we're very proud of the quality, as you can see here, 90% of our home health agencies receive three stars or greater and 97% of the agencies have three stars or greater inpatient satisfaction.

The key area of our strategy is to create market overlaps, so that we can integrate the care between our two operating segments. We call these overlap market. That definition is where we have a market where we have a rehabilitation hospital. We seek to have a home health agency that's typically around within a 30-mile radius so that we can integrate that care. 60% of patients that are discharged from rehabilitation hospitals will go home with home health. So that provides an opportunity for us in our overlap markets to integrate that care, have a nice consistent collaborative effort at the time of discharge from our rehabilitation hospitals into the home setting with home health so that we can ensure that all the questions from the patient, the patient family, all the medications have been reconciled, we've made all the additional arrangements for follow-up visits and have really tightened the collaborative efforts that so often gets overlooked as we go from one health care setting to another.

Let me talk about our quality. We really feel that this is the backbone of our opportunity for growth going forward is the quality that we provide in both of our segments, and we're very proud of what we have. Quality is measured in a number of different metrics, but none are more

important than our ability to both get the patient back to the community at the time of discharge from our hospitals, and then once they are home, make sure that we are taking care of those patients so that we can minimize the percent of those patients that need to be readmitted back to the acute care hospitals. So you can see the breakout here in blue between the results we have on our hospitals. So we have 79% – almost 80% of our patients are discharged back to the communities at the time of discharge from our hospitals and you compare that to the industry average of 76.3%. So we have a 300 bps of better percent outcome on that. And we attribute a lot of that through the developed programs that we have in our hospitals, and you can see the certified clinical programs, we have 295 of those certified programs in our hospitals.

And then simply on the home health, where, in this case, it's better to have a lower percentage. So we have a lower percentage of 15.8% compared to an industry average of 17.2% on the 30-day hospital readmission. So if we can keep the patients moving and progressing towards the home, not have those patients be readmitted back to the acute care hospital, either while they are in our hospital or within 30 days after they have been discharged home that goes a long way and not only attributing to our overall quality but also keeping the cost of care down for these patients.

Talked a lot about not only our quality but that we provide that quality in a very cost-effective manner. And you can see the metric that we've looked at here, from the inpatient rehabilitation here in the blue, lateral number here, you can see the average cost per discharge for Encompass Health versus the industry average is almost 26% lower. You can see the 13.6% versus 18.3%. Then down on home health, we also have the cost number that's significantly lower at 11.6%. So if you think about the areas that we focus on in making sure that we provide that cost-effective care, we look at everything from managing our labor, that's – the largest single segment of our cost is managing labor. So if we can do that, having the proper skills mix, being able to react and respond appropriately to changes in volume. We have on the hospital side, we have some benefits of scale as our hospitals typically are larger than the competition we have in our marketplaces.

And then in home health, we have the market density where we're able to provide additional staffing efficiencies because they are not driving all over from one setting to the next. We have this higher density within our marketplaces. So there are number of different initiatives. We're very proud of our cost effectiveness. It's something that our management team is very focused on, on a daily basis. We have the management tools through our IT reporting structure to make sure that we're providing the data and information to our management team so that they can manage this cost-effective side with our care.

One of the most compelling aspects of our business is the demographic tailwind. Our average age patient is right at that 76, 77 age range. And when we think about the aging population and as we all grow older, there is a greater chance that we will suffer some malady or some type of accident that will require the need of rehabilitative services. And you can see here, what we've listed out, the baby boom wave that comes in 2022 and you can see the growth impact and the growth trends as the baby boom generation ages out to our age cohort.

Then on the table, on the right-hand side, you can see the growth rates of that 70 to 74 in the 75% to 79% are 79 age at the 5% through the 2018 and 2022 time frame. So as the baby boom generation ages out, increased need for rehabilitative services is only going to increase as we move forward. We see our growth strategy in terms of being multifaceted. We have the opportunity and a strong track record taking market share gains, once again, driven by our clinical programs and the outcomes that we're able to achieve. When we think about our hospitals and the opportunity to grow our hospitals, we look at adding capacity through bed additions. We have very comprehensive way that we track and review our occupancy percentage and work and plan ahead for opportunities to add beds to our existing hospitals.

And then we also have a very nice pipeline of de novo projects to develop new hospitals from ground up in either existing marketplaces or new marketplaces. And then there are some opportunistic opportunities for acquisitions on the IRF side. On the home health side, I mean, think about the maturation in an acquired home health locations, where we have acquired either smaller home health systems or agencies and we moved them up to our systems. We move them into our ability to drive the volume and the clinical excellence to our standards. It gives us an opportunity to growth those agencies. We're also looking further opportunities to prioritize to create these additional market overlap, where we have both a rehab hospital and an agency that is a priority area as we look at agencies that we can acquire and add to our system.

And then we've also really done a nice job in the past couple of years of taking the opportunity to build additional scale in hospice through our acquisitions. And that's a service line that we've really grown to show some proficiency add and see that as being another attractive area for growth for us moving forward and benefits also from many of the same characteristics, demographics and otherwise that are home health and IRF business benefit from.

All right. Targeted growth for new de novo hospitals is four to six per year. You can see what we have coming on in year 2019. We've already opened up the hospital in Lubbock. We'll be opening up Boise, Marietta and then Katy, Texas, by the end of this year. We've already announced two hospitals for the year 2020, both in new states for us, Sioux Falls, South Dakota, and Coralville, Iowa, both of those being 40 beds. And then you can see down below, we'll add 150 beds this year through bed additions. Kind of our marker per year is right at 100. So this will be a strong year for bed additions that we'll see the benefits of it going into next year.

The home health and hospice industry is very fragmented. There are 11,800 agencies that are out there. Most of those have revenues, $5 million or less. So it's very much an industry of small players that are out there. You can see here from this time frame, moving from left to right, our track record of acquisitions, some of these are larger than others; or in some years, it's been mostly through small agency acquisitions, but we target anywhere from $50 million to $100 million per year in acquisitions. We've had an acquisition there. You can see from 2019, Alacare, which we're in the process of closing, we'll hopefully have that done by the end of the second quarter of this year. That acquisition puts us from a hospice perspective, though, moving us into the top 10 list of hospice providers in the United States, given the 23 additional locations in home health and hospice that Alacare will bring to our company.

So when you think about not only the growth but the opportunity to support that growth with operational initiatives, this year we have the increase in clinical collaboration which has been a focus for us now for a number of years. That is our opportunity to stay focused on the opportunities to have the patient transition from our hospital at the time of discharge into our home health. We put a big focus on building our stroke market share. We've shown a real nice ability to have outstanding quality measurements and have nice growth on stroke and our rehabilitation hospitals that then transition to our home health. And then we've also taken this opportunity to further develop our post-acute solutions using the data and our partnership with Cerner and the IT investments that we made over the years to advance this cost.

Our clinical collaboration that we refer to is the standardization of all those tasks that it takes to prepare a patient for and have a successful discharge from our hospitals to the home setting, and you can see here, we've had some nice growth on that. We've – this most recent quarter, we were at 36%. We think we can grow that from a longer term perspective, up to 60%. Our near-term goal is 40% on a collaboration percent rate. We currently have 81 of our marketplaces are now, what we would call, overlap markets where we have both a hospital and a home health agency.

So, this is an area for continued focus. It gives us an opportunity not only to continue to add volume in our home health but it gives us a chance to integrate care. We've seen some nice tick in some of the quality measurements on the patient satisfaction side as well as the ability to increase the number of patients going home versus skilled nursing facilities from our hospitals because of this clinical collaboration. So there's not only volume side but there's very much quality upside that comes from clinical collaboration. We talked about the stroke market share and what a great program this has been for us. This gives you some idea in terms of what the potential addressable market is for stroke patients. So there will be about 800,000 stroke cases this year. And if you net out those individuals that won't survive their stroke, it leaves about 626,000 strokes of which a portion of those will need inpatient rehabilitative care.

We have established a co-branding relationship this year with the American Stroke Association, which is a nice opportunity for us to work collaboratively with a very well known brand out. They are carrying the message of stroke prevention, and we are carrying the message of stroke care and the fact that there are better outcomes seen when patient suffering from a stroke are treated in an IRF setting versus a skilled nursing facility. We talked earlier about the number of programs that we had in our hospitals that are certified by Joint Commission. You can see here that we have a 130 of our hospitals hold stroke-specific certifications.

So, we believe that this will help us contribute to our increase in our stroke market share. We think that if we carry on consistently, responding in terms of our clinical outcomes, you can see that our growth rate here in stroke alone has been right at the approximately 6% over the past three years. So this continues to be a focused opportunity for us and an opportunity for growth.

Post-acute solutions is our ability to lever what we've done in terms of investment on the IT side of our business; the opportunity to gather the data and use that data, whether it's from our own systems or partnership with Cerner to develop clinical decisions or tools to enhance our clinical approach to patients and also work with acute care assistance in helping to identify which

patients belong in which segment of post acute. And we started piloting this initiative in 2018 in Tyler, Texas. We subsequently rolled it out to Petersburg, Virginia, and then this year, we've rolled it out into the Houston marketplace, where we continue to refine the efforts and our ability to use this data to improve overall patient care and also be an asset and a good partner to the acute care hospital systems that we're working with.

We've also used some of the information from Medalogix in helping to identify best practices for home health optimization in terms of the number of visits for episode or patients with various diagnostic categories on identifying what's the optimal number of visits, what type of skill set is needed to provide care for those patients in order to reach the optimal outcome.

So overall, we'll continue to focus on opportunities to use this vast amount of data that we're collecting now, not only, once again, in our own systems but working with Cerner and expanding that going forward. Our business model generates substantial free cash flow and gives us a lot of different opportunities to deploy this cash. Our number one focus is supporting the growth that we have in our core business areas. The best return we have is on our IRF bed expansion. I mentioned earlier, we'll have over 150 beds coming online this year, which will benefit significantly from next year when we think about growth and same-store growth. It also helps us in terms of funding for new de novo hospitals that will do four to six per year as well as help fund the acquisition in our home health and hospice segment.

It also gives us opportunities to look at our balance sheet and review debt reduction opportunities. Our leverage at the end of first quarter is right at 2.8 times. So, we have very strong balance sheet to support our growth. Then we also have opportunities for shareholder distributions. As you can see here, as we think about the opportunities to either have cash dividends or stock repurchases or also through the home health rollover shares that will have some of our free cash flow go to addressing that within this next year.

So to wrap things up, when you think about our company and our organization and the strategy that we have, we exist in very attractive healthcare sectors. We talked about the demographics that are helping to drive growth in both our facility based and our home health and hospice. We're industry-leading positions when you think about our outcomes and our quality and the opportunity to provide that care in a very cost-effective manner.

From the real estate standpoint, we own 70% of our real estate, which is a little bit different. It puts us – we consider it to be a competitive advantage, particularly in times where there could be pricing pressures that are out there. We talk about our financial strength and we feel that there is going to be significant growth opportunities going forward in this industry, not only due to the demographics but due to the fact that both of these segments are in very fragmented marketplaces that give us an opportunity to be a consolidator in the marketplace.

So with that, Matt?

Q&A

<Q – Matt Larew>: [Indiscernible] (00:24:31) we got to ask one question here in a couple of minutes, which is, in the first quarter, you grew about 14% in your Medicare Advantage volumes and IRFs, and obviously, a very strong Medicare Advantage within home health. I think traditionally, folks might have thought that the Medicare management is less attractive or the headwind is on both sides, but it seems like that conversation may be a better appreciation compares about discrepancies in quality throughout the market. Maybe if you could characterize how that opportunity changed for you and how you are using data to form those conversations?

<A – Mark J. Tarr>: Yes. So, we've worked for a number of years now with, what we call, our value proposition specifically on the inpatient rehabilitation side. Medicare Advantage historically had sent the majority of their patients to skilled nursing facility. And they didn't typically pay a whole lot of attention to the longer-term cost involved with caring for patients. So they sent them to a skilled nursing facility. There's a much greater likelihood of patient being sent to a skilled nursing facility to be readmitted back to the acute care hospital.

So with time now we've seen a very nice uptick on our Medicare Advantage growth. This last quarter was 14%. One out of every three referrals we get from Medicare Advantage is a stroke patient. So we continue to make strides and progress on this value proposition specifically when there is time to look more and more at the outcomes that we are able to achieve with our patients in getting them back. You saw before that we get almost 80% of our patients are sent back to the community and only a small portion of those go to a skilled nursing facility or back to the acute care hospital.

So, we think the MA plans are starting to think longer term about their costs. We continue to make progress. We think it's not only strokes, but we think that this progress that we've made with MA plans will reach out into other diagnostic categories, too, and not just strokes. On the home health side, we continue to work with MA plans. They have been not as quick to recognize the benefits of home health. So we have put our focus on our growth on the Medicare patient population, and we'll continue to have dialogue with MA plans and negotiate the opportunities for better payment levels there.

<Q – Matt Larew>: Okay. One question.

<Q>: [Question Inaudible]

<A – Doug Coltharp>: I think it's a very good point, which is based on the demographics and based on the fact that there isn't any technological obsolescence that's likely to reduce the incidence of maladies that we treat in an aging patient population. We anticipate that we will see growth in at least that 5% to 7% area for the IRF; and that's total group, not just same store. We think the growth rates for our home health and hospice business will be larger, based on the market opportunity, the objective of achieving further clinical collaboration and based on additional acquisition opportunities. So we have had growth in the home health over the foreseeable future on the top line and probably low single digits; and hospice growth, we would target close to 20% per annum for the foreseeable future.

<A – Mark J. Tarr>: One of the points, we didn't make strides is that the patients that go into our hospitals are nondiscretionary in nature. I mean, they are medically fragile. They have to be in a facility. So that it's not a decision whether they send that patient home or do they send it to an IRF. These are patients that need to be in a facility with 24-hour care. So that is not going to be obsolete at any point in the future.

<<Matt Larew, Analyst, William Blair & Co.>>

Thank you. We'll move to Burnham B.