

Select Medical Corp.

Takes from the call

Reiterate Rating: BUY | PO: 29.00 USD | Price: 21.82 USD

Margin lift driven by better CIRH

All four segments grew revenue and EBITDA y/y with the most significant improvement in Critical Illness Recovery Hospitals (CIRHs). Select Medical (SEM) continued to make progress on reducing labor costs in its CIRH segment and continues to expect to reduce CIRH's SWB ratio to 52% in 2025 as commercial rates continue to improve (similar comments were made on Q2 call). The pipeline of denovos and acquisitions remains full in all four segments. We reiterate our Buy rating as we see the improvement in labor combined with commercial re-pricing as drivers of upside over the next two years.

Contract labor use below pre-COVID

Registered Nurse (RN) agency usage in the CIRH segment dropped to the target 15%, lower than pre-COVID levels. Agency RN costs declined 17% Q/Q on an -18% lower use partially offset by a 1% increase in the avg rate (to \$78 from \$77; little change through Q3). RN use declined during Q3: 15.6% in July, 15.5% in Aug, 15.1% in September, which resulted in monthly spending declining (from \$6.2m in July to \$5.8m in September). Sign-on bonuses were flat q/q at \$7.8m, while orientation hours +18% q/q.

CIRH margins benefited from lower labor, better pricing

Margins improved 320bps y/y on the lower labor costs. CIRH Occupancy declined 400bps q/q to 64% (seasonality) and was down 300bps y/y, but case mix index was up and threshold days declined which drove strong pricing (+11.6% y/y).

Concentra pricing up on mix

Workers' comp rates were up 3% and employer rates increased 7%. The overall pricing (+6% y/y) benefited from the mix as employer services vols were down, while Workers' comp vols grew (higher rates).

Outpatient Rehab pricing to be +2% on commercial

The vol increase (+9%) offset by pricing (-3%) was consistent with Q2 trends. SEM's initiatives on clinical productivity contributed to additional volumes - expect continued improvement. SEM expects pricing in the +2% range in 2024 as the higher commercial rates help offset the Medicare rate cut.

03 November 2023

Equity

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Stock Data

Price	21.82 USD
Price Objective	29.00 USD
Date Established	3-Nov-2023
Investment Opinion	B-1-7
52-Week Range	18.86 USD - 33.51 USD
Mkt Val (mn) / Shares Out (mn)	2,792 USD / 128.0
Average Daily Value (mn)	12.67 USD
BofA Ticker / Exchange	SEM / NYS
Bloomberg / Reuters	SEM US / SEM.N
ROE (2023E)	17.4%
Net Dbt to Eqty (Dec-2022A)	274.2%
ESGMeter™	Medium

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SWB = Salaries, wages, and benefits

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Timestamp: 03 November 2023 11:12AM EDT

Price objective basis & risk

Select Medical Corp. (SEM)

Our \$29 PO is based on 8.8x our 2024E Adjusted EBITDA less Non-Controlling Interest estimate, towards the middle of its historical 7.5-10x range, which we think is justified given the strong performance in outpatient businesses offsetting weaker inpatient margins.

Upside risks to our PO are outperformance in CIRH and IRF segments, better-than-expected Medicare rates, faster rebound to volumes, or larger-than-expected cost offsets (especially in labor).

Downside risks to our PO are: continued labor disruption, COVID disruption, Medicare rate pressure, lower-than-expected cost saves from labor during a recession, a recession impacting growth, high leverage and execution risk on deals.

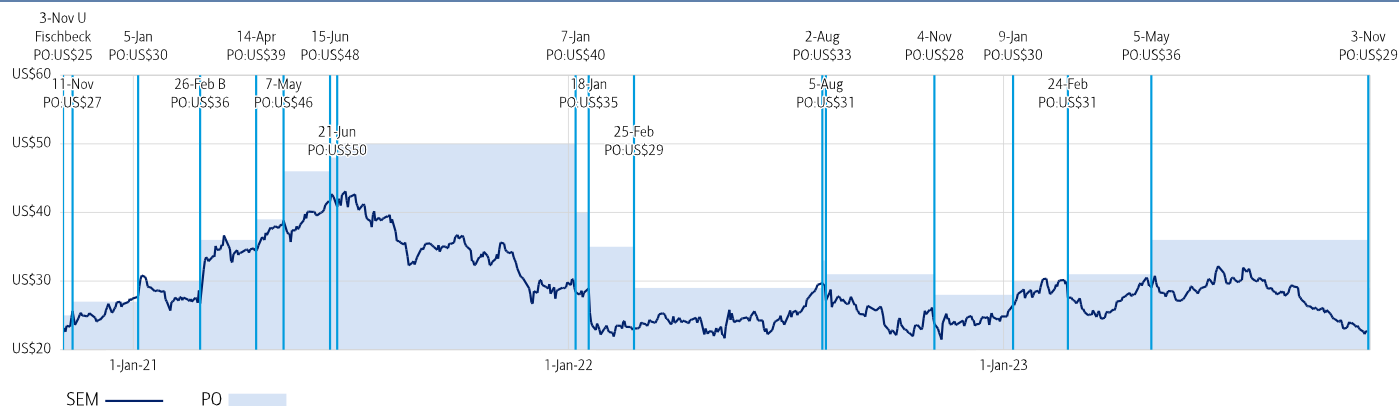
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Select Medical (SEM) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	233	60.21%	Buy	113	48.50%
Hold	83	21.45%	Hold	33	39.76%
Sell	71	18.35%	Sell	25	35.21%

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Sell	798	22.83%	Sell	370	46.37%

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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