

Encompass Health (EHC)

\$66.25 (As of 04/30/20)

Price Target (6-12 Months): **\$70.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/08/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: C

Momentum: B

Summary

Encompass Health Corp.'s earnings of 87 cents per share met the Zacks Consensus Estimate but declined 16.3% year over year, led by a rise in expenses that outdid revenue growth. Shares of the company have performed better than its industry in the past year. Its top line has been consistently increasing since 2010, driven by a rise in revenues from its inpatient rehabilitation plus home health and hospice segment. Ageing population should spur long-term demand for the services provided by the company but should under pressure in the near term due to COVID-19-led uncertainty. It actively pursues mergers and acquisitions to increase market density and build scale in hospice. Nevertheless, uncertainty related to reimbursement, high debt and labor cost are some of the headwinds.

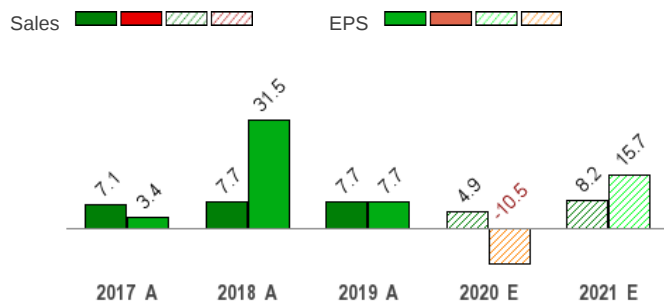
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$83.30 - \$48.01
20 Day Average Volume (sh)	754,225
Market Cap	\$6.5 B
YTD Price Change	-4.4%
Beta	0.86
Dividend / Div Yld	\$1.12 / 1.7%
Industry	Medical - Outpatient and Home Healthcare
Zacks Industry Rank	Top 30% (76 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	-1.7%
EPS F1 Est- 4 week change	-3.7%
Expected Report Date	08/03/2020
Earnings ESP	-18.5%
P/E TTM	17.8
P/E F1	18.9
PEG F1	2.1
P/S TTM	1.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,286 E	1,296 E	1,298 E	1,342 E	5,226 E
2020	1,182 A	1,174 E	1,195 E	1,263 E	4,832 E
2019	1,124 A	1,135 A	1,162 A	1,184 A	4,605 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.05 E	\$1.04 E	\$0.98 E	\$1.06 E	\$4.05 E
2020	\$0.87 A	\$0.78 E	\$0.79 E	\$0.95 E	\$3.50 E
2019	\$1.04 A	\$1.08 A	\$0.93 A	\$0.85 A	\$3.91 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/30/2020. The reports text is as of 05/01/2020.

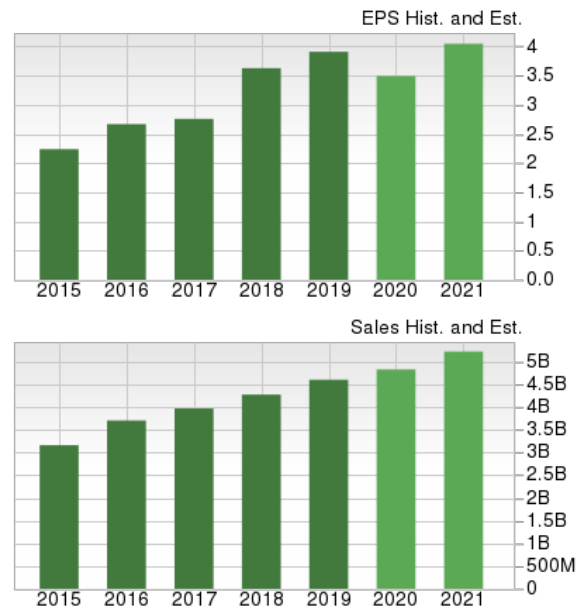
Overview

Encompass Health Corporation is a provider of integrated healthcare services. It offers both facility-based and home-based patient care through its network of inpatient rehabilitation hospitals, home health agencies and hospice agencies. With a national footprint that includes 130 hospitals and 278 home health plus hospice locations across 36 states and Puerto Rico, the company delivers high-quality, cost-effective, integrated care in the healthcare space. It provides a continuum of facility-based and home-based post-acute services for its patients and their families, which will gain more prevalence as coordinated care and integrated delivery payment models, such as accountable care organizations and bundled payment arrangements.

The company operates through two segments: Inpatient Rehabilitation as well as Home Health and Hospice business

The company's **Inpatient Rehabilitation** hospitals (78% of 2019 revenues) offer specialized rehabilitative care over a wide array of diagnoses and deliver comprehensive, high-quality, cost-effective patient care services. The company provides specialized rehabilitative treatment on both inpatient and outpatient basis. It operates hospitals in 32 states and Puerto Rico with concentrations on the eastern half of the United States and Texas. As of Dec 31, 2018, the company runs 130 inpatient rehabilitation hospitals including one operating as a joint venture. In addition to its hospitals, the company regulates five inpatient rehabilitation units via management contracts.

The company's **Home Health and Hospice** (22%) business is the nation's fourth largest provider of Medicare-certified skilled home health services in terms of revenues. It operates home health and hospice agencies in 30 states focusing on the Southeast and Texas. The company acquired a significant portion of its home health and hospice business when it purchased EHHI Holdings, Inc. ("EHHI") on Dec 31, 2014. This segment provides a range of Medicare-certified home care services, which comprise skilled nursing, physical, occupational and speech therapy, medical social work plus home health aide services.



Reasons To Buy:

- ▲ **Acquisitions:** The company's mergers and acquisition strategy is aimed to increase market density, increase overlap with the company's in-patient rehabilitation facilities (IRFs) and build scale in hospice. The buyout of Alacare Home Health & Hospice fits the bill here. This deal expands Encompass Health's services into new markets and complements three markets in which it has existing IRFs in Alabama. It will also make Encompass Health one of the country's top 10 largest hospice providers based on Medicare reimbursements. The company aims to address demand for facility-based and home-based post-acute care services in markets where it is not currently present by constructing or acquiring new hospitals and purchasing or opening home health and hospice agencies in those extremely fragmented industries. We thus believe, the company's acquisition strategy will continue to fuel inorganic growth.
- ▲ **Sound Debt Position:** The company's primary sources of liquidity are cash in hand, cash flow from operations and borrowings under its revolving credit facility. As of Mar 31, 2020, the company had approximately \$105 million in cash and nearly \$613 million available to it under its \$1 billion revolving credit facility. The company does not face any near-term refinancing risk as the amounts outstanding under its credit agreement do not mature until 2024 and its bonds all mature in 2023 and beyond. The company's leverage ratio at the end of the first quarter of 2020 was 3.5X
- ▲ **Share Price Performance:** The stock has outperformed its industry in a year's time. Given the company's strong fundamentals it is expected to further gain.

Increasing revenues, inorganic growth via mergers and acquisitions and consistent cash flow generation should aid the company.

Reasons To Sell:

- ▼ **Reduced Availability of Personal Protective Equipment (PPE):** The increased utilization of PPE resulting from COVID-19 pandemic created supply-chain challenges for the company. It experienced reduced allocations of PPE from primary suppliers and this prompted the company to find alternative suppliers, paying premium prices that are as much as 15X of its normal pricing and managing through limited visibility into production schedules and shipment status. The company believes that production capacity, both domestically and internationally, is increasing but supply disruptions including elevated costs persist for at least next several weeks, which might drain EBITDA.
- ▼ **Business Growth Uncertainty due to COVID-19:** Beginning March, the company experienced lower volumes and higher operating expenses related to the COVID-19 pandemic. These lower volumes are expected to continue in the near term, which will weigh on overall earnings. Also, given the rapidly-changing operating conditions on account of the COVID-19 pandemic, the company cannot accurately estimate the impact the plaguing health peril may have on its full-year financial results. As a result, it withdrew its 2020 guidance and five-year growth targets.
- ▼ **Uncertainty Relating to Reimbursement:** Patient-Driven Groupings Model (PDGM) will dramatically change home health reimbursement beginning January 2020 and will require the company to evolve into a value-driven, patient-centered provider, which will be able to deliver quality care in today's rapidly-changing healthcare landscape and beyond. PDGM adds a significant change to the home health industry and agency leaders must gear up for managing the changes necessary to a successful transition.
- ▼ **High Labor Cost:** Salaries and benefits forming nearly 60-65% of the company's total cost are on a rise for the past many years. The company is witnessing an escalation in labor costs, which is outpacing general inflation rate growth. To address this challenge, the company will continue focusing on maintaining the competitiveness of its compensation and benefit programs and improving its recruitment, retention and productivity. Shortages of nurses and other medical personnel including therapists may from time to time require the company to ramp up usage of more expensive temporary personnel, generally called contract labor. Labor supply scarcity is an acute problem hounding the healthcare companies and an elevation in this cost will exert pressure on the margins.
- ▼ **Suspension of Share Buyback:** In an effort to enhance its operational and financial flexibility, in the face of the COVID-19-induced business uncertainty, the company deferred its share buyback plans. The suspension of share repurchases will affect the bottom line.

Uncertainty relating to reimbursement, high debt and increasing labor cost are some of the headwinds facing the company.

Last Earnings Report

Encompass Health Q1 Earnings Meet & Revenues Miss

Encompass Health Corp.'s earnings of 87 cents per share met the Zacks Consensus Estimate but declined 16.3% year over year.

This year-over-year downside was because of a rise in expenses that outpaced the uptick in revenues.

Revenues of \$1.18 billion missed the Zacks Consensus Estimate by 1.69% but grew 5.2% year over year. Top-line growth was driven by volume and pricing growth in the inpatient rehabilitation segment and volume growth in the home health and hospice segment.

Adjusted EBITDA of \$228 million was down 6.1% year over year.

Segment Results

Inpatient rehabilitation segment's revenues of \$909.2 million were up 4.5% year over year, driven by 5% higher revenues from Inpatient business, partly offset by 14.7% decline in revenues from Outpatient and other business.

Adjusted EBITDA of \$215.5 million decreased 6.3% year over year due to revenue growth.

Home Health and Hospice segment's revenues of \$272.8 million were up 7.4% year over year, driven by a respective increase of 2.4% and 39.5% in the Home Health and Hospice sub-segments.

Adjusted EBITDA of \$41 million was down 11.4% year over year due to lower reimbursement rates under PDGM, increased salaries, and wages and higher administrative costs.

2020 Guidance Update

Given the fast-shifting operating conditions post the COVID-19 pandemic outbreak, the company cannot precisely estimate the effects that the health hazard may have on its full-year financial results. As a result, the company withdrew its 2020 guidance and five-year growth targets.

Financial Update

During the quarter, free cash flow of \$74.6 million declined 41.6% year over year.

As of Mar 31, 2020, the company had almost \$105 million in cash and roughly \$613 million available to it under its \$1 billion revolving credit facility. It does not face any near-term refinancing risk as the amounts outstanding under its credit agreement do not mature until 2024 and its bonds all mature in 2023 and beyond. The company's leverage ratio at the end of the first quarter of 2020 was 3.5X.

Quarter Ending 03/2020

Report Date	Apr 28, 2020
Sales Surprise	-1.69%
EPS Surprise	0.00%
Quarterly EPS	0.87
Annual EPS (TTM)	3.73

Recent News

Encompass Health and Shannon Health to Form Joint Venture - Jan 8, 2020

Encompass Health and San Angelo has announced plans to form a joint venture for a new, 40-bed, freestanding inpatient rehabilitation hospital in San Angelo, Texas.

Valuation

Encompass Health shares are down 7.9% in the year-to-date period but up 1.17% the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Medical sector are down 3.4% and 4.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry are down 0.6% but the sector is up 0.4%.

The S&P 500 index is down 9.6% in the year-to-date period and down 0.4% in the past year.

The stock is currently trading at 17.7X forward 12-month earnings, which compares to 21.83X for the Zacks sub-industry, 21.72X for the Zacks sector and 20.71X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.44X and as low as 12.26X, with a 5-year median of 16.42X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$70 price target reflects 18.59X forward earnings.

The table below shows summary valuation data for EHC

Valuation Multiples - EHC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.7	21.83	21.72	20.71
	5-Year High	22.44	21.83	21.72	20.71
	5-Year Low	12.26	14.49	15.81	15.18
	5-Year Median	16.4	17.6	18.72	17.44
P/S F12M	Current	1.24	2.04	2.44	2.75
	5-Year High	1.84	2.45	3.84	3.43
	5-Year Low	0.78	0.71	2.44	2.54
	5-Year Median	1.24	1	2.97	3
P/B TTM	Current	3.64	2.77	3.36	3.42
	5-Year High	6.55	3.88	5.05	4.55
	5-Year Low	2.88	1.91	2.84	2.85
	5-Year Median	4.1	2.47	4.3	3.63

As of 04/30/2020

Industry Analysis Zacks Industry Rank: Top 30% (76 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
The Ensign Group, Inc. (ENSG)	Outperform	1
Amedisys, Inc. (AMED)	Neutral	2
American Renal Associates Holdings, Inc (ARA)	Neutral	3
Chemed Corporation (CHE)	Neutral	2
Quest Diagnostics Incorporated (DGX)	Neutral	3
Elanco Animal Health Incorporated (ELAN)	Neutral	3
Hanger Inc. (HNGR)	Neutral	3
RadNet, Inc. (RDNT)	Neutral	3

Industry Comparison Industry: Medical - Outpatient And Home Healthcare				Industry Peers		
	EHC	X Industry	S&P 500	CHE	ELAN	ENSG
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Outperform
Zacks Rank (Short Term)	3	-	-	2	3	1
VGM Score	B	-	-	B	D	A
Market Cap	6.52 B	701.50 M	20.61 B	6.61 B	9.85 B	2.01 B
# of Analysts	9	3	14	2	7	3
Dividend Yield	1.69%	0.00%	2.11%	0.31%	0.00%	0.53%
Value Score	C	-	-	C	D	B
Cash/Price	0.02	0.03	0.06	0.00	0.04	0.04
EV/EBITDA	10.19	11.64	11.87	21.76	25.09	17.56
PEG Ratio	2.08	2.58	2.47	2.58	1.93	0.98
Price/Book (P/B)	3.86	2.84	2.67	9.18	1.66	3.04
Price/Cash Flow (P/CF)	10.65	12.56	10.66	24.16	13.01	11.83
P/E (F1)	18.39	26.96	19.01	25.35	24.92	14.69
Price/Sales (P/S)	1.40	1.44	2.10	3.32	3.21	0.88
Earnings Yield	5.28%	2.80%	5.05%	3.94%	4.01%	6.82%
Debt/Equity	1.93	0.46	0.72	0.24	0.42	1.98
Cash Flow (\$/share)	6.22	1.90	7.01	17.24	1.90	3.16
Growth Score	C	-	-	A	D	A
Hist. EPS Growth (3-5 yrs)	16.11%	12.31%	10.88%	20.43%	NA	14.58%
Proj. EPS Growth (F1/F0)	-10.60%	1.38%	-7.32%	17.78%	-6.47%	13.69%
Curr. Cash Flow Growth	8.30%	6.12%	5.92%	14.93%	-2.65%	18.22%
Hist. Cash Flow Growth (3-5 yrs)	13.00%	13.00%	8.55%	14.21%	NA	16.88%
Current Ratio	1.05	1.38	1.23	0.73	2.90	1.20
Debt/Capital	67.44%	46.53%	43.84%	19.56%	29.58%	66.44%
Net Margin	7.36%	2.93%	11.08%	11.60%	2.21%	4.84%
Return on Equity	22.49%	14.15%	16.44%	36.13%	7.33%	17.32%
Sales/Assets	0.77	0.97	0.54	1.66	0.35	0.99
Proj. Sales Growth (F1/F0)	4.93%	0.00%	-1.42%	8.78%	-3.08%	4.59%
Momentum Score	B	-	-	D	C	A
Daily Price Chg	-4.28%	-2.20%	-2.39%	-5.09%	-0.88%	-8.20%
1 Week Price Chg	-4.74%	-0.51%	-1.74%	1.12%	-1.81%	-2.28%
4 Week Price Chg	6.70%	17.07%	17.07%	-2.61%	18.97%	16.47%
12 Week Price Chg	-16.97%	-16.07%	-18.53%	-14.55%	-22.00%	-28.28%
52 Week Price Chg	4.63%	9.09%	-9.82%	27.52%	-21.21%	-26.36%
20 Day Average Volume	754,225	161,014	2,641,413	116,746	2,758,288	403,582
(F1) EPS Est 1 week change	-2.36%	0.00%	0.00%	-1.57%	0.00%	0.00%
(F1) EPS Est 4 week change	-3.73%	-2.82%	-6.62%	-0.15%	-4.67%	0.00%
(F1) EPS Est 12 week change	-5.53%	-11.28%	-13.28%	4.08%	-12.26%	13.11%
(Q1) EPS Est Mthly Chg	-15.99%	-9.80%	-11.97%	-6.77%	-9.80%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	B
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.