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Encompass Health Corp. (EHC)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Encompass Health's First Quarter 2023 Earnings Conference Call. [Operator Instructions] Today's conference is being recorded. If you would like – 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 Miller

Chief Investor Relations Officer & 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 first quarter 2023 earnings call. Before we begin, if you do not already have a copy, the first quarter earnings release, supplemental information, and related Form 8-K filed with the SEC are available on our website at encompasshealth.com. On page 2 of the supplemental information, you will find the Safe Harbor statements, which are also set forth in greater detail on the last page of the earnings release.

During the call, we will make forward-looking statements, which are subject to risks and uncertainties, many of which are beyond our control. Certain risks and uncertainties like those relating to regulatory developments, as well as volume, bad debt, and labor cost trends that could cause actual results to differ materially from our projections, estimates, and expectations are discussed in the company's SEC filings, including the earnings release and related Form 8-K, the Form 10-K for the year ended December 31, 2022, and the Form 10-Q for the quarter ended March 31, 2023 when filed. We encourage you to read them.

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You are cautioned not to place undue reliance on the estimates, projections, guidance and other forward-looking information presented which are based on current estimates of future events and speak only as of today. We do not undertake a duty to update these forward-looking statements. Our supplemental information and discussion on this call will include certain non-GAAP financial measures. For such measures, reconciliation to the most directly comparable GAAP measure is available at the end of the supplemental information, at the end of the 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, Encompass Health's President and Chief Executive Officer.

Mark J. Tarr

President, Chief Executive Officer & Director, Encompass Health Corp.

Thank you, Mark, and good morning, everyone. We're very pleased with our first quarter results, which once again exhibited strong volume growth and substantial year-over-year improvement in labor costs. Our first quarter revenues increased 9.5% and adjusted EBITDA increased 17.5%. Demand for IRF services remained strong and we have continued to invest in capacity additions to meet the needs of patients requiring inpatient rehabilitation services.

We opened three de novos in the first quarter and a fourth de novo earlier this month, adding a total of 199 beds. Over the balance of the year, we plan to open three more de novos and add 93 beds to existing hospitals. Our Fitchburg Wisconsin de novo originally scheduled to open in Q4 of this year has been moved to Q1 of 2024 due to weather-related construction delays. We continue to build and maintain an active pipeline of de novo projects, both wholly owned and joint ventures with acute care hospitals.

We currently have 18 de novos under development with opening dates beyond 2023. This pipeline includes Danbury, Connecticut, for which we recently received approval for a certificate need. Danbury will be our first hospital in the state of Connecticut, and we look forward to providing high-quality IRF services to patients in this market.

During Q1, we again met the increase in demand for IRF services while reducing contract labor and sign-on and shift bonus expenditures. Contract labor was down approximately $21 million or 51% from Q1 of 2022, while sign-on and shift bonuses decreased approximately $5 million or 23% from Q1 of 2022.

On a sequential basis, contract labor and sign-on and shift bonus expenditures were similar to Q4 of 2022. As compared to Q4, contract labor rates were lower, but FTEs increased, primarily due to higher patient volumes. Our talent acquisition efforts resulted in 54 same-store net new RN hires in Q1.

Earlier this month, CMS issued the 2024 IRF proposed rule. This included a net market basket update of 3%, which we estimate would result in a 2.9% increase for our IRFs beginning October 1 of 2023. The IRF's final rule is expected to be released in late July or early August. We are continuing to invest in our hospital-based technology through initiatives like our Tablo on-site dialysis rollout.

We now offer in-house dialysis in 64 of our hospitals and will continue to roll out in 2023. Reducing our reliance on third-party providers and obviating patient transport to receive this service leads to fewer disruptions to therapy

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schedules and improved patient outcomes and satisfaction. On-site dialysis via Tablo also reduces our cost for these services.

Moving now to guidance, we are increasing our guidance for 2023. We now expect net operating revenue of $4.70 billion to $4.77 billion; adjusted EBITDA of $870 million to $910 million; and adjusted earnings per share of $2.94 to $3.23. The key considerations underlying our guidance can be found on page 12 of the supplemental slides.

Finally, I want to remind investors that we are planning to host an Investor Day in New York City on September 27, 2023. At that meeting, we will provide more detailed insights into key elements of our strategy, including de novo hospitals, clinical technologies and labor management. Please mark your calendars for September 27. Details will follow in the days ahead.

We hope to see you there.

Now, I'll turn over Doug for some further color on the quarter.

Douglas E. Coltharp

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

Thank you, Mark, and good morning, everyone. As Mark stated, we were very pleased with our Q1 results. Revenue for the quarter increased 9.5% over the prior year to $1.16 billion, and adjusted EBITDA increased 17.5% to $229 million. We continue to see strong volume growth in Q1. Total discharges grew 9.4% and same-store discharges grew 5.9%.

As we've mentioned previously, in the summer of 2021 when the clinical labor market began tightening and contract labor and shift bonuses starting to rise, we made the strategic decision to continue staffing our hospitals at levels sufficient to accommodate the increasing demand from IRF appropriate patients, even when it required premium cost labor to do so. We have persisted in this approach thereby allowing our hospitals to provide value to our patients, referral sources and payers. As a result, our value proposition continues to resonate, and we are experiencing gains in market share.

As Mark noted, we made significant improvement in year-over-year labor costs in Q1. Our Q1 contract labor plus sign-on and shift bonuses of $37 million was comprised of $20.7 million in contract labor and $16.3 million in sign-on and shift bonuses. Contract labor in Q1 declined approximately $21.2 million or 51% from Q1 of 2022. Agency rates declined year-over-year and sequentially. Our Q1 2023 agency rate per FTE was $183,000, down from $240,000 in Q1 of 2022, and $211,000 in Q4 of 2022.

We expected rates to moderate from Q4 once we got past the premium pay associated with holiday shifts. The reduction in rates is a favorable sign and indicates the overall market for contract labor is improving. We are optimistic at the end of the public health emergency next month and with it, the cessation of the COVID stipend paid to acute care hospitals will inject further discipline into the market.

We indicated previously seasonality of our business and capacity growth via new hospitals and bed expansion could lead to a sequential increase in contract labor FTEs in Q1 of '23 and that is what we experienced. Our contract labor FTEs increased from 325 in December to 520 in March. This was attributable to volume growth and seasonality.

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As evidence of our progress in managing contract labor, in March of this year, we had 230 fewer contract labor FTEs than in March of 2022 against an increase of 395 in our average daily census. We believe that the level of contract labor expense we experienced in Q1 represents an approximate quarterly run rate for the balance of 2023. This does not represent the height of our aspirations, and we will maintain our focus on further reducing contract labor FTEs and expense. Sign-on and shift bonuses decreased $4.8 million or 23% from Q1 of 2022 and increased modestly sequentially. We also believe that Q1 sign-on and shift bonus expense represents a reasonable quarterly run rate expectation for the rest of 2023.

Revenue reserves related to bad debt as a percent of revenue increased 20 basis points to 2.4% as we experienced increased pre- and post-payment claim review activity during the quarter. In addition to TPE, CMS recently initiated an audit program using supplemental medical review contractors or SMRCs. Under this program, CMS has authorized the SMRCs to conduct widespread post-payment reviews of IRF claims with dates of service from March of 2020 through December of 2020.

Under the SMRC audit program, we have thus far received approximately 1,000 record requests at 30 locations totaling approximately $21 million in claims. To date, we have received initial results on 11 of these locations, and the results have been favorable. Of the approximately $8.8 million in claims covered by these results, approximately 78% have already been approved without being subject to another level of appeal.

While the results so far have been favorable, we are still objecting to the time period of this review, the initial phase of the public health emergency and to the interpretations of medical necessity criteria serving as the basis for denied claims. As has been the case with prior audits, we remain confident in the clinical judgment supporting the admission of patients into our hospitals as well as with the veracity and thoroughness of required documentation.

EPOB for the quarter was 3.32, an increase from 3.28 in Q1 of 2022. EPOB is typically lower in the first quarter due to higher volumes. Our guidance assumes EPOB to be approximately 3.40 for Q2 through Q4 of this year. Q1 de novo net preopening and ramp-up costs totaled $4.2 million, and we continue to expect $10 million to $12 million of these costs for the full year.

Finally, we ended Q1 with a net leverage ratio of 3.1x, down from 3.4x at the end of 2022.

And with that, we'll open the lines for Q&A.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Thank you. We'll take a question from Kevin Fischbeck of Bank of America. Your line is open.

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

Hello, Kevin.

Kevin Fischbeck
Analyst, BofA Securities, Inc.
Q

Hello. Great, thanks. Good morning. So I just wanted to dig into some of your labor comments because obviously, in your guidance, you raised the wage outlook and you're looking for contracts and sign-on bonuses to kind of be similar from here through the rest of the year. It seems like most of the other companies seem to be talking about modest improvement in these metrics as the year goes on. So just love to hear a little bit about why -- the wage got a little worse and why you're not expecting improvement on that.

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

Yes. Kevin, I think we'd point to a couple of things. One is I think we had made more progress on a relative basis than perhaps some of our peers. And I think we've also been exhibiting higher volume growth and adding more capacity to our base. So those things do factor in. I want to reiterate a comment I made in my prepared comments there, which is those expectations do not represent the height of our aspirations. So we're going to continue to focus on opportunities to make improvement in those levels.

Maybe just to shine a bit of a brighter light though, on the level of improvement that we made on a year-over-year basis in Q1. If you look at Q1 of '23 with an average of 459 contract labor FTEs, that comprised 1.8% of our total FTEs. If you compare that to Q1 a year ago, where we had an average of 706 FTEs, that was 2.9% of our total FTEs for the quarter. And the rate dropped from $240,000 to $182,000.

The most recent, kind of accurate or normalized comparison we can have is all the way back to 2019. And so if we look at the full year of 2019, we had contract labor FTEs that were about 0.9% of our total FTE workforce. So we're not back to that level yet, and we're not sure that we'll get all the way there. But we have made substantial progress over the last year.

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

And probably it's a huge focus for our operating teams and they are exhibiting a great deal of disappointment in terms of managing those extra shift bonuses and the amount that they are having to pay for extra shift bonuses or the sign-on of new staff. And I also wanted to express the focus that we have right now on retention of our existing employees.

So not only on reducing contract labor but once we do bring on new nurses or other staff, we're very focused on making sure that we are focusing on the details that it takes to bring them on, orient them and have an equal

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amount of focus on the retention aspects to make sure that we get staffing where we wanted in the contract labor and the premium costs down as low as we can.

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

A

And we saw the evidence of that in the first quarter with our nursing turnover dropping below 25% and our therapy turnover, which has always been low, below 8%.

Kevin Fischbeck
Analyst, BofA Securities, Inc.

Q

Okay. That's helpful. And then I guess on volumes, a bit of a debate about how strong volumes actually are, how much of this is somewhat easy comps of a disrupted Q1 of last year. Do you have any color about how volumes progressed through the quarter? Was January really disrupted and therefore stronger this year, year-over-year? Or was it strong throughout? Any color about kind of what you think maybe drove some of the volume outperformance? Thanks.

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

A

Yeah. Kevin, we saw pretty consistent volume growth throughout the quarter and it was not only throughout the quarter, but we saw nice growth in all eight of our geographic regions. So I am very pleased with the progress we've made there. I think if you consider what the driving aspects of that are and you don't have to look any further than our quality indicators.

Our ability to get patients back home, our ability to keep the number of patients that go back to the acute care hospitals as low as it can be, and as well as those who get sent to a skilled nursing facility. But I do think that the work our teams have done in separating themselves based upon our quality outcomes and the value proposition continues to resonate with the payers and referral sources and is assisting our growth going forward.

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

A

I think what was really encouraging about the quarter was just how broad-based the growth was for us geographically across the patient mix spectrum and across payors as well. To provide some specifics there, if you look at our two major payor categories for the quarter, Medicare Advantage was up 20% and over 17% on a same-store basis, and Medicare was up 9% on a total basis and nearly 5% same-store basis.

We saw growth in every one of our major categories of patient mix. And what we did see – and it was one of the factors that impacted pricing for the quarter, is that we saw growth in stroke and neurological, but every other patient category grew faster. And to us, that's an important signal that more normalized flows are occurring throughout the entire health care system.

Operator: Thank you. We'll take our next question from Andrew Mok of UBS. Your line is open.

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

A

Hello there, Andrew.

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Andrew Mok
Analyst, UBS Securities LLC

Q

Hi. Good morning. Very strong volumes in the quarter, but pricing yield was flat year-over-year. Can you help us understand or walk us through any items impacting rates beyond the sequestration impact?

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

A

Yeah. So there were a number of items. Sequestration is certainly a significant one. We called out that there was a $7 million net negative adjustment related to the SSI adjustment factor. It was $2.5 million positive in Q1 of last year, and it went the other way almost to the tune of $4.5 million in Q1 of this year. The bad debt expense, for reasons I've discussed in my prepared remarks, were up about 20 basis points. But a bigger factor is one that I was just pointing to, which was the change in the patient mix.

And so you really had two things going on there. First is you may recall that although we didn't get the same 20% stipend that acute care hospitals get for patient how enters – coding with COVID. We do – we were able to code and we're directed to code COVID patients as a co-morbidity, which led to an extra payment and we had a 41% drop in the quarter of patients who were coding with COVID co-morbidity and so that decreased reimbursement as well.

But then it was the broadening in the patient mix that I just talked about that resulted in somewhat lower acuity. We again did have growth in stroke and neurological which are our two highest acuity categories, but growth was faster in areas like lower extremity joint replacement and cardiac, point to two specific areas.

Andrew Mok
Analyst, UBS Securities LLC

Q

Got it. That's helpful. And then just as a follow-up, you already opened four de novos this year, I think through April which presumably impacts 1Q. How much startup cost did you incur in the quarter and how do you expect that to track throughout the year based on your latest de novo opening plan? Thanks.

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

A

Yeah. So we have a little over $4 million in the quarter, continue to expect the range to be $10 million to $12 million for the full year. And basically, you can look at the opening dates that we have in there for new facilities and it's going to track and most of those costs are going to be born in the months leading up to the opening of any one of those facilities.

Andrew Mok
Analyst, UBS Securities LLC

Q

Great. Thanks for the color.

Operator: We'll take our next question from Ann Hynes of Mizuho Securities. Your line is open.

Ann Hynes
Analyst, Mizuho Securities USA LLC

Q

Hi. Good morning.

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

Good morning, Ann.

Ann Hynes
Analyst, Mizuho Securities USA LLC
Q

How are you? So when I look at current EBITDA guidance, where do you think you're most conservative and what would have to happen maybe to get you to the low end? And then secondly on the Tablo that you're in-sourcing, is there any other services like the Tablo that you can in-source over time? Thanks.

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

Yeah. So, I think when we look at the revised guidance, obviously on the top line, you've always got some potential volatility around volume and we did see more of a pricing impact from the change in the patient mix in the first quarter than we were anticipating. Perhaps we underestimated the year-over-year change related to the COVID comorbidities, so there is some variability there. But the single biggest factor then remains what is the trend line on labor expense, we're going to continue to make the tradeoff that we have been making with regard to volume over labor expense. I definitely think that the current guidance range that the bias is more towards the – away from the lower end and more towards the mid to higher end.

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

And Ann, this is Mark. Relative to your question about Tablo, I would say that we are always looking for ways to become more efficient providers and improve our services. I would say that the dialysis was an area that became obvious, particularly starting back in 2020 and 2021. We had difficulty with our existing outstanding providers to provide the care when nursing shortage is really started coming into effect.

So it highlighted our need to go out and do what we needed to do to provide that services in-house and reduce our reliance on outside agencies to provide it. So I think that Tablo has been a real good solution for us there, and we'll continue to look at other opportunities that may exist, particularly from the clinical provision of our care.

Ann Hynes
Analyst, Mizuho Securities USA LLC
Q

Great. Thanks.

Operator: We'll take our next question from A.J. Rice of Credit Suisse. Your line is open.

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

Morning, A.J.

A.J. Rice
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. Hey. First, I might just ask about the JVs. Obviously, you've got a big backlog there, 18 in development. Are you seeing the timeframe from when you start discussions to when something finalizes? Is that compressing as

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you get more of these done? Are the terms on the deals changing in any way economics because of the type of group this JV-ing? Is that changing? Just give us an update on what you're seeing out there.

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

A

Yes. A.J., just in way of a clarification, you said we had 18 de novos that have been announced and are under development with opening dates beyond 2023. Only a subsection of those will be JVs. I think right now, the percentage of the portfolio that's inclusive of JV opportunities is somewhere between 35% and 40%.

The approach that we take on JVs and the economics around those really haven't changed very much with regard to the gestation period on it. If you're doing a joint venture with a partner who's accustomed to doing joint ventures with other providers and perhaps someone who has experience with us, those are going to go much faster. If it's a first time in both of those categories for a partner, it's probably going to be a little bit longer.

Beginning about three years ago, we made kind of a subtle shift in our strategy. And as we develop more experience on successfully opening de novos, we got more comfortable going into a market where we thought it might be preferable to have a JV partner just announcing that we were coming on a wholly owned basis and then having subsequent conversations with potential partners about JV-ing as opposed to wiring it on the front end.

So we really haven't experienced anything in those negotiations that's impacting the timing of facilities. The biggest challenge we have right now is just the elevation in construction cost. Again, we've mentioned previously and we'll be talking more in the days ahead about our utilization of pre-fabrication. That helps the containment costs but construction costs over the last two years are certainly elevated.

A.J. Rice
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Maybe on the follow up to ask about your MA contracting. We hear a lot of the MA plans talking about post-acute care coordination, putting more focus on that. Does that create any opportunities or challenges for you? And more broadly, what are you seeing with your MA re-contracting, any change and other value based aspects to it?

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

A

I really haven't seen a lot in the way of value-based initiatives arising from that payer category. You know, generally speaking, we continue to make great progress on Medicare Advantage. If you look at the payer mix for the first quarter, it was 16% of the aggregate. That compares to, say, 9% as recently as 2018. So steady growth of the payment differential in spite of the broadening of acuity within our MA book of business, continued to be very favorable at under 5%.

I mentioned previously that the growth for the quarter was 20% and over 70% on the same-store basis. The real opportunity that exists there is, even with that tremendous progress that we've made on Medicare Advantage, the admission to referral rates for MA patients remains at half of what it is for traditional Medicare. So, from traditional Medicare, we run it about a 64% admission to referral and its 32% for Medicare Advantage.

And so that just once the fact that there are eligible patients who would benefit from treatment in an IRF, who have Medicare Advantage coverage, who are not receiving that coverage for various reasons. And that's an

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opportunity for us and it's an opportunity for the MA plans. It's also something that CMS really highlighted and provided some specific guidance around in the recent MA update.

A.J. Rice
Analyst, Credit Suisse Securities (USA) LLC

Q

Interesting. Okay. Thanks a lot.

Operator: We'll take our next question from Steven Valiquette of Barclays. Your line is open.

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning, everybody. Hey. Good morning. So my question really kind of relates also to the full year outlook, just given the strength in the operations in the first quarter that was pretty consistent and all signs point to momentum in the second quarter. I also thought maybe, perhaps the full year guidance could have been raised a little bit more.

With your comment here during the Q&A that there's now a bias for the full year results to come in at the high end. I guess the question now really is just to confirm whether that comment was related to essentially all of the key guidance metrics that you provided previously? Or were there specific guidance metrics that you were alluding to with that comment about the bias to the high end? Just wanted to try to get a confirmation on that. Thanks.

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

A

Yeah. First, a clarification, I don't think I said high end. I think I said...

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Sure.

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

A

Less on the low end and more in the mid to high.

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Okay.

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

A

Steve, as you know, we issue annual guidance for our key financial metrics. And from time to time, what we see is that quarterly consensus estimates diverge from the internal expectations that we had in establishing that guidance. Now, we had a very good quarter. We feel really good about how our business is performing. And as a result, we raised guidance after just one quarter of the year being done. And so I think you should interpret that as it is.

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Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Okay. All right. Appreciate the extra context on that. Thanks.

Operator: And we'll move next to Pito Chickering of Deutsche Bank. Your line is open.

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

A

Good morning, Pito.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys.

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

A

Pito.

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Hey. Good morning and thanks for taking my questions. Great job on the quarter. I'll ask sort of the volume question just a different way. Your occupancy of 73.4%, I think the highest I have in my models. Like number one, what occupancy ratio should be considered to be max occupancy due to different genders, sharing rooms or requirements for one person in a room? Number two, sort of how fast are the beds coming online versus occupancy increasing? And number three, taking multi-year view. Do you foresee any capacity constraints or do you guys – can you bring on beds fast enough to start of keep this level?

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

A

All right. There's a lot in that Pito, but, yeah. So the theoretical peak occupancy or max occupancy rate that we have is rising over time with the change of the composition of our rooms skewing more towards private versus semi-private, which allows us to work around the rooms requiring isolation or gender compatibility and we still got a long way to go on that, particularly with our legacy hospitals.

We're a little over 40% in all private rooms right now. We're continuing to address that issue in two or three important ways. One is almost all of our capacity additions without exception, the new hospitals and the bed expansions are all private rooms. And then the second is we're undertaking some of our hospital renovation efforts to take semi-private rooms and convert those into private rooms. Can't do it 100% in a lot of those facilities, but it is increasing.

When you look at all private room hospital, the occupancy max is going to be in the 90% range, right? And it's really just more based on patient flows and discharge timing than anything else. In a semi-private room depending on the configuration and the patient mix, it's going to be more in that probably 70% to 80% range, but we would expect it to increase over time. I know I didn't get to all of your questions, Pito. Which ones did I miss there?

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Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

You bet. Great answer so far. I guess – and then the question is, as you look at your bed additions, so how fast this coming online versus demand which is fairly significant here? And sort of taking multiyear view, do you foresee any capacity constraints or do you guys – can you bring on beds fast enough to meet through this almost hypergrowth of demand?

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

A

Yeah. Pito, I think we're going to be in good shape in terms of how we plan for the bed additions and which hospitals and accommodate the increasing demand for services. So I don't anticipate a widespread capacity challenge in terms of diminishing our opportunity for growth. We've been very careful and very disciplined in thinking about which facilities need the bed additions now and accommodate the growth that's out there, but also to make sure that we minimize those hospitals that have a significant higher semi-private complement, so that we can increase the number of private room complements.

And then my final comment on that is we still have some hospitals that are heavily weighted on semi-private rooms, but have the capability to provide those patients that are looking for a private room. They can still provide a single room for them that may be semi-private but not have the second bed occupied. So we've been able to accommodate the demand and foresee that going forward.

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

A

And, Pito, in almost all situations, the occupancy level is just to find a bed expansion, we can move pretty quickly. Even in CON states, there's typically a provision that allows for an expansion at some level providing you've maintained a certain occupancy level for a period of time. Obviously, we're unfettered in most instances non-COM states unless there's a physical constrain on facility. And again, the utilization of prefabricated construction, even if it's just headwalls or exterior panels, can allow us to shorten the construction cycle on those.

Steve J. Valiquette
Analyst, Barclays Capital, Inc.

Q

Great. Thanks so much, guys.

Operator: [Operator Instructions] We'll move next to Brian Tanquilut of Jefferies.

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

A

Hello, Brian.

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

A

Good morning, Brian.

Brian Tanquilut
Analyst, Jefferies LLC

Q

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Hey, good morning, guys. Congrats on the quarter. Doug, I guess as I think about staffing, so you're expecting the same level of temp staff, but how are you thinking about bill rates for temp labor going forward or at least for the rest of the year?

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

When we talk about the average rate per contract labor FTE. And the fact of the matter is there continues to be significant disparity across geographic markets. So there could be a little bit of a push me, pull me, which is we may see that as the labor market improves, across our entire network, we're able to bring down the level of contract labor FTEs, but there could be certain markets where it's still required in those markets, the rate is likely to be somewhat sticky.

So I would expect some additional improvement with regard to FTEs where improvement in labor conditions in existing market is somewhat offset by capacity additions. And because we'd see more of a concentration in harder markets or more stubborn markets, we may see the rate drift a little north. But I would tell you, that is complete speculation at this point. And so every day is a new observation point.

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

But I will say, Brian, it's Mark, I mentioned earlier the I mentioned earlier the discipline in which our operators and their various marketplaces are applying to this. I mean, part of that is testing the sensitivity of the market to relative to price as well. And so, we have been very aggressive at trying to push down the rates as we go forward whether that is from a contract standpoint or whether that is offering less on shift bonuses. Then maybe what we have done historically. And certainly on the sign-on bonuses, we've pretty much put a moratorium on sign-on bonuses and certain marketplaces where we just don't think they're necessary.

Brian Tanquilut
Analyst, Jefferies LLC
Q

Got it. All right. Thank you, guys.

Operator: And we'll go next to Ben Hendrix of RBC Capital Markets.

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

Hello, Ben.

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

Good morning, Ben.

Ben Hendrix
Analyst, RBC Capital Markets LLC
Q

Hey. Good morning, guys. Thank you. You talked at length last quarter about the EBITDA flow through from changes to EPOB, and now you're reaffirming the 3.4 for the balance of the year. And apologies if I missed it, but how should we think about the phasing through the rest of the year given the sequential decline from 4Q? I

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assume that there's a discharge growth for things versus the pace of hires as a component. But what else do we need to keep in mind for the EPOB guidance there? Thanks.

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

A

Yeah. I think the two most significant factors are the progression of patient volumes through the next three quarters, and then also they're impacted by the opening and ramp up of new hospitals. And so, obviously, you're going to have some seasonality in the second and third quarters as we normally do with regard to patient volumes. And then, again, just to factor in the timing as indicated in the schedule on our supplemental slides regarding the additional de novos that will open this year.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Thank you.

Operator: This does conclude our question-and-answer session. I'm happy to return the call to Mark Miller for any closing comments.

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

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

Operator: This does conclude today's conference. You may now disconnect your lines and, everyone, have a great day.

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