06-Aug-2024

Encompass Health Corp. (EHC)

Q2 2024 Earnings Call

Copyright © 2001-2024 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Mark Miller
Chief Investor Relations Officer, 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.

OTHER PARTICIPANTS

Whit Mayo
Analyst, Leerink Partners LLC

A.J. Rice
Analyst, UBS Securities LLC

Andrew Mok
Analyst, Barclays Capital, Inc.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Kevin Fischbeck
Analyst, BofA Securities, Inc.

Scott J. Fidel
Analyst, Stephens, Inc.

Brian Tanquilut
Analyst, Jefferies LLC

Jared Haase
Analyst, William Blair & Co. LLC

John W. Ransom
Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning everyone and welcome to Encompass Health's Second Quarter 2024 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 will be a question-and-answer period. [Operator Instructions] . 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. Please go ahead.

Mark Miller

Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator. And good morning, everyone. Thank you for joining Encompass Health's second quarter 2024 earnings call. Before we begin, if you do not already have a copy, the second 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

Copyright © 2001-2024 FactSet CallStreet, LLC

release and related Form 8-K, the Form 10-K for the year ended December 31, 2023, the Form 10-Q for the quarter ended March 31, 2024, and the Form 10-Q for the quarter ended June 30, 2024 when filed. We encourage you to read them. 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 are pleased with our second quarter performance as strong discharge growth facilitated an increase of 9.6% in revenue and 8.9% in adjusted EBITDA. Total discharges for Q2 increased 6.7%, including 4.8% in same-store. Our discharge growth continues to be broad based across geographies, payers and patient type. Neurological conditions and stroke, our two most common primary conditions treated grew 6.3% and 6.6%, respectively, while smaller categories, including other orthopedic conditions, major multiple trauma and knee and hip replacement experienced double-digit increases.

Within our payer mix, Medicare discharges increased 7.2% for the quarter, while Medicare Advantage discharges grew 9.6% for the quarter. Owing largely to our Q2 results, we are again increasing our 2024 guidance. Doug will cover the details of the quarter and increased guidance in his comments.

Demand for IRF services remained strong and we are continuing to invest in capacity additions to meet the needs of patients requiring inpatient rehabilitation services.

During Q2, we added 194 beds to our capacity comprised of three de novo hospitals with a total of 130 beds, 140-bed satellite hospital and the addition of 24 beds to existing hospitals. In July, we expanded into a new state for our company as we opened a 50-bed hospital in Johnston, Rhode Island. Over the balance of the year, we expect to open two additional de novos with a total of 100 beds and add approximately 30 more beds to existing hospitals. We are continuing the expansion of our joint venture partnership with Piedmont, the leading healthcare system in the state of Georgia. In May, we opened a 40-bed IRF unit within Piedmont Atlanta Hospital. In July, we expanded the relationship further by adding our existing 70-bed hospital in Augusta, Georgia. Our joint venture relationship with Piedmont now includes six open hospitals and the previously announced plans to build hospitals in Athens and Loganville, Georgia. With 15 development projects beyond 2024 already announced and underway, our pipeline remains robust and balanced between wholly-owned and joint ventures.

We also recently made the decision to undertake a major ERP conversion from predominantly an Oracle PeopleSoft Platform to Oracle Fusion. The conversion is intended create a highly capable and sustainable cloud-based ERP infrastructure to support the future growth of our company and facilitate our culture of continuous

Copyright © 2001-2024 FactSet CallStreet, LLC

operational improvement. Fusion includes specialized supply chain solutions for healthcare organizations that represent an upgrade from the functionality within our current system. Other key Fusion modules include financial and human capital management processes. We are pleased to have identified a solution that allows us to maintain and build upon our strategic relationship with Oracle. And we have engaged a leading consulting firm to assist us with the design and implementation of Fusion. Our efforts in this regard began in earnest in Q2, and we expect to go live sometime late in 2025.

During the quarter, we also resumed activity under our share repurchase authorization, buying back approximately 200,000 shares of our common stock for approximately $17 million. In July, we announced an increase in our share repurchase authorization to $500 million. We also announced an increase in the company's quarterly dividend, next payable in October of approximately 13% to $0.17 per share.

On July 31, 2024, CMS released the 2025 IRF final rule. This included a net market basket update of 3%, which we estimate would result in approximately 3.3% increase for our IRFs beginning October 1, 2024, based on our current patient mix.

Across our more than 160 inpatient rehabilitation hospitals, we are providing high-quality, cost-effective care to medically complex patients. Our dedicated clinical teams work collaboratively with physicians to administer this care, producing leading scores and patient satisfaction and quality outcomes. This value proposition increasingly resonates with patients, caregivers, referral sources and payers. The demand for inpatient rehabilitation services remains considerably underserved and continues to grow as the US population ages. We intend to continue to expand our capacity and capabilities to help meet this need.

Now I'll turn it over to Doug.

Douglas E. Coltharp

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

Thanks, Mark, and good morning, everyone.

We are pleased to report another really solid quarter with Q2 revenue increasing 9.6%, driving 8.9% adjusted EBITDA growth. The revenue increase resulted primarily from discharge growth of 6.7%, including 4.8% same-store growth. Of note, this marks eight consecutive quarters of same-store discharge growth exceeding 4%. New-store growth in Q2 was impacted by the timing of de novo openings. Specifically, we had two openings in Q1 of 2023 which therefore rolled into same-store beginning in Q2 2024, and our first de novo openings this year did not occur until mid Q2. Revenue growth in Q2 also included a $10.3 million increase in provider tax revenues.

Our net revenue per discharge in Q2 increased 2%, lower than anticipated, primarily due to an increase in bad debt expense as a percent of revenue to 2.9%. The largest factor leading to the increase in bad debt expense was an increase in medical necessity claim review audits. To elaborate, we had experienced a low level of TPE audits from our primary MAC, Palmetto, from Q3 2023 through Q1 2024. The TPE audits by Palmetto ramped up significantly in Q2 and our practice is to establish reserves when a claim is submitted for review. The increase in medical necessity claim review audits in Q2 also includes initial appeals of non-affirm claims under RCD. We are still early in the stages of RCD and few of the appealed claims have yet to be resolved.

Adjusted EBITDA in Q2 increased 8.9% to approximately $272 million, inclusive of an approximately $5 million benefit from net provider tax revenues. Total premium labor expense for Q2 was $32.6 million and contract labor FTEs were 1.6% of total. These metrics are consistent with our expectations of a stabilizing labor market.

Copyright © 2001-2024 FactSet CallStreet, LLC

We continue to generate significant free cash flow. Adjusted free cash flow increased 14.7% to $142.5 million, bringing our year-to-date total to $310.1 million. We expect full year adjusted free cash flow of $495 million to $580 million. Our leverage and liquidity remained very favorable. Net leverage at quarter end was 2.5 times compared to 2.7 times at year-end. We ended the second quarter with $154.4 million in unrestricted cash and with no amounts drawn on our $1 billion revolving credit facility.

In July, reflective of the strength and consistency in our performance, Moody's upgraded our Corporate Family Rating from Ba3 to Ba2, and our unsecured notes rating from B1 to Ba2. We also issued notice for the redemption of $150 million of our 5.75% senior notes due 2025 with the settlement date of August 15.

As Mark mentioned, during Q2 we resumed activity under our share repurchase authorization, repurchasing 198,708 shares for $16.8 million. And in July we increased our share repurchase authorization to $500 million and declared a cash dividend of $0.17 per share. We are again raising our 2024 guidance. We now assume net operating revenue with a range of $5.275 billion to $5.350 billion; adjusted EBITDA in a range of $1.04 billion to $1.075 billion; and adjusted earnings per share of $3.97 to $4.22.

The key considerations underlying our guidance can be found on page 12 of the supplemental slides. And I want to take a moment to note several updates. We have updated our Medicare pricing assumption for Q4, reflecting the IRF final rule released last week, and now expect a 3.3% Medicare pricing increase. Our assumption for full year 2024 bad debt reserves has increased to 2.4% to 2.6% of revenue, primarily due to the increase in medical necessity claim review audits we've experienced in Q2. We continue to anticipate $15 million to $18 million of de novo net preopening and ramp-up costs for 2024. Q2 net preopening and ramp-up costs were $6.9 million, bringing our year-to-date cost to $8.7 million. Oracle Fusion conversion costs in the second half of 2024 are expected to approximate $2.5 million. The addition of our existing Augusta, Georgia hospital for the joint venture with Piedmont is expected to increase income attributable to non-controlling interest, or NCI, in the second half of 2024 by approximately $3.5 million.

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

Copyright © 2001-2024 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll take our first question from Whit Mayo with Leerink Partners.

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

Hey, good morning, Whit.

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

Good morning, Whit.

Whit Mayo
Analyst, Leerink Partners LLC
Q

Hey. Good morning, guys. Maybe just first on the – Doug, on the higher bad debt, how was that versus expectations? Thoughts on the back half, and how you've incorporated that into the guide on maybe a dollar basis, just given the higher audits? And are these higher audits actually higher than what you expected? Thanks.

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

Yeah. It's a little hard to predict the activity under TPE. The single largest factor here were the TPE audits with Palmetto. And as I tried to outline in my comments, those tend to be a little bit lumpy. So after several quarters where there wasn't much activity there, Palmetto selected, which they were entitled to do, 20 claims from each of the hospitals within their jurisdiction. And because our practice is to establish a reserve immediately when the claim is selected for review and before it's been processed, Q2, you saw the accumulation of the reserve for all of those claims selected by Palmetto, although very few of them had been processed. Now what we've witnessed since the end of the second quarter is that more of those claims are getting processed with a favorable resolution and new claims have not been selected. And so that really kind of informs our outlook for the balance of the year.

Whit Mayo
Analyst, Leerink Partners LLC
Q

Okay. Maybe just to follow up – and we can talk about that offline, but just, Doug, buybacks, you've presumed a little bit more activity, maybe not a question on the quarter or the year, but just how you think about buybacks becoming a larger part of the uses of cash in the future? It wasn't a large amount in the quarter, it was something, I know the authorization was nudged up to $500 million. Just want to kind of think how you're sort of evaluating buybacks on a go-forward basis. Thanks.

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

Yeah. We think, as we had talked about previously, we really kind of crossed a Rubicon with regard to cash flow in 2023 where we were – began generating free cash flow above the level that is required to fund all of our discretionary CapEx. And at the same time, our leverage has been coming down predominantly based on the year-over-year increases in EBITDA. So that gives us capacity to allocate free cash flow to other uses. And we've stated pretty consistently that we think that the best additional use beyond capacity expansion is shareholder

Copyright © 2001-2024 FactSet CallStreet, LLC

distributions. We have tended to like a balanced approach between share repurchase activity and an increase in the dividend. I think you saw the initial moves in that direction in Q2, and with the increased authorization we would expect to see kind of a – that become a more stable utilization of or allocation of our free cash flow. We don't have a specific timeframe in mind over which we intend to use that authorization, but it was put in place for us to utilize.

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

Yeah. Whit, this is that Mark. I mean, this is a common and frequent discussion from our board in terms of how to use this free cash and how best to recognize with our shareholders.

Operator: Our next question comes from A.J. Rice with UBS.

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

Good morning, A.J.

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

Good morning, A.J.

A.J. Rice
Analyst, UBS Securities LLC
Q

Hi, everybody. Maybe just – I know you reiterated your cost figures for SWB per FTE up 4% to 5%. I'm seeing contract labor up sequentially a little bit. We're not seeing that from that acute guys and all of that, but maybe that's due to your incremental bed capacity and bridging to get permanent people or what's going on there and anything else to call out on labor?

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

I think with regard to the premium labor, it's consistent with the story we've told the last several quarters, which we felt like we were at a roughly stabilized level. I do think it is important to note that we're keeping the dollars level at the same time that our volume continues to grow, not just in the new stores, but with that same-store growth, again, eight consecutive quarters of same-store discharge growth exceeding 4%. So, we don't necessarily think that there'll be much near-term leverage against those, although we continue to focus on trying to bring that down. We seem to have stabilized at roughly 1.5% to 1.6% of FTEs.

I think in the – in terms of the assumption of SWB being up 4% to 5% a year, we were up 3.5% for the first half of the year. So that would suggest we'd have to be up kind of in the higher end of that 4% to 5% range to get the full year there. And so there may be some conservatism built into that assumption, but we think just given some of the uncertainty with regard to labor conditions and the fact that it can change, particularly on a geographic market by market basis, that it was prudent to leave the assumption there.

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

Copyright © 2001-2024 FactSet CallStreet, LLC

A.J., that's a contract labor, so 50% of the spend was within 13 hospitals for Q2, so it's within a small percentage of our hospitals and just some of those marketplace that remain still a bit of a challenge.

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

And, on...

A.J. Rice
Analyst, UBS Securities LLC
Q

Okay.

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

...with regard to the philosophy around being proactive with regard to market adjustments, again, that really has served us well. Our turnover levels for both nursing and therapy were again very favorable in Q2 and we continue to have great success at net new RN hires. So that's the trade-off against somewhat higher inflation level on SWB, we think it's probably a good one.

A.J. Rice
Analyst, UBS Securities LLC
Q

Okay. I noticed you continue to see growth about 0.5 percentage point on your revenue mix in Medicare Advantage and would you call traditional managed care was a little down about 0.5%, otherwise pretty stable. Anything to call out there? Any – I mean, I know we've got underlying growth in Medicare Advantage enrolment. Is that basically what's driving that or anything on contracting wise or – to call out?

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

No. I think it really is just kind of tracking the overall market growth. We do feel like we continue to make good inroads with Medicare Advantage plans. 90% of our contracted Medicare Advantage revenue is on an episodic versus a per diem basis. And once again, we were just at about a 3% discount in the overall book of Medicare Advantage to Medicare from a pricing perspective. So, feel good about what's happening there and about the way our value proposition is resonating with that payer class.

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

A.J., as we've said before, a large percentage of the cases that we see through Medicare Advantage are stroke programs and those programs that are more medically complex patients, which is really an area that we feel we've developed as a sweet spot in our ability to provide that value proposition, to get those patients back to the communities.

Operator: We'll take our next question from Andrew Mok with Barclays. Please go ahead.

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

Morning, Andrew.

Copyright © 2001-2024 FactSet CallStreet, LLC

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

Morning, Andrew.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Hi. Good morning. First, can you just clarify what the startup cost number was in the quarter? And then I wanted to follow up on the guidance components. Looks like there's an implied deceleration in the back half, even though the bad debt increase is largely impacting 2Q and it looks like SWB per FTE is tracking below the low end of your guidance in the first half. So any other items that we need to consider in the back half for guidance? Thanks.

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

Okay. So first on the preopening ramp-up costs, in the quarter, $6.9 million; year-to-date, $8.7 million; full year assumption unchanged at $15 million to $18 million. I think in the second half, I think the things that we would call out are the Oracle Fusion conversion costs, the NCI impact from adding our Augusta Hospital to the Piedmont joint venture. And then we do based on that 4% to 5% SWB increase for the full year and the fact that we ran at 3.5% for the first half of the year, that would suggest a potentially higher rate of inflation in the second half. We don't know if that'll come to fruition and that's why I mentioned earlier there may be some conservatism to that assumption, but we think it's prudent to leave it there at this point.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. And if I could just follow up, this is the second quarter in a row that we've seen some provider tax revenue flowing through the outpatient and other side of the business. Can you help us understand your exposure to these programs more broadly and whether or not you have exposure on the inpatient side? Thanks.

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

It's very volatile and very difficult to predict. Most states have some form of program that's out there. You don't get a lot of visibility into what your participation is going to be. There tends to be a time lag based on the state's fiscal year which in most instances doesn't align with our fiscal year. So it can be really lumpy. If you look at last year, in the first two quarters, it was negligible. And so some of this is out of period, some of it is in period. It's kind of a long-winded way of saying that it's just – it's really hard to predict and it's – as a result, it's very difficult for us to incorporate it into any of our guidance.

Operator: Our next question comes from Pito Chickering with Deutsche Bank.

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

Morning...

[indiscernible] (00:26:43)

Copyright © 2001-2024 FactSet CallStreet, LLC

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Good morning, guys. So, looking at the changes from the previous guidance versus the updated guidance, I estimate about $23 million of headwind, some of it from the work – the Oracle, the JV sale and bad debt, about $8 million of tailwinds coming from Medicare pricing and provider tax EBITDA. So if I think about you raising guidance by $24 million with a $14 million negative impact from the headwinds – the net headwinds, is that a good way if I think about your guidance change?

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

A

Yeah. So I'll give you the math kind of the way that I'm thinking about it, Pito. And so I'm now focused on the EBITDA guidance at the midpoint, for lack of a better starting point. And so from our initial guidance, it's up $22.5 million, but to your point, there have been tailwinds and headwinds that were not included in that initial guidance. So in terms of the tailwinds, we've had provider tax impact on EBITDA for the first half of $10 million. We also had positive insurance accrual adjustments that weren't factored into our initial guidance of $6 million, so that's $16 million. Offsetting that, if you go to the midpoint on the revised bad debt range, it's about a $16 million impact. And then the Piedmont and Fusion together are $5 million, so that's $21 million. So in that headwind of $5 million, which would suggest the midpoint of the EBITDA guide has gone up by $27.5 million to $28 million. And really all of that has been attributable to the strength in volume that we saw in the first half of the year.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Got it. And then so looking at the back half of the year, with your revenue guidance not changing that much, I guess, where are you seeing sort of better core margin leverage versus your previous leverage? Thanks.

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

A

I'm sorry, I didn't – Pito, could you give me that last question again? I didn't quite get that.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Q

Oh, so apologies. I guess so back to sort of the guidance question, you're not changing your revenue guidance that much, so implying you're seeing better core margin in the back half of the year, so previous guidance, I guess. Is that how we should be thinking about just better margins versus your revenues not going up that much back half of the year?

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

A

I'm sorry, Pito. I kind of had trouble following that again. I might be a little slow this morning.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Q

Oh, [indiscernible] (00:29:14) apologies, actually. So I'll skip that one and change that one to...

Copyright © 2001-2024 FactSet CallStreet, LLC

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

Okay. Thank you.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.
Q

...de novo, so I guess what's the cost to build a new facility in 2024 versus start of 2023? I guess, has the ROIC for building de novos gotten better as inflationary pressures have come down in the last year? Thanks.

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

Yeah. And so, you're always looking forward about three years to get a – first time an idea about a new de novo pops into our head to the time it gets open is roughly a 2.5- to 3-year time horizon. Right now we've seen costs really hang in there pretty well at that $1.2 million per bed that we've been talking about for a while, that's for a de novo activity. Bed expansions are more in the $700,000 and those have been relatively stable. Some of that is a result of the slowing down of inflation in the market, a lot of it has to do with our use of pre-fabrication and then also some supply chain efficiencies. In terms of the ROIC, with the cost per bed staying relatively stable, we are still seeing pro forma to generate attractive ROIC, which is why we continue to push forward with new capacity additions.

Operator: Our next question comes from Kevin Fischbeck with Bank of America.

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

Good morning, Kevin.

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

Good morning, Kevin.

Kevin Fischbeck
Analyst, BofA Securities, Inc.
Q

Hey, guys. So I guess a couple of questions. First one, on the guidance components in the back half of the year wasn't a 100% clear to me how do we should think about these headwinds as we think about 2025. I guess we're just kind of – the Piedmont seems like we just double it and say it's a full year impact next year. But is the bad debt number – should we be thinking about the annual number as the right number, should we be thinking about the second half run rate as the right number? And then the Fusion costs, are there going to be additional costs in 2025 that we should think about, or is that all going to be wrapped up this year?

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

Yeah. So I think for an initial estimate on Piedmont and Fusion, take the numbers for the second half of this year multiply by 2, maybe plus or minus a little bit, just based on growth at Piedmont and based on not knowing the full range of activity that we're going to make on Fusion through the progress of 2025 when we intend to go live. The bad debt, it's too early for us to formulate an estimate for 2025, although I don't think sitting here today that I

Copyright © 2001-2024 FactSet CallStreet, LLC

would pencil anything that is markedly different from kind of the history we've had over the last two or three years. I think what we saw...

Kevin Fischbeck
Analyst, BofA Securities, Inc.
Q

Okay.

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

...in Q2 was a bit of a spike and that's why we expect it to normalize in the second half of the year, we'll just have to see how much and how fast.

Kevin Fischbeck
Analyst, BofA Securities, Inc.
Q

Okay, that's helpful. And then I guess with joint ventures, like I'm kind of used to seeing facilities being thrown into a joint venture once you create them. But with Piedmont, I guess you've been involved with them already. So what benefit do you get by adding an additional facility into a joint venture versus just kind of keeping all of the economics yourself?

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

And so we've had a couple of existing facilities that have been added into the Piedmont joint venture, one in Newnan, Georgia, and this one in Augusta, Georgia. Augusta, Georgia, was added specifically, we had an existing hospital there that we've had for better than 10 years. Piedmont did not historically have a presence in that market, and they acquired an acute care hospital, so it's consistent in terms of how we're approaching the entire state of Georgia in markets where we overlap, to be partnered together.

Operator: Our next question comes from Scott Fidel with Stephens.

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

Morning, Scott.

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

Morning, Scott.

Scott J. Fidel
Analyst, Stephens, Inc.
Q

Hi, thanks. Good morning. First question. So just thinking about what you were just talking about on the eight consecutive quarters now of at least 4% same-store discharge growth and the fact that your – being opportunistic on investing in wages to sustain that clinical capacity. As we think about the updated guidance for the full year, should we be thinking about you looking to target delivering at least that 4% same-store discharge growth in both the third and fourth quarters implied in the guidance?

Copyright © 2001-2024 FactSet CallStreet, LLC

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

A

We don't provide specific quarterly guidance around volume growth or any other metrics. What we have said before, and I think what we continue to adhere to is that we expect a discharge growth CAGR of 6% to 8% and we've been consistently delivering within that range or above that range.

Demand for services, as Mark cited in his comments, remains good. Our hospitals have the capability to serve those patients well and staffing has not been a constraint, nor do we foresee it being a constraint in terms of being able to meet the volume demands for our facilities.

Scott J. Fidel
Analyst, Stephens, Inc.

Q

Okay. Got it. And then follow-up question. Just interested as sort of the latest, I guess, contracting interactions with the managed care payers, just as it relates to – obviously, it's been a challenging backdrop for MA in 2024 and in 2025, the reimbursement pressure will continue. So, just curious, has there been any change in the contracting posture from MA plans because of that. And then also, just from, I guess, sort of the utilization management and sort of medical management side of things as well from the managed – from the Medicare Advantage plans, whether you've seen any sort of tightening behaviors just because of some of the financial pressures that they're facing. Thanks.

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

A

So in terms of the contracting, no, there really hasn't been any change in the nature of the discussions between the two. I'll remind you that particularly prior to this year, there were a number of years where the MA plans had very significant annual increases and they did not feel compelled to share that largesse with us during that timeframe, so you can't have it both ways.

With regard to the actual relationship, once those plans are in place, I would say that it is improving and becoming more constructive, but there is no doubt that the preauthorization policies and the screening that gets done by the MA plans remains a challenge in a lot of our markets. We have a very talented people at all of our hospitals who work very hard to make sure that those patients in need of inpatient rehabilitation care have an opportunity to come to one of our hospitals so they can go get well and that's true for MA patients as well.

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

A

I think one thing [indiscernible] (00:36:15), we've gotten very detailed from our clinical approach with our therapists or nurses that may be – or even our medical directors that may be working to justify the admission of a patient and support the clinical benefits and the potential gains that should be seen by that patient in our hospitals. So, we've involved the medical directors and clinicians in that process to a much greater degree than what we had in the past.

Operator: [Operator Instructions] We'll take our next question from Brian Tanquilut with Jefferies.

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

A

Hey, good morning, Brian.

Copyright © 2001-2024 FactSet CallStreet, LLC

Brian Tanquilut
Analyst, Jefferies LLC

Q

Hey, good morning, guys.

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

A

Good morning, Brian.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Good morning. Maybe just to go back on the audit, maybe Doug, is this specific to Palmetto or are there – or is this a broader – more national thing? And then maybe just as I think the mechanism here, right, so as the claims are processed, is there a reserve release that we should expect – we could expect down the road?

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

A

Yes. So the majority of the activity has been with Palmetto. I'll remind you that they are our largest MAC by a long shot. And then with – it's exactly – it works exactly as you said, Brian, when a claim is selected, we immediately establish a reserve and we had all of those claims had been selected in Q2 and very few had had a decision rendered upon them by Palmetto at the end of Q2. As we have progressed beyond the end of Q2 to this point, more of those claims have been processed. Many are a favorable resolution or approved, and as soon as they are approved, we go ahead and release the reserve. Well, actually they get approved and then once the cash comes in, we release the reserve.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Okay. Got it. And then maybe Mark...

[indiscernible] (00:38:24)

Brian Tanquilut
Analyst, Jefferies LLC

Q

No, go ahead.

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

A

As that flows through the quarter, unless there are incremental claims that are selected for review, you would see a reversal of some of the bad debt expense that we experienced in Q2.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Got it. Yeah [indiscernible] (00:38:44). That makes sense. And then maybe, Mark, as I think about, seeing that you opened – or you've got an announcement for Rhode Island, are there plans, I mean, how are you thinking about new geographies outside your current footprint of states? Are there states that are screening for you guys as attractive new market entry opportunities we should be thinking about?

Copyright © 2001-2024 FactSet CallStreet, LLC

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

Yeah. Well, you can look on our slides in terms of the development activity. We're very excited about some of the new states, and I mentioned the Rhode Island earlier, but if you look at other states, you've got Danbury, Connecticut on there, that'll be a new state for us next year. You also have geographies within existing states that we're excited to pursue. So, we examined literally any MSA that could be a potential marketplace for us. There are certain states that we'll never enter, but we have a broad approach in terms of evaluating different geographies and the opportunities to enter new states.

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

And remind you there that if we just look at a proxy for the demand for IRF services, as the number of presumptively eligible CMS 13 discharges coming out of acute care hospitals every year that ultimately wind up in an IRF bed, that conversion rate nationwide is only about 14%. So, we know that there's a lot of unmet demand out there and that demand is increasing every year, just given the aging demographic in this country.

Operator: Our next question comes from Jared Haase with William Blair. Please go ahead.

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

Hey, Jared.

Jared Haase
Analyst, William Blair & Co. LLC
Q

Hey, good morning. Thanks for taking the questions. Maybe just a quick one, just on the quarter. Occupancy was up nicely again year over year, but it did decline a bit sequentially. Is that typical seasonality or are there any other nuances that you'd sort of share in terms of how that metric shaped up for the quarter? Then any comments on what a fair assumption would be for the back half of the year?

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

Yeah. So, Q1 is normally based on seasonality, a very strong quarter for us from an occupancy perspective. Q2 was also impacted by the fact that in Q1 we did not bring on any new capacity. And in Q2 we added 194 beds and most of those came on in the second half of the quarter. And so that weighs down on occupancy while you're in the ramp-up phase.

Jared Haase
Analyst, William Blair & Co. LLC
Q

Okay. That makes sense. And then wanted to ask another one just on the labor inflation trends. And I know it's early, but specifically, I was wondering if there's any color you can share in terms of just expectation for 2025. I'm sure some of that will – or [ph] maybe be informed about (00:41:36) how things shape up in the second half of the year. Obviously, you guys typically try to lead the market on inflation trends. So, maybe any thoughts you'd share in terms of broader expectations for the industry?

Copyright © 2001-2024 FactSet CallStreet, LLC

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

So, Jared, it's Mark, I mean we can comment on what we're seeing right now, and that is certainly a normalization of some of the marketplaces. We've put a lot of effort into our recruitment, talent acquisition function. We're seeing some nice trends in our ability to retain our nurses and our therapists. If you look at our turnover rates, they are equal to, if not better than pre-pandemic. So, if these trends were – continue in the future, which we fully expect, then we'll certainly be well positioned to continue to be able to service the growth that we have out there and continue to grow as a company.

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

Obviously, a lot of volatility out there right now in the overall macroeconomic picture, as we've all witnessed this week. So, it's a little hard to predict what's going to happen next year. But, it kind of feels maybe what we hope for is that we'll see things settle down into that level of overall labor inflation that we saw in the first half, roughly 3.5%.

Operator: Our next question comes from John Ransom with Raymond James.

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

Morning, John.

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

Hey. Good morning, John.

John W. Ransom
Analyst, Raymond James & Associates, Inc.
Q

Hey. Hey there. Sorry, I have – I found the timer's going off here, right as you – right as you had me pick up. My question is a broader one. If we look at the post-acute landscape, there have been a lot of changes. But do you think where we are now is that the referral patterns to yourself, to home health, to SNFs, do you think those have stabilized? Has the role of conveners diminished? So other than [indiscernible] (00:43:41), do you see – do you think that we've kind of settled out and where the referrals are going to go or are you still going to have a knife fight over all this?

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

So, John, it's Mark. I think that certainly during COVID and immediately post COVID, the different settings in post-acute and the capabilities or lack thereof, because of staffing and other resources played out in the favor of IRFs and certainly we took advantage of that in terms of our ability to handle medically complex patient. I do think that we continue to take market share from nursing homes, majority of which reason [indiscernible] (00:44:28) in terms of our ability to show that we can get better outcomes because we have more resources, can handle more medically complex patients. So, I think there's still some settling to be had out there. But I think that there has been a fair amount of settling certainly since post COVID.

Copyright © 2001-2024 FactSet CallStreet, LLC

In terms of the conveners, whenever we've seen them enter our marketplace, there might be some real aggressive actions there that could impact us in the short run, but in the long run the outcomes play out and any impact in terms of referral patterns that might be changed on a short-term basis work to our favor in the long run.

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

And they do seem to be popping up much less frequently than they were, say, from 2015 to 2020, which was kind of that that period where they were most popular.

John W. Ransom
Analyst, Raymond James & Associates, Inc.
Q

Yeah. I mean [indiscernible] (00:45:24) layoffs and I just wonder if their day has sort of coming on.

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

I think so.

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

Yeah.

John W. Ransom
Analyst, Raymond James & Associates, Inc.
Q

Yeah. Okay. Thank you.

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

Thank you.

Operator: This does conclude today's question-and-answer period. I will now turn the call back over to Mr. Mark Miller for any additional or closing remarks.

Mark Miller
Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator. 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 program. Thank you for your participation. You may disconnect at any time.

Copyright © 2001-2024 FactSet CallStreet, LLC

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 2024 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.

Copyright © 2001-2024 FactSet CallStreet, LLC