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Encompass Health Corp. (EHC)

Barclays Global Healthcare Conference

CORPORATE PARTICIPANTS

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

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

OTHER PARTICIPANTS

Andrew Mok
Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Andrew Mok

Analyst, Barclays Capital, Inc.

Hi, good morning, and welcome back to the Barclays Global Healthcare Conference. My name is Andrew Mok, I'm the facilities analyst here at Barclays. And I'm pleased to welcome Encompass Health here to the conference. We have on stage with me, Mark Tarr, CEO; and Doug Coltharp, CFO. Welcome.

QUESTION AND ANSWER SECTION

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Mark, you just reported 4Q results 2026 guidance a few weeks ago. Why don't you start with just giving us the current state of affairs of the business and how you're thinking about the year ahead?

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

A

Yeah. So we're coming off three years of very high level of execution and we're extremely positive about our outlook going forward. You look at the continued need for our services with the aging demographics, there's an imbalance of the supply and demand. There are very few beds being added outside of our organization in terms of net gains in beds in IRF industry. So, this continued demand is out there. We're one of the few that are of the scale to continue to capture this growth that's out there in front of us.

We're also excited about a number of the states that are in the midst or in the throes of discussions around repealing the certificate of need. We've talked before about the state of North Carolina, has very attractive demographics for us. We have one hospital there, but we think there are many other markets that we could grow in. There are plans in place for the state of South Carolina next year. This last week, we've been made aware that the state of Tennessee has some discussion going on. So, not only are we looking at same-store growth in existing markets, but we're looking at the opportunities to grow in new states. And you combine that with our free cash flow and the opportunities to use that to fund our growth, we have been focused on expanding our capacity.

Historically, we've done that through de novos as well as bed additions to our existing hospitals. This last earnings call, we started to introduce the concept of a small format hospital, which we think will have an opportunity for us to add a different concept in terms of capacity growth. So, we're extremely positive about this outlook for this year and our future.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Right. And last month, we made a remark that Encompass has never before been presented with the greater opportunity. I think some might find that a bit surprising, just given the strong growth you've delivered over the last three years. So what underpins the conviction today and what feels most different about the next few years relative to recent history?

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

A

Well, I think there are a number of things of which I've stated in terms of this continued need for our services. But the fact that we have executed at such a high level over the last three years, bringing on new de novo hospitals, adding capacity. We've been able to address labor in a very constructive fashion in terms of reducing our premium pay, our clinical outcomes are the best they've ever been. So, there are just a number of things that are out there, Andrew, that I think we have a lot to look forward to going forward and have a lot of momentum going into this year.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Great. And you've emphasized that supply demand gap. You called out North Carolina, South Carolina, Tennessee, as potentially new or expanding markets. Where else do you see the greatest gaps today and how do you expect that to evolve over the next few years?

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

A

Well, I think there are – certainly there are other states that we're looking at. We're looking at existing marketplaces where we can add density. We've expanded significantly in the state of Florida. Texas is a big state for us, but we've entered new states just last year we entered state of Connecticut. We have projects in the pipeline for states out west. So, we're looking for any markets that have the demographics and the growth trends that would present us for the chance to go in and develop marketplace.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Moving on to volumes. Discharge growth was stronger in the first half of 2025 and moderated in the back half as you face some tougher comps and the timing of some of your maturing de novos. As we think about 2026, what should we keep in mind when considering the cadence of volumes this year?

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

A

Yeah. I think one of the things that impacted discharge growth in the second half last year was that we had several unit closures and that's a bit of an anomalous situation for us. You haven't heard us talk about that previously. We have a relatively finite number of units that we've been operating inside the walls of an acute care hospital. We do that predominantly as an accommodation, and we do that in markets where there is a freestanding host hospital, if you will. It's difficult to make money on those. In almost all instances, those units are leased from the host hospital. We had two such units that closed during the second half of 2025, one in Sewickley, Pennsylvania, which is a suburb of Pittsburgh and the other in Cincinnati. And that was because they were coming to the end of the lease. And in both cases, the acute care hospital host had plans to either repurpose the space or close that space. Although those impact volume, they were at best breakeven from an EBITDA perspective.

As we roll into the first half of 2026, there are two more of those types of situations. One is we just recently at the end of February, closed another unit in Bridgeport, West Virginia. And so, that will have an impact as well. And then, a bit of a larger scale, we had one skilled nursing facility unit that we ran as part of our Cardinal Hill Hospital in Lexington, Kentucky. That was a gift with purchase. When we bought that facility back in 2014, we had kept it open as an accommodation to some of our referral sources in that market. It was a 74 beds facility that only ran at about a 25 ADC. All of those discharges counted as part of our total discharge that we reported. It became evident that, that unit was no longer important to the marketplace, and so we closed that at the end of the year.

All of this to say that those are going to weigh on first half discharge growth. We anticipate and I made this comment in our fourth quarter earnings call that for the full year, unmitigated, it's about a 70-basis-point drag on discharge growth and we expect to mitigate about half of that because in three of the four markets, we're adding additional capacity to the host hospital. The way that that shakes out through the course of the year is its impact is going to be more pronounced in the first two quarters of the year. We would anticipate that the impact in Q1 is probably on the order of 90 to 100 basis points and then it'll begin to decrease through the course of the year.

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

A

But I do want to reiterate, these are anomalies. Andrew, if you look to our history. We're in the business of opening and growing hospitals. It just so happened that we had a number of these and they were all predominantly tied back to leases. It reiterates what we like to control our own real estate and why we don't do more units within acute care hospitals. So, this is not a trend of things to come.

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

A

Right. Evidence back it. Although, it's having an impact on volume, it's neutral from an EBITDA perspective. So, these units in aggregate, we're not contributing any EBITDA. And to Mark's point, with regarding the capacity expansion, we'll be adding between 500 and 600 beds to our total base in each of the next couple of years. And we would probably expect that trend to continue beyond that.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

On those new bed additions, how quickly are you seeing demand absorb that new capacity and how much runway do you think you see for sustaining that pace of investment?

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

A

We have ascended the learning curve on opening up de novos. We've seen that the ramp-up on those facilities is accelerating. In a typical de novo, particularly if it's in a brand new market, we would expect to achieve a 70% stabilized occupancy level after about 12 months. Bed additions because you're building into an existing infrastructure and established referral patterns and existing payer contracts ramp up even faster than that. Our anticipation is that when we begin with the small format hospitals in 2027, they're going to be probably closer to a bed addition than the de novo.

So, the return on those capital investments is generated relatively quickly. Even on a de novo when we're going into a new market, we expect for the ROIC on those facilities to be in excess of our weighted average cost of capital by the time we get to the end of the third year.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Great. And what's driving, obviously, the returns are higher, but what's driving the interest of this newer hospital format? Why are we seeing that now where you're exploring this avenue?

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

A

I think there's a number of reasons behind it. We do have some hospitals. We've already expanded with bed additions. And therefore, the footprint of the land itself doesn't make it – there's just enough space to add additional beds there. We have certain markets that there is demand, but we think that having a second or third location in a marketplace geographically helps us to be better suited for where the patients are within those marketplaces. So, we think the small format hospital has a lot of different points of rationale behind it that lend itself well to fitting the need and adding capacity. We think it will also appeal to our joint venture partners in certain

markets. I was in a meeting last week with one of our partners in Texas and they're very excited about having opportunity to open up a small format hospitals.

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

I think the other things that are contributing to that, the evolution in construction techniques and specifically the utilization of prefabricated components, which allows us to employ more standardization in the hospitals that we're building, and also to speed up the time of construction, which means that we start the cash flows on those projects generating faster. We combine that with some pretty intensive industrial engineering to figure out how to best use labor in a facility of that size. And then, all of the small format hospitals will need to operate as remote locations of an existing hospital so that we can leverage the management team and the existing insurance contracts and the Medicare certification process as well.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. Let's move on to payers and regulations. You've called out MA utilization management as a challenge in some instances where conversion rates don't necessarily align with Medicare coverage requirements. Can you describe your decision to use admit and appeal strategy and how sustainable that is?

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

Yeah. So, first of all, if you look back over the last four years, we've had great success increasing our MA penetration. Between 2019 and the end of 2025, MA as a percentage of our total payer mix almost doubled from just under 9% to almost 17%. And the four-year CAGR from 2021 through 2025 with just under 9% in terms of MA discharge growth. But we did see a slowdown in 2025 and it became more pronounced in the fourth quarter. And specifically, in the fourth quarter with one of the national plans with whom we do pretty extensive business. We saw a market decrease in their conversion rate. When we speak to conversion rate, it's simply all the referrals that we have received of patients who are covered by that particular plan. What percentage are admitted?

Now, not all of the reasons for a non-admittance are due to pre-authorization, but the overwhelming majority is. And that plan, which had historically run at one of our more challenging conversion rates of just under 20%, that dropped on a national basis by almost 500 basis points in the fourth quarter. And there was no reason for that to have happened in terms of a change in the types of patients that were being referred to us. So, it was some kind of policy change.

Historically, with the MA plans, even though there are multiple levels of appeal, starting with the MA plan and then progressing through additional levels like an intermediary for CMS, the ALJ and so forth. Historically, the approach that we've taken is if we were denied admittance in the pre-authorization, we simply moved on. We dropped it and moved on. And beginning this year, we are piloting in about 10 of our hospitals different approach where we are highly confident that the patient meets all of the Medicare coverage criteria. Even if we get that initial denial, we are going to admit the patient and start the appeal process.

With regard to the appeal process, without dragging into too much detail, the first level of appeal is you kick it back to the MA plan for what's called an expedited review, which is you turn this down on pre-authorization, we believe this patient qualifies, take another look. We've actually had some early success on the expedited review. If it gets turned down there, it moves to what's called an independent review entity, which is an entity that is

employed allegedly by CMS that has tended to be more of a rubber stamp in favor of the managed care plan, but it has to procedurally go through that step. It can then go from there to the ALJ.

Beyond the ALJ, it goes back to a Medicare administrative body and then ultimately up to the district courts. We're at the very early stages of this but we believe we've already seen some shifts in behavior.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Great. Can you talk a little bit about or share your historical appeals win rate?

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

A

So, we don't have a lot of experience with regard to appealing these claims up to the ALJ level from an MA perspective. But there's no reason to believe, again, because these patients are very similar to what we've seen on the fee-for-service side, that it wouldn't in large – to a large extent mirror the success that we've had at the ALJ level and through the appeals process on fee-for-service, which has been relatively high.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Great. Let's move on to the TEAM model. It's been a source of anxiety for some investors, particularly RCD expansion TEAM model. At a high level, like what's the core message you want investors take away? Why these are manageable changes?

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

A

So, in all of the marketplaces, so we have 89 hospitals that are in TEAM marketplaces that accounts for about 2% of our total discharges. 41 of those 89 hospitals are joint venture hospitals. So, we have seen these types of programs come out from CMS in the past and we've managed through them in very strong fashion. With those others in the past, with TEAMs, we were out discussing meeting with our referring acute care hospitals. They recognize the fact that our quality outcomes stand out and the fact that they would be penalized if they change their referral patterns to patterns that would increase their rate for readmission. So, we don't see this as being something we can't work through. And our track record in the past shows that we have had the ability to mitigate pretty high form.

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

A

Yeah. And I think that's one of the real key. One of the inherent flaws in analyzing the potential impact of these models is an assumption that all else stays the same. And yet, when you think about it, if you start to direct patients in accordance with the specifics laid out in the TEAM model, the potential repercussions that it has on the avoidable days and length of stay in the acute care hospital, which is the most expensive setting. And then, also on readmission rates could easily overwhelm any benefit that you might get from the risk participation model.

It's also the case that we are likely to lose some patients within those specific diagnostic categories that are covered by TEAM in those markets. But it may also mean then, because those patients are staying for slightly longer length of stay in the acute care hospital that other patients coming out of the acute care hospital who are eligible for IRF services need to be shifted into the IRF setting and the benefit that we can bring to the acute care

hospital is our ability to treat a more medically complex patient allows those to take the patients safely out of the acute care hospital earlier.

You also mentioned RCD, and I think the key takeaway on RCD, which was expanded into the state of Texas beginning of March, and it's scheduled to get expanded into California at the beginning of May is there's nothing new here. We have been subject to Medicare audit – claims audit programs of all kinds of different acronyms for the entire time that we've been in existence and those audits have been extensive. This has a different acronym and it has somewhat of a different procedure. But the documentation that is required and Medicare coverage requirements for the types of patients that should be admitted to an IRF have not changed at all.

We've been pleased with the progress that we've made in RCD in the state of Alabama. That's by far our most difficult MAC. As we look at the MACs that are going to be responsible for our hospitals in Texas and California, Noridian and Novitas. Not only are we able to look at our historical experience with those MACs around other audit programs, most notably TPE, but we can look at the experience that they've had to date with RCD in Pennsylvania with other providers, and the affirmation rate there has been above 98%.

Andrew Mok
Analyst, Barclays Capital, Inc.

Q

Great. Let's move on to labor and technology. I think you've been partnering with Palantir for close to two years now. Can you talk about that relationship and the impact that it's had in areas like admissions, documentation and denials response?

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

A

I think our approach with Palantir, first of all, it's been a great partnership with them over the past couple of years. We started out by looking at ways we can help our clinicians, particularly around documentation. And what you just cited was specifically each of our patients are evaluated by a clinical liaison that goes out with pretty extensive evaluation form where they are collecting clinical data from the medical record. We work with Palantir to help to look at ways to make this more efficient process. We have reduced the time by almost 20 minutes for that type of an evaluation, the documentation. So, it helps our clinical liaisons be more efficient. They can move on to the next patient. It helps our own – it also helps our own job satisfaction in terms of just not having to do such mundane documentation. So that's just one aspect. But there are a number of others that were utilizing Palantir in the future. Doug, I know you've been involved to this.

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

A

Yeah. So, one of the elements that's contributed to our improved performance under RCD in the state of Alabama is, as we were seeing a higher than we had anticipated, non-affirmation rate from our MAC, we needed to – in response to begin the appeals process, you need to generate a letter based on the response that you've gotten from the MAC that attempts to present information from the patient records to overcome that.

And so, we found that we can use a Palantir tool to generate that response letter very quickly and with a higher degree of accuracy than we were able to do manually. It still has to be reviewed by a clinician before it could be sent, but that certainly has helped boost our affirmation rate there. We'll be using a version of that in this MA admit and appeal process as well. And then, big initiatives that we have underway with Palantir for 2026 include revenue cycle management staffing – clinical staffing model with the hopes to continue to improve getting the right license and the right really honing our EPOB strategy. And then finally, real estate market analysis,

increasingly important with the additional modality of the small format hospital [ph] to be labelled (00:21:34), to look at a market to analyze what is the right mode to enter that market and ultimately to count on the expansion of that market over time.

Is it a traditional de novo that's expandable? Is it its current location? Is it a traditional de novo of 50 beds or so? That's not going to be expandable with the idea that you'll add one or two more small format hospitals in the future. So, it's going to be a much more sophisticated analytical tool for that.

Mark J. Tarr
President, Chief Executive Officer & Director, Encompass Health Corp.
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So, we've used our data now working with Oracle Cerner for various purposes. Predictive modeling stands out in terms of identifying patients that may be likely for potential readmission. We've looked at it from a fall rate, how to reduce our fall rate. So, I see this Palantir initiative as just yet an extension of some of the initiatives we've already utilized in the past. We're committed to utilizing this technology to improve our efficiencies where we can.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. Let's move on to labor. Labor tends to draw a lot of attention during periods of stress, but it remains a critical focus even when conditions are stable. How are you investing behind the scenes to build durable staffing pipelines and leadership benches? And how do those investments ultimately show up in retention productivity and quality outcomes?

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

So, it's been probably about five years ago now, we centralized talent acquisition into our offices in Birmingham. So, we took that off the hospitals and combined it in one centralized function. That's been one of the best things we've done around labor. We have 70-some recruiters. That's all they do, all day long, help us find nurses and therapists and other critical positions that are out there. So, we've seen that really help support our hospitals. One of the areas that we've seen it really shine is with our de novo hospitals. For three years running now, we've been able to open up all of our hospitals without any contract labor.

So, that's just one opportunity there. We've utilized some clinical ladders that we put in for nurses and therapists for helping to increase our retention. Our turnover numbers are lower than they've been now four or five years. So, we've seen a lot of opportunities to utilize, whether it's on the recruitment side or the retention side, to reduce our premium pay, eliminate contract labor per diem and shift differentials where we can. So, it all plays a part in that. We've made some really nice progress on that the last two or three years. We think there's more opportunities to go, but we remain very focused on that.

Douglas E. Coltharp
Chief Financial Officer & Executive Vice President, Encompass Health Corp.
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Our premium labor spend in 2025 was half of what it was at the peak in 2022. We entered 2025 assuming that we would do well to hold the premium labor spend, constant nominal dollars from 2024 even as we added capacity and grew volumes and yet we took $21 million out of that spend. And so, I think our focus on labor productivity and efficiency is really evident in those numbers.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. Maybe just to finish up here, Encompass ended 2025 at less than 2 times net leverage. What's the right leverage range for your business and how should we think about the uses of excess cash across growth CapEx, share repurchase and dividend?

Douglas E. Coltharp

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

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Yeah. So, if you look at 2025, we were able to fund $527 million in growth CapEx, just shy of $160 million in share repurchase and a little over $70 million in cash dividends in our common stock, all with internally generated cash flow and the leverage ratio dropped to 1.9 times. If you use the midpoint of our guidance across the metrics for 2026, it would suggest free cash flow of roughly $825 million, $725 million of growth-related CapEx. The dividend will increase slightly, call it $70 million or $80 million. I mean, you're still going to be able to generate those two spends out of internally generated cash flow. And if you did nothing else, the leverage ratio at the end of the year, given the midpoint of our EBITDA guidance, would fall to about 1.8 times which would suggest that you could repurchase up to $250 million of stock and still hold the leverage ratio at 2 times.

So, I think there's a lot of flexibility. I think those same categories are going to be likely places that we devote free cash flow and capital allocation.

Andrew Mok

Analyst, Barclays Capital, Inc.

Great. With that, we're out of time. So, thank you so much for joining.

Mark J. Tarr

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

Thank you.

Andrew Mok

Analyst, Barclays Capital, Inc.

And please enjoy the rest of the conference.