Home Health

Final rates better as behavioral adjustment will be phased-in; more cuts coming

Industry Overview

Final 2024 rate 300bps better than proposal

The final Medicare rate update of +0.8% is much better than the -2.2% cut proposed as the behavioral adjustment will be phased in: -2.6% cut in 2024, down from -5.1% proposed. This is similar to the phase-in in the final 2023 regulation as CMS wanted to lessen the impact in a single year. While a relief vs proposal, the +0.8% update is well below the wage inflation, and more cuts are coming: 1) -2.6% likely in 2025 - the second part of the behavioral adjustment, and 2) -20% or bigger cut to recoup overpayments, likely phased in. We remain cautious on EHAB as the net Medicare rate updates will likely be below the cost inflation for the next several years on top of the negative mix shift.

Total behavioral adjustment estimate increased

As CMS uses more recent data, the estimate of the cuts needed continues to increase. CMS now estimates the permanent adjustment to reflect the behavior changes under PDGM needs to be -9.48%, up from the prior est of -9.36%. After considering the -3.9% cut implemented in 2023, CMS estimated a -5.779% cut would be needed, up from -5.653% in proposal. In response to the industry's pushback against the rate cuts, CMS noted the industry Medicare margins remain high (17% estimated for 2023).

Adjustment to be phased-in, -2.6% in 2024

Similar to the 2023 reg, CMS recognized the potential hardship of implementing the full cut and finalized half of -5.779% or a -2.89% permanent adjustment for 2024. This cut implies a 2.6% reduction for all Medicare home health payments as certain visits are not included in these reductions. The lower behavioral adj in 2024 means there would be additional cuts in the future. CMS left the door open on timing.

Recoupments of 20% coming, likely higher

CMS slightly raised its estimate of the total overpayments in 2020-2022 to $3.49bn vs $3.44bn in the proposal, which imply a -20% cut. CMS did not propose to start the cuts given the behavioral cuts being implemented. It plans to propose the cuts in the future, noting the amount will likely continue to increase until the permanent behavior adj is fully implemented. EHAB and AMED most exposed. ADUS much smaller -Exhibit 4.

Rates likely flattish in 2025, -2% in 2026

Assuming the second part of the 5% beh adj is implemented in 2025, the net rate update would be flattish. Meanwhile, if we assume the recoupments start in 2026 and are spread over 4 years, net rate update would be -2% in 2026 – See Exhibit 2.

Market basket 30bps better than proposal

Market basket (MB) update was finalized at +3.3%, 30bps better than the proposal, which is reduced by a -0.3% productivity adjustment (in line with proposal), with +0.4% fixed dollar loss adjustment (20bps above the proposal). Combined with the -2.6% behavioral adj, this results in a net update of +0.8%, 300bps better than the proposal. This is comparable to +0.7% in 2023. Exhibit 1.

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CMS = Centers for Medicare & Medicaid Services

PDGM = Patient Driven Groupings Model

EHAB = Enhabit

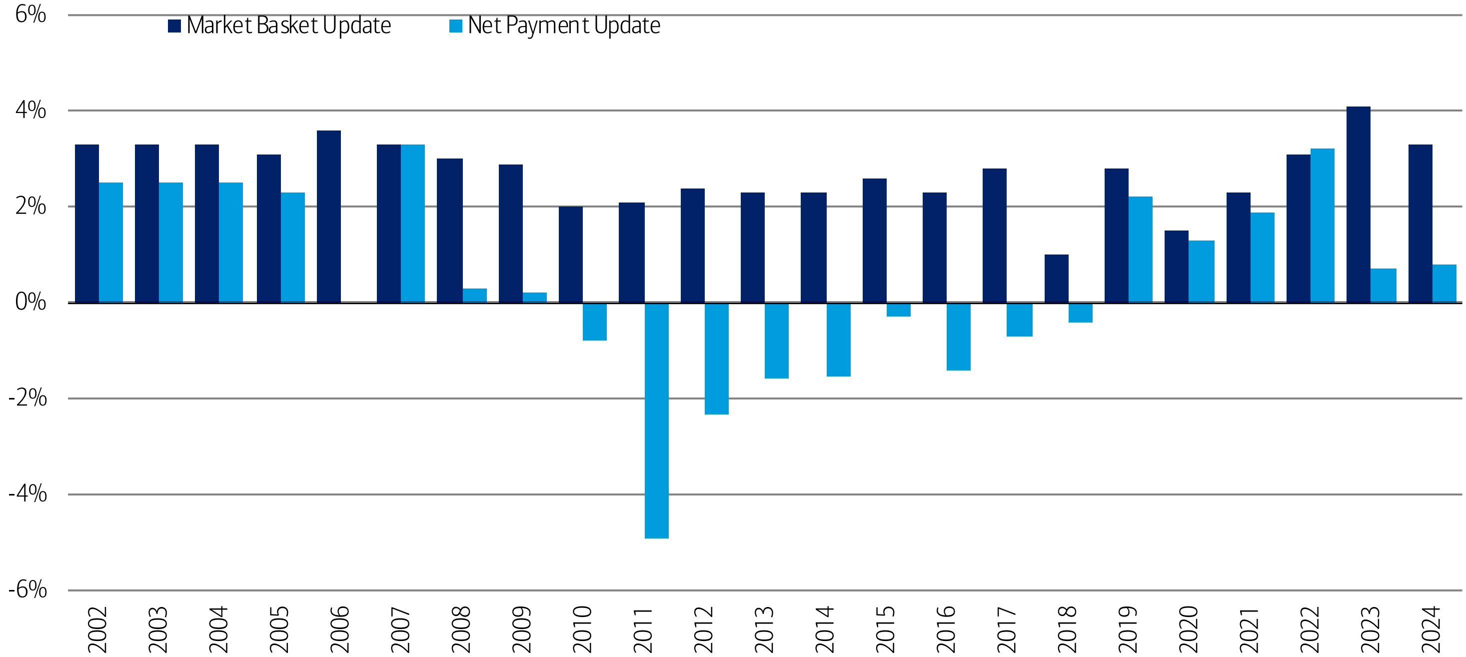
AMED = Amedisys

ADUS = Addus Home Care

Net rate update better, comparable to 2023

The +3.3% MB update is below the +4.1% in 2023 but above the historical avg ex 2023. This is in line with +3.3% finalized for Hospice. 2024 final reg calls for a net +0.8% update to rates, similar to the +0.7% update in 2023 and below rate updates in 2019-2022.

Exhibit 1: Annual rate updates for Medicare home health payments
2024 final reg calls for a net +0.8% update to rates, similar to 2023, below 2019-2022 updates



Source: CMS

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Recoupments would be significant, but temporary

In addition to the permanent cut to rates, CMS is also considering future reductions to recoup the estimated overpayments. CMS now estimates the total overpayments in 2020-2022 were $3.5bn, which imply a -20% cut. In a positive, CMS agreed that implementing the temporary cuts (recoupments) at the same time as the permanent cut (behavioral adj) would adversely impact providers and it did not propose the recoupments for 2024. It plans to propose the cuts in the future.

Given the magnitude of the cuts needed to recoup the overpayments, we expect those cuts to be spread over multiple years. Previously, MedPAC had suggested a 4-year phase-in. We note, the recoupment would be a temporary cut which means that after it is implemented (and overpayments are recouped), it would be reversed the next year.

Assuming the second part of the behavioral adj is implemented in 2025, we would expect the recoupments to start in 2026. Assuming a 4-year phase in, there would be a 5% cut in 2026, then rates would grow in 2027, 2028, and 2029, and would be followed by an outsized rate increase in 2030 to reverse the temporary cut.

Net of the market basket update, the 5% cut implies a negative net rate update in 2026, with rates staying depressed until the recoupments are completed.

Exhibit 2: Rates could be flattish in 2025 if the second part of the beh adj is implemented, and negative in 2026 when recoupments start
Estimated rate updates assuming -2.6% beh adj cut in 2025, Recoupments start in 2026, and are phased in over 4 years

	2023	2024	2025E	2026E	2027E	2028E	2029E	2030E
Market basket (MB) update	4.1%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%
Behavioral adj phased in	-3.5%	-2.6%	-2.6%					

Exhibit 2: Rates could be flattish in 2025 if the second part of the beh adj is implemented, and negative in 2026 when recoupments start
Estimated rate updates assuming -2.6% beh adj cut in 2025, Recoupments start in 2026, and are phased in over 4 years

	2023	2024	2025E	2026E	2027E	2028E	2029E	2030E
Recoupment of 21% phased in over 4 yrs				-5.0%	-5.0%	-5.0%	-5.0%	0.0%
reversing prior yr's recoupment				0.0%	5.0%	5.0%	5.0%	5.0%
Productivity adjustment	-0.1%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%
Other	0.2%	0.4%						
Total Adjustments to MB	*-3.4%*	*-2.5%*	*-2.9%*	*-5.3%*	*-0.3%*	*-0.3%*	*-0.3%*	*4.7%*
Net Rate update	**0.7%**	**0.8%**	**0.4%**	**-2.0%**	**3.0%**	**3.0%**	**3.0%**	**8.0%**

Source: BofA Global Research estimates

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Looked differently, the recoupments temporarily lower the payment rate. After the recoupments are completed, the rate returns to the level it would be at without the recoupments.

Exhibit 3: Assuming a 4-year phase in, the rate would return to the expected level in 2030
Example rate over time with recoupments and without recoupments

	2025E	2026E	2027E	2028E	2029E	2030E
Net Rate update without recoupment	0.4%	3.0%	3.0%	3.0%	3.0%	3.0%
Rate without recoupment	100	103	106	109	113	116
Net Rate update with recoupment	0.4%	-2.0%	3.0%	3.0%	3.0%	8.0%
Rate with recoupment	100	98	101	104	107	116

Source: BofA Global Research estimates

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EHAB and AMED impacted the most by recoupments

We estimate the 20% cut before any offsets would be 112% cut to EHAB EBITDA, -72% to Amedisys (AMED), and -7% to Addus (ADUS). Meanwhile, the recoupments are likely phased in over time given the magnitude of the cut required. Assuming a 4-yr phase-in, there would be a 5% cut in 2026. Before any offset the 5% cut to Medicare implies a 28% cut to EHAB 2025E EBITDA, -18% for AMED, and -2% for ADUS.

Exhibit 4: The recoupment would be a significant headwind to EHAB and AMED
Estimated impact of 20% cut to Medicare rates

($m)	EHAB	AMED	ADUS
2025E Home health revs	$934	$1,541	$72
% Medicare	68%	63%	70%
Medicare revs	$632	$966	$51
% cut to Medicare rate	**-20%**	**-20%**	**-20%**
Rev/EBITDA impact before offsets	-$128	-$196	-$10
% of 2025 EBITDA before offsets	***-112%***	***-72%***	***-7%***
cut in 2026 assuming 4yr phase in	***-28%***	***-18%***	***-2%***

Source: BofA Global Research estimates

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Price objective basis & risk

Enhabit Home Health & Hospice (EHAB, C-3-9, $7.28)

Our PO of $9 is based on 9.2x 2024E Adj EBITDA, a discount to the average multiple we use for POs in the HC Facilities universe. The discount is justified by EHAB's exposure to the home health Medicare rate cuts, its relatively high leverage, and worse operating performance over the last two years. The multiple is below the historical average for the home health sector given the negative reimbursement outlook and much higher leverage vs peers historically.

Upside risks to our PO are: 1) Medicare rate update is much better. 2) labor cost pressures dissipate faster than expected, 3) volume growth is faster than expected, 4) the company deploys capital accretively beyond what's included in the guidance, 5) executes better on offsetting reimbursement headwinds. 6) Headwind from Medicare Advantage negative mix shift is better than expected.

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 are worse than expected. 5) Headwind from Medicare Advantage negative mix shift is worse than expected.

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	Pediatrix Medical Group, Inc.	MD	MD US	Kevin Fischbeck, CFA

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Hold	83	21.45%	Hold	33	39.76%
Sell	71	18.35%	Sell	25	35.21%

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