PARTICIPANTS

Corporate Participants

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

Other Participants

Matt Borsch – Analyst, BMO Capital Markets Corp.

MANAGEMENT DISCUSSION SECTION

Matt Borsch, Analyst, BMO Capital Markets Corp.

Okay. Well, thank you, everyone. Thank you for joining this next session of BMO 2020 Healthcare Research Conference. We are delighted to be able to welcome Encompass, and very much appreciate their willingness to participate. Representing the company is Doug Coltharp, the Chief Financial Officer, as well as Crissy Carlisle, who is Head of Investor Relations that all of you know. Thank you, both, for joining us.

FACTSET:callstreet
corrected transcript

QUESTION AND ANSWER SECTION

<Q – Matt Borsch – BMO Capital Markets Corp.>: What I'd like to start with, if I could, is maybe if you could just touch on the updates that you provided on utilization trend? And I want to thank you probably then the most proactive and visible company, certainly from what we can see in providing real-time information or frequent information about what you're seeing. And I think you've done a tremendous service, that's true. So, I want to thank you for that. And maybe just one other thing, if you can touch on the 8-K that you filed relative to the return of the relief funds that you paid back to the government.

<A – Doug Coltharp – Encompass Health Corp.>: Certainly, Matt. Thanks. Let me start with the volume trends and I appreciate your comment. We have long had a philosophy of transparent communications and timely communications in the investment community. And really recognizing the substantial disruption in our business from the COVID-19 pandemic, as well as the disruption to the healthcare provider community overall, when we made the decision to withdraw our guidance in the beginning of April because of lack of visibility, we felt it was important to update the investment community periodically with the trends that we were seeing in volume. The good news is that since reaching a low point with regard to volume in all three of our business lines in the middle part of April, we've seen a steady climb and now are at or above pre-COVID-19 level.

If we look specifically at each of the business lines within inpatient rehabilitation, which is by far our largest business line, we came in with a strong ADC, which stands for average daily census, average number of patients who are in our facilities at any point in time. We came into the crisis with that number running very strong. At the end of February, we had 6,782 patients in our facility. That dropped significantly to a low point around the middle of April at 5,139; and as of June 17, it was the date that we reported on in the 8-K released last evening, we're up to 6,537, crossed over 95% of pre-COVID-19 levels.

On home health, we have been measuring the volume with regard to starts of care. Starts of care is a statistic that is sum – or I should say, starts of episodes, which is sum of starts of care, which would be an admission plus a recertification. Again, came into the crisis very strong with 4,950 per week. That dropped down to low point again in mid-April of 4,120, and has recovered as of the weekend of June 14, 5,250, so, actually exceeding the pre-COVID level.

We had disclosed previously that there's a little bit of a dynamic that's going on, going to restrict our momentum somewhat in the month of June with regard to home health, and that is since we have reached our low point in April with new admissions that, just by definition, means that we're going to have lower recertifications, because there are fewer patients who would qualify for a recertification in the month of June, but we don't think that that means that there's any abatement in the positive trend we're seeing with regard to volume recovery.

Finally, hospice, which is our smallest business line, we had just about 260 patients in-house for our hospice business for the week that ended March 1, which again was pre-COVID. And we're back up to 262 at the end of the week of June 14. So, pretty much a full recovery there. That's on the volume side. I do think it's important to note, and we talked about this in some of our more recent equity conference participations, that we continue to run some expenses substantially higher than our pre-COVID-19 level.

And it's an array of things that you might think are very logical. Our labor as a percentage of revenue is running higher and has a lot to do with things like donning and doffing for some protection equipment [ph] to get (00:05:02) ready to address a patient's care. It also means that in many instances, we're having to treat patients on a one-on-one basis, whereas before, we may have been able to get some leverage with activities such as [ph] recurrent therapy or group

therapy. (00:05:16) So just want to make sure everybody understands that although volume is recovering, our margins are still running lower, and that will continue to be the case for the foreseeable future.

Looking [indiscernible] (00:05:27), Matt, you asked about our decision to return funds that we received under the CARE Relief program. And first of all, let me say that we have been enormously appreciative. The actions that have been taken by the administration, by Congress, by HHS, by CMS to, in real time and in a real meaningful way, attempt to address the pandemic through an array of things such as funding and regulatory relief. So, in this particular instance, we received under the CARE Relief Act two tranches totaling $238 million from the government. And these were funds that were meant to compensate us for foregone revenues and extra expenses, specifically related to the COVID-19 pandemic. And we have certainly had foregone revenues and extra expenses.

Nonetheless, we made the decision after careful evaluation to return all $238 million back to HHS. And we did that in the latter part of May. And there were a number of reasons that led to that. First relates to allocation. The allocation method that was used by HHS [ph] really to fund (00:06:45) to various providers differed materially from the first tranche to second tranche. Both of the funds that we received were in the first tranche. The communication with regard to the second tranche, there was some language clinically stated that the methodology that was intended to apply across both tranches that used in the second tranche. When we looked at the second tranche, we felt like that would have resulted in a meaningfully lower allocation to us. Our estimate was $238 million should have been [ph] $80 million and there was a (00:07:22) portion of these funds that we had not really been entitled to receive.

Second factor was aggregation. We actually received these funds at 209 separate legal entity accounts. And we had tried to research during the timeframe that we were holding the funds and evaluating whether or not to sign the attestation, whether or not the funds could be aggregated towards a use or if they had to be held at the individual entity level and used specifically to offset foregone revenue and expenses, and required reporting and auditing at that level as well. We did not get a clarification and our best understanding was it could not be aggregated and to be used the individual entity level, which would have imposed a very significant administrative burden on us, would have limited our ability to utilize the first amount what now would have been approximately $80 million.

Third factor was that we believe that the funds will have to be taxed at Federal level as well. That obviously reduces the ability of those funds to offset foregone revenue and increase [ph] expenses. (00:08:32) An additional factor was that it's clear in the language that accompanied the receipt of the funds that you would not be permitted to use the funds, had an alternative reimbursement source. And we believe that at least a portion of the foregone revenue and extra expenses that we are incurring maybe remedied via our business interruption insurance policies. That's probably going to take a long tail to resolve for the period of time in which we are negotiating that with various carriers, we would not be able to avail ourselves [ph] of at least that (00:09:09) portion of these funds.

And finally, we felt that the attestation that we will be asked to sign in order to keep the funds was very open ended and allowed for the unilateral provision, additional provisions in terms and conditions down the road. That was problematic. That's a very long response, but when you're returning $238 million, I think it merits that kind of detailed answer.

<Q – Matt Borsch – BMO Capital Markets Corp.>: Well, sure and thank you so much for all that information. That actually that is tremendously helpful and I applaud you for taking that proactive step both in getting the funds and then in making decision that is best for the company to return them. So, that's great.

Maybe just staying on COVID-19-related for the moment, actually, the next couple of questions will be. I know you've gotten this before, but I want to just touch on long-term effects, structural impacts from the pandemic that you could reasonably foresee at this point changing the dynamics of what you do. I know there's more telemedicine generally, but what are you expecting – let's say that tomorrow we have a vaccine and by the time we get to 2021, the pandemic is over, what structural changes, if any, impacting your business would you predict?

<A – Doug Coltharp – Encompass Health Corp.>: It's difficult to say right now whether any of the regulatory relief that's been put in place for all three of our business lines will remain. There is the potential that things like some relaxation of the 60% Rule within the IRF segment could remain, the use of some of the telehealth specifically to initiate starts to bear more flexibility about physician face-to-face in home health, I think could be something that stays with us for a longer period of time. And we would view all of those things as positive, because they allow for an easier transition from patients between sites of care.

On the flip side, I think the higher utilization, although not at peak levels, higher utilization of PPE is with us today. I also think that there are going to be expectations with regard to social distancing that are going to be here to stay as well. Within the IRF setting, that means that things like the utilization of group therapy, which is a healthy thing because it contributes to socialization, which is an aspect of recovery from the patients that we are treating, that that may be diminished to some degree, that will be more reliant on individual [ph] than (00:11:59) group therapy. I think there are some things that will emanate from this, that will ultimately result in higher expenses.

And, again, on a positive side, I think what we've been able to do through the course of this pandemic is highlight some important constituencies, ranging from acute care hospitals to physician community to Medicare Advantage plans, the value proposition of our business, specifically, the value proposition of being able to transition customers seamlessly from the IRF setting to the home health setting. So, I think that although we were already making great progress in terms of enhancing our relationships with those constituencies, [ph] the prices has served as a strength to that (00:12:43) perhaps to put us on a steeper upward curve.

<Q – Matt Borsch – BMO Capital Markets Corp.>: That's a very interesting point. So, the health plans, it's made a difference to them, that you can offer the seamless transition. And they've shown they put a higher value on that in a period where there's, obviously, a lot of concern around health [indiscernible] (00:13:07)

Okay. Let me ask about the impact to the pandemic on M&A. And, obviously, I know that you're not going to comment on what's ahead. But your discussions and, on the one hand, maybe some smaller companies that you may look at are more pressed, given everything that's happened and a higher costs and lower revenue and all that sort of thing. On the other hand, just this sheer disruption and distancing from the pandemic may mean that a lot of discussions are on hold. So, can you just touch on those mix of factors as they relate to your looking at acquisitions?

<A – Doug Coltharp – Encompass Health Corp.>: Certainly. So, we, and I think a lot of the other larger providers of home health services had anticipated the implementation of PDGM was going to be very difficult for many of the smaller players in the industry. Particularly one that's been layered on everything that has happened in the home health industry over the last four to five years, if you recall includes a substantial multiyear rebasing, which is a euphemism for price reduction for home health providers, included increased quality reporting requirements and other items that have placed pressure on working capital like Review Choice Demonstration.

We've anticipated coming into this year that this incremental pressure from PDGM would force many of those players over the brink. They would either simply decide to fold up shop or they would

be available for acquisition. What has occurred is that the COVID-19 pandemic has essentially deferred that timeline. It has because it has been very difficult to discern specifically what disruption to the business is related to PDGM versus what is related to the pandemic. And there's also been a lifeline that has been extended through the various relief programs, including the CARE Relief funds that we've talked about earlier as well as things like the PPP loan program that have given some additional time for these players to kind of work through the circumstances.

We think this is a deferral, not a change in the landscape, and maybe the second half of this year or it could be the first half of last year, but ultimately, we would expect to see increased consolidation amongst smaller players, and would expect to be a player in that consolidation [ph] ourselves. (00:15:46) and may point to slower activity for the balance of this year. [indiscernible] (00:15:52) as we had mentioned in some of our previous public discourses that there were a number of large – are a number of larger hospice of providers that are in the hands of private equity players. And coming into the year, those private equity sponsors had indicated they might be looking to take those properties to market during the course of 2020.

Well, for the most part they've elected to defer on those transactions, given the overall environment, both in terms of the disruption to this business. And then some of the volatility that's occurred in the leverage finance market. So, that may be delayed by six months or a year. But, again, we would expect to see those [ph] properties (00:16:32) available some time at least in [ph] 2020. (00:16:35)

Ultimately, we think both home health and hospice remain prime candidates for consolidation and it's our intent to either build scale in both of those busineses.

<Q – Matt Borsch – BMO Capital Markets Corp.>: That's great, that's great. Thank you for that. And, Doug, if I could circle back just to a point you made about the higher expenses related to all the precautions that you had to take in light of the pandemic and that continuing for the foreseeable future, at this point, knowing what you know now, would you anticipate that those probably stretch well into 2021 as well?

<A – Doug Coltharp – Encompass Health Corp.>: It's hard to say that they'll stretch into 2021. I think the best assumption we have right now is they're going to be with us for much if not all of 2020. Then we'll see as we head into 2021 whether or not the course of the pandemic has allowed us to establish a new baseline. I would think that if we get a more normalized environment, there are going to be some changes in the way we all behave, professionally, socially, that may contribute to somewhat higher expenses.

But ultimately, we have been very astute across all of our business lines driving efficiencies. We benefit in doing so from the scale of our operations, benefit from a embedded technology that is ahead of our peers. We benefit from a culture of best practices. So, I'm optimistic that we'll have the ability to again realize a lot of efficiencies [ph] and for the (00:18:18) foreseeable future, we're just counting on higher expense ratios.

<Q – Matt Borsch – BMO Capital Markets Corp.>: That's very helpful. Thank you. And a question, if I could, on current trends just in terms of anything you can say about the revenue mix and how you think that is impacted, if at all, by the pandemic [ph] at least as you've seen it (00:18:42) sort of through the course of the second quarter, if you care to say anything about that.

<A – Doug Coltharp – Encompass Health Corp.>: Yeah, certainly. So, the place where it's easiest to both see it and to talk about it is within the IRF segment and almost 80% of our revenue there. And we've made some previous comments on this beginning with our first quarter earnings call. The waiver by the MA plans, the pre-authorization requirements for the months of April and May led to a real surge in our Medicare Advantage book of business in the IRF segment during that

timeframe. So, we saw average weekly referrals during that timeframe increase about 7% from the pre-COVID levels. And as importantly, the number of those referrals that were converted to admissions, increased by almost 60%. So, our payer mix shifted during the second quarter very heavily towards Medicare Advantage.

Good news is, over the last five years, we have done a fabulous job underscoring our value proposition with Medicare Advantage plans. And one of the results of that was that the payment differential between Medicare fee-for-service and Medicare Advantage had narrowed to an all-time low of approximately 6% by the end of the first quarter of 2020, but it's still lower. And so that's going to have a slightly negative impact on our revenue per discharge for the second quarter, but it contributed to heavier volume.

Those pre-authorization requirements were reinstated by all of the MA plans by the end of May. And as anticipated, we've seen a slowdown in admissions from Medicare Advantage, not to where we were pre-COVID but lower than the peak that we experienced in May. At the same time, we've been seeing an increase in fee-for-service. So, we're starting to move back towards a more normalized patient mix on the IRF side. But those are some of the things that will impact the revenue mix and the pricing there.

In home health, unfortunately, as we implemented PDGM, we didn't have the ability to establish [ph] some (00:20:58) baseline for comparison before we got the impact of COVID-19. So, there are a whole host of things that are being influenced, some by PDGM implementation, some by the COVID-19 pandemic, which really can't be separated. And they relate to things like we know just based on the dynamic business that our referrals directly from institutions have been down because of lower volumes [ph] in admissions (00:21:24) and our referrals from physicians are up significantly. Much of that appears to be attributable to the pandemic, some of it could be could be attributable to PDGM.

<Q – Matt Borsch – BMO Capital Markets Corp.>: Right. Okay all right. But it's great – I mean, it sounds like, in terms of structural impact longer term and in terms of competitive advantage, the negative impact is minimal, if at all, and actually got some advantages coming out of this. So, that's great to hear.

<A – Doug Coltharp – Encompass Health Corp.>: Net-net, I'd say it's a positive.

<Q – Matt Borsch – BMO Capital Markets Corp.>: Yeah, yeah. Right. And if I could just circle back to one point, as you talked about suspending e-authorizations or that period in which the authorizations were suspended. Is that – as you go back and look at that, does that give you ammunition to argue for, if you wanted to, a different authorization process? In other words, the things that maybe would have been delayed because they were subject to an authorization process that have instead went forward, are you going to be able to look at those in retrospect and say, well, all of these would have happened anyway?

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. I think we're going to be able to make a pretty good case in that regard. We're still digesting the information in trying to assimilate the form that will allow us to underscore over the MA plans, just how good of a steward we were to the patients that they sent to us during that period of time when the preauthorization was waived.

But when I look at the aggregate level for that period of time, what I can see is that the average acuity of the MA patients that we were treating did not change much from the pre-COVID-19 period. And the average length of stay actually went up slightly. What it tells you is that we didn't take advantage of that window by accepting a lot of marginal acuity patients, maybe could've been better treated in another setting like a [ph] SNF for (00:23:28) home health.

corrected transcript

We continue to concentrate on those patients most in need of our care. And then if we couple that with the fact that we had a very favorable discharge destination result for those patients, had a low number of acute care transfers and a high number of discharged community, we are hopeful that that will resonate further and allow us to continue the momentum we've had with the Medicare Advantage plans.

<Q – Matt Borsch – BMO Capital Markets Corp.>: Well, that sounds fantastic. And let me just ask – we're almost out of time, but I had one sub question on that which is do you think that in your partnerships with payers, can you have a process for Encompass that is at all different from what the plans apply in the marketplace more broadly to your understanding [ph] anyway? (00:24:18)

<A – Doug Coltharp – Encompass Health Corp.>: I do. I think we've essentially got the ability to create synthetic bundle between the IRF. Remember, one of the reasons that we got in the home health business is that more than 60% of the patients who get discharged from an IRF acquire a follow-on home healthcare. So, I think our ability to go to an MA plan – okay, let's look at a particular type of patient. And or a lump-sum, we will basically take your patients with that diagnosed category and we'll determine the appropriate course of care between the IRF and home health. We will be responsible for the care of that patient for a fixed amount perhaps some kind of collar that offers an incentive for increased quality on one hand and a decrement if we don't hit the metrics on the other hand, [ph] for, say, a (00:25:06) 60-day period of time.

That is something that we think we'll be able to advance faster than our competitors, the integration of our business, because of the business information and technology that we have in place.

Matt Borsch, Analyst, BMO Capital Markets Corp.

All right. We're out of time, but this has been a great section. And thank you, Doug. Thank you, Crissy. And again, congratulations on what you've accomplished and thank you on behalf of the investors for the visibility you've provided during this difficult period.

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

Thanks for hosting us, Matt.

corrected transcript

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2020. CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.