

Encompass Health (EHC)

\$69.15 (As of 01/03/20)

Price Target (6-12 Months): **\$73.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/08/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: B

Growth: C

Momentum: B

Summary

We are initiating coverage on Encompass Health with a Neutral recommendation. The stock has outperformed its industry in the past year. The company's top line has been consistently increasing since 2010, driven by rise in revenues from its inpatient rehabilitation plus home health and hospice segment. Aging population aging should spur long-term demand for the services provided by the company. It actively pursues mergers and acquisitions to increase market density and build scale in hospice. This strategy should drive inorganic growth. Its profitable operations generate steady operating cash flow, which enables capacity expansion, debt repayment, dividend disbursement and share buybacks. Nevertheless, uncertainty relating to reimbursement, high debt and high labor cost are some of the headwinds.

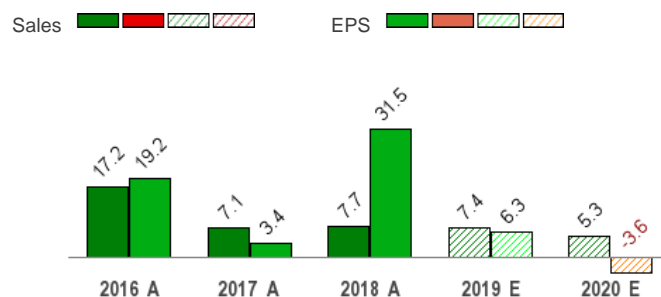
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$72.94 - \$56.74
20 Day Average Volume (sh)	441,338
Market Cap	\$6.8 B
YTD Price Change	-0.1%
Beta	0.82
Dividend / Div Yld	\$1.12 / 1.6%
Industry	Medical - Outpatient and Home Healthcare
Zacks Industry Rank	Top 9% (23 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	4.5%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/06/2020
Earnings ESP	0.0%
P/E TTM	18.0
P/E F1	18.6
PEG F1	2.1
P/S TTM	1.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,196 E	1,204 E	1,206 E	1,232 E	4,838 E
2019	1,124 A	1,135 A	1,162 A	1,173 E	4,593 E
2018	1,046 A	1,068 A	1,068 A	1,096 A	4,277 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.94 E	\$0.97 E	\$0.90 E	\$0.92 E	\$3.72 E
2019	\$1.04 A	\$1.08 A	\$0.93 A	\$0.82 E	\$3.86 E
2018	\$0.93 A	\$0.99 A	\$0.91 A	\$0.80 A	\$3.63 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 01/03/2020. The reports text is as of 01/06/2020.

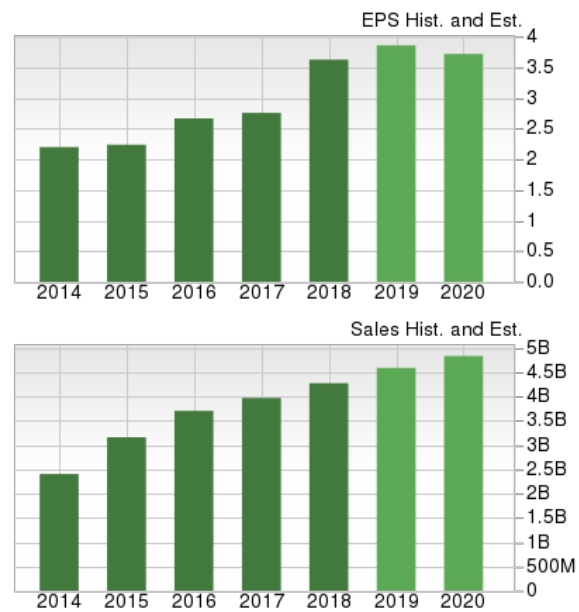
Overview

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 2018 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:

▲ **Rising Topline:** The company's top line has been consistently increasing since 2010, driven by rise in revenues from its inpatient rehabilitation plus home health and hospice segment. Its revenues witnessed a CAGR of 12.6% from 2010 to 2018. Demographic trends, such as population aging should spur long-term demand for the services provided by the company. While it treats patients of all ages, most patients are of 65 years and older, and the number of Medicare enrollees are expected to grow approximately 3% per year for the foreseeable future. This demographic trend will fuel demand for the company's services and aid revenue growth.

▲ **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.

▲ **Consistent Cash Flow Generation:** The company's profitable operations led to a steady operating cash flow generation over the past many years. Net cash provided by operating activities witnessed a CAGR of 13.5% from 2014 to 2018. Strong cash flow generation enables capacity expansions, debt repayment, dividend disbursement and share buybacks.

Reasons To Sell:

- ▼ **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 Debt:** The company's debt to equity of 222.43% is way higher than 116.6% for the industry. Also, its times interest earned ratio of 4.4 is lower than 4.8 for the industry. A higher-than-average leverage level and lower-than-average debt servicing capability induces financial risk.
 - ▼ **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.
-

Last Earnings Report

Encompass Health Q3 Earnings & Revenues Beat

Encompass Health Corp.'s third-quarter 2019 earnings of 93 cents per share surpassed the Zacks Consensus Estimate by 4.5% and also inched up 2.2% year over year.

Better-than-expected results were driven by strong volume and revenue growth at both its segments: Inpatient Rehabilitation plus Home Health and Hospice.

Revenues of \$1.2 billion beat the Zacks Consensus Estimate by 0.6% and also grew 8.4% 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 \$231.6 million was up 3.3% year over year.

Segment Results

Inpatient rehabilitation segment's revenues of \$872.3 million were up 5.7% year over year, driven by 6.5% growth in revenues from Inpatient business, partially offset by 20.2% decline in revenues from Outpatient and other business.

Adjusted EBITDA of \$210.6 million dipped 1.1% year over year due to higher salaries and benefit expense.

Inpatient rehabilitation segment's revenues of \$289.3 million were up 19.5% year over year, driven by a respective increase of 14.2% and 53.7% in the Home Health and Hospice sub-segments.

Adjusted EBITDA of \$50.8 million was up 17.6% year over year owing to revenue growth and improvements in caregiver optimization and productivity in home health, partially offset by expenses related to the integration of Alacare.

Share Repurchase and Dividend Payment

During the third quarter of 2019, the company bought back shares worth approximately \$2 million. It also paid out a quarterly dividend of 27 cents per share.

2019 Guidance Update

The company expects net operating revenues between \$4.5 billion and \$4.6 billion, adjusted EBITDA in the range of \$940-\$960 million and adjusted earnings per share between \$3.71 and \$3.85.

Quarter Ending **09/2019**

Report Date	Oct 28, 2019
Sales Surprise	0.57%
EPS Surprise	4.49%
Quarterly EPS	0.93
Annual EPS (TTM)	3.85

Valuation

Encompass Health shares are up 9.5% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry are down 19.2% but the Zacks Medical sector is up 5.8%.

The S&P 500 index is up 25.4% in the past year.

The stock is currently trading at 18.55X forward 12-month price to earnings, which compares to 20.08X for the Zacks sub-industry, 21.31X for the Zacks sector and 18.71X 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 16.46X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$73 price target reflects 19.57X forward 12-month earnings.

The table below shows summary valuation data for EHC

Industry Analysis Zacks Industry Rank: Top 9% (23 out of 252)



Top Peers

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

Industry Comparison Industry: Medical - Outpatient And Home Healthcare				Industry Peers		
	EHC Neutral	X Industry	S&P 500	CHE Neutral	ELAN Neutral	ENSG Underperform
VGM Score	B	-	-	B	D	A
Market Cap	6.82 B	1.04 B	23.66 B	7.07 B	10.85 B	2.42 B
# of Analysts	8	2	13	2	6	4
Dividend Yield	1.62%	0.00%	1.79%	0.29%	0.00%	0.44%
Value Score	B	-	-	C	D	B
Cash/Price	0.07	0.06	0.04	0.00	0.03	0.02
EV/EBITDA	11.33	12.06	13.88	25.56	29.27	20.18
PEG Ratio	2.10	2.09	1.99	2.55	NA	1.33
Price/Book (P/B)	4.08	3.85	3.36	10.51	1.94	3.44
Price/Cash Flow (P/CF)	12.08	12.50	13.62	29.43	14.62	16.32
P/E (F1)	18.59	28.17	18.74	28.17	24.05	19.96
Price/Sales (P/S)	1.51	1.30	2.67	3.77	3.52	1.07
Earnings Yield	5.38%	2.92%	5.32%	3.55%	4.16%	5.01%
Debt/Equity	1.94	0.48	0.72	0.32	0.43	1.77
Cash Flow (\$/share)	5.72	1.98	6.94	15.00	1.99	2.78
Growth Score	C	-	-	A	D	A
Hist. EPS Growth (3-5 yrs)	15.79%	13.13%	10.56%	19.50%	NA	13.13%
Proj. EPS Growth (F1/F0)	-3.63%	12.22%	7.41%	13.06%	13.43%	3.65%
Curr. Cash Flow Growth	24.32%	20.06%	14.83%	88.71%	9,351.95%	34.15%
Hist. Cash Flow Growth (3-5 yrs)	10.83%	9.79%	9.00%	10.87%	NA	10.03%
Current Ratio	0.97	1.11	1.23	0.67	3.12	1.11
Debt/Capital	67.34%	51.70%	42.92%	23.97%	29.85%	63.86%
Net Margin	7.07%	3.20%	11.08%	11.14%	3.04%	4.84%
Return on Equity	23.89%	16.02%	17.10%	35.06%	7.79%	17.27%
Sales/Assets	0.79	0.91	0.55	1.71	0.35	1.12
Proj. Sales Growth (F1/F0)	5.33%	5.30%	4.20%	10.57%	1.50%	0.36%
Momentum Score	B	-	-	B	B	D
Daily Price Chg	0.01%	0.00%	-0.61%	0.14%	-1.26%	0.67%
1 Week Price Chg	0.40%	0.40%	0.13%	0.69%	1.88%	-2.10%
4 Week Price Chg	-3.00%	1.91%	2.60%	2.00%	7.14%	7.04%
12 Week Price Chg	8.76%	15.27%	8.87%	6.73%	9.60%	15.41%
52 Week Price Chg	14.94%	16.10%	29.34%	66.05%	-6.40%	20.09%
20 Day Average Volume	441,338	90,908	1,603,615	59,972	2,797,140	239,617
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.61%	-0.55%	0.00%
(F1) EPS Est 12 week change	0.57%	0.29%	-0.57%	0.67%	-3.59%	-11.16%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	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	B
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.