

Select Medical Corp.

Another beat as recovery continues. 2024 EBITDA guide brackets consensus

Reiterate Rating: BUY | PO: 29.00 USD | Price: 25.95 USD

Beat, EBITDA guide slightly below

Adj EBITDA was 1% above consensus on 1% higher revs (margins in line). Margins increased +150bps y/y to 10.9% driven by the improvement in Critical Illness Recovery Hospitals (CIRHs). 2024 EBITDA guide brackets consensus with the midpoint 1% below consensus (3% below our est). We trim our 2024/25E EBITDA to reflect the -0.2% FY24 Medicare rate update for CIRHs being well below cost inflation, and roll out 2026 est. Our PO of \$29 represents 9.0x 2024E EBITDA less NCI (vs 8.9x prior) given the increased visibility. Reiterate Buy given the continued improvement.

Revs to grow 5%, EBITDA +6% y/y in 2024

2024 rev guide midpoint of \$7bn is 1% above consensus, in line with our est. Implies +3.5-6.5% growth y/y. Adj EBITDA to grow 3-9% y/y as margins to be -10bps to +30bps y/y. EPS guide is 9% below consensus/ 13% below our est. on higher interest expense.

Better EBITDA for Inpatient Rehab (IRF) and Concentra

Revs were slightly worse than our est at CIRHs while better in the other segments. EBITDA was below our est. in CIRHs and Outpatient but beat in IRF and Concentra.

CIRH and IRF margins improved nicely

CIRH rev grew 1% as strong pricing (+4.6%) was offset by vols -3.5% y/y. Margins improved 220bps y/y to 10.1% (140bps below our est) – this is notable given the FY24 rate update took effect Oct 1, 2023, and points to the continued labor improvement in the segment. IRF revs grew nicely, +9.4%, driven by strong vols (+6.6%) and solid pricing (+2.6%). Margins improved 190bps y/y to 25.5%, and beat our est.

Margins solid at Concentra, worse at Outpatient

Concentra revs grew +6.2% y/y driven by pricing (+5%) with vols +1% y/y. Margins improved 50bps y/y to 15.5%, and in line with our est. The full year margin was 19.7%, up 30bps y/y (Q4 seasonally the weakest quarter). Outpatient rehab revs grew +6% y/y with strong vols (+11%) offset by -2% pricing (Medicare rate cut). Margins improved 190bp y/y to 7.5% but were 130bps below our est.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.23	1.99	2.02	2.30	2.61
GAAP EPS	1.23	1.91	2.02	2.30	2.61
EPS Change (YoY)	-58.7%	61.8%	1.5%	13.9%	13.5%
Consensus EPS (Bloomberg)			2.22	2.42	2.69
DPS	0.50	0.50	0.50	0.50	0.50
Valuation (Dec)					
P/E	21.1x	13.0x	12.8x	11.3x	9.9x
GAAP P/E	21.1x	13.6x	12.8x	11.3x	9.9x
Dividend Yield	1.9%	1.9%	1.9%	1.9%	1.9%
EV / EBITDA*	13.0x	10.4x	9.8x	9.2x	8.7x
Free Cash Flow Yield*	2.8%	10.6%	5.4%	6.1%	6.9%

* For full definitions of *IQmethod*SM measures, see page 4.

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Refer to important disclosures on page 5 to 7. Analyst Certification on page 3. Price Objective Basis/Risk on page 3.

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23 February 2024

Equity

Key Changes

(US\$)	Previous	Current
2024E Rev (m)	6,969.3	6,995.9
2025E Rev (m)	7,314.2	7,342.5
2026E Rev (m)	NA	7,710.2
2024E EPS	2.32	2.02
2025E EPS	2.65	2.30
2026E EPS	NA	2.61
2024E EBITDA (m)	884.4	855.0
2025E EBITDA (m)	943.5	912.6
2026E EBITDA (m)	NA	966.0

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Stock Data

Price	25.95 USD
Price Objective	29.00 USD
Date Established	3-Nov-2023
Investment Opinion	B-1-7
52-Week Range	21.28 USD - 33.51 USD
Mrkt Val (mn) / Shares Out (mn)	3,321 USD / 128.0
Free Float	79.0%
Average Daily Value (mn)	11.55 USD
BofA Ticker / Exchange	SEM / NYS
Bloomberg / Reuters	SEM US / SEM.N
ROE (2024E)	17.1%
Net Dbt to Eqty (Dec-2023A)	232.6%
ESGMeter™	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

iQprofileSM Select Medical Corp.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	6.1%	8.2%	8.6%	9.1%	9.6%
Return on Equity	11.8%	17.6%	17.1%	19.7%	22.5%
Operating Margin	6.3%	8.9%	9.2%	9.6%	9.8%
Free Cash Flow	94	353	178	203	230

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.8x	2.3x	1.6x	1.5x	1.4x
Asset Replacement Ratio	0.9x	1.1x	1.1x	1.2x	1.3x
Tax Rate	NM	NM	NM	NM	NM
Net Debt-to-Equity Ratio	274.2%	232.6%	226.9%	219.7%	210.8%
Interest Cover	2.5x	3.0x	2.9x	3.2x	3.4x

Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	6,334	6,664	6,996	7,343	7,710
% Change	2.1%	5.2%	5.0%	5.0%	5.0%
Gross Profit	733	932	982	1,042	1,098
% Change	-20.2%	27.1%	5.3%	6.1%	5.4%
EBITDA	647	807	855	913	966
% Change	-31.7%	24.8%	5.9%	6.7%	5.9%
Net Interest & Other Income	(169)	(213)	(217)	(222)	(221)
Net Income (Adjusted)	159	254	261	300	343
% Change	-60.4%	59.9%	2.6%	14.9%	14.5%

Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	284	409	468	539	612
Depreciation & Amortization	206	209	211	207	203
Change in Working Capital	(160)	59	(224)	(124)	(141)
Deferred Taxation Charge	8	(16)	0	0	0
Other Adjustments, Net	(53)	(79)	(37)	(166)	(179)
Capital Expenditure	(190)	(229)	(241)	(253)	(265)
Free Cash Flow	94	353	178	203	230
% Change	-57.2%	273.6%	-49.6%	13.9%	13.6%
Share / Issue Repurchase	(196)	(13)	0	0	0
Cost of Dividends Paid	(65)	(64)	(62)	(63)	(63)
Change in Debt	256	(213)	(86)	(110)	(137)

Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	98	84	84	84	84
Trade Receivables	941	940	1,100	1,162	1,229
Other Current Assets	232	233	233	233	233
Property, Plant & Equipment	1,001	1,024	1,083	1,158	1,250
Other Non-Current Assets	5,393	5,408	5,408	5,408	5,408
Total Assets	7,665	7,690	7,909	8,046	8,205
Short-Term Debt	76	100	100	100	100
Other Current Liabilities	1,079	1,148	1,098	1,035	961
Long-Term Debt	3,835	3,588	3,502	3,391	3,254
Other Non-Current Liabilities	1,284	1,279	1,659	1,968	2,337
Total Liabilities	6,275	6,116	6,358	6,495	6,653
Total Equity	1,391	1,550	1,550	1,551	1,551
Total Equity & Liabilities	7,665	7,665	7,909	8,046	8,205

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Hospital Management

Company Description

Select Medical Corp operates critical illness recovery hospitals (39% of revenue), inpatient rehabilitation facilities (13%), outpatient rehabilitation clinics (16%), and Concentra (27%) in the US. At 3/31/21, Select operated 99 critical illness recovery hospitals in 28 states, 30 rehab hospitals in 12 states, and 1,809 outpatient rehab clinics in 37 states and the District of Columbia. Concentra, which is operated through a joint venture subsidiary, operated 519 medical centers in 41 states.

Investment Rationale

SEM has diversified business risk by growing the outpatient and commercial businesses. SEM has been a net beneficiary from COVID, and we believe that a decent amount of the critical illness recovery hospitals (CIRH) share shift that occurred will be sustained post COVID, while the outpatient businesses rebound. We see potential upside to estimates if the company can execute against its guidance and/or deploys capital.

Stock Data

Average Daily Volume 472,662

Quarterly Earnings Estimates

	2023	2024
Q1	0.56A	0.57E
Q2	0.61A	0.62E
Q3	0.45A	0.46E
Q4	0.36A	0.37E

Price objective basis & risk

Select Medical Corp. (SEM)

Our \$29 PO is based on 9.0x 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.

Analyst Certification

I, Kevin Fischbeck, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Acadia Healthcare	ACHC	ACHC US	Kevin Fischbeck, CFA
	Addus HomeCare	ADUS	ADUS US	Joanna Gajuk
	Agilon Health	AGL	AGL US	Adam Ron
	Apollo Medical	AMEH	AMEH US	Adam Ron
	BrightSpring Health Services	BTSG	BTSG US	Joanna Gajuk
	Chemed Corporation	CHE	CHE US	Joanna Gajuk
	Elevance Health Inc	ELV	ELV US	Kevin Fischbeck, CFA
	Encompass Health	EHC	EHC US	Kevin Fischbeck, CFA
	HCA	HCA	HCA US	Kevin Fischbeck, CFA
	Humana Inc	HUM	HUM US	Kevin Fischbeck, CFA
	Option Care Health	OPCH	OPCH US	Joanna Gajuk
	Oscar Health	OSCR	OSCR US	Adam Ron
	Select Medical Corp.	SEM	SEM US	Kevin Fischbeck, CFA
	Service Corp.	SCI	SCI US	Joanna Gajuk
	Surgery Partners, Inc	SGRY	SGRY US	Kevin Fischbeck, CFA
	Tenet Healthcare	THC	THC US	Kevin Fischbeck, CFA
	The Cigna Group	CI	CI US	Kevin Fischbeck, CFA
	UnitedHealth Group	UNH	UNH US	Kevin Fischbeck, CFA
	Universal Health Services	UHS	UHS US	Kevin Fischbeck, CFA
	US Physical Therapy	USPH	USPH US	Joanna Gajuk
NEUTRAL				
	Alignment Healthcare	ALHC	ALHC US	Adam Ron
	AMN Healthcare	AMN	AMN US	Kevin Fischbeck, CFA
	Brookdale	BKD	BKD US	Joanna Gajuk
	Centene Corporation	CNC	CNC US	Kevin Fischbeck, CFA
	Molina Healthcare, Inc.	MOH	MOH US	Kevin Fischbeck, CFA
	Privia Health	PRVA	PRVA US	Adam Ron
UNDERPERFORM				
	AdaptHealth Corp.	AHCO	AHCO US	Joanna Gajuk
	Agility Health Inc	AGTI	AGTI US	Kevin Fischbeck, CFA
	Cross Country Healthcare	CCRN	CCRN US	Kevin Fischbeck, CFA
	DaVita Inc	DVA	DVA US	Kevin Fischbeck, CFA



US - Facilities, Hospitals and Managed Healthcare Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Enhabit Home Health & Hospice	EHAB	EHAB US	Joanna Gajuk
	Pediatrix Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	$\text{Cash Flow From Operations} - \text{Total Capex}$	N/A
Quality of Earnings	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	$\text{Cash Flow From Operations} - \text{Total Capex}$	$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	$\text{Basic EBIT} + \text{Depreciation} + \text{Amortization}$

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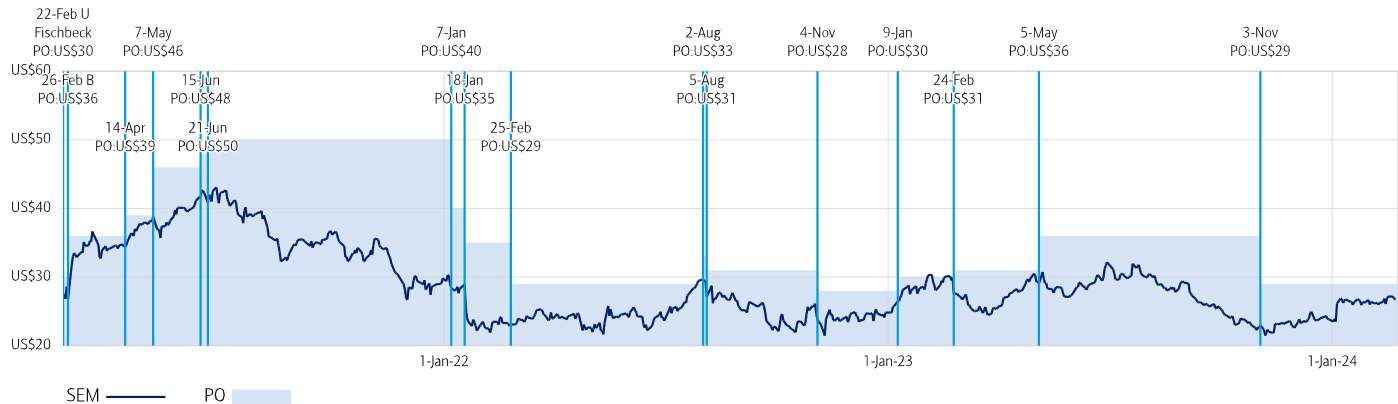
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Important Disclosures

Select Medical (SEM) Price Chart



SEM — PO

B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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