

Select Medical Corp.

Takes from the call

Reiterate Rating: BUY | PO: 33.00 USD | Price: 27.76 USD

Additional color on guidance

SEM is guiding to 2024 EBITDA of \$830-\$880m, up +2.8% to +9.0%. Growth in both the CIRH and Outpatient Therapy are held back by Medicare rate cuts. Guidance also includes \$12.3m of start up losses in 2024 (similar to 2023). The company indicated that the impact of the cuts to the high cost outlier threshold as the biggest swing variable in the guidance, as it remains to be seen how referral sources respond and how well its mitigation strategies take effect. 4Q24 will see a \$20m increase in interest expense as swaps expire. With the quarter we are raising our PO to \$33 (9.7x 2024E EBITDA less NCI vs 9.0x prior) and reiterate our Buy rating as we see improvement in labor and accelerating de novo development driving upside.

Spinoff of Concentra

Concentra revs grew 6% driven largely by rate. Workers comp vols up 6%, but employer-based visits lower rate vols) were down (similar to recent quarters), which helped rate growth. SEM believes that the tax-free spin of Concentra (2024 completion date) will help create shareholder value (letter from the IRS still pending). SEM believes that Concentra's dominant position in the occupational therapy space isn't fully appreciated. Margins have improved meaningfully since it bought Concentra, so from here the story will be about solid organic growth augmented by deals/de novos. Concentra acquired 3 centers and opened 3 centers in Q4. Plans 5 de novos in 2024, another 2 in 1Q25. Strong acquisition pipeline, one under LOI. SEM 10-K disclosed a subpoena from the California Department of Insurance documentation relating to Concentra's billing and coding for physical therapy claims submitted to commercial insurers and workers compensation. The company doesn't believe that this suit will impact the spin timing.

Critical Illness Recovery hospital (CIRH) labor normalizing

Critical Illness Recovery hospital SWB as a percentage of revenue declined from 59.8% to 57.6%. For the year, SWB as a percent of revenue dropped from 63.4% in 2022 to 57.2% in 2023. SWB continues to trend favorably and is expected to end Q1 at/below 55%. RN agency down 17% in Q4. Utilization dropped from 15% to 14% (was at 15-18% pre-pandemic) and rate/hour dropped from \$78 to \$70. Agency utilization declined through the quarter - 14.4% to in Oct, 13.8% in Nov, 13.0% in Dec. In Q4, CIRH occupancy was down, but case mix and better contract rates drove revenue/patient day. Q1 volume is starting strong and now up y/y. SEM continues to work on improving clinical efficiency and expects to be back to low/mid-teens margins within 2-3 years.

Strong denovo pipeline across the businesses

In the quarter. \$3.6m of start up losses vs \$3.1m in Q4 2023. The company has a number of projects to add capacity beyond the Concentra assets noted above. In the IRF business, in 2023 it opened 128 beds and in 2024 it expects to open 533 IRF beds. In the CIRH division, it opened 227 beds with an additional 70 CIRH beds in 2024. In the outpatient therapy division, it has 19 de novos in the pipeline for 2024, 10 in 1H.

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Timestamp: 23 February 2024 12:01PM EST

23 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	29.00	33.00

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Stock Data

Price	27.76 USD
Price Objective	33.00 USD
Date Established	23-Feb-2024
Investment Opinion	B-1-7
52-Week Range	21.28 USD - 33.51 USD
Mkt Val (mn) / Shares Out (mn)	3,553 USD / 128.0
Free Float	79.0%
Average Daily Value (mn)	13.12 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

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LT = Long-term

CIRH = Critical Illness Recovery Hospitals

IRF = Inpatient Rehab Facility

CARES = Coronavirus Aid, Relief, and Economic Security

NCI = Non-controlling interest

SWB = salaries, wages and benefits

Price objective basis & risk

Select Medical Corp. (SEM)

Our \$33 PO is based on 9.7x 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.

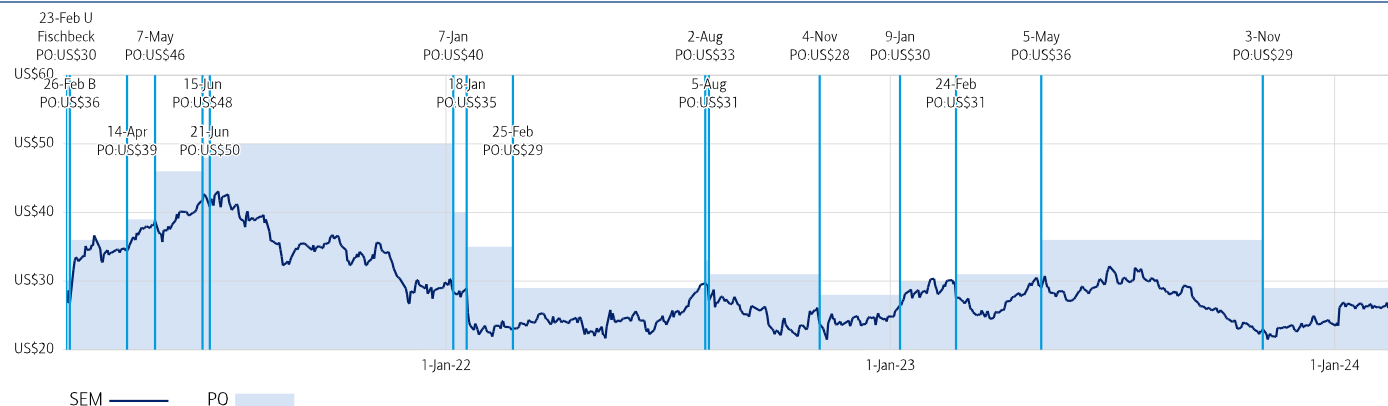
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Select Medical (SEM) Price Chart



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

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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
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Sell	807	22.84%	Sell	383	47.46%

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

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