PARTICIPANTS

Corporate Participants

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

Other Participants

Kevin Fischbeck – Analyst, BofA Securities

MANAGEMENT DISCUSSION SECTION

Kevin Fischbeck, Analyst, BofA Securities

All right. Great. I want to thank everyone for joining us. It's my pleasure to introduce Encompass Health here at our Virtual Las Vegas Health Care Conference. Encompass is the largest provider of inpatient rehab and one of the largest providers of home health and hospice services as well. Presenting today, we have Mark Tarr, President, CEO; Doug Coltharp, CFO; and Crissy Carlisle from Investor Relations.

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QUESTION AND ANSWER SECTION

<Q – Kevin Fischbeck – BofA Securities>: So, we're just going to jump right into Q&A. You guys, you have put out an 8-K this morning going through kind of the volume trajectory and trends into April. So, maybe that's a good place to start. Do you want to walk us through kind of what you're seeing across each of the businesses?

<A – Mark Tarr – Encompass Health Corp.>: Sure, Kevin, and thank you for having us today. We're delighted to be here. So yeah, we released an 8-K. I think the important takeaways is that we are seeing volumes rebound post-pandemic. We're certainly seeing a general willingness from the public to have greater confidence engaging back into the health systems. We have seen the decline in number of COVID patients in our hospitals as well as our home health agencies. And along with that, we're seeing fewer and fewer of our own staff in quarantine.

So, in first quarter, there was that one point where we had 30 hospitals, 30 marketplaces that had been capped due to COVID quarantine-related issues or just isolation of COVID patients in our hospitals. So, that number is down to two this week. So, there has been no capacity issues in our hospitals relative to COVID either on the quarantine side, of our staff or the COVID patients. We've seen nice volume increases downstream from the acute care hospitals that seem to be returning back to a normal rhythm. We've seen surgery schedules start to fill up now, so we're seeing the elective procedures begin to be admitted into our hospitals, primarily the lower extremity joint placements, as well as an uptick in our home health business with elective procedures.

So all in all, we're very positive about the momentum that we see. We feel very good about what we did in Q1. And I'd mentioned at that point that we felt we'd be taking some momentum out of Q1, and you can see the results with our April release on where we are.

<Q – Kevin Fischbeck – BofA Securities>: That's great. I guess when you think about your guidance and your expectation for the rest of the year, I mean, how are you thinking about that trajectory as we exit Q4 of this year? Are we back to normal? Do you see pent-up demand at any point during the year?
<A – Mark Tarr – Encompass Health Corp.>: We had factored in our guidance at the second half of 2021, we'd be back to normal, that any major impacts from COVID would be primarily in the first half. We do think that there's a chance that there's pent-up demand out there. As we've said on our Q1 call, our patient population being 76-year-olds in our hospitals and 77 on the home health side probably won't be the first group that goes back to select elective procedures, but we do feel this growing confidence with time to expect them to go back in and have those elective procedures.

We also think that you will see skilled nursing facilities and assisted living facilities, their volumes increase with time which ultimately impacts our home health volumes, and there's starting to be some anecdotal comments back from some of the providers in those two spaces that they're starting to see their populations come back after a real low point during the pandemic too. So, we think there's a lot of momentum going into the second half and hopefully will be beyond the pandemic then or at least very low impacts from the pandemic.

<Q – Kevin Fischbeck – BofA Securities>: All right. Great. And I guess one of the things that we've kind of been seeing for a while is that there has been this shift of volumes out of the inpatient setting into the outpatient setting. It's been a long-term trend and to some degree, it feels like that [ph] accelerator got (04:45) a boost during COVID. How do you think about the implications on your two main businesses of that shift? And as things return to normal, what does that mean at the end of the day for volumes? Does this volume shift persist longer than people might think? Can you capture more of that on the outpatient side? And then on the inpatient side, are there going to be pressures for longer than people may think?

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<A – Mark Tarr – Encompass Health Corp.>: I think the major shifts in terms of just post-acute settings, the beneficiaries are going to be home health. I think IRF will benefit from that as well. The sector that has seen the largest negative impact, of course, is skilled nursing homes, and a number of those patients that historically maybe have gone there for active rehab program, I think many of those were low acuity patients and in large part they've been lower extremity joint replacements. I think those patients, those that are able to go home and receive that rehabilitation in and receive that rehabilitation in the home setting versus skilled nursing facility, you're going to see that lower acuity take their opportunity to go home and have home health agencies treat those patients.

I think, on the other side of it, there have always been a fair number of stroke patients, there's always been a fair number of fractured hip patients with significant comorbidities that could have benefited from an IRF setting instead of being sent to a skilled nursing facility. So I think both of our sectors have a potential to benefit from changes in the post-acute setting world just given what we saw from the results or lack thereof provided through the nursing.

<Q – Kevin Fischbeck – BofA Securities>: Okay. That makes sense. And I guess you guys have been talking about assisted living and nursing home volume coming back and that's helping to boost to some degree the volume in the home health business. I guess it's just a little counterintuitive today to think about that being a tailwind when, in theory, you've been taking some volume out of the nursing home. So how does that net out in your view?

<A – Mark Tarr – Encompass Health Corp.>: So I think the types of patients, I think that the nursing homes will – the volumes will start to come back in nursing, but I think what you're going to see is a different kind of patient. And so and I think you're going to see patients that historically are able to receive rehab, active rehab, those short-term patients, short-stay patients in the nursing home, those are the patients that will go home with home health.

I think they're going to have more of a convalescent type of patient in a skilled nursing facility. They will still need to have care provided to them. And so I don't think that you'll see a large number of the types of patients that we're currently treating with our home health there in the assisted living or the skilled nursing facilities. So, I see it being a change due to more of a convalescent patient going to a skilled nursing facility versus home or to an IRF.

<Q – Kevin Fischbeck – BofA Securities>: Okay. Yeah. That makes sense. And then the company is in the process of reviewing strategic alternatives for the home health and hospice businesses. How do you think about the potential range of scenarios there? Are you feeling confident there's going to be some sort of transaction on that asset, or is you keeping that asset still a very viable potential outcome?

<A – Mark Tarr – Encompass Health Corp.>: So, we announced in December that we were going to be undergoing a strategic alternative review for the home health and hospice. That process is well underway. As we've said, we're evaluating all options, whether that is a partial separation, complete separation, merger, sale. We do not go into the process with any bias in any direction. We are being very – working with our advisers and we're doing a great deal of due diligence on this. As you might imagine, it's a very comprehensive and complex review. Our focus right now is identifying how best to return our shareholders for the long term. And so, we hope to provide and certainly intend to provide an update on our Q2 earnings call and update the investment community on where we are with the process at that point.

<Q – Kevin Fischbeck – BofA Securities>: Okay. I guess maybe with that potential transaction out there, it might make sense to kind of step back and say, if you do get rid of that home health asset, how should we be thinking about the RemainCo growth there? You obviously outlined some long-term targets on the IRF side but I just want to make sure that we're thinking about it right if we think about G&A, deleveraging and things like that. I mean, what should we be expecting from the RemainCo if you spin-off the home health business?

<A – Mark Tarr – Encompass Health Corp.>: Well, as we've announced, we have eight hospitals, eight de novo hospitals that we're bringing on in 2021. We have 12 that we're bringing on 2022. So we'll be using a pretty substantial amount of our free cash flow in funding the growth for the next few years just servicing the growth opportunities that we have in our IRF facilities. And – but we're very excited about the future of that if that were the way that we would go and think that the free cash flow that we have would either help fund the growth or we would certainly consider continuing on with the dividend program or the potential for share buyback.

<A – Doug Coltharp – Encompass Health Corp.>: I think the segment results that we've been publishing provide a pretty good proxy for a starting point of the IRF business even as a RemainCo. The long-term targets that we put back out with the fourth quarter earnings release and the issuance of guides this year will remain intact for the IRF business because those were specific to the IRF.

In terms of the leverage profile, we would continue to target leverage for that business at about 3 times. And with regard to the impact on G&A and any stranded cost we might incur as you separate out the home health and hospice business, it's important to remember that we've maintained a fair degree of autonomy for that business along the way. And so even if there is some friction cost [indiscernible] (11:49) completely offset dollar for dollar the G&A expenses that might have been associated with providing centralized services to home health as you separate it out. Those costs are likely to be absorbed by the expansion in the IRF business which, as Mark just referenced, is accelerating over the next several years.

<Q – Kevin Fischbeck – BofA Securities>: Yeah. Maybe next just talk a little bit about that organic growth on the IRF side because it is an acceleration [ph] as it's always been – it's looking (12:19) part of your plan to do these de novos but it is a market acceleration the next couple of years. How do you think about the 2023 and beyond opportunity? Is this the new run rate or does this – is this more about Florida opened up and this is a huge opportunity in the near-term but it should normalize to something else longer term?

<A – Doug Coltharp – Encompass Health Corp.>: No, we've put out there for the next five years we think that we'll be between six and 10 new IRFs [ph] per M (12:48). Obviously we're exceeding that in 2022. Florida is playing a role in that. But if I look at the composition of our pipeline today, you've got the 12 to 15 opportunities that we had identified beginning back on the Investor Day, March of 2020 that are related to Florida. But you got an equal or potentially larger pool of identified projects that exist outside the state of Florida. And those cut across both the CON and non-CON space.

<A – Mark Tarr – Encompass Health Corp.>: Kevin, you've also seen us with a number of announcements. There are also a combination of 100% owned, solely owned, or projects that we're doing with either current partners where we're adding hospitals into that partnership or new partners such as the hospital we opened this year in San Angelo, Texas with Shannon Health.

<A – Doug Coltharp – Encompass Health Corp.>: I think the partnership that we announced last week with Piedmont in Georgia's real exciting. There, we're taking a couple of existing hospitals and turning those into JVs but it's also giving us the opportunity to look at expansion opportunities in a strategically very important market for us and one that has had some challenges in regard to [ph] CO (14:02) and procurement.

<Q – Kevin Fischbeck – BofA Securities>: And I guess how do you think about the joint venture versus 100% fully owned? Which is a better economic outcome for you guys?

<A – Doug Coltharp – Encompass Health Corp.>: Depends on the market. And really they both kind of wind up in the same place. From pure ROIC perspective, you're going to do better on the

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joint venture. To cut the capital that you're putting forward in half [indiscernible] (14:29) venture because we're managing the facility we also get the benefit of a management fee as part of our economics, get more than 50% of the economics and 50% of the capital [indiscernible] (14:44) that drives them. But from a pure growth and EBITDA perspective, we prefer to be 100% owned. We like the blend of those markets. It depends on any number of things. If there is a single dominant acute care system in a market and a lot of times it's going to make sense to go in with a joint venture relationship and derisk your entry. If there are several acute care hospitals who all have roughly equal market shares, we can find it better to be independent and play Switzerland [indiscernible] (15:15).

<A – Mark Tarr – Encompass Health Corp.>: And Kevin, there are times when we'll enter a market as a wholly owned entity and then partner it later on as we see strategic opportunities. And the joint venture model, we always like to stress we've been doing that particular model for over 30 years now. Our first partnership is with Vanderbilt in Nashville and we've never had a partnership unwind. So we're very proud of that track record and think it's been a very effective business model for us.

<A – Doug Coltharp – Encompass Health Corp.>: And specifically an example of what Mark's talking about is with Piedmont. We're taking our existing Newnan hospital, which is a suburb of Atlanta that's been highly successful, and we're folding that into the partnership. Piedmont is actually paying cash to acquire their [indiscernible] (16:03) interest based on a current market valuation. And we're also taking our Henry County facility, which is not yet open, but is very far along in development which we had initially pursued on a solo basis [indiscernible] (16:17). So we've got a lot of flexibility with regard to that, as Mark suggested. We have more than a third of our hospitals operated in JVs. We have more experience in joint venture relationships than anybody else [indiscernible] (16:31).

<Q – Kevin Fischbeck – BofA Securities>: Yeah. And I guess when we think about all these de novo facilities, oftentimes when companies are [ph] opening – not bringing as many (16:38), there's a decent amount of start-up losses associated with that. I mean, how do you think about that? Should we be forecasting a bigger drag in 2022 or do you think that the long-term CAGRs that you've outlined for IRF growth is more or less a consistent growth target over the next few years?

<A – Doug Coltharp – Encompass Health Corp.>: I think because you're accelerating, you're going to see a couple of years where there's going to be an EBITDA drag. Pointing to $15 million to $20 million of preopening expenses plus EBITDA drag from the ramp-up this year. With 12 openings next year and with the eight that have opened this year still seasoning into 2022, we're going to see an even larger drag in 2022. That's going to start to flip in 2023. And I would assume that by the time we get to the second half of 2023, the EBITDA contribution from the early vintages of this accelerated growth are going to contribute enough EBITDA to overcome start-up and ramp-up costs associated with the next class.

<A – Mark Tarr – Encompass Health Corp.>: Sure. And it's about between $1 million and $2 million per hospital in preopening costs.

<A – Doug Coltharp – Encompass Health Corp.>: Then you've got about six to nine months before you're EBITDA positive on a four-wall basis.

<Q – Kevin Fischbeck – BofA Securities>: Okay. And then you guys are still active even though you're going through a strategic review of buying home health and hospice assets. The Frontier deal a reasonably-sized deal. How do you see the M&A outlook there? What's the pipeline look like and how are you thinking about home health versus hospice assets?

<A – Doug Coltharp – Encompass Health Corp.>: So certainly, the M&A pipeline for hospice recovered very quickly. It really became pretty robust in the second half of last year. That was not

surprising because unlike the IRF business, the SNF business and the home health business, hospice was not undergoing the payment [indiscernible] (18:41). And hospice had remained relatively steady, at least from an ADC perspective, through the course of the pandemic, although I think most of the providers, ourselves included, had shown some short-term issues with regard to the [indiscernible] (18:57). So it was fairly easy to model the business on a go-forward basis and to reach some agreement between buyers and sellers on the price of the asset.

Those were, however, trading at pretty significant multiples. And so we took a look at a number of those properties but ultimately did not choose to act on.

Now, there wasn't a lot of activity in the home health space in the second half of last year, and that was at least partially attributable to the combined impact of PDGM and the pandemic. And adding to that was of course the fact that even a lot of the smaller providers received some form of aid under the CARES Act, which we're starting to see that free up right now and I think Frontier is a good indication of that. And we're still under the anticipation that there's going to be an accelerated level of consolidation activity. It really needs to happen in the business. Even with some of the consolidation activity that had taken place particularly prior to 2020, you still have something like 11,000 licensed home health agencies in the US. And the overwhelming majority, more than 90%, have less than $5 million in revenue which is very difficult for those sized entities to continue to compete when you've got all these incremental quality reporting measures and everything else that's happening out there. And there's a real desire on the major players, ourselves included, to increase their scale and their market density.

<Q – Kevin Fischbeck – BofA Securities>: Okay. That make sense. And then I guess one of the things that we've been monitoring – or we're always monitoring is for providers is labor outlook. COVID seems to have created some pressures there over the last few quarters and it seems that providers generally are kind of saying they expect labor costs to moderate. But it seems like their staffing companies are talking about a supply/demand shortage just as big, if not bigger, in 2022 than it was entering 2020. So love to hear your thoughts about labor and potential pressure and how you may be able to offset it.

<A – Mark Tarr – Encompass Health Corp.>: So we're starting to see more and hear more about marketplaces that it's getting tighter particularly on the nursing side. And for us it's been a little bit more problematic on the home health side than it has been on our hospital side. Think a couple things are happening here. You have more and more people that are once again entering back into the health care environment. So, patients going back to receiving care. So you're having an increasing demand. You also have some short-term dynamics going on that I tie back to pandemic. You have some nurses that during the pandemic had decided to set it out for a year and let the pandemic go and then they'll get back into the workforce. You had a number of nurses that have entered traveling programs that have gone to marketplaces that had a big COVID surge and now that has dissipated, they were able to make a lot of money and now they're going back to their home market or whatever market they want to be in. And so they will begin to enter the workforce but they may be taking the next couple months off because they've made a significant amount of money. And then you just have what was already existing in terms of a bit of a nursing shortage.

So I think some of that will normalize out. You'll have those nurses that re-enter the workforce. You'll have nurses that had been in a traveler's program making a lot of money, they will go back to their marketplaces. And then we'll have a bit more of a normalization.

But longer term, and I think this stuff will help to reach some sort of a pre-pandemic level, but we had some nursing shortages even then. So we've put a lot of focus on retention of our nursing staff. We've put a lot of focus on bringing on recruiter staff in terms of our own company so they can more effectively fill open slots that we have within our organization. And then we'll have to look at market adjustments where necessary. But we're doing everything we can around the edges right now before we go in and start doing a great deal of market adjustments.

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But we'll do what we need to, to mitigate the nursing shortage. Like I said, it is starting to be a bit more problematic now than it was. And we'll see what we can do to mitigate. There's a lot of different options to take doing that. But in the long run, we think nursing is going to be more problematic this year than it has been in the past.

<Q – Kevin Fischbeck – BofA Securities>: Okay. All right. That makes sense. This other trend that we are seeing within both businesses is that MA's been growing as a percentage. Can you talk a little bit about how you think about the profitability of MA versus fee-for-service business? Is there anything we should be thinking about as a result of that shift?
<A – Doug Coltharp – Encompass Health Corp.>: Yeah. So we've been experiencing pretty aggressive M&A growth on the IRF side of the business for a number of years preceding COVID. You might recall that in 2019 I think our IRF M&A book of business grew about 19% and that had been preceded in 2018 by something like 12% or 13%. It accelerated even further during the pandemic. We think that is a recognition of the Medicare Advantage plans of the value we bring to the table, particularly in treating a higher acuity patients. We're optimistic that it's going to be sticky as we move forward, although we don't expect to see that same level of percentage growth.

I think as you know as well, Kevin, we've also been successful really over a period of eight or nine years on the IRF side in narrowing the gap between the fee-for-service payment and Medicare Advantage. If you wound the clock back into kind of that 2011, 2012 timeframe, you would have seen a differential where MA was about a 25% to 30% discount [indiscernible] (25:24) service. And a relatively even percentage of our MA book back then was on a case rate basis [indiscernible] (25:35). If you fast forward that to today, the payment differential is only about 8% which is down to the high single digits, and about 80% of our MA revenues are paid on an episodic basis versus [indiscernible] (25:51) basis. That's a really healthy trend, feel good about it there.

I cannot tell you the same rosy story with regard to home health. And unfortunately, in spite of some of the investments you see managed care companies making directly in the space, they do not seem ready, although I think they're getting there, to differentiate home health providers on the basis of quality. And they default instead to the lowest price in the market because they tend to be more concentrated in larger, dense markets where there are a lot of small mom-and-pop agencies who are out there who are willing to trade volume for price. There's always somebody that will undercut you.

And so as a result, if you look at our aggregate Medicare Advantage book of business on the home health side, the discount to fee-for-service is still in that 25% to 30% range. It really hasn't moved at all. And we really spend our time and our resources there both in terms of the sales force and our clinical resources pursuing the Medicare fee-for-service business which is much more profitable for us because it's there.

<Q – Kevin Fischbeck – BofA Securities>: Okay. That's helpful. I guess one of the things that we've seen I think a little bit about this to some degree but we're asking most of the companies how they think about how COVID has impacted the business. Are there things today that you're doing from a care perspective or from an operations perspective as a result of COVID that you think now is going to be the new normal going forward?

<A – Mark Tarr – Encompass Health Corp.>: Yeah, Kevin, I do. I think the fact that we decided early on once we saw that we could clinically do a great job with COVID patients, we were there to help our referral sources early on. And so we took COVID patients right from the start. We have great outcomes with COVID patients. I think that we built a great deal of goodwill with our referral sources and we showed them what we could do with a high acuity patient. So, we had been talking about this value proposition for a long time with regard to stroke patients and MA plans. Well, I think that that is going to expand the scopes of the types of patients, not only stroke patients, but other patients that have medically complex profiles. And I think that our reputation, the IRF sector as a

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whole and Encompass within that sector has benefited from our ability during the pandemic of picking a highly acute patient. And the same thing with our home health segment too. Our home health team took COVID patients right from the start. And I think that builds a great deal of goodwill into the future in terms of working and maintaining those relationships with our referral sources.

<A – Doug Coltharp – Encompass Health Corp.>: A few other things in that category. We have diversified our supply chain and access more domestic sources. That'll be an ongoing thing. We've learned how to utilize vehicles such as this videoconferencing and tele-working with referral sources and other constituencies and not just reporting work from home. That will continue. We've put rapid testing equipment and supplies in all of our hospitals. That'll continue. So overall, I think we've improved the efficiency of the business.

Kevin Fischbeck, Analyst, BofA Securities>
All right. Unfortunately, I think that's all we have time for. So I want to thank you guys for joining us today, and I look forward to doing this in person in Vegas next year.

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

Thanks for having us, Kevin. Appreciate it.

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

Thank you, Kevin.

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