

Encompass Health

Quick takes from the call

Reiterate Rating: BUY | PO: 77.00 USD | Price: 59.62 USD

Volumes strong, broad based

Stroke up 8.8%, hip/knee lower extremity up 14% (off of small base), Cardiac up 2.4%, major multiple trauma up 10.4%. Saw broad strength in volumes across geographies. Overall volume growth was strong but has slowed, but on more difficult comps and the company sees a return to normal seasonality. Believes that IRFs have taken share from other provider settings during COVID and that this is durable. EHC expects to continue to benefit from the ramp of 25 de novos it built from 2021-2023. Reiterate Buy.

Color on Q4 guide

Discharges from Q3 to Q4 to be flat. Merit increase in Q4 should offset a lot of the Medicare rate update in Q4. \$3.3-\$5.3m start up loss swing headwind from Q3 to Q4 (going from a \$900k positive to a \$2.4-\$4.4m loss).

Labor should continue to improve in 2024

Reduced contract labor and sign on bonuses despite 4% ss growth. Although wage growth accelerated to 6% and is expected to remain in this level in Q4, EHC sees this as a good trade off as it helped the company add 200 net new hires for the second straight quarter, reduce turnover and reduce reliance on contract labor. At the same time, although the rate for contract labor/FTE went up q/q for the second straight quarter, utilization has declined and the company attributed the rate increase to mix (as the last jobs you can permanently fill are the most difficult, resulting in a higher temp cost to fill them). Contract labor as a percentage of FTEs was 1.5%, down 40bps y/y, down 30bps q/q, but still above the 1% level prior to COVID. EHC expects contract labor to be stable to down in 2024. Meanwhile, it expects wage growth to moderate in 2024 as well.

Medicare Advantage continues to grow, rates improving

Medicare Advantage (MA) volumes were up 11% in Q3, +15% YTD. MA stroke growth has been strong but the value proposition with MA being recognized across a broader acuity setting. 3-4% contract rate between Medicare and MA. The rate differential between MA and FFS was only 3-4% in Q3, down from -5.9% in Q2 and -4.7% in Q1,

Bed additions/De novos going well

Favorable weather means will accelerate 1 de novo hospital opening into Q4, reaching 441 beds for the year. 3 bed additions shifting to 2024 due to local permitting issues. Will add 150+ beds to existing hospitals in 2024. The company downplayed the write-off of one of its projects, noting that it has 18 de novos going to open after 2023 and 50 projects in the pipeline. It views walking away from one as showing discipline. \$10-\$12m of start up losses on denovos (similar to this year) next year is likely a good starting point.

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Equity

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Stock Data

Price	59.62 USD
Price Objective	77.00 USD
Date Established	27-Oct-2023
Investment Opinion	B-1-7
52-Week Range	50.22 USD - 72.06 USD
Mkt Val (mn) / Shares Out (mn)	6,028 USD / 101.1
Average Daily Value (mn)	38.43 USD
BofA Ticker / Exchange	EHC / NYS
Bloomberg / Reuters	EHC US / EHC.N
ROE (2023E)	24.8%
Net Dbt to Eqty (Dec-2022A)	148.8%
ESGMeter™	Medium

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EHC = Encompass Health

FTE = Full-time equivalent

IRF = Inpatient rehab facility

PR = Puerto Rico

SS = Same store

FFS = fee-for-service

q/q = quarter over quarter

y/y = year over year

YTD = year to date

Price objective basis & risk

Encompass Health (EHC)

Our PO of \$77 is based on 10.3x 2024E EBITDA, a premium to the multiple the legacy stock was trading at when HealthSouth announced plans to acquire the home health/hospice business in late 2014 to reflect the faster growth and the more favorable demographics. EHC's facilities are defensive given their acuity level and focus on Medicare reimbursement.

Upside risks to our PO are: 1) labor cost pressures dissipate faster than expected, 2) volume growth is faster than expected, 3) the company deploys capital accretively beyond what's included in the guidance, 4) executes better on offsetting reimbursement headwinds.

Downside risks to our PO are: 1) Labor cost inflation worse than expected, 2) Medicare rate cuts are deeper than we expect, 3) the company fails to offset the reimbursement pressures, 4) volumes slow down, 5) startup costs associated with JV and de novo growth strategies are worse than expected.

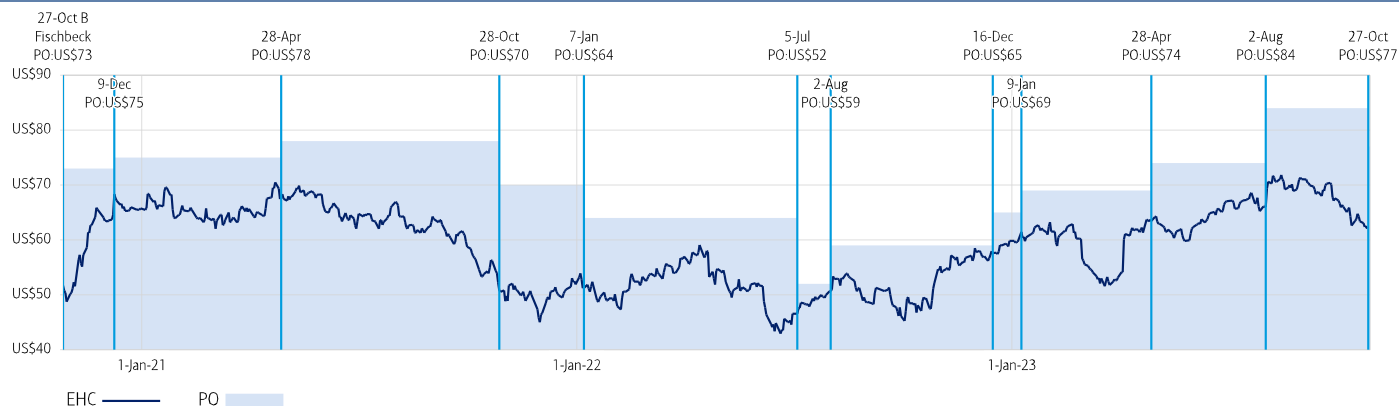
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Encompass Health (EHC) Price Chart



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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%

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

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Sell	798	22.83%	Sell	370	46.37%

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