PARTICIPANTS

Corporate Participants

Mark David Miller – Senior Vice President-Investor Relations and Strategic Planning, Encompass Health Corp.
Mark J. Tarr – President, Chief Executive Officer & Director, Encompass Health Corp.
Douglas E. Coltharp – Chief Financial Officer & Executive Vice President, Encompass Health Corp.
Barbara A. Jacobsmeyer – Chief Executive Officer of Home Health and Hospice, Encompass Health Corp.

Other Participants

Kevin Fischbeck – Analyst, Bank of America Merrill Lynch
Brian Tanquilut – Analyst, Jefferies & Company, Inc.
Matt Larew – Analyst, William Blair & Co. LLC
A.J. Rice – Analyst, Credit Suisse
Andrew Mok – Analyst, UBS Securities LLC
Pito Chickering – Analyst, Deutsche Bank
Frank G. Morgan – Analyst, RBC Capital Markets LLC
John W. Ransom – Analyst, Raymond James & Associates, Inc.
Scott J. Fidel – Analyst, Stephens, Inc.
Ann Hynes – Analyst, Mizuho Securities USA LLC
Steven J. Valiquette – Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Encompass Health's Third Quarter 2021 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'll be a question-and-answer period. [Operator Instructions] You'll 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 will now turn the call over to Mark Miller, Encompass Health's Chief Investor Relations Officer.

Mark David Miller, Senior Vice President-Investor Relations and Strategic Planning, Encompass Health Corp.

Thank you, operator, and good morning, everyone. Thank you for joining Encompass Health's third quarter 2021 earnings call. With me on the call today are Mark Tarr, President and Chief Executive Officer; Doug Coltharp, Chief Financial Officer; Barb Jacobsmeyer, Chief Executive Officer-Home Health and Hospice; and Patrick Darby, General Counsel and Corporate Secretary.

Before we begin, if you do not already have a copy, the third 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 risks and uncertainties, many of which are beyond our control. Certain risks and uncertainties, like those

FACTSET:callstreet
corrected transcript

relating to our ongoing strategic review and its impact on our business and stockholder value, as well as the magnitude and impact of COVID-19 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 year ended December 31, 2020 and the Form 10-Q for the quarters ended March 31, 2021, June 30, 2021 and September 30, 2021, when filed. We encourage you to read them.

You're 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 Supplemental Information at the end of the earnings release and as part of the Form 8-K filed yesterday with the SEC, all of which are available on our website.

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 Tarr.

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

Thank you, Mark. Good morning, everyone. When we last spoke to you in conjunction with our Q2 earnings report in late July, we pointed to accelerating momentum in both business segments and the expectation that favorable operating trends would continue through the second half of this year. Based on that expectation and our strong performance through the first half of the year, we increased our 2021 guidance for the second time this year.

In August, it became increasingly evident that the COVID surge, which at that time was disproportionately impacting the Southeast and Texas, was creating challenges, particularly for home health and hospice business. We believe these headwinds are largely transient and that we have passed the peak impact, and we have taken and continue to take actions across our organization to mitigate these challenges.

Nonetheless, these challenges will remain with us to some degree in the near term, and so, accordingly, we have revised our 2021 guidance down. Nothing related to these prevailing headwinds does anything to dampen our enthusiasm for the long-term prospects of the businesses we operate and for our competitive position in the industry. To the contrary, these circumstances only underscore the growing demand for the services we provide and the paramount importance of producing high-quality patient outcomes in a cost-effective manner.

I'm going to speak more about current operating trends and the actions we're taking in a moment. But first, I'd like to update you on the strategic alternatives review for our home health and hospice business. As we stated in our press release last evening, we expect to effect the partial or full separation of our home health and hospice business into an independent public company via a carve-out IPO, spin-off, or split-off.

We are targeting such a transaction in the first half of 2022 and expect to announce a more precise timing in the form of a separation transaction in connection with our fourth quarter earnings release. While there can be no assurance that a transaction of this nature will be consummated, we have made specific or significant progress on the various tasks necessary to complete a separation transaction and we will further our state of readiness over the balance of this year. We've also

transitioned our home health and hospice business to new leadership and now have in place a team in which we have supreme confidence.

As we previously stated, we believe a full or partial separation of the home health and hospice business will enhance the long-term success and value of the business. We have thoroughly evaluated a broad array of public and private transaction alternatives and further believe that effecting the separation via the formation of an independent public company is superior to the other alternatives considered. Among other considerations, this belief is based on the anticipated strategic focus, future growth and value-creating opportunities, execution risk, and tax efficiency resulting from such a transaction.

We understand that there is some fatigue within the investment community regarding the duration of this process. We appreciate your patience and strongly believe our review period is appropriate and common for a thorough exploration of transactions in the best interest of shareholders. We have deployed substantial resources, internal and external, to the analysis of alternatives and to the aforementioned separation preparations. And I'll remind you, we've undertaken this process while continuing to address the needs of a vulnerable segment of our patient population amidst the challenges of a continuing global pandemic.

With that, I'm going to turn back to the quarter and operating trends. Doug will go into greater detail on key metrics during his remarks. In spite of the aforementioned COVID-related challenges, our consolidated financial results for Q3 were solid. As compared to the same period last year, Q3 consolidated revenue grew 9.4% and adjusted EBITDA grew 6.7%. Discharge volumes in our inpatient rehabilitation hospitals increased 8.7% in Q3 with 6.7% same-store growth, further underscoring the positioning of our facilities as the trusted choice for patients, providers, and payers.

All those staffing issues were more pronounced in the home health and hospice business, the IRF business was not immune. During Q3, we utilized higher levels of contract labor, sign-on bonuses, and shift bonuses in order to meet the increased demand for our IRF services. These pressures on our labor costs were partially offset by improved productivity. We are continuing to expand the capacity of our IRF business to meet the rising demand for services by opening new hospitals and adding beds to existing facilities.

We opened 4 new 40-bed inpatient rehabilitation hospitals in Q3. And earlier this week, we opened our 8th hospital for 2021, a 50-bed facility in Henry County, Georgia. We've also added 89 beds to existing facilities. Our de novo pipeline remains very strong with an anticipated 10 to 12 openings to occur in each of the next two years.

Turning now to home health and hospice, while the long-term value proposition of home healthcare services remains intact, we are currently operating in a challenging environment, primarily due to COVID surge and industry-wide labor pressures. The underlying drivers of increased home care remain unchanged: strong and increasing patient preference for care in the home, demographic tailwinds due to the aging of the population, and cost advantages to providing care in the home rather than in other settings.

Our total home health admissions decreased 0.9% in the third quarter of 2021 compared to the same period of 2020. This decrease resulted from a reduction in episodic admissions that was largely offset with the continued significant growth in non-episodic admissions, primarily due to our new contract with United Healthcare. The primary limitations on admissions growth during Q3 were the reduction in elective procedures, reduced occupancy levels and access restrictions in senior living facilities, and staffing constraints that caused us to turn away qualified referrals.

In the second quarter of 2021, our episodic admissions from patients receiving elective procedures in acute care hospitals had returned to historic levels. In Q3, this trend abruptly reversed due to the

COVID surge and restrictions placed on these procedures by state governments and local healthcare systems. As compared to the same period last year, our Q3 episodic admissions from patients receiving elective procedures in acute care hospitals were down approximately 400 admissions. Episodic admissions from patients residing in senior living facilities declined approximately 1,100 compared to the prior year.

Demand for home care has remained strong. In Q3, we estimate that we lost approximately 2,500 admissions due to staffing constraints. The constraints are resulting from the combination of quarantined employees due to COVID exposures and industry-wide staffing shortages. We, along with other industry players, are responding to staffing constraints by increasing the use of higher-cost contract labor and paying higher salaries and wages to existing staff and new hires, including sign-on bonuses.

We also encouraged our employees company-wide to get COVID vaccinations and have seen a meaningful increase in employee vaccination rates over the past several months. Currently, 74% of our inpatient rehabilitation hospital-based employees and 61% of our home health and hospice location-based employees are fully or partially vaccinated. We're pleased with the progress we're making in addressing staffing constraints.

During the third quarter of 2021, the number of our home health locations with staffing limitations decreased from a high of 85 to a low of 62 as the quarter closed. Currently, we have 50 home health locations with staffing limitations. We're also pleased with the progress we're making in regards to hiring of nurses. We hired 435 full-time nurses in the third quarter of 2021 compared to 306 in the third quarter of 2020, an increase of 42%. While we're making progress, these labor pressures are not expected to abate in the near term and it takes time to onboard staff.

On average, it takes 60 days before a new full-time clinician is operating at expected productivity levels, which results in higher cost per visit due to a decrease in productivity. It may take several quarters before we reach a point where we return to historic productivity levels, given our need to recruit and onboard staff. Finally, we are seeing some encouraging signs thus far in Q4. Our average home health admissions per day are up 14, and the number of quarantined field employees has dropped from 155 in September to 109 in October.

Now, I'll turn over to Doug to provide more detail on the quarter and to outline our revised guidance and the key underlying assumptions.

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

Thanks, Mark, and good morning, everyone. I'd be remiss if I didn't welcome to his first earnings call for in Encompass Health, Mark Miller, who you heard from at the outset of this call. As many of you know, Mark joined us about two months ago, and he comes to us with a longstanding relationship with our company.

Turning now to the details of the quarter, as compared to 2020, third quarter consolidated net operating revenues grew 9.4% and consolidated adjusted EBITDA increased 6.7%. On a year-to-date basis through the first nine months of 2021, revenues increased 10.9% over the same period in 2020 and 11.2% over the comparable period in 2019. Our year-to-date consolidated adjusted EBITDA increased 25% over 2020 and 6.7% over 2019.

We continue to generate significant free cash flow. Adjusted free cash flow for the first nine months of this year was $437 million, up 19% over the same period last year. Much of this free cash flow was utilized to expand our businesses. Through Q3 of this year, we deployed approximately $366 million towards new hospital construction, bed expansions and acquisitions, extending the reach of

our businesses and underscoring our confidence in the long-term prospects of each. We also distributed $84.7 million to our shareholders via cash dividends on our common stock. Even with these outlays, our net leverage ratio declined to 3.1 times, down from 3.6 times at the end of Q4 2020.

Turning now to segment results, our Q3 inpatient rehabilitation revenues grew 12.4% and adjusted EBITDA increased 10.7%. The revenue increase was driven by both volume and price. Total discharges increased 8.7% in Q3, including same-store growth of 6.7%. Compared to Q3 2019, same-store volumes increased 2.9%. Net revenue per discharge increased 2.4% in Q3, resulting primarily from increased reimbursement rates and the continuation of higher acuity. We expect acuity to trend back towards 2019 levels as the pandemic eventually recedes and patient flows normalize throughout the healthcare system.

SWB, as a percent of revenue, increased 30 basis points as we incurred additional costs in the form of higher sign-on and shift bonuses and increased use of contract labor to meet increased patient volume in the midst of the tight labor market. This ratio also increased due to preopening expenses and the ramp-up of new hospitals. These items were partially offset with improved labor productivity as employees per occupied bed declined to 3.37 in Q3 as compared to 3.44 in the year prior.

Home health and hospice segment revenue decreased 0.2% in Q3 based on lower volumes. Home health episodic admissions declined 7.8% in the quarter, largely offset by a 34.2% increase in non-episodic admissions, resulting in a 0.9% decrease in total admissions. Hospice admissions declined by 2.7% in Q3 as a same-store decrease was only partially offset by the impact of the Frontier acquisition. The Q3 increase in home health revenue per episode of 0.2% was below our expectation, primarily due to the mix between early and late payment periods during the quarter as well as our LUPA.

Under PDGM, early payments within an episode are ascribed a higher payment than late periods to cover the service-level intensity associated with the start of care. This mix shift tends to occur in periods when episodic admissions are declining. Home health and hospice segment adjusted EBITDA decreased 10.4% in Q3, primarily due to higher cost of service-related staffing challenges. Cost per visit in Q3 2021 was $82 compared to $75 in Q3 2020. The increase in cost per visit was due to market increases for nurses, increased use of contract labor, and lower clinician productivity associated with recent hires.

As Mark discussed, we revised our 2021 guidance to reflect Q3 results and current expectations for Q4. Our guidance assumes IRF segment volume growth will remain strong in Q4 and home health and hospice volumes will remain challenging due to ongoing staffing constraints. Elevated labor costs are expected to persist in both segments for the balance of the year. An enumeration of key assumptions underlying our revised guidance may be found on page 19 of our supplemental slides. After giving effect to these considerations, we have revised our 2021 guidance to include net operating revenues of $5.080 billion and $5.130 billion, adjusted EBITDA of $1.025 billion to $1.045 billion and adjusted EPS of $4.23 to $4.38.

And with that, we'll open the line for questions.

corrected transcript

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we will take our first question from Kevin Fischbeck with Bank of America. Your line is open.

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

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

<Q – Kevin Fischbeck – Bank of America Merrill Lynch>: Great. Good morning. I guess, a question on the home health labor pressures. Is there a way to kind of break out how much of the pressure in the quarter were things that might logically decline next year, like signing bonuses or temp labor as COVID declines and [ph] daily dosings (00:22:21) decline versus what you, I think, characterized as market rate updates for wages, which might have a longer-term impact on margins into next year. And I guess, how do you think about those wage updates? Do those create a reset in your mind at all around normalized margins for the business?

<A – Mark Tarr – Encompass Health Corp.>: Kevin, I'm going to let Barb Jacobsmeyer comment on it, she has been making this a priority since moving into her new role.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Right. So, I think, Kevin, when we think about it, we think kind of like you mentioned the short term and the long term. So, long term continuing into the future is, obviously, the market adjustments that we're making to make us a little bit more competitive in our markets. Short term would be the higher sign-on bonuses, the contract labor that we're paying that does come at a large premium. The impact of the quarantines, because when we have folks out, from a quarantine perspective, we are paying premium labor, whether it's contract or extra visit bonuses to cover the impact of the quarantines.

And then, there is also a big productivity cost. Doug mentioned this a little bit. Our employees tend to be in orientation about three to four weeks for general orientation. After that period, they move into our branch operations cost, but we ramp their caseload up over time and that ramp-up is determined by their past experience as well as how well are they adjusting to the role. We work hard and are probably focused even more on this on not ramping up too quickly, because we don't want to impact that employee's engagement, and ultimately, turnover.

We monitor the number of employees that have been on staff for 60 days and less and how many of those are below productivity expectations. So, to give an example, in quarter three, we had 793 employees that had been with us for 60 days or less that had not hit full productivity. That compared to 270 in quarter three of last year. So, that's a little good news/bad news. The good news is we have the hiring, which is why we have all the folks in there. The bad news is that really does impact productivity and that cost per visit.

<Q – Kevin Fischbeck – Bank of America Merrill Lynch>: But I guess, do you view – how much of this pressure today on margins do you think is kind of maybe permanent and, potentially, impacting your views about long-term margins versus transient? Do you think it's all recaptured at some point or is there some longer-term impact? Thanks.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: The market adjustments will remain for the long-term. So, that is the increase that we're doing in markets based on the wage pressures in those markets. The short term, as we get more people hired and out of orientation, the short term impact is the contract labor, the productivity costs and the impact of quarantines.

<A – Doug Coltharp – Encompass Health Corp.>: And bear in mind, if elevated labor costs stay with us and the industry for an extended period of time, and you're going to have a little bit of an exception in 2022 because of the anticipated reinstatement of the sequester. The higher labor costs

ought to find their way into the reimbursement program. That's a significant component of how CMS is supposed to determine the annual updates to the reimbursement scheme. So, that would suggest that, absent the reinstatement of sequester, some of the margin pressure resulting for more permanent higher labor costs ought to be offset by reimbursement rates.

<Q – Kevin Fischbeck – Bank of America Merrill Lynch>: Great. Thanks.

Operator: And we can move next to Brian Tanquilut with Jefferies. Your line is open.

<Q – Brian Tanquilut – Jefferies & Company, Inc.>: Hey. Good morning, guys.

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

<Q – Brian Tanquilut – Jefferies & Company, Inc.>: Good morning. Yes. So, I'll ask the first question about the IRFs, first, right? So as I look at your performance during quarter, obviously, pretty good. Same store at 6.7%, but non-same-store discharge was 2%, right? So given all the bed adds that you've been doing and what's in the pipeline, I mean, how should we be thinking about kind of like the overall growth trajectory as we exit COVID for the IRFs side of the business?

<A – Doug Coltharp – Encompass Health Corp.>: I think it's consistent with the long-term targets that we'd issued at the beginning of this year. We're sitting here on the day, obviously, where we've made a downward revision to guidance for 2021. But as Mark suggested in his comments, that is after two previous increases to guidance. And even with today's revision, we're landing 2021 ahead of where we were when we issued those long-term targets. We feel very positive about the contribution of the new stores that we've been adding, excited about the eight that have come on board, many of those more recently here. So, their contribution to 2021 is going to be limited and we've got 12 coming on board in 2022.

Now, again, as we look at 2022, because you're going to be bearing some preopening expense, it is going to some degree mute the contribution of the eight that opened in this year's vintage, but the cumulative of effective those, as you move into 2023 and the outer years, is going to be a very positive tailwind for the IRF segment.

<A – Mark Tarr – Encompass Health Corp.>: Brian, I think you've heard us also comment in the past about how well we have acclimated to taking on the higher acuity patients, specifically last year and then having that reputation come over into 2021 from referral sources that we remain very loyal to last year. They've remained with us this year. And these relationships and the opportunities [ph] would (00:28:13) show our quality and outcomes and [ph] wire (00:28:17) the higher acuity, I think that has really gained traction and contributes to our ongoing profile and the growth opportunities that we have out there.

<A – Doug Coltharp – Encompass Health Corp.>: And we're excited not only about the growth that we experienced in the quarter. Bear in mind, we had that 6.7% same-store increase, but it was also – that represented an almost 3% same-store increase over Q3 2019. So in addition to the contribution we're getting from new stores, we're getting very nice results out of our existing plan as well.

Operator: And we can move next to Matt Larew with William Blair. Your line is open.

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

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

<Q – Matt Larew – William Blair & Co. LLC>: Hi. Good morning. Thanks for taking my question. Could you clarify the contract labor utilization and maybe the [indiscernible] (00:29:10) in the

quarter relative to historical levels? I'm just curious – you mentioned the number of nurses you hired, is this mostly RN where the pressure is, or you see them cover the subcategories as well?

<A – Doug Coltharp – Encompass Health Corp.>: Matt, we're picking up a lot of background noise. I think one of the questions was quantify contract labor for the quarter for home health, and we can do that. Didn't hear the second part of that. The other was to give you some kind of breakdown on the new hires between the types of nurses.

<Q – Matt Larew – William Blair & Co. LLC>: That's correct. I apologize. I'm [ph] in the airport (00:29:45). I'll jump off after this one.

<A – Doug Coltharp – Encompass Health Corp.>: Okay. We'll hit at least those two. And if we missed the third part of your question, please feel free to circle back with Mark.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: So from a contract labor perspective, quarter-over-quarter, we've seen an increase in about $800,000 in contract labor. When you look at the visits that are conducted by contract labor nurses, it's been about 1.5% of our total visits in quarter three of this year, that compares to about 0.8% last year. The bulk of all of that is nursing, and that comes at quite a premium when we break those down to a per visit. The cost of the nurse is higher. They tend to be less productive because they're also kind of learning our systems. And so, we pay about a $64 premium per visit when we use contract labor.

When you look at the hires that we've been successful, the number that we mentioned of the 435 full time, those are all full-time RN and LN. 287 of those were RNs and 148 were LNs. So, really a good breakdown of RNs and LNs for our quarter three hires. And I think that covered the question.

Operator: And we will move next to A.J. Rice with Credit Suisse. Your line is open.

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

<A – Doug Coltharp – Encompass Health Corp.>: Hey, A.J.

<Q – A.J. Rice – Credit Suisse>: Hi, everybody. Just to start, maybe. I understand you're still in the process of reviewing the options and haven't made a decision yet, but is there any way to talk about sort of the key variables in your mind, of the pros and cons of the different strategies for the home health business you put out, the spin, the split, the IPO? What are you trying to evaluate that makes it still an open question in your mind?

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. So, I think Mark enumerated many of the considerations in his comments. Our objective is to position both of our businesses to optimize the long-term value creation. And our board has instructed us from the beginning to thoroughly evaluate all reasonable means to achieve this end. And this is a process that to be done right requires time and extensive resources, and we have devoted both. And moreover, it's not being conducted in a static environment.

In terms of why we have not chosen a specific option in order to create a public company now, I'd suggest at least two things. One is we don't need to. We're not effecting the transaction now. And the second is that conditions will continue to evolve and we feel that we are very well-positioned and prepared to choose the best structure to fit the prevailing conditions at the time that we're getting ready to go.

And so, we're going to look to things that Mark suggested before. We're going to look at everything from tax efficiency to pro forma capital structure to both businesses, to the ability of both businesses to capitalize on the long-term growth opportunities, just making sure that we set both

FACTSET:callstreet
corrected transcript

businesses up so that they are positioned to pursue their strategic plans and create long-term value for the shareholders.

<Q – A.J. Rice – Credit Suisse>: Okay. Maybe just a clarification. On the comments about the tightness of the labor supply in the IRF business, I'm assuming that's mostly nurses. I didn't have a sense that there was as much of a tightness on the physical therapy side, but I just want to make sure of that. And can you characterize how big your nurse portion of your labor cost in the IRF business is?

<A – Mark Tarr – Encompass Health Corp.>: Yeah. Hey, A.J., this is Mark. You're correct, the biggest labor challenges were almost very specific to nursing. We did have some support staff that also became challenging throughout the year, but the vast majority of it tied to nurses. We've not had any difficulty in finding therapists. So, all of our focus has been on recruiting specifically of RNs and retaining RNs as well and reducing contract labor dependency.

<Q – A.J. Rice – Credit Suisse>: Okay. Thanks.

Operator: And we can move next to Andrew Mok with UBS. Your line is open.

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

<Q – Andrew Mok – UBS Securities LLC>: Hi. Good morning.

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

<Q – Andrew Mok – UBS Securities LLC>: Good morning. Thanks for the question. It sounds like most of the home health volume pressure is attributable to staffing constraints, but it's not clear to me that that's also the driver of pressure in the hospice business, which saw same-store admissions down 14%. Can you speak specifically to the trends you're seeing in hospice and drivers of underlying demand there? Thanks.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Sure. So, the main challenge has been staffing constraints. 10 of our locations, or what we're considering our priority markets that we need, were not able to take the admissions that we need to because of staffing. I would also say that we're working to diversify our referral sources, which have a little bit less reliance on our own home health patients. Today, our home health patients represents about 23% of the hospice referrals. And so, obviously, when our home health volume is down, that impacts the potential of the referrals for hospice. So, we're working to, obviously, fill those staffing holes, but also working to diversify those referral sources.

<A – Doug Coltharp – Encompass Health Corp.>: Andrew, the other thing that we would point you there that has an implication for staffing within hospice is if you compare Q3 this year to Q3 last year, our patient days and our ADC were actually up, but our length of stay has increased. And frankly – and I don't know if there is any way to sugarcoat this – that has a lot to do with the types of patients we're seeing, because prior to the rollout of the vaccine, we were seeing a lot of shorter-term patients who were coming out of COVID and expiring within a fairly brief period of time. When you're facing any staffing constraints and you have a longer length of stay, your ability to take on new admissions is limited.

<Q – Andrew Mok – UBS Securities LLC>: Got it. That's helpful. And just a follow-up for Barbara, now that you've completed your first quarter as CEO of Home Health and Hospice, can you speak to the continuity of the business and depth of the team in light of some recent departures? Thanks.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Absolutely. So, I think what's first important to know is that five of our eight executive team – management team members have been

FACTSET:callstreet
corrected transcript

with home health and hospice for over 10 years. Probably, really important to know is two of these members are EVP over our Sales and our EVP over our Home Health and Hospice Operations have actually been with the company for over 20 years. So, Crissy and I are obviously new to the team, but not new to the company. So, the main team member that we're currently working to recruit is our Chief Human Resource Officer. But other than that, we feel really good about the executive management team.

But shortly after I took the role, I focused on the structure of what I would say is our senior management. That's the group that's really over the operations in the field and our sales leadership. We did some promotions with some increased responsibilities. And based on those, all of these leaders signed a non-compete, non-solicit agreement. And so, I'm feeling very confident about the team we now have in place. They are not only fully committed, but they're a talented group who is excited about changing some of the prior philosophies and kind of the way we've always done it mentality. And I will tell you, they've had some really great ideas that we've already implemented and think that we're seeing that already in our recruitment efforts. So, I'm really excited about the team we have in place.

<A – Mark Tarr – Encompass Health Corp.>: I will [ph] have to (00:37:48) add – and this is Mark. While we're certainly impressed with what Barb has done there in her short time, we're not surprised. Barb has been with this organization for 14 years. We've seen her response – or rather response to her leadership style from staff. People like to work for Barb, and she has a knack for recruiting and retaining very talented people in her management team. And those skill sets are transferable from the hospitals segment to the home health segment. So, I'm not surprised at all with how the team has rallied around Barb.

<Q – Andrew Mok – UBS Securities LLC>: Great. Thanks for all the color.

Operator: And we can move next to Pito Chickering with Deutsche Bank. Your line is open.

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

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

<Q – Pito Chickering – Deutsche Bank>: Hey. Good morning, guys. Just to actually follow-up on that one. So, this is for Barb. [indiscernible] (00:38:44) sort of, I guess, two days ago that you lost five high-ranking executives to Homecare Holdings. Do you now have contracts with like remaining executives for home health as you head into the transaction and do you have plans to hire or replace any of the executives who have departed?

<A – Barb Jacobsmeyer – Encompass Health Corp.>: So, we have – actually through internal promotions, we have [indiscernible] (00:39:11) the entire executive and what I would call senior management team in place. So, the only position we are still needing to recruit and we actually have some great candidates in the pipeline is for our Chief Human Resource Officer position, and that's actually a new position. So, we feel about the focus we have. And as I mentioned, we – I feel that we've locked it in place, so we did not have restricted covenant agreements with the senior level. And so, those are all in place now, and so I think we have a stable good management team going forward.

<Q – Pito Chickering – Deutsche Bank>: Okay. Great. And then, back on the topic of staffing wages. Looking just at full-time employees, what is wage inflation you're seeing today in 3Q and 4Q versus pre-COVID? And can you quantify how much labor costs were premium labor during 3Q that should normalize out when the COVID surge pressures go away? Thanks so much.

<A – Doug Coltharp – Encompass Health Corp.>: So, it's a little bit difficult to answer the second part of the question. Barb gave you the increase in contract labor on the home health side. I will tell

you on the IRF side, in terms of sign-on and shift bonuses, we had I think about a $12 million increase from Q2 into Q3. So, it's not insignificant on that end. Pito, remind me the first part of your question.

<Q – Pito Chickering – Deutsche Bank>: Yeah. You bet. Looking at sort of staffing wages just for your full-time employees. Just sort of curious, what sort of wage inflation you're seeing as you are renewing those employees sort of today? So, what percent are you increasing as wages today versus 2019 pre-COVID?

<A – Doug Coltharp – Encompass Health Corp.>: But generally speaking, if you kind of measure it on a per FTE basis and the equivalent would be the portion that's within CPV on home health, about – I would say, in the third quarter, we saw SWB per FTE up about 6.5% to 7% and that's versus, call it, the normalized assumption that we'd had which was in the 3% to 4% range. Trying to determine at this point in time how much of that has a stickiness factor is difficult. We do think it's going to be prevalent in the fourth quarter and that's taken into our guidance assumptions. I think it's too early to suggest how much of that might start to dissipate as we move into 2022.

<Q – Pito Chickering – Deutsche Bank>: Great. Thanks so much.

Operator: And our next question comes from Frank Morgan with RBC Capital Markets. Your line is open.

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

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

<Q – Frank Morgan – RBC Capital Markets LLC>: Good morning. Hey, I guess I'll ask one labor question here staying on topic. I always thought of rehab nurses in the home healthcare as probably being less susceptible to moving around. But I guess my question here is, where are these nurses going or what type of setting are they going to or are they just retiring? That'd be my first question. And then, the second question is more just about if you could go back and look between all your different segments, maybe talk a little more – give us a little more color about kind of either how they exited the quarter or where they are now and some of those key operating indicators. Thanks.

<A – Mark Tarr – Encompass Health Corp.>: Yeah. Frank, this is Mark. I'll take the IRF response to your nursing question and ask Barb to talk about the home health. But certainly, within IRF, the typical preference of our nurses, if they don't choose rehab, they're typically going back to the acute care hospital in the inpatient setting. So, you've heard us talk about in the past having a higher percentage of our nurses get that certified rehab nursing accreditation. And if we can encourage them to do so, we see far less turnover of those CRRNs in our hospitals going away to the acute care hospitals.

But it's certainly not atypical for particularly nurses early on in their career. If they start out in a rehab setting, they want to get acute care hospital a try. And then, what we often see as well is we'll get a number of nurses that will tire from being in an ICU-level environment and want to come down to a situation where they have more patient care time over duration, length of stay, that we see in an IRF setting. So, that's kind of the major differences between the IRF versus the acute care hospitals.

And I'll let Barb talk about home health.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Yeah. So for home health and hospice, we do lose them to competing home health and hospice agencies. I would say, though, during the COVID, we lost a portion to both traveling as well as a group that just really wanted to be at home.

It was hard for them to manage that workload on top of kids not being in school, that sort of thing. That's a group that we're really working to re-recruit, are the ones that kind of stepped away for a while and we're working to bring them back, which is why we think it's so important to offer the flexibilities of two days a week, three days a week, because while some may be willing and interested to come back, they may still be trying to juggle things. So, we're just really trying to create those flexibilities so we can re-recruit all those staff members.

We're also seeing a larger increase of folks interested doing home health and hospice for the first time. Some coming from the acute care hospitals, because frankly they're just exhausted, and so, they're coming to look to do something a little different, something that allows a little bit more flexibility. So, while we're losing some to some competing home health and hospice, I think we're really being creative on where we're recruiting new folks from.

<A – Mark Tarr – Encompass Health Corp.>: Right. I think we also experienced a number of nurses that took up on these traveler engagements that were highly profitable for the nurses. They required them to travel to the surge markets. And then, as we saw in 2020, typically that those nurses will come back to the marketplace that they initially left. But it's a little early to tell how quickly these nurses will come back to the markets that we've seen from the surge transition here in the second half of 2021.

<A – Doug Coltharp – Encompass Health Corp.>: And then, Frank, your question on the trajectory for both businesses coming out of Q3 into Q4, as is included in our guidance considerations for 2021, we expect continued strong volumes for the IRF business in Q4 and October is supportive of that. And then, with regard to the home health, just to reiterate some things that Mark highlighted in his script, during the third quarter, the number of our home health locations with staffing limitations had decreased from a high of 85 to a low of 62 as the quarter closed. And currently, we have only 50 – it's a relative term – home health locations with staffing limitations. And then, we are starting to see some more encouraging signs as we enter into October with regard to volumes. And average home health admissions per day are up by 14 in the month of October. And the number of quarantined field employees has dropped from 155 in September to 109 in October.

Operator: And we can move next to John Ransom with Raymond James. Thank you for your patience.

<A – Doug Coltharp – Encompass Health Corp.>: Hey, John.

<Q – John Ransom – Raymond James & Associates, Inc.>: Hi. Thanks.

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

<Q – John Ransom – Raymond James & Associates, Inc.>: Good morning. Just trying to figure out, I mean, once you decide what to do with home health and hospice, what's the outside sort of timeframe from decision to execution? Are you going to have to get a year-end audit? Is there like a multi-month SEC process? Just help us understand the back end of this once you decide to pull the trigger. And also, could you help us think about any sort of additional costs? Let's assume it would be a separate public company, how should we think about the [ph] trap (00:47:47) – the additional costs that would result from that? Thanks.

<A – Doug Coltharp – Encompass Health Corp.>: There will be additional costs to establish our home health and hospice business as a separate company. We've done a very thorough analysis of that, including having it vetted by third-parties. But we have not disclosed that yet. With regard to the lead time with the SEC or anybody else, it depends on the specific form of the transaction. None of the lead times, particularly given the work that's been done to date, should be viewed as particularly onerous.

With regard to some of the other preparatory steps, as we've said repeatedly beginning since our second quarter report, we've made substantial progress there. We've previously referenced the fact that we have the carve-out audited financials, including a three-year look-back already prepared. It's relatively easy to update those to reflect additional quarters as we progress through this. The S-1 had been filed confidentially, which suggests a certain state of readiness as well.

So, again, as we have said kind of consistently, the degree of preparation that has gone into this has been very substantial. We'll continue to invest in our state of readiness for the balance of the year. But we are at a very high degree of readiness to pursue a transaction when we believe the market backdrop and the underlying business trends are appropriate.

<Q – John Ransom – Raymond James & Associates, Inc.>: So, I mean, just to clarify, Doug. So, part of the – I mean, I'm assuming it doesn't take a year to make a decision. So, part of your thinking is, maybe right now is not the best time just given the challenges in the operation. So if you were to launch it separately, maybe waiting for a more favorable backdrop of fundamentals, is that project partly – am I hearing that right?

<A – Doug Coltharp – Encompass Health Corp.>: You're right, it doesn't – I guess there is no hard stop on it, but it didn't take us a year to make a decision. So at the end of July, we stated that based on our review to that point, we determined that it did make sense to separate the business and we didn't foreclose on the form of the transaction. We're taking a step further today and saying, we now believe that separating it into a public – separate independent public company makes the most sense. So, those are important decisions to make along the way.

I guess, in terms of your view on the timeframe, John, and I understand some of the fatigue that's out there, Mark referenced in his comments. What's your point of reference? I mean, how many of these have you done? And have you done an analysis of all of the analog transactions to determine that [ph] IRF (00:50:32) process is particularly lengthy?

<Q – John Ransom – Raymond James & Associates, Inc.>: Sure. I take your point, Doug. Sorry to ask the question. Thanks.

Operator: And we will move next to Scott Fidel with Stephens [ph] Bank (00:50:50). Your line is open.

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

<Q – Scott Fidel – Stephens, Inc.>: Hi. Thanks. Good morning. First question, just interested on the some of the pickup that you did see in October on home health admissions. If you can just give us a little flavor on how you've seen those trending across the different markets and geographies. Has it been relatively consistent in terms of the pick up or is it a bit more staggered still across the markets?

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Yeah, it's really been about the areas where we've seen the quarantines come down. I mean, the referrals, frankly, have been there. So, it really has come to the quarantines dropping, getting folks out of orientation and starting to build up their caseload. So where we're seeing this growth is really about the branches moving away from being constrained because of staffing limitations to now being able to take more of these referrals. And so, that's really been where we've seen the progress.

<Q – Scott Fidel – Stephens, Inc.>: Got it. And then, just as my follow-up, and without addressing the planned separation itself, I'm just interested if you could talk to us about how you're thinking about deployment of growth capital towards HH&H in the interim period here. And are there any limitations on that or is it all systems go in terms of – if, for example, you see M&A opportunities arise over the next quarter or two, will you plan to move forward on those? Thanks.

<A – Doug Coltharp – Encompass Health Corp.>: I think we demonstrated in a very tangible way that we're continuing to move forward to capitalize on M&A growth opportunities in home health and hospice. And that was the Frontier transaction, which was an approximately $100 million deal that we closed at the end of June. We continue to be active in terms of our development pipeline. Obviously, we remain cognizant of any impact that might have on our flexibility with regard to effecting form of separation. But we do believe that the growth pipeline via M&A in both home health and hospice remains attractive.

We're also going to be ramping up our de novo activity for both of those in home health and hospice, and that's something that, frankly, we haven't capitalized on well in the past and will be more featured in our growth story going forward. Within the IRF segment, we really like the returns that we're seeing out of deploying capital towards the new hospital openings and the bed expansion. And so, it's going to be rinse-repeat on that, albeit at an accelerated level with 12 new openings targeted for 2022.

Operator: And we can move next to Ann Hynes with Mizuho. Your line is open.

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

<Q – Ann Hynes – Mizuho Securities USA LLC>: Good morning. So, we spent a lot of time on this call talking about labor challenges and how it's negatively impacted revenue and margin in the home health and hospice business. But we really haven't talked about the opposite side of the equation, the demand side. And I know the underlying demand profile of the home health is attractive. But I mean, do you think there's a structural change going on maybe with families not wanting some home health aides in the house?

And I guess, the reason I'm asking is that the one thing that really stood out to me in your presentation is that only 61% of your home health employees are vaccinated. Do you think that's going to be a structural impediment to admissions if families don't want an aide in their – around their elderly parent, that's not vaccinated?

And I think my second question would be – I mean, you have expressed confidence in the long-term business for home health, but how do you view the intermediate term, meaning over 2022 and 2023? Do you think we should just be modeling a lower revenue and growth rate and margin profile as kind of COVID works through the system? And I guess, maybe an add-on to that question, since nobody has asked, for 2002, while we're finalizing our models, is there anything you really want us to consider while we finalize them for 2022? Thanks.

<A – Doug Coltharp – Encompass Health Corp.>: So, that was quite a bit, Ann. We'll try to get to those questions, making very good use of your one question and one follow up. So, why don't we start with some of the things from a demand perspective, because Barb's got some good data on that, that are supportive of strong demand.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: So, yeah, I think, first of all, patients are continuing to want the care in the home. As we mentioned, we know we turned away, at a minimum, 2,500 admissions in this quarter. So, the referrals are there, the patients wanting the care in the home is there. We don't have a lot of aides. Most of ours is skilled, so skilled nursing and skilled therapy. What we have found, because our staff wear the full protective equipment, when they go into a patient's home, we have not seen the reluctance of having the individuals come into the home, knowing that our teams are wearing all the protective equipment. So, we don't feel that that's impacted or will impact the volume or the need for the skilled care in the patient's home.

<A – Doug Coltharp – Encompass Health Corp.>: Barb, you we want to hit referrals, too, referral sources?

<A – Barb Jacobsmeyer – Encompass Health Corp.>: So, our referral sources, from a standpoint, I mean, we continue to get the referrals from – we've [ph] grown (00:56:21) a lot with our physicians – physicians' offices wanting to give direct referrals. And that really is the goal of helping patients before they need that acute level of care. And so, that's why I feel like we're getting more and more of those referrals directly from physicians' offices. So, you're kind of getting them pre-acute and then continuing with the referral sources that we've seen historically from the skilled nursing facilities and the ALS and ILS.

We've also seen an increase in the referrals as they come from surgery centers, because as some of the electives have certainly declined, some of that has moved to surgery centers. So, we continue to focus on diversifying the referral sources that we go to.

<A – Doug Coltharp – Encompass Health Corp.>: So, Ann, as we think about volume going forward, our view is that there is no limitation on volume growth imposed by demand that we have the referral sources out there and established that we need to drive to our volume objectives. We think we have some additional work that we need to do on the sale side to be able to capitalize on all of those, but we've made very substantial progress there. And the area of focus is the clinical staffing limitations. And based on some of the programs that Barb described in her comments, we feel like we're going to make good progress on that through Q4 and into 2022. So, does that get all the [ph] things (00:57:51) for you?

<Q – Ann Hynes – Mizuho Securities USA LLC>: All right. Thanks. Yeah. And then just for 2022, is there anything that you really want – we should consider anything out of the ordinary?

<A – Doug Coltharp – Encompass Health Corp.>: The sequester is going back in. So, you're basically going to deal with no pricing increase on your Medicare book of business, which as you know, for us, is very substantial.

<Q – Ann Hynes – Mizuho Securities USA LLC>: All right. Thanks.

Operator: And we can take our final question from Steven Valiquette with Barclays. Your line is open.

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

<A – Doug Coltharp – Encompass Health Corp.>: Hey, Steve.

<Q – Steve Valiquette – Barclays Capital, Inc.>: Thanks. Good morning, everybody. So with the announcement of the some form of likely separation of home health and hospice from IRF potentially in the first half of next year, I guess, I'm curious if you can discuss on a preliminary basis just the importance from your view of keeping the operational synergies in place between the two operations on how you structure any transaction, particularly in patient referrals back and forth, but also in other areas?

And I kind of asked it because there was, obviously, a similar precedence spin-off transaction in the public markets back in 2019 that showed that some of these operational synergies can stay intact for two separate entities between home health and a facility-based post-acute care company. So also wondering if there's any useful clinical learnings from the precedent transaction that may help guide you as well. Thanks.

<A – Mark Tarr – Encompass Health Corp.>: Yeah. Steve, this is Mark. I'll take that. What we've referred to in the past as clinical collaboration, in our view, was the standardized process of the discharge – coordination collaboration of the patients from our IRFs to our home health locations.

That will remain a priority. And having the collaborated efforts is a priority in the overall quality of care for our patients.

I think what we've seen that we've learned from what we refer to as our overall app markets is that we can also replicate many of those facets of that process with non-owned home health agencies in markets where we don't have a presence. So, that focus on the transition from patients from our IRFs to home health will remain a priority even after the transaction next year.

<A – Barb Jacobsmeyer – Encompass Health Corp.>: Another thing I would add to that is, so one of the things that was so important in the initial phases of clinical collaboration is that there's a fair number of home health agencies that don't have the full complement of physical, occupational and speech pathology. Those are the types of services that many of our IRF patients need because we have so many neurological patients. And so, knowing that we are staffed to be able to take those patients, take them that we can provide the care within that first day or two after the patient goes home, those are important factors for our IRFs because it's what really helps them have the lower readmission rates and the better patient satisfaction. So providing that level of care is not going to change. And so, the need for that level of care also won't change. So, as Mark mentioned, we don't need that being significantly impacted by a separation.

<A – Mark Tarr – Encompass Health Corp.>: Steve, just as a reminder. Barb brings a unique perspective to that, because she was the lead role from the IRF side of the clinical collaboration. Now, she's gone to the home health side of that. So, she knows it from both sides of the equation and is in a unique position to affect that.

<A – Doug Coltharp – Encompass Health Corp.>: And so, Steve, to bring that all together, we think that there are four key factors that will lead to the stickiness of this post the separation. The first is we have 90 overlap markets established. So in order to have any kind of clinical collaboration, you have to coexist in the same market, and we've been very deliberate about increasing the overlap market since we had the two companies together. The second is that the protocols and the procedures governing clinical collaboration have been in place for almost seven years now and refined through consistent best practices approaches over that timeframe.

The third, as Barb mentioned, is we have staffed our home health agencies with the clinical resource, predominantly on the therapy side, to serve the types of patients who are being discharged from the IRF. And the fourth is we have a proven track record for producing positive results.

<Q – Steve Valiquette – Barclays Capital, Inc.>: Okay. That's some very helpful color. Thank you.

Operator: And this does conclude our question-and-answer session. I'll turn the program back over to our presenters for any closing remarks.

Mark David Miller, Senior Vice President-Investor Relations and Strategic Planning, Encompass Health Corp.

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

Operator: Thank you for your participation. This does conclude today's program. You may disconnect at any time.

 Copyright © 2001-2021 CallStreet

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 2021. 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.