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Encompass Health Corp. (EHC)

Q3 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Encompass Health's Third Quarter 2025 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.

Mark Miller

Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator, and good morning, everyone. Thank you for joining Encompass Health's third quarter 2025 earnings call. Before we begin, if you do not already have a copy, the third quarter earnings release, supplemental information, and related Form 8-K filed with the SEC are available on our website at encompasshealth.com. On page 2 of the supplemental information, you will find the Safe Harbor statements, which are also set forth in greater detail on the last page of the earnings release.

During the call, we will make forward-looking statements 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 quarters ended March 31, 2025, June 30, 2025 and September 30, 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 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 President and Chief Executive Officer, Mark Tarr.

Mark J. Tarr

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

Thank you, Mark, and good morning, everyone. Revenue in Q3 increased 9.4% and adjusted EBITDA grew 11.4%, contributing to year-to-date revenue growth of 10.6% and adjusted EBITDA growth of 14.5%. Owing largely to our Q3 results, we have again increased our 2025 guidance. Doug will cover the details of the quarter and guidance in his comments.

Our dedicated and highly competent clinical teams continue to deliver outstanding patient outcomes. Our Q3 discharge community rate was 84.6%. Our discharge to acute rate was 8.6% and our discharge to SNF rate was 6%. Our performance on each of these quality metrics exceeds the industry average. Our high-quality patient care was again recognized by Newsweek and Statista, who named Encompass Health America's most awarded leader in inpatient rehabilitation for the six consecutive years.

We continue to invest in our clinical staff by providing professional growth and development opportunities such as our Career Ladder programs. These programs contribute to our continued favorable turnover rates. Q3 2025 annualized RN turnover of 20.2%, and annualized therapist turnover of 7.8% are consistent with last year's very favorable trends.

In Q3, we opened three new hospitals, a 40-bed hospital in Danbury, Connecticut, our first in that state, a 50-bed hospital in Daytona Beach, Florida, and a 50-bed hospital in Wildwood, Florida or The Villages. We also added 39 beds to existing hospitals. Earlier this month, we opened a 50-bed hospital in St. Petersburg, Florida. We expect to open two additional 50-bed hospitals in Q4, one in Amarillo, Texas, and the other in Lake Worth, Florida, and add approximately 37 beds to existing hospitals.

The demand for inpatient rehabilitation services remains considerably underserved and continues to grow as the US population ages. The Medicare beneficiary population is the fastest growing segment of the US population. It is estimated that by 2030, one in five Americans, more than 70 million people will be aged 65 or older. The 65 or older population has been growing consistently at a CAGR of approximately 3%. The average age of our Medicare beneficiary patient is 77 years old, and the age 75 plus population is growing at approximately 4%, yet the supplied licensed IRF beds in the US has increased only nominally.

As a result, the demand for treatment of the complex medical conditions such as stroke necessitating IRF care intensity, remains significantly underserved. We are responding to this unmet need by continuing to open new hospitals and add beds to existing hospitals. We have again increased our expected bed addition growth. We now expect to add approximately 127 beds to existing hospitals in 2025 and approximately 150 to 200 beds in both 2026 and 2027.

Our pipeline of announced new hospitals with opening dates beyond 2025 currently consist of 14 hospitals with 690 beds. With an active pipeline of more than 40 projects, additional hospital locations will soon join this list. To this point, last week we received CON approval to build a 40-bed hospital in Clarksville, Tennessee.

On October 3, we converted our ERP system to Oracle Fusion. Our team worked tirelessly and diligently for more than 18 months to accomplish this challenging feat. We experienced no significant disruptions to our operations from the conversion. Although like any other project of this magnitude, there remain bugs to be resolved and refinements to be made.

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 growth of 9.4% in Q3 was driven primarily by a 5% increase in total discharges and a 3.3% increase in net revenue per discharge. As we have previously stated, quarterly fluctuations in discharge volume growth and the composition of that growth between same and new store is a normal expectation of our business model.

Volume growth in any particular quarter is influenced by factors such as the prior year period comp, the timing of capacity additions in the current and prior year, and the calendar, for example, the day of the week on which the quarter ends and the timing of any holidays. Specific to Q3, discharge growth comp in Q3 2024 is a very strong 8.8%. Q3 2024 same-store discharge growth of 6.8% is our highest since Q2 2021 when we were normalizing from COVID.

As for the timing of capacity addition, in comparison to Q3 2025, Q3 2024, same-store growth benefited from a significantly higher number of de novo beds, transitioning from new store to same-store, as well as a higher number of bed additions to existing hospitals in the immediately preceding quarters. Additionally, this year we consolidated two satellite locations comprising 72 beds in Cincinnati, Ohio and Sewickley, Pennsylvania, into their host hospitals.

This was primarily attributable to lease expirations and allows for market rationalization. Ultimately, we expect to transition much of the volume in these closed units to the remaining hospitals. And in the case of Cincinnati, we are adding beds to accommodate this expectation. Nonetheless, these consolidations had a negative impact of approximately 35 basis points on Q3 total and same-store discharge growth.

As Mark stated, the market for IRF services is growing and underserved. Reflective of this market opportunity, we are again increasing our estimated annual bed additions to existing hospitals through 2027. We've increased the estimated bed additions to existing hospitals for 2025 from approximately 110 to approximately 127, and for each of 2026 and 2027 from approximately 120 to now 150 to 200. Taken together with our new hospitals, capacity expansions now total approximately 517 beds in 2025, 540 to 590 beds in 2026 and 450 to 500 beds in 2027.

Q3 2025 adjusted EBITDA increased 11.4% to \$300.1 million. The quarter included \$10.8 million of net provider tax revenue, an increase of \$7.7 million from Q3 2024, owing largely to retroactive payments related to newly initiated programs in Tennessee and West Virginia. This increase in net provider tax revenue was partially offset by a \$1.6 million increase in non-controlling interest expense associated with higher net provider tax revenues at joint venture hospitals.

Q3 2025 adjusted EBITDA also included a \$1.3 million retroactive property tax assessment associated with one of our California hospitals, and approximately \$3 million in accelerated supplies purchases in anticipation of the October Fusion ERP conversion.

Q3 SWB per FTE increased 2.6%. Premium labor cost comprised of contract labor and sign-on and shift bonuses declined \$5.6 million from Q3 2024 to \$27 million. Benefits expense per FTE increased 1.9% as we anniversaried the large increase in group medical claims experienced in Q3 last year.

EPOB of 3.42 for the quarter was driven in part by the timing of capacity additions. Q3 adjusted free cash flow decreased 8.2% to \$174.2 million, primarily due to a \$55.8 million increase in working capital, which included accelerated payments of accounts payable in preparation for the October Fusion conversion. We expect accounts payable balances to normalize during Q4.

On a year-to-date basis, free cash flow increased 16.5% to \$582.5 million. We have increased our full year adjusted free cash flow estimate to \$730 million to \$810 million.

During Q3, we repurchased approximately 221,000 shares of our common stock for approximately \$25 million, bringing the year-to-date total to approximately \$82 million. We also declared a cash dividend of \$0.19 per share, which was paid earlier this month.

Our leverage and liquidity remain well positioned. Net leverage at quarter end was [Technical Difficulty] (00:14:26) 2 times. And in September we retired remaining \$100 million balance of our 2025, 5.75% senior notes. As Mark stated, we have again raised our 2025 guidance. We now assume net operating revenue of \$5.905 billion to \$5.955 billion. Adjusted EBITDA of \$1.235 billion to \$1.255 billion and adjusted earnings per share of \$5.22 to \$5.37. The key considerations underlying our guidance can be found on page 11 on the supplemental slides.

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

QUESTION AND ANSWER SECTION

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

Mark J. Tarr

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

Good morning, Joanna.

A

Douglas E. Coltharp

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

Good morning, Joanna.

A

Joanna Gajuk

Analyst, BofA Securities, Inc.

Hi. Good morning. Yeah. Hi. How are you? Thanks so much for taking the question. So, I guess maybe first on the discussion around the, I guess, accelerated bed additions and then, two, because clearly the volume seems to be the issue, I guess, or where questions are in terms of just slowdown this quarter. But obviously you kind of explained a couple of things. But let's talk about the future rates.

Q

So, how should we think about this accelerated bed addition plans impacting your volume growth going forward? And I guess to that point, your 6% to 8% sort of long-term growth goal, can you talk about – I know you don't give any specifics for 2026, but kind of how should we think about it into next year? Thank you.

Douglas E. Coltharp

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

Yeah. So, I think the fact that for the second time this year, we're increasing bed expansions and now doing it for a multi-year period is really a validation of our business model and strategy. It reflects the fact that our de novos have been performing well and are justifying bed expansions as they mature. It also reflects what we've been saying about the unmet need for our IRF services really across the country and our unique position to be able to step in and add capacity.

A

We've also talked in the past that bed additions to existing hospitals offer the highest return on invested capital we have. So, that's a favorable component as well. And I think all of you have observed, as we have, that our occupancy has been steadily rising over the last couple of years. So, this is in response to that demand that we're seeing at existing facilities.

We continue to be very optimistic about the market that is in front of us, the total addressable market. This suggests that on a go-forward basis we're going to be more heavily weighted in the past than we have been towards bed additions in terms of total capacity expansion. But it's going to be continued utilization of both of those arrows in our quiver, maintaining the de novo program, and then the increased bed expansions that we outlined for at least the next three years.

Mark J. Tarr

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

A

Joanna, you may recall from our past calls where we've mentioned that one of the areas for prioritizing where we add beds is to help give a higher complement of private beds to those hospitals that have a high percentage of semi-private rooms. So, that too has helped with our overall occupancy.

Douglas E. Coltharp

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

A

I think it's important to note, too, that these aren't just numbers that we have specifically identified projects and the number of beds that each one of those hospitals supporting those increased ranges for bed additions over the next three years.

Joanna Gajuk

Analyst, BofA Securities, Inc.

Q

Thank you so much.

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

Mark J. Tarr

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

A

Hey. Good morning, Pito.

Douglas E. Coltharp

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

A

Hey, Pito.

Pito Chickering

Analyst, Deutsche Bank Securities, Inc.

Q

Good morning, guys. Not surprising, I'm going to ask a similar question there. But I guess you're sitting back here looking out for the next couple years here. What percent of – or I guess, what level of CapEx as a percent of revenue should we be modeling in order to keep your discharge growth in that 6% to 8% range? Just are you scaling up bed additions to sort of get to proper levels of occupancy for more durable growth.

Douglas E. Coltharp

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

A

Yeah. So, growth CapEx this year at the midpoint of the estimate is about \$580 million. We're increasing the number of bed expansions and holding the number of anticipated de novos relatively constant from year-to-year. So, the figure at the midpoint of the range at 175, you're up about 50 beds in each of the next two years and the

average cost per bed on a bed addition is roughly \$800,000, that would be the incremental to the 580 that you might pencil in.

Pito Chickering

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Great. And then a question on occupancy. In order to maximize margins just to maintain growth. What is target occupancy before you expand beds at facility and how quickly can you expand capacity at those facilities? And any color on what percentage of your facilities today are at max occupancy and a headwind for growth? Thanks so much.

Douglas E. Coltharp

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

A

Yeah. So, there's a lot of it depends on there as we talked about before in terms of when you're hitting what might be considered a peak occupancy. The composition between private and semi-private beds that Mark mentioned earlier goes a long way towards that determination. We've been steadily moving the percentage of our overall portfolio that is comprised of private beds. At the end of Q3, it was up again to 57%. And again, that compares favorably to 41% at the end of 2020.

Generally speaking, whether it's semi-private or private, hospital starts in our radar screen for potential bed expansion after it crosses 80% of sustained occupancy. Within an all-private room hospital, because you're not facing issues of gender or germ compatibility, you can run into the mid 90% and do that very efficiently. With semi-private, you're probably going to peak out just south of 90%.

In terms of ability to add beds, it depends on the physical configuration of the plant and then really whether or not you're in a CON state or not. I will note that even for our hospitals in CON state, in almost every instance that we can think of the process for adding beds to an existing hospital is much shorter and less complicated than it is for getting a CON for a new hospital.

When I mentioned the physical plant for the building, we have some older legacy hospitals that just cannot be expanded anymore. We have the ability to address capacity needs in those markets by adding a freestanding satellite. You've seen us do that effectively a number of places in our portfolio. We are also in the design process and something that we're going to be talking a lot more in the future, which is what we call a Small Format hospital, which will be a smaller version of a freestanding unit that can be used for bed expansion opportunities and market diversification.

And that would be roughly a 24-bed unit built on, say, 2 to 2.5 acres of land. It's a very efficient plant. Again, we expect to be talking more about that in the future. In most cases where we do have the ability to add beds to an existing hospital, it could happen pretty quickly, meaning from the point of ideation to it working its way through the design and construction timeline, it's certainly less than 24 months and it may be closer to 18 months.

Pito Chickering

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks so much.

Operator: And we will take our next question from Ann Hynes with Mizuho Securities. Your line is open.

Douglas E. Coltharp

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

Good morning, Ann.

A

Mark J. Tarr

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

Hey, Ann.

A

Ann Hynes

Analyst, Mizuho Securities USA LLC

Hi. Good morning. I know your stock is down a little bit on today's earnings. Did expectations come in line with your estimates? Did anything surprise you in the quarter versus what you initially thought? And then secondly, maybe if you can give an update just on the Washington outlook and is there anything that the company is watching closely? Thanks.

Q

Douglas E. Coltharp

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

I would say no surprises in the quarter other than the retro payment from Tennessee and West Virginia on the net provider taxes, and maybe the California property assessment, those were kind of in the Q, but we weren't sure when they would come through. Otherwise, I would say just kind of scanning down the P&L that everything was pretty much in line with our expectation.

A

And another quarter of really good labor management, both in terms of controlling the spend, seeing a year-to-year decrease in the premium labor spend felt really good. We had been anticipating, but until it gets there, you don't know that we would see a nice decrease in the inflation rate on the benefits because of what we experienced in the second half of last year.

And it was nice to see yet another quarter where bad debt was at the low end of our expectations. TPE activity did resume at a modest level in Q3, but again, nothing that caused any alarm and our performance under RCD remains very strong in the latest cycle. So again, aside from maybe the timing and the magnitude of the out-of-period provider tax revenue, nothing that was a surprise. Mark, you want to add anything?

Mark J. Tarr

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

Ann, relative to your question around Washington, in spite of Washington being closed down, a lot of areas, we remain active there. We are not seeing anything near term that is of concern. It was – it's our understanding that CMS was called back to the office this week. So hopefully things go back to a normal flow there. But we're just not overly concerned about anything that we see right now on the horizon.

A

Patrick W. Tuer

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

And this is Pat. Just a quick expansion on the labor comment. There's a lot to be proud of here. Both our centralized [ph] TA (00:25:19) team and our operators have done a great job. We posted our best same-store net hiring quarter since Q3 of 2023. Turnover is back down to pre-pandemic levels and contract labor shift and sign-on bonus are at their lowest level since Q1 of 2021.

A

Ann Hynes

Analyst, Mizuho Securities USA LLC

Great. Thank you.

Q

Operator: And we can move next to Matthew Gillmor with KeyBanc. Your line is now open.

Douglas E. Coltharp

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

Hey, good morning, Matt.

A

Mark J. Tarr

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

Hello, Matt.

A

Matthew Gillmor

Analyst, KeyBanc Capital Markets, Inc.

Hey, good morning. Good morning, guys. I thought I might ask about payer mix. I think there was some favorability in the first half with traditional Medicare in VA. It seems like that maybe normalized in the third quarter with moderation in pricing. Just curious if you could give some comments on how payer mix evolved in the third quarter compared to the first half?

Q

Douglas E. Coltharp

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

Yeah. So, in terms of payer mix, if we just look at the growth rates by payer in Q3, relatively comparable between Medicare and Medicare Advantage, both were up – or Medicare was up 4.4%. This is total discharge growth. Medicare Advantage was up 4.8%. Managed Care saw another nice increase, 9.2%.

A

I'll remind you that that includes the volume that we're getting under the VA Community Care Network. And that continued to see another nice increase in the quarter. That was up. And again, it's off of a relatively small base, but that was up almost 26% on a year-over-year basis and that pays at the Medicare CMG rate. That contract now comprises about 18% of our total Managed Care volume. In terms of elsewhere in the payer mix, Medicaid was up about 3.5%. So overall, we feel like the growth across the payers is pretty well balanced.

Matthew Gillmor

Analyst, KeyBanc Capital Markets, Inc.

That's great. And then, Doug, I thought I might see if you could provide some comments on headwinds and tailwinds for 2026. I know you're not providing specific guidance, but anything to call out just from a modeling perspective as we're thinking about next year?

Q

Douglas E. Coltharp

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

I don't know that a lot comes immediately to mind other than I think net provider taxes will continue to be a bit of a wildcard. But again, if you look at the progress that we've made through the course of the year on premium labor, I think that sets us up well, going into 2026. Again, the level of capacity expansion overall is going to be up somewhat next year.

A

My guess is because we're going to be at roughly the same level on de novo activity, that's ramp up cost and start-up cost will be comparable next year to what they are this year. Could be a little bit of fluctuation in bad debt, but things seem to have settled in there. So Matt, we're currently in the budgeting process for 2026, but I'm not aware of anything at this point that I would call out as significant headwind or tailwind. And look...

Matthew Gillmor

Analyst, KeyBanc Capital Markets, Inc.

That's great.

Q

Douglas E. Coltharp

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

... [indiscernible] (00:28:29) this environment would not be a bad thing.

A

Matthew Gillmor

Analyst, KeyBanc Capital Markets, Inc.

Yeah. Got it. All right. Thanks, guys.

Q

Operator: And we will go next to Whit Mayo with Leerink Partners. Your line is open.

Mark J. Tarr

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

Good morning, Whit.

A

Douglas E. Coltharp

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

Good morning, Whit.

A

Whit Mayo

Analyst, Leerink Partners LLC

Thanks, guys. Maybe just back to volumes for a second. You quantified the satellite consolidation. I think that was 35 basis points. Doug, any way to put numbers around the timing of beds, the calendar, I think 4th of July might have been on a Friday. There are some other factors there. I mean, the comp is the comp. It is what it is. Just wondering if just there's any way to put a framework around maybe just quantifying what some of those other factors might mean optically for the same store discharges? Thanks.

Q

Douglas E. Coltharp

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

You can kind of walk yourself in circles a little bit in trying to do that. It was a little bit of an odd cadence to the quarter. When you compare to last year, the toughest comp that we were actually up against was the month of July and yet we did pretty well in July. The quarter – volume in the quarter was kind of a U-shape. July was solid. We reached a nadir in August and then recovered nicely in September.

A

And so, I don't know that we can point to any specifics. We've got kind of the same dynamic with more holidays as we look at Q4. And so, I think overall, the dynamics with regard to the impact of the capacity expansions in the satellites for Q4 set up a lot like Q3 with an extra dynamic around the timing of holidays.

And it's a bit of a wildcard. So, we can look for instance at the month of October and it ends tomorrow on a Friday that happens to be Halloween. Is that a positive or negative? I don't know. It's a factor, though. Likewise, Thanksgiving this year is two days short of the latest it can fall, it falls on Thursday, the 27th. Again, that's going to have an impact, but it could be a positive or a negative. So, it's again, difficult to be too specific about those things.

We look again and I think, we're not measuring this – we're not managing this business quarter-to-quarter. And we've said all along that there were going to be fluctuations based on the factors that I identified in my script. We set out a target to have a discharge CAGR between 2023 and 2027, total discharges of somewhere in the 6% to 8%. We're almost three years through that five-year target and we're 7.5%. We've increased the number of capacity additions that we're going to have in future periods. So, obviously we feel very good about the prospects of the business.

Mark J. Tarr

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

A

Whit, there weren't really, if you look at our actual program mix, when we mentioned the payer mix or the program mix or anything that really stood out, we continue to see progress made and continued absolute case growth for strokes, other neuro continues to be strong. So, there wasn't anything that really kind of stood out from a volume standpoint that would tie back to our program mix.

Douglas E. Coltharp

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

A

And I think that's important to note. Obviously, we analyze the volume and the trends there in a lot of different ways. We didn't see anything looking at the third quarter results that said, we need to make a course correction other than in the normal course of business where we do recognize that some markets outperformed others and we'd like to see a rising tide lift all boats.

Whit Mayo

Analyst, Leerink Partners LLC

Q

Yeah. I can kind of tie your brain into a pretzel trying to figure this out. My second question is really just an update on the review choice demo and how your experiences evolved this year versus your expectations. Thanks.

Douglas E. Coltharp

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

A

So, every month since the end of the first quarter, we've run with all seven of our hospitals in the state of Alabama having affirmation rates north of 90%. Cycle three ended in June and because of our performance early in that cycle, we did not clear the 90% affirmation rate for all of Cycle three. Cycle four began on July 1st, and since Cycle four began, all seven of our hospitals have been north of the target 90% affirmation rate.

It remains a situation where we have to stay very hands on with regard to Palmetto and as much as we can through a government shutdown, we're also staying very much in touch with CMS to ensure that we are being treated fairly and appropriately throughout this process. So, we continue to have to apply more administrative resources to this than should be necessary. But generally speaking, the program is running much better than it was during the course of Cycle two and Cycle three.

Whit Mayo

Analyst, Leerink Partners LLC

Thanks.

Q

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

Mark J. Tarr

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

Hey, Andrew.

A

Douglas E. Coltharp

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

Good morning, Andrew.

A

Andrew Mok

Analyst, Barclays Capital, Inc.

Hi. Good morning. Given all the de novos and supply demand factors, we don't usually hear much about closures or consolidations in this space. So, I was hoping you can speak a little bit to that dynamic. Was this truly a unique event or does this happen with more regularity and is only getting called out given the extra attention to volumes in the quarter? Thanks.

Q

Patrick W. Tuer

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

Hey, Andrew. This is Pat. Both of those are unique situations where the – where we were renting space from the hospital or location closed. So one-off events, very small percentage of our portfolio and not anticipating any additional activity in the future.

A

Andrew Mok

Analyst, Barclays Capital, Inc.

Great. And maybe a question on the Medicare landscape more broadly. It's undergoing some pretty big changes, whether there's a slowdown in Medicare Advantage growth next year or greater than normal churn across the national payers. Just curious how you're thinking about that and any implications for your business? Thanks.

Q

Douglas E. Coltharp

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

I think and again, it's reflected in some of the discharge growth rates by payer that I reviewed earlier. But what we like is that we do well across the payer spectrum. Obviously, our two primary areas of focus are with Medicare fee-for-service and Medicare Advantage. If Medicare Advantage growth is slowing, that means that the greater opportunity is within fee-for-service and that actually pays a slightly higher rate and we do better with regard to conversion rates, the percentage of admits to referrals.

A

That's not a bad dynamic for us. Conversely, if Medicare Advantage growth resumes, well, we've demonstrated, particularly over the last four years, that we can effectively play in that sandbox as well. So in terms of how we're planning for 2026, a more global shift between Medicare Advantage and Medicare fee-for-service is not going to impact how we plan the business.

Patrick W. Tuer

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

A

Andrew, this is Pat. Just some additional context. So, when we look at strokes, about half of them in the country are going to skilled nursing facilities and that's including in markets that we currently operate in. So we see continued upside there. The same story plays out with brain injury, which is just a huge patient population that we have the opportunity to serve. And then the – while it's not fee-for-service, Medicare, that VA dynamic that Doug talked about before, it's a small end size, but it grew 25.6% and that – this was the first quarter where we have really put some scaled attention to it.

And, we had a – originally when this opportunity came out, we weren't sure how to size it. We thought it was proximity to a VA. And when we looked across our portfolio at what we were currently pooling, we had hospitals that were 250 miles away from a VA that were growing double-digit percentage points. So, we looked at hospitals like that and what they were doing from a process perspective, created a toolkit, scaled that up, and Q3 is really the first time that we have implemented that. So, I see upside in these areas in 2026.

Andrew Mok

Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: And we will go next to A.J. Rice with UBS. Your line is now open.

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

Hey, everyone. Just to maybe think about – we obviously talked a lot about the development and program and so forth. I wonder if you could comment on your pipeline. And, you sort of had hit on this trajectory of 6 to 10 a year, averaging about 8, and you sort of got that pipeline baked for the next three years, it looks like.

Is there any pressure that people want to move faster than you are able to accommodate them in terms of potential partners out there? What's the competitive landscape to other people? Are they on a basically the same timeframe that are competing against you for those joint ventures? Any thoughts on that?

Douglas E. Coltharp

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

A

Yeah. So go back to a couple of things that Mark mentioned in his comments. One is we've got 14 projects that were announced and underway as at the end of Q3. Since then, we've already added another project with the awarding of another CON in the state of Tennessee. That's within a total active pipeline, meaning more than just exploratory conversations of 40 projects. And we feel good about being able to operate at least the midpoint of that 6 to 10 target range.

What could change that and move us up in the near-term? We've talked before about the potential for CON restrictions to be dropped in some key states, namely North Carolina. In terms of pressure from any other parties, I think you specifically cited potential joint venture partners to move more quickly. It tends to be the opposite, which is we can move much more quickly than our partners just because of the experience we have, both in operating as a joint venture and the way that we have streamlined our design and construction process. So that is not an issue.

With regard to competition, we've got a number of parties out there, namely Select Medical and HCA, who have publicly stated plans to increase the number of beds they're adding. They have different models than we do, and the market remains incredibly underserved. So, we don't see that in any way crowding this out. And as we've mentioned previously, part of the reason that in spite of the very attractive market opportunity that is out there, you don't see more competition coming in is the barriers to entry in this business are really high.

It is capital intensive, it is clinically complex, it is heavily regulated, all of those things make it very difficult for somebody who is not really well-capitalized and experienced to step into the breach.

Mark J. Tarr

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

A

A.J., the fact that we've done a lot of new development over the last X number of years, and we have the resources internally, whether that is through real estate or our design construction team and we can move with high priority on first mover advantages, speed to market. I think we've shown that over and over again.

Relative to your question around joint venture partners, as Doug noted, it does vary from partner to partner. But if you look at a partner like what we have with Piedmont in the state of Georgia, I mean, we collectively have – both systems have really prioritized post-acute and rehabilitation in particular. We now have seven hospitals without partnership because we move at a brisk pace to make sure we were taking advantage of the opportunities in the various marketplaces they serve. So, we think we're very well aligned with our partnership opportunities out there.

A.J. Rice

Analyst, UBS Securities LLC

Q

Okay. On your – at one point when we had met during the summer, you said that you may be looking at expanding your prefab capability, that there was some geographic constraints on. Where does that stand at this point and what might that do for you, if you are able to open that up to a broader geography?

Douglas E. Coltharp

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

A

Yeah. So, what A.J. is referencing specifically is right now there are some geographical limitations on where we can utilize specifically full prefabrication of hospitals and that relates to transportation costs. Right now, the way that we are using prefab construction for larger projects is we're essentially building modules and those modules are loaded on the flatbed trucks and transported to the site.

And we are using predominantly trucks because the modules are too wide, so you effectively utilize rail. So we are looking at two things. One is can we change the configuration of the modules, so they can fit on rail, which is a more cost effective mode of transportation and could increase the geography to what's [ph] applicable (00:42:17) or do we need a second manufacturing site that would be closer to those geographies or there is a version of modular construction on prefab that is called panelized construction.

So, if you think about taking a cardboard box and folding it from where it's open, that changes the overall dimensions of that particular module and it can potentially fit on rail. So, there are a number of things underway that I would state are very much still in the evaluation stage.

A.J. Rice

Analyst, UBS Securities LLC

Okay. Thanks a lot.

Q

Douglas E. Coltharp

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

I will say that the other thing that is changing as a dynamic, and this is more empirical or anecdotal than it is completely empirical right now, is that we are seeing that increasingly for our type of construction, whereas we used to compare conventional to full prefab, there's really not much happening. There's no pure conventional anymore. Almost all conventional construction.

A

Certainly all that we're using at least uses componentized prefab construction, meaning the incorporation of prefab bathrooms or head walls or both. So it's a bit of a hybrid model. And as that has become the norm, the cost differential has stayed relatively constant between the two, which has been significant. But the construction timeline, which had a significant advantage for pre – for full prefab, is decreasing. And so, there's a – that's a dynamic we need to keep an eye on, a favorable dynamic.

A.J. Rice

Analyst, UBS Securities LLC

Okay. Thanks a lot.

Q

Operator: And we'll move to our next question, which comes from Brian Tanquilut with Jefferies. Your line is open.

Mark J. Tarr

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

Good morning, Brian.

A

Douglas E. Coltharp

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

Hey, Brian.

A

Brian Tanquilut

Analyst, Jefferies LLC

Good morning, guys. Good morning. Maybe, Doug, as I think about the salaries line as a percent of revenue, it looked pretty good this quarter. But tying it back to your comments and just on the ramp. I'm just curious, how are you thinking about labor and then maybe EPOB, where that eventually optimizes once all the ramping of capacity happens?

Q

Douglas E. Coltharp

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

A

Yeah. So, I'm going to ask first for Pat to comment on EPOB and then I'll talk maybe a little bit about just other trends within SWB.

Patrick W. Tuer

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

A

Thanks, Doug. Brian, this is Pat. One of the comments on the quarter for EPOB, part of it is related to the timing components of de novo activity, but the other piece ties back to the hiring that we've done in Q3. We had 162 net RNs hired for the quarter. Outside of RNs, we had a really robust hiring quarter. And those are people that are currently in some form of orientation or precepting right now that is pushing EPOB up. That will normalize in the future. And if retention stays where it is to the benefit of other buckets like premium pay.

Mark J. Tarr

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

A

Brain, we've – as we've said in the past, that 3.4 number of EPOB, that's where we feel is the right number. I mean, there might be times when you have a volume increase, most of the EPOB dropped down a little bit, but on an ongoing basis, we feel that's the right number to make sure that we are efficient. But yeah, we are also responding to the staff and the ability to retain staff is critically important. So that 3.4 would be a number that we really try to work towards.

Douglas E. Coltharp

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

A

So, in terms of labor trends and combining what Pat and Mark have offered on EPOB, we think that we made great progress and more the progress that we anticipated on reducing premium labor spend in 2025. If we can hold that relatively steady on a nominal dollar basis, moving into 2026, that would certainly be a positive even as volume grows.

I think our assumption is that our core underlying SWB per FTE inflation is probably going to stabilize at least for the near-term, somewhere around 3% to 3.25%. The benefit piece, which is about 10.5% of the total SWB line, predominantly because of group medical, which is 75% of benefits including payroll taxes, is likely to have an inflation factor in 2026 in the high single digits.

Patrick W. Tuer

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

A

Just to clarify that, 162 net RNs hired was a same store number as well.

Brian Tanquilut

Analyst, Jefferies LLC

Q

Got it. And then maybe, Doug, just quickly on the ERP rollout, just curious what you can share with us in terms of number one, what you're seeing so far? And then number two, what kinds of efficiency gains should we expect on the P&L at some point and kind of like the timeline in terms of achieving those targets?

Douglas E. Coltharp

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

A

So, the good news is we threw the switch on October 3 and lights didn't go out, right? But – and this was a very comprehensive ERP conversion across all finance and accounting functions across supply chain, which is a big

deal for us and across all HR functions. The overwhelming majority of modules within that were from the get go smoothly and efficiently and as we had hoped.

But as is the case with every one of these items, there are bugs that need to be fixed and refinements that need to be made. That's why you see the \$3 million in incremental post-implementation expenses that we've added for this year. We, in anticipating that this would be the case, asked our implementation consultants and we did this back in the summer to continue to devote those same resources to us for a period of time, post implementation to help us work through these things in the real term.

And those – we're knocking items off the list on a daily basis. As we had stated from the get-go, unlike a lot of other ERPs that were driven because of inefficiencies or inconsistencies in the legacy system, that was not necessarily the case here. Again, many times the driver for an ERP conversion is a company that has grown through acquisitions and has not converted every one of their various business units over to a single unit. That wasn't applicable for us.

We were on a single operating system. Everybody was basically on PeopleSoft products, and we were operating efficiently. I say that because ultimately we do believe that there will be enhanced efficiencies in workflows from the full implementation of Fusion. But it's not something that was done for a specific ROI, and therefore we're not looking to quantify a specific impact on our P&L.

Mark J. Tarr

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

A

Hey Brian. This is Mark. I mentioned in my script, but I do want to give a call out to our teams here in Birmingham, as well as our teams on the hospitals as part of this conversion. They've worked day and night plus the weekends to make sure that this execution was near flawless. And not just any organization can do this in the manner that they did. But I'm really proud of what they've done.

Operator: And we can move to our next questioner, Jared Haase with William Blair. Your line is open.

Mark J. Tarr

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

A

Hey. Good morning, Jared.

Douglas E. Coltharp

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

A

Jared?

Jared Haase

Analyst, William Blair & Co. LLC

Q

Hey. Good morning, guys. Thanks for taking all the questions and all the details thus far. I'll ask another one on sort of the backdrop or outlook for Medicare Advantage. And I'm curious, we've heard a lot about the plans sort of talking about them moving members from more flexible PPO products towards these HMOs. And I'm curious, when you see kind of that shift in mix towards more of a managed care products like that, does that have any impact on Encompass either from your kind of a pre-authorization perspective or maybe your ability to be a part of those, call it, narrower or tighter networks?

Patrick W. Tuer

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

A

Hey, Jared. This is Pat. We have not seen much change on – in the MA side on the pre-auth perspective and don't anticipate changes as we head into 2026. We – as Doug said, we have a lot of success on the pre – prior-auth perspective and as we navigate the layers of appeal, but it's still a grind every day dealing with those plans. But our teams are persistent and advocating for the patients in those markets that deserve our level of care.

Jared Haase

Analyst, William Blair & Co. LLC

Q

Okay. Great. That's helpful. And then maybe just a follow-up on occupancy. When we think about the confluence of your, I guess, 2025 capacity investments maturing and then the additions that you have planned for next year. Any nuances we should keep in mind from, I guess, a cadence perspective next year in the occupancy rate, or should we sort of pencil that in staying relatively constant in the mid-70s range?

Patrick W. Tuer

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

A

Yeah. I think just maybe thinking initially about the Q4, Q1 dynamic. So, remember we had a – we had our highest ever occupancy level in Q1 of last year. And then as you look maybe to Q3 and Q4 of this year, we're adding a lot of our bulk capacity, meaning the de novos coming online late in the year. So, we had an opening that occurred very late in September and then we've got one each in October, November and December.

So those are all still going to be very much in ramp mode as we move into the first quarter of next year. So, it wouldn't – and I haven't put a pen to paper yet, but wouldn't surprise me if you saw some downward pressure in terms of the year-over-year comparison in occupancy rates in the first quarter of next year. Of course, all of that can change depending on the intensity of a flu season. I guess you got to flow – throw COVID into the mix and all that other kind of stuff.

Anyway, there will be period to period fluctuations as a result of the timing of capacity additions. But our overall occupancy rates remain on an upward trajectory.

Mark J. Tarr

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

A

Jared, in our supplemental slides, on slide 17, we have the development activity and when the hospitals will come on in 2026. So just draw your attention to that.

Jared Haase

Analyst, William Blair & Co. LLC

Q

Got it. That's really helpful. Thanks for all the detail.

Operator: [Operator Instructions] We will go next to Raj Kumar. Your line is open.

Mark J. Tarr

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

A

Hey, Raj.

Douglas E. Coltharp

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

Hey, Raj.

A

Raj Kumar

Analyst, Stephens, Inc.

Hey. Good morning. Maybe just kind of [indiscernible] (00:53:44) on the kind of satellite consolidation and maybe I missed the comment, but what's kind of embedded from a year-on-year standpoint in 4Q in terms of the growth headwind? And then maybe just one on the kind of potential impacts from the negative headlines that came out early in the 3Q. Do you kind of see any changes to referral patterns as a result of that, or was it kind of business as usual?

Q

Mark J. Tarr

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

Yeah. I'll take your – I'll answer the last question first. This is Mark. We've not seen any impact among our referral patterns. As we stated on last quarter's call, we are very proactive in terms of communicating with our joint venture partners, with our referral sources, and they're all aware of our quality and we share that openly. So, we've not seen any negative fallout from that article.

A

Douglas E. Coltharp

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

With regard to the Q4 potential headwind from the two satellite closures, again, we estimated that at 35 basis points in Q3. Even before we add the beds to Cincinnati we should start seeing a resumption or consolidation of some of that volume into the remaining hospitals in that market. So I would say it'll probably be a little bit less, maybe 25 to 30 basis points in Q4.

A

Raj Kumar

Analyst, Stephens, Inc.

Got it. And then as my follow-up, just kind of thinking about the reopening and start-up cost. \$11 million year-to-date, I think, roughly \$7 million from the low end of what's embedded for this year. So maybe kind of helping us think about from the three hospitals that are opening in 4Q, how much of that was realized in the third quarter?

Q

And it seems like you have like a back half weighted pipeline next year as well from an opening standpoint. So maybe what's kind of being assumed in 4Q spend related to the first half hospitals in 2026?

Douglas E. Coltharp

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

Yeah. And so that's – it's going to be on kind of a rolling basis. So, the estimate for the year is \$18 million to \$22 million, you're at \$11.5 million through three quarters, probably pegging the midpoint of that range is not a bad place to be in terms of the Q4 estimate. Most of that is going to be related to the openings that occur and Q4 portion is applicable to the early openings in 2026.

A

Probably a good proxy for where we might land with regard to a 2026 number is something in the same range that we had for the full year this year. And two, when you get into the latter stages of 2026, that is going to include some expenses related to 2027 openings.

Raj Kumar

Analyst, Stephens, Inc.



Great. Thank you.

Operator: At this time, there are no additional questions. I'd like to turn the program over to Mark Miller for any closing remarks.

Mark Miller

Chief Investor Relations Officer, Encompass Health Corp.

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

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

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