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Encompass Health Corp. (EHC)

Q1 2025 Earnings Call

CORPORATE PARTICIPANTS

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

Douglas E. Coltharp
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OTHER PARTICIPANTS

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.

Whit Mayo
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Matthew Dale Gillmor
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Encompass Health's First Quarter 2025 Earnings Conference Call. At this time, I'd 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]

You will be limited to one question and one follow-up question. Today's conference call is being recorded. If you have any objections to potentially being recorded you may disconnect at this time.

I'll now turn the call over to Mark Miller, Encompass Health's Chief Investor Relations Officer.

Mark Miller

Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator and good morning, everyone. Thank you for joining Encompass Health's First Quarter 2025 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 such as guidance and growth projections, 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 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, 2024, and the Form 10-Q for the quarter ended March 31, 2025 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 is 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 to report another strong quarter. First quarter revenues increased 10.6% and adjusted EBITDA increased 14.9%. First quarter total discharge growth of 6.3% was a strong result, particularly in light of Q1 2024's 10% discharge growth. Recall that Q1 2024 benefited from an extra day due to leap year and because the quarter ended on Easter Sunday. First quarter of 2025, same store discharges grew 4.4%.

Once again, the efforts of our dedicated and highly competent clinical team allowed us to accommodate this volume while maintaining outstanding patient outcomes. Our Q1 discharge community rate was 84%. Our discharge to acute rate was 8.9%, and our discharge to SNF rate was down to 6.4%. Our performance on each of these quality metrics compare favorably to the industry average.

We continue to invest in our clinical team by providing professional growth and development programs such as our clinical ladder and in-house continuing education opportunities. These programs contribute to the continuing improvement in our clinical turnover trends. Q1 of 2025, annualized RN turnover was 20.1%, down from previous year's 20.4%, and annualized therapist turnover rate was 6.3%, down from prior year's 7.7%.

Due in large part to our Q1 results, we are increasing our 2025 guidance. Doug will go into greater detail 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.

In Q1, we opened a new 40-bed joint venture hospital in Athens, Georgia, our seventh JV hospital in partnership with Piedmont. We also added 25 beds to existing hospitals. Over the balance of the year we plan to open six de novos with a total of 300 beds as well as a 50-bed free standing satellite hospital. Consistent with our historical practice, the satellite will be accounted for as a bed addition. We anticipate adding another 125 to 145 beds to existing hospitals in 2025, inclusive of the aforementioned satellite.

We continue to build and maintain an active pipeline of de novo projects both wholly-owned and JVs, while also monitoring and assessing bed expansion opportunities. Our pipeline of announced de novo projects with opening

dates beyond 2025 currently consist of 10 hospitals with 500 beds, and we anticipate additional projects will be announced over the balance of the year. In response to strong volumes and current occupancy levels at some of our hospitals we have increased our bed expansion plans and now expect to add approximately 120 beds to existing hospitals in both 2026 and 2027.

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. On April 11 of this year, CMS released the 2026 IRF proposed rule. This included a proposed net market basket update of 2.6%, which we estimate would result in a 2.7% increase for our Medicare patients beginning October 1, 2025, based on our current patient mix. Based on historical practice, we expect the IRF final rule to be released in late July or early August.

Yesterday we announced that Pat Tuer has been promoted to the newly established position of Chief Operating Officer, where he will oversee hospital operations across the organization. Pat's promotion was prompted by our significant growth and robust development pipeline. Since joining Encompass Health in 2018, Pat has held several leadership roles, most recently Group President, overseeing three of our geographic operating regions with a total of 69 hospitals. Pat has been instrumental in shaping our operational success and driving the delivery of exceptional care to the patients and communities we serve.

Many of you met Pat at our Investor Day in 2023 and at investor conferences and meetings since then, and we are excited to have him in this new role. He's with us here in the room this morning. Now I'll turn it over to Doug.

Douglas E. Coltharp

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

Thank you, Mark and good morning, everyone. Revenue for the quarter increased 10.6% to $1.46 billion and adjusted EBITDA increased 14.9% to $313.6 million. Revenue growth for the quarter was driven by a 6.3% increase in total discharges and a 3.9% increase in net revenue per discharge. Same store discharges grew 4.4%.

Our volume strength continues to be broad based across geographies and patient and payor mix. Net revenue per discharge growth of 3.9% was higher than anticipated, due in part to payor mix. Q1 SWB per FTE increased 3.2%.

Premium labor cost comprised of contract labor and sign-on and shift bonuses declined $5 million from Q1 2024 to $28.6 million. Contract labor in the quarter was $16.4 million, down $2.9 million from Q1 2024 and sign-on and shift bonuses were $12.2 million, down $2.1 million. Contract labor FTEs as a percent of total FTEs was 1.3% for the quarter.

Consistent with our recent trend, benefits expense per FTE increased 14%. Growth in benefits expense per FTE is being driven by an increase in the severity and frequency of group medical claims. Group medical expense growth is expected to remain elevated in Q2 and begin to ease in the second half of the year as we anniversary the increase experienced in 2024.

It's also worth noting that Q1's benefits per FTE increase comes off a low base as benefits per FTE growth in Q1 of 2024 was 0.7%. Net preopening and ramp-up costs were $2.1 million. As previously stated, we expect these costs to be heavily weighted towards the second half of the year due to the timing of our new hospital openings.

Q1 adjusted free cash flow increased 32.7% to $222.4 million. We now expect full year adjusted free cash flow of $620 million to $715 million. Our primary use of free cash flow continues to be capacity expansions. As Mark mentioned, given the growing demand for IRF services and our increasing occupancy rates, we have increased our pipeline of bed addition projects. This is reflected both in our raised growth related CapEx assumptions for 2025 and our estimated bed additions through 2027. For 2025, we now anticipate adding 100 to 120 beds to existing hospitals for 2026 and 2027 we now anticipate adding approximately 120 beds to existing hospitals.

During Q1, we repurchased 333,679 shares of our common stock for a total of $32.1 million and declared a cash dividend of $0.17 per share. Our leverage and liquidity remain well positioned. Net leverage at quarter end was 2.1 times compared to 2.2 times at year end. We ended the quarter with $95.8 million in unrestricted cash and no amounts drawn on our $1 billion revolving credit facility.

Moving on to guidance. As Mark stated, based primarily on our Q1 results, we are raising our 2025 guidance as follows. Net operating revenue of $5.85 billion to $5.925 billion. Adjusted EBITDA of $1.185 million to $1.220 billion and adjusted earnings per share of $4.85 to $5.10. The key considerations underlying our guidance can be found on page 11 of the supplemental slides.

With that, we'll open the lines for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And we'll take our first question from Pito Chickering with Deutsche Bank. Please go ahead. Your line is open.

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

Good morning, Pito.

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

Good morning, Pito.

Pito Chickering
Analyst, Deutsche Bank Securities, Inc.
Q

Hey, good morning, guys. Great quarter. First question here on payor mix. It's been a long time since we've seen such a big move up in Medicare fee for service. Is this due to any strategic actions that you guys have put in place or something else because you added such a nice revenue per discharge in the quarter?

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

Yeah. Pito, your observation is absolutely correct. As a matter of fact we haven't seen Medicare fee for service discharges grow faster than Medicare Advantage discharges since the middle of 2022 and it was somewhat of a surprise to us. It is not the result of any deliberate strategic actions in which we're favoring referrals or patient admissions from fee for service versus Medicare Advantage.

We, like the Rest of the World, have heard anecdotally about the fact that perhaps MA growth based on new enrollment may have slowed a little bit, but we really don't think that, that was having a discerning impact on the mix for the quarter.

One trend or one quarter does not a trend make so we're not necessarily anticipating that this is the new normal on a go-forward basis. As a matter of fact, our revised guidance assumes that we get back into the kind of payor mix dynamic that we were seeing prior to this quarter, but it's certainly something we'll keep an eye on.

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

Pito, just a reminder, over 9% of our admissions come directly from the acute care hospitals referral sources in our marketplaces. So, as Doug noted, we don't know if this is a major trend or not, but we're pretty much just there to try to service the referral sources that are existing in our marketplaces.

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

It is interesting if you look at the payor mix in totality for the quarter and even with the reversal in terms of the trend between fee for service and Medicare Advantage, Medicare fee for service and Medicare Advantage together as a percentage of our payor mix increased about 150 basis points and those are our two highest reimbursement payors. And then Medicaid and managed care, which are below that in terms of reimbursement, declined by about 140 basis points. And so, it was those factors that really contributed significantly to the 3.9% increase in revenue per discharge.

Pito Chickering Q
Analyst, Deutsche Bank Securities, Inc.

Okay, great. And then can you talk about your employees per occupied bed and occupancy? It's a high-class problem, but your occupancy hit a new high and your employees per occupied bed hit a new low, has provided a lot of leverage on the P&L. Are you guys sort of behind on hiring with the current demand or is this a seasonal dynamics between occupancy employees per occupied bed and how you think about planning for hiring the next few quarters due to demand and productivity? Thank you.

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

Yeah, Pito. We remain committed to that 3.4 number on EPOB. Clearly, we got some leverage in the first quarter. As you noted, that's the highest occupancy rate we've had. A couple of notes on that would be as remember we only had one de novo hospital came online in Q1, so you didn't have the de-levering of the ramp up. We will have obviously a higher number of de novos coming up, particularly in the third and fourth quarters. So that's going to impact EPOB as we bring on staff at those new hospitals, but had not yet opened with patients.

No, I don't think we're behind. We remain committed. We have the talent acquisition team that continues to hire, particularly focused on nurses, but they've done a great deal with other positions. We did redirect some of those resources that were staffing new hospitals onto existing hospitals in markets where we continue to run a high percentage of contract labor that may have continued – contributed to the decrease in the contract labor dollars you saw in the first quarter. We were just able to fill more of those open positions at those hospitals with permanent staff versus contract labor.

So I wouldn't read a whole lot into the EPOB. We'll continue to focus on running as efficient as we can, but we still think that 3.4 number is a good number.

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

Pito, you hit out a couple of key relationships in that number. One is that there is some seasonality factored and Q1 is normally a very good volume quarter for us, and that proved to be the case this year as well. So there is some seasonality factored in. That said, I would say that overall the discharge growth in the quarter was higher than our initial expectation.

The second thing is that there is definitely a correlation between labor productivity and occupancy because you're creating patient density when you're running higher levels of occupancy and that gives rise to coverage issues.

But to Mark's point, we're not anticipating that this is a new sustainable run rate. And when you factor in the seasonality in the business and the timing of new capacity additions through the course of the year, we expect that number to gravitate a little bit north.

Operator: And we will take our next question from Andrew Mok with Barclays. Please go ahead. Your line is open.

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

Good morning, Andrew.

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

Hi, Andrew. Or not.

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

Andrew are you out there?

Operator: I believe Andrew may have disconnected. We will take our next question then from Whit Mayo with Leerink Partners. Please go ahead. Your line is open.

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

Hello, Whit. Hello, Whit.

Whit Mayo
Analyst, Leerink Partners LLC
Q

Hey, guys. Good morning.

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

Good morning, Whit.

Whit Mayo
Analyst, Leerink Partners LLC

Q

Congrats – yeah. Congrats to Pat. I guess my first question, I'm curious just there's a lot of conversation around tariffs and wanted to just get what your updated thoughts are on either supply cost or construction expenses so I'll just start there. <A – [05F40C-E]Doug Coltharp – Encompass Health Corp.>: Yeah. Like probably everybody else in this country, we're a little bit in wait and see mode. We've done a pretty thorough assessment based on the information that is available to us, and it's obviously a very dynamic environment. Right now we don't believe that we have much, if any, in the way of near term risk either with related to construction costs or more generally speaking, within our supply chain. Much of the material that is related to the projects that are currently under construction has already been procured and it hasn't been subject to any of the tariffs.

And within our broader supply chain, based on some of the reconfiguration that we originally did out of COVID and based on the underlying contracts that are in place, we're fairly insulated against that, at least for fiscal year 2025. We'll continue to keep an eye on this but right now, we're not estimating any kind of significant impact.

Whit Mayo
Analyst, Leerink Partners LLC

Q

Okay. And then it sounds like you guys are increasing a little bit the commitments on bed growth and additions next year, just was wondering if you had any initial expectations around startup costs for 2026? And also if you could just remind us on Medicaid supplemental, sort of what the exposure is there? Thanks.

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

A

Yeah. I don't have an initial range for you on the 2026 startup cost. My guess is that and I'd have to look more specifically and compare timing from quarter to quarter and specifically look at what some of the timing around early 2027. But I wouldn't expect the number to be markedly different than what we're anticipating for 2025 and 2026.

In terms of the Medicaid supplemental payments, as we've said previously, for us it's just not nearly as big a deal as it is for the acute care hospitals. I want to remind you of some of the historical context. If we go back to 2023, the total EBITDA impact for us from provider tax revenue minus the provider tax expense was a negative $800,000. The year prior in 2022 it was positive $2 million. Last year it was a bigger number with a $15.4 million impact, favorable impact on EBITDA. But even that pales in comparison to that what you're experiencing with some of the acute care hospitals. And for the quarter, for Q1, the total impact was $3 million to EBITDA, which was a decrease of $1.9 million from the $4.9 million EBITDA impact in Q1 of 2024.

Whit Mayo
Analyst, Leerink Partners LLC

Q

Great. Thanks.

Operator: We will take our next question from Matthew Gillmor with KeyBanc. Please go ahead. Your line is open.

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

Hey, Matthew.

Matthew Dale Gillmor
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey, good morning, guys, and congrats as well, Pat. Maybe going back to labor efficiency and asking about the SWB per FTE metric, it seems like that ran relatively modestly in the first quarter so favorable. I was curious how that played out versus your expectations and it sounded like from Doug's comments that labor and sign on and shift bonuses was favorable. I was curious sort of how you thought about the sustainability of that going forward.

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

Yeah, so you're absolutely right at 3.2% in terms of the total SWB inflation rate for the first quarter, we were slightly below the low end of the guidance range that we had for the full year. The benefit piece being up 14% was pretty much in line with our expectations and again was consistent with the trend that we saw at least in Q4 of last year.

The points of leverage that got us below the low end of the range were twofold. One you just mentioned was we had anticipated that across the course of the year, and we continue to have this anticipation that the total spend on the premium labor categories from 2024 to 2025 would remain essentially flat from a nominal dollar perspective. And we saw a year over year decrease.

We're not sure again that I know I've used this phrase already once today, but we're not sure that one quarter makes a trend. So we're still building into our guidance the anticipation that flat is a good assumption.

And then the second is that are just removing the premium labor categories or SW per FTE inflated at a more modest rate than we had recognized in the second half of the year. Again, we're not ready to call that a new trend, but it was a favorable outcome for the quarter.

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

And I think just I would say that we have a history of running relatively low contract labor. Clearly, the volume growth that we've had for the past couple of years has put some upward pressure on that. But our operating teams are very focused on filling a full time and part time positions and continuing to drive down the need for contract labor. And they have the tools to do that. So as we continue to see some of the labor markets normalize or even soften a bit from where they were in previous years, we remain very focused on driving down those numbers.

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

And we were pleased with the 1.3% of total FTE being contract labor FTEs in the quarter. That's the lowest we've been at in a while. I'll remind you that our run rate prior to the initial peak in labor conditions, which really occurred in the third quarter of 2021, had been just below 1%. So we're not at that level. We don't know that we're getting back to that level. The rate per contract, labor also has really stabilized kind of in that $175,000 to $180,000 on an annualized basis. Again, that's higher than it would have been prior to this peak conditions arising in Q1 of 2021,

which was closer to $145,000 to $150,000. But it's substantially down from the peak which we hit in the first quarter of 2022, which was $240,000.

Matthew Dale Gillmor
Analyst, KeyBanc Capital Markets, Inc.
Q

That's great. Thank you. And then one quick one on flu. I think in the past sometimes you've called out flu leading to more patients with debility coming to your facilities. Just curious if there was any of that impact in the quarter and anything to flag there?

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

I don't think it was anything that's material. Yes, that seemed to be a pretty active flu season. The ability to measure that impact on our volumes for Q1, I think it's negligible. But it was out there, but [ph] I can't say (00:33:21) it's any more significant or less significant than previous years.

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

Yeah. I think within the patient mix, the strength was actually more broad based and wasn't driven as much by flu volume. And you actually see that in the fact that debility and you're correct, Matthew, that that's typically where you'll see some of those flu volumes show up and debility on a year over year basis only increased 1.2% in the quarter. That good growth in stroke again it added roughly 4%. Brain injury was up 8%. Neurological up almost 7%.

Matthew Dale Gillmor
Analyst, KeyBanc Capital Markets, Inc.
Q

Got it. Thank you.

Operator: We'll take our next question from Ann Hynes with Mizuho Securities. Please go ahead. Your line is open.

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

Morning, Ann.

Ann Hynes
Analyst, Mizuho Securities USA LLC
Q

Hi. Good morning. Just going back to the capacity because it was so high in the quarter and this de novo strategy, what – obviously it's working and at what point do you think you could or would want to accelerate your growth strategy? Do you think that's in the cards over the next couple of years since the strategy has been so successful?

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

Well, we are accelerating the growth strategy, starting with the bed expansions, and that's the most direct way to alleviate any pressures arising from higher occupancy rates. I do want to point out that because we've been

increasing steadily this proportion of our portfolio that is comprised of private rooms versus semi-private rooms, our theoretical occupancy rate has been increasing along the way.

To give you some specifics on that, if we go back to 2020, just over 40% of our total beds were in private rooms.

At the end of the first quarter, 56% of our total beds were in private rooms. So that 78.8% occupancy rate that we experienced was the highest that we can recall ever having occurred. And it does suggest that we need to accelerate some of these bed expansions over a multiyear period of time, which fortunately we have both the access to capital and the capabilities within our design and construction team to be able to do.

With regard to accelerating de novo activity beyond the current range, that's got a longer lead time associated with it. It's typically from the time we ideate on a particular market to getting the doors open, it's about three years. As Mark alluded to in his comments, we would expect that through the course of this year, we're going to be announcing additional de novo projects that will be opening in beyond 2025. But for the immediate time being, we believe staying in this range of 6 to 10 per year, perhaps trying to operate at the midpoint or higher, is the appropriate place for us to be.

And I'll remind you, beyond just the spend and the demands on our design and construction team, each one of those hospitals has to be staffed with a trained clinical workforce. At capacity, a 50-bed hospital is running about 100 FTEs and about two-thirds of those are clinical. We want to make sure that we are adding capacity into this demand curve, which is very real out there, that we're doing so in a way that is also ensuring that we produce high quality patient outcomes.

Ann Hynes
Analyst, Mizuho Securities USA LLC

Q

Great. And just on guidance, obviously, you beat consensus by a healthy margin. And I know, Doug, I think I believe you said during the call is that volume was ahead of your expectation. What did you beat your internal expectations by and I guess the guidance range versus the beat is that just conservatism on your part or is there something we should model that maybe The Street's mismodeling through the rest of the year?

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

A

Well, that is a series of really loaded question, most of which you knew in advance I wasn't going to answer. The quarter was ahead of our expectations. I'm not going to give you a specific number on that. But [ph] I cited (00:37:39) some of the specific areas where it was ahead earlier, which is we did a little bit better on volume than we anticipated. And the two biggest upside surprises for us were that revenue per discharge based on the payor mix that we hadn't anticipated. And then also the fact that we got a lot of leverage in the SWB line. Some of that was the EPOB coming down based on the higher volume in the occupancy rate and some of it was the leverage that we got against premium labor. So certainly that was a favorable outcome for Q1.

It's uncertain to us how much of that is sustainable for the balance of the year. And so we've maintained a lot of the annual assumptions that we had in the guidance considerations. Another area of favorability, we were at the low end of the bad debt assumption, right at 2%. That owed in large part to the fact that we had only a de minimis amount of TPE activity during the quarter. And as we all experienced last year, we know that TPE audit activity can be very lumpy. And so we left that assumption for the full year the same. It's only the first quarter. Obviously, we'll be more informed about the sustainability of any of these trends after we are able to book another quarter.

Ann Hynes
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you.

Operator: We'll take our next question from Joanna Gajuk with Bank of America. Please go ahead. Your line is open.

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

A

Morning, Joanna.

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

A

Hi, Joanna.

Joanna Gajuk
Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Hey. Good morning. Thanks so much for taking the question. So maybe on the demand, right, you spoke about a lot of unmet demand for the services where you like you said you keep expanding your expansion plans, right. So can you give us a little bit more there? Are there some geographies that stand out or is it broad based? Can you talk about maybe also competitive environment, like why you're the only one, I guess, aggressively building and adding that?

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

A

Joanna, this is Mark. I'll start. I'll say that the demand was across all geographies. As you know, we have 8 geographic operating regions and we saw nice growth and the majority of our markets and certainly across all those operating regions. As we've noted before, I mean, we certainly benefit from the aging demographic. And I think that's exactly what we're seeing with nondiscretionary patients and patients that have multiple co-morbidities and issues that require first, in large part, acute care level care and then ready for inpatient rehabilitation care. So the demand continues to grow closely linked to the aging demographic.

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

A

Yeah. To give you some specifics that we've cited before, if you look going backwards for more than a decade, the age cohort that is most served by us and by IRFs in general has been growing at a CAGR of close to 4%. And over that same decade-plus period, the total supply of IRF beds in the US has increased less than 3% in total. That's not a CAGR, that's total.

So what already started as an inadequate supply of IRF beds in this country widened substantially over that period. Why are – and we're not the only one who is adding capacity here. I think if you look at Select Medical, they've announced plans to substantially ramp up their capacity on the IRF side as well.

But perhaps the two of us kind of standalone and why is that the case?

Well, it's really difficult to do this. First of all, it requires very substantial capital outlays to build a freestanding hospital or even to add capacity to existing hospitals. We've mentioned before we feel good about we've been able to stabilize the cost per bed on de novo construction at about $1.2 million. And even for bed expansions with the cost per bed now is north of $800,000. So the capital outlay is very extensive.

The clinical expertise is to treat these very medically complex patients is also a barrier to entry, as is the need for a robust compliance function. And one of the things that we really benefit from is the fact that we enjoy substantial economies of scale that allows us to get operating leverage across these platforms and also to extrapolate best practices. So yeah, if it were easy to do, given the attractiveness of the market, we'd probably see a lot more capacity coming in. But that's just not the case. It's highly complex and expensive.

Joanna Gajuk
Analyst, BofA Securities, Inc.

Q

Right, exactly. Thanks for that. If I may, I guess related question on your bed expansions, right? So it sounds like you expect or generating more free cash flow, but then you're also raising your bed expansion outlook. I mean, I guess [indiscernible] (00:42:47) occupancy being higher, so should we expect the additional free cash flow to just go towards these bed additions? Can you remind us of the [ph] terms (00:42:57) you get on these bed additions and maybe contrast that with de novo? Thank you.

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

A

Yeah. So consistent with our previous statements, the highest and best use of capital for us is on capacity expansions through both de novo and bed expansions and bed expansions are the highest return of capital we have because we're leveraging components of the fixed infrastructure and we're building into a market where we already enjoy a presence and where the demand curve has already been established.

The occupancy rates are driving our decision to put more capital into the bed expansions. Fortunately, we have the capabilities again within our design and construction area to push forward some of those projects. As we and Mark mentioned in his comments, we've now run 11 straight quarters with same store growth north of 4%. And so, as a result, the pipeline of our hospitals that are qualifying for bed expansions based on their occupancy rates has increased. And so, we're definitely going to give a prioritization with regard to capital allocation to adding capacity so that we're able to serve the needs of the patients in those markets.

Joanna Gajuk
Analyst, BofA Securities, Inc.

Q

Thank you.

Operator: We'll take our next question from Brian Tanquilut with Jefferies. Please go ahead. Your line is open.

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

A

Hey, Brian.

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

A

Hey, Brian.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Hey, guys. Good morning. Congrats on the quarter.

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

A

Thanks.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Maybe -- yeah, Doug, maybe I'll follow up just on the commentary to Joanna's question. So as we think about some of these challenges that hospitals are staring down with [ph] DPP (00:44:38) payments probably going away or getting a cut and whatnot, are you seeing anything in the market in terms of maybe either increased interest in partnering with you guys or the opposite where they're pulling back from plans to open IRF beds if that's a path that they're looking at? Just curious what you're seeing.

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

A

Yeah, I think it's the former. I think we continue to see more and more interest from various acute care hospitals about wanting to partner, and that's reflected in our pipeline. So we continue to believe that probably at least half of de novos that will be opening over the next several years are likely to be in joint ventures. We get a great example. Again, Mark mentioned in his comments, we've now got seven hospitals as part of the Piedmont joint venture. And that's the kind of success that really I think makes other acute care systems take notice of the effectiveness of these types of partnership relationships.

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

A

And Brian so we also have take note, I mean, there are a number of our existing partnerships systems that currently have one or more rehab hospital JV with us that continue to look at their marketplace and as they expand their presence, they are also taking into account the [ph] need for a rotation (00:45:57). So, you can look at Piedmont, our partnership in the St. Louis marketplace with BJC. Those are two examples of partners where we have multiple rehab hospitals as part of that overall relationship.

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

A

And I think what the acute care hospitals are increasingly aware of is that either a formal or an informal relationship with us in terms of having a freestanding IRF in the market can increase their capacity in one of two ways. One is we have demonstrated consistently that we have the ability to take highly complex medical patients out of the acute care hospitals earlier than other providers in their state without in any way endangering the patient's recovery path. And so when we're doing that, we're allowing them to free up that bed more quickly.

The second of the more tangible way is when we use our model of going in and removing a unit from an acute care hospital and folding it into a freestanding hospital so that, that space within the acute care hospital can be repurposed for general medical and surgical purposes and increase their overall capacity to address those patient needs.

Brian Tanquilut
Analyst, Jefferies LLC

Q

No, I appreciate that. And then maybe my follow up, Mark, as I think about maybe an economic slowdown here, you guys have been there at Encompass for a while and experienced previous recessions. Just curious how you're thinking about the durability of demand? And maybe, Doug, just to kind of layer onto this, any comment you can make on like exchange subsidy exposure or just exchange exposure within your patient populations? Thanks.

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

A

So, Brian, I'll take the first question. I mean, the demand for our services does not fluctuate with the economic status. I mean it's – our patients are non-discretionary. And therefore, if you look back historically during periods of recession or high growth in the economy, it doesn't necessarily reflect and influence the need for our services. So I would not anticipate any decline in a recessionary economy.

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

A

And your second question, Brian, we have de-minimis exposure to the exchanges.

Brian Tanquilut
Analyst, Jefferies LLC

Q

Awesome. Thank you.

Operator: We'll take our next question from A.J. Rice with UBS. Please go ahead. Your line is open.

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

A

Hello, A.J.

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

A

Hey, A.J.

A.J. Rice
Analyst, UBS Securities LLC

Q

Hi. Thanks, everybody. [ph] Good to talk (00:48:30) to everybody. First, I guess, on the benefit expense, I think you called out that it was up 14% is the sort of the second quarter where you've called that out. I wonder how much of a headwind is that? I don't know if you've sized benefit as a percentage of your SWB, but it would be just interesting to know that.

And is there anything you can do or you just have to wait till you anniversary that and then it will moderate as a pressure point or is there anything you could proactively do to manage that in a different way?

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

A

Yeah. So first part of your question is benefit expense in total typically runs about 10% or 11% of total SWB. In terms of what we can do, we proactively work with our third-party consultants, kind of assessing our trends versus broader trends within the US with large employers and specifically within the health care community.

We look at things like any changes to the composition of our benefits programs, the relationship between employee and employer responsibility and so forth. And so on a regular basis, we're making changes to those programs to try to contain the cost, but also to make sure that we're offering the most competitive benefits program we can from an employee's perspective, because that's a big aspect of retention, and we'll continue to do that proactively.

We do think and you pointed this out, A.J., that we're going to see that growth rate begin to moderate as we move into the second half of the year, simply because we saw that step up in the second half of last year. In our discussions with our consultants, what we're seeing in our program apparently is pretty consistent with the peer group that's out there.

A.J. Rice
Analyst, UBS Securities LLC

Q

Okay. And then the follow-up question I know last year about this time, there was some noise in the numbers with the Palmetto audits and the TPE program and how that was playing out.

Any updated thoughts on where all that stands at this point? And are you back to sort of a normal situation pretty much [ph] this year (00:50:45)?

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

A

I think there's the potential for some of the same dynamic to exist. And so this is the interplay specifically with Palmetto between RCD in Alabama and TPE. And as a reminder, Palmetto is our largest MAC. They're responsible for approximately 80% of our overall hospitals, including the seven that we have in Alabama.

And so they remain consumed with the RCD program in Alabama, under which, by the way, our performance has gotten better. But it is not where it ought to be and it remains a lot of hand-to-hand combat in trying to overcome very inconsistent treatment by Palmetto on those claims.

But with regard to TPE, what we have seen at least since RCD has been in place, is that they seem to lack the capacity to run a consistent TPE program and administer RCD. And so the TPE activity, at least last year, proved to be very lumpy.

We have left some room for that kind of lumpiness in our assumption regarding bad debt for the full year. As corollary to that, I'll remind you we had that big step up when those claims were selected by Palmetto under TPE for review in the second quarter. But what we've seen is those had played out over a multi-quarter period of time, is that our recovery rate against those claims or our success rate against those claims selected from review has been highly favorable.

So there's the chance that you might see a blip just based on our reserve methodology. If we see the same kind of pattern under TPE that we saw last year but I don't think it causes us concern that the aggregate level of bad debt expense is on the rise.

A.J. Rice
Analyst, UBS Securities LLC

Q

Okay, thanks a lot.

Operator: [Operator Instructions] We'll take our next question from Jared Haase with William Blair. Please go ahead. Your line is open.

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

A

Hello, Jared.

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

A

Morning, Jared.

Jared Haase
Analyst, William Blair & Co. LLC

Q

Hey. Good morning. Thanks for taking the questions and I'll echo the congrats on a strong quarter. Maybe I'll ask one on the quarter just to kind of put a finer point on things and specifically the strong EBITDA performance.

I know we've obviously focused a lot on the trends around labor, but curious if there were any other, I guess, areas in OpEx where you saw good leverage or operating efficiency and if you could talk about, you know, the durability of some of those areas of leverage if you saw any? Thanks.

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

A

Yeah, anytime you're running at high volumes and particularly with the density that comes with the higher occupancy rate you're creating OpEx leverage throughout the P&L, but the definitely the more pronounced – the most pronounced area of that and it's because it's our single largest expense category was in the SW line.

I think we've pretty well already addressed our thoughts regarding the sustainability of that. We expect the – as the primary measure of productivity, we expect the EPOB number to move north over the balance of the year just based on the seasonality and based also on the capacity expansions that are coming on through the course of year.

Jared Haase
Analyst, William Blair & Co. LLC

Q

Perfect. That's helpful. And then maybe back to something you talked about in the prepared remarks, just some of the consistent performance you've had and your discharge rates and quality metrics. And I guess I'll just ask, what are the sort of biggest drivers in your view, in terms of the ability to sustain that level of performance on quality, just considering how rapidly you've grown the business over the last couple of years?

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

A

Yeah, as Doug noted earlier, bringing new staff in and making sure as we add capacity that we are appropriately staffed, that we have the staff on boarded, that even at our existing hospitals as we bring on new staff, we are training them and getting them oriented.

So I feel like our quality and if you just look at our trends, we continue to increase the quality. If you look at our discharge community, the reduced number of discharges being sent to skilled nursing facilities. We always focus on patient satisfaction with our net promoter scores.

So we would not be adding growth if we couldn't assure ourselves that we could show and produce the quality outcomes that we do as an organization. So I think it's very sustainable. We're very proud of where we're headed, particularly in those discharge status metrics. And we continue to focus on our – with our clinical teams on how can we get incremental outcomes every day.

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

Just to underscore what Mark said there, because I think it's important to note, we have experienced very rapid growth both in terms of on a same store basis and through the capacity expansions over a multiyear period of time. And yet we now have the highest net promoter scores and the highest employee engagement scores that we've ever had. And that's something that we're really proud of.

Jared Haase
Analyst, William Blair & Co. LLC
Q

That's great to hear. Thank you.

Operator: We'll take our next question today from Andrew Mok with Barclays. Please go ahead. Your line is open.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Hi. Good morning.

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

Hey. Good morning, Andrew.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Good morning. The revenue discharge per discharge number was pretty strong in the quarter, 3.9% and finished above the underlying pricing expectation. So I know that number contemplates a number of items, including core pricing, acuity and bad debt.

Bad debt came in on the lower end of expectations, but it still looks like it's strong. Could you flesh out kind of like the underlying drivers of that number and how we should expect that to trend for the balance of the year? Thanks.

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

No, you're exactly right. And there are a number of things that go into it. The largest ones, I'd point out were that bad debt was at the low end of the range that you just cited. The second is that we had that shift in the payor mix, which I alluded to earlier, and it was not only that fee for service grew faster than Medicare Advantage.

It's when you look more broadly at the change in the overall mix that – whereas Medicare Advantage and Medicare fee for service as a percentage of the payor mix in total for the quarter moved up 150 basis points.

And those are our two highest reimbursement categories. You had managed care and Medicaid. Medicaid by far being our lowest moved down 140 basis points. So that's a real favorable shift there. We also had some favorable trends within our quality metrics to help improve our reimbursement as well.

In terms of our assumptions on a go forward basis again, we don't believe that one quarter makes a trend, so we're not assuming that this flip in the growth rate between Medicare Advantage and fee for service will sustain itself for the balance of the year.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. And then maybe just a follow up on share repurchase. I know you lowered the share count number in the guidance, but how are you thinking about the level of share repurchase contemplated in the guide? Did you give that number? And how do you expect that to evolve over the next 12 to 18 months? Thanks.

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

We did not put out a specific number. I will note that with the share repurchases that we made in the first quarter actually slightly exceeded those that we made to all of 2024.

We've talked previously about the fact that we find ourselves in the enviable position of being able to fund all or at least the vast majority of our capacity expansions with internally generated funds and we've also been seeing based predominantly on the growth in our EBITDA, the net leverage ratio come down so that is creating capacity for us to allocate more capital to share repurchases. And we think that's an appropriate utilization and a good complement to the growth CapEx we have. So I think you should anticipate continued activity under the share repurchase program.

Andrew Mok
Analyst, Barclays Capital, Inc.
Q

Great. Thank you.

Operator: And we'll take our next question from John Ransom with Raymond James. Please go ahead. Your line is open.

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

Morning, John.

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

Hey, guys.

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

Morning, John.

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

So your acute care, I won't call them peers, but the care industry's been kind of reporting some issues and changes in behavior with Medicare Advantage. Are you guys – I mean, they've been under a lot of stress, as you know, but are you guys seeing anything new or different in your managed care negotiations? Not just rate, but other behavior changes as they try to manage their posture?

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

I think from a contracting perspective, we continue to have success and we're already at a very high level of moving away from per diem contracts to episodic contracts and tying those new contracts, even if they initially started to discount directly to the fee for service reimbursement.

I will say that the overall level of price increase that we saw within our Medicare Advantage book of business in the first quarter was a bit higher than we anticipated. It came in at about 5%. Again, not ready to call that a new normal so I don't know whether it's reflective, John, of the overall environment out there with Medicare Advantage, but we do feel like we're having good success with regard to our Medicare Advantage contract.

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

So I would say that the whole pre-authorization process continues to be challenging. And I would say it's probably a little early to say whether or not we're seeing significant differences or new trends enter around the pre-authorization process in most of our markets.

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

And some things that we noted or continue to persist, which is the ratio of admits to referrals for Medicare Advantage, is substantially below what it is for fee for service and we see no reason why that should exist.

And then also the number of days between a referral and ultimately a decision coming through Medicare Advantage plans is much slower than it is for fee for service, which [ph] does not endure (01:01:28) to the benefit of the patient or the acute care hospital housing patient.

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

Hey, 5% is pretty [ph] stout (01:01:37). Thanks, guys. Appreciate it.

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

Thank you.

Douglas E. Coltharp

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

A

Thank you.

Operator: And there are no further questions on the line at this time. I'll turn the program back to Mark Miller for any additional 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 and you may now disconnect.