

Encompass Health (EHC)

\$57.53 (As of 03/16/20)

Price Target (6-12 Months): **\$61.00**

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: B

Growth: B

Momentum: B

Summary

Shares of Encompass Health have 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. Ageing population 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. The company's profitable operations led to a steady operating cash flow generation over the past many years. Nevertheless, uncertainty related to reimbursement, high debt and labor cost are some of the headwinds.

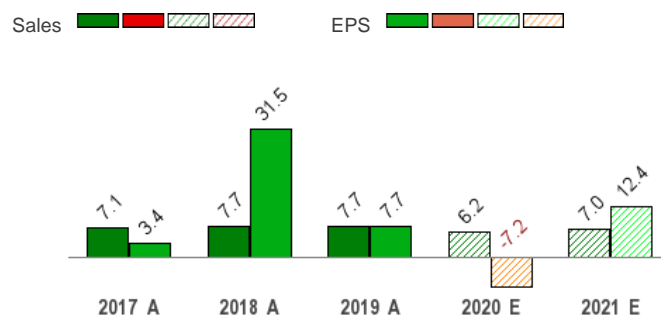
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$83.30 - \$52.01
20 Day Average Volume (sh)	1,017,705
Market Cap	\$5.7 B
YTD Price Change	-17.0%
Beta	0.90
Dividend / Div Yld	\$1.12 / 1.9%
Industry	Medical - Outpatient and Home Healthcare
Zacks Industry Rank	Top 15% (38 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-2.3%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-0.1%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	14.8
P/E F1	15.9
PEG F1	1.8
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,284 E	1,296 E	1,301 E	1,338 E	5,234 E
2020	1,204 E	1,213 E	1,216 E	1,258 E	4,891 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	\$1.04 E	\$1.08 E	\$1.00 E	\$1.05 E	\$4.08 E
2020	\$0.89 E	\$0.93 E	\$0.86 E	\$0.95 E	\$3.63 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 03/16/2020. The reports text is as of 03/17/2020.

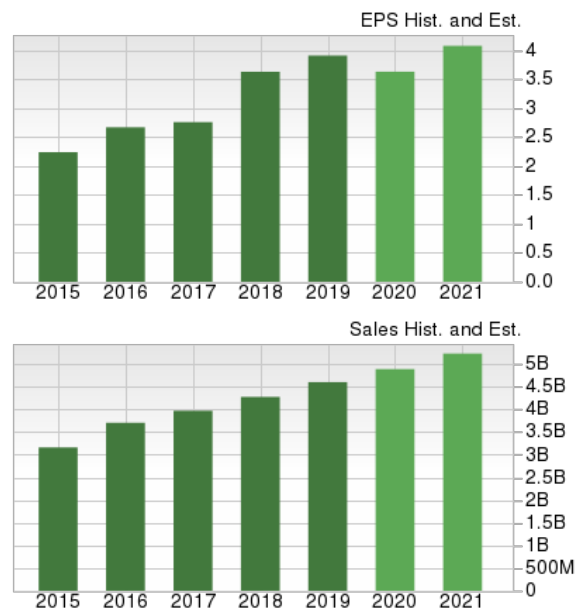
Overview

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:

▲ **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 14.2% from 2014 to 2019. 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.

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

▲ **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 6.7% from 2014 to 2019. 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 198% is way higher than 112% for the industry. Also, its times interest earned ratio of 4.5 is lower than 5.6 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.

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

Last Earnings Report

Encompass Health Q4 Earnings Miss & Revenues Beat

Encompass Health Corp.'s fourth-quarter 2019 earnings of 85 cents per share missed the Zacks Consensus Estimate by 2.3% and also inched up 6.3% year over year.

The upside year-over-year was driven by strong volume and revenue growth at both its segments: Inpatient Rehabilitation plus Home Health and Hospice.

Revenues of \$1.9 billion beat the Zacks Consensus Estimate by 0.6% and also grew 8.02% 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 \$238.2 million was up 7.4% year over year.

Segment Results

Inpatient rehabilitation segment's revenues of \$896.7 million were up 6% year over year, driven by 6.2% growth in revenues from Inpatient business and 1.3% growth in revenues from Outpatient and other business.

Adjusted EBITDA of \$225.1 million increased 6.3% year over year due revenue growth.

Home Health and Hospice segment's revenues of \$287.7 million were up 14.9% year over year, driven by a respective increase of 10% and 45.1% in the Home Health and Hospice sub-segments.

Adjusted EBITDA of \$49.6 million was up 12.5% year over year owing to revenue growth, partially offset by higher support and overhead costs.

2020 Guidance Update

The company expects net operating revenues between \$4.85 billion and \$4.95 billion, adjusted EBITDA in the range of \$935-\$965 million and adjusted earnings per share between \$3.50 and \$3.72.

Quarter Ending **12/2019**

Report Date	Feb 06, 2020
Sales Surprise	-0.14%
EPS Surprise	-2.30%
Quarterly EPS	0.85
Annual EPS (TTM)	3.90

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 6.9% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Medical sector are down 17.9% and 22.5%, respectively.

The S&P 500 index is down 16.5% in the past year.

The stock is currently trading at 15.4X forward 12-month price to earnings, which compares to 15.2X for the Zacks sub-industry, 16.1X for the Zacks sector and 13.8X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.4X and as low as 12.2X, with a 5-year median of 16.4X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$61 price target reflects 16.4X forward 12-month earnings.

The table below shows summary valuation data for EHC

Valuation Multiples - EHC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.44	15.28	16.13	13.88
	5-Year High	22.44	21.46	21.08	19.34
	5-Year Low	12.26	14.49	15.81	13.88
	5-Year Median	16.45	17.61	18.73	17.42
P/S F12M	Current	1.14	1.86	2.19	2.55
	5-Year High	1.84	2.45	3.84	3.43
	5-Year Low	0.78	0.71	2.19	2.54
	5-Year Median	1.24	1	2.96	3
P/B TTM	Current	3.35	2.44	3.59	3.21
	5-Year High	6.6	3.74	5.05	4.55
	5-Year Low	2.88	1.91	3.45	2.85
	5-Year Median	4.11	2.47	4.32	3.63

As of 03/16/2020

Industry Analysis Zacks Industry Rank: Top 15% (38 out of 253)



Top Peers

The Ensign Group, Inc. (ENSG)	Outperform
Amedisys, Inc. (AMED)	Neutral
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

Industry Comparison Industry: Medical - Outpatient And Home Healthcare				Industry Peers		
	EHC Neutral	X Industry	S&P 500	CHE Neutral	ELAN Neutral	ENSG Outperform
VGM Score	B	-	-	C	D	A
Market Cap	5.66 B	529.78 M	16.36 B	5.86 B	7.72 B	1.34 B
# of Analysts	9	2.5	13	2	5	4
Dividend Yield	1.95%	0.00%	2.63%	0.35%	0.00%	0.80%
Value Score	B	-	-	F	C	B
Cash/Price	0.02	0.09	0.06	0.00	0.04	0.05
EV/EBITDA	9.29	9.75	10.54	19.35	20.57	13.92
PEG Ratio	1.77	1.84	1.46	1.94	1.28	0.65
Price/Book (P/B)	3.35	2.27	2.26	8.04	1.30	2.03
Price/Cash Flow (P/CF)	9.25	9.37	8.80	21.17	10.19	7.90
P/E (F1)	15.64	17.78	13.18	22.35	17.32	9.82
Price/Sales (P/S)	1.23	0.94	1.78	3.02	2.51	0.59
Earnings Yield	6.31%	4.76%	7.56%	4.47%	5.79%	10.20%
Debt/Equity	1.93	0.58	0.70	0.24	0.42	1.98
Cash Flow (\$/share)	6.22	1.93	7.01	17.24	1.90	3.16
Growth Score	B	-	-	A	D	B
Hist. EPS Growth (3-5 yrs)	16.11%	12.31%	10.85%	20.43%	NA	14.58%
Proj. EPS Growth (F1/F0)	-7.13%	14.23%	5.72%	17.10%	5.47%	13.62%
Curr. Cash Flow Growth	8.30%	6.70%	6.15%	14.93%	-2.65%	18.22%
Hist. Cash Flow Growth (3-5 yrs)	13.00%	12.35%	8.55%	14.21%	NA	16.88%
Current Ratio	1.05	1.23	1.24	0.73	2.90	1.20
Debt/Capital	67.44%	55.12%	42.57%	19.56%	29.58%	66.44%
Net Margin	7.79%	2.93%	11.64%	11.35%	2.21%	4.84%
Return on Equity	23.68%	13.50%	16.74%	35.38%	7.33%	17.32%
Sales/Assets	0.77	0.87	0.54	1.66	0.35	0.99
Proj. Sales Growth (F1/F0)	6.21%	5.32%	3.50%	10.59%	0.34%	5.29%
Momentum Score	B	-	-	D	C	A
Daily Price Chg	-9.98%	-11.98%	-12.67%	-13.23%	-13.69%	-20.39%
1 Week Price Chg	-17.28%	-13.28%	-11.01%	-3.30%	-11.66%	-31.12%
4 Week Price Chg	-30.36%	-35.14%	-32.63%	-25.76%	-37.51%	-52.04%
12 Week Price Chg	-17.25%	-33.40%	-30.17%	-16.30%	-33.40%	-44.18%
52 Week Price Chg	-4.42%	-14.24%	-23.26%	11.03%	-38.81%	-50.95%
20 Day Average Volume	1,017,705	164,138	3,457,426	159,285	6,922,258	486,547
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.11%	-0.11%	-0.48%	4.24%	-1.06%	3.14%
(F1) EPS Est 12 week change	-2.48%	-1.56%	-0.93%	4.24%	-8.11%	13.03%
(Q1) EPS Est Mthly Chg	-0.70%	0.00%	-0.60%	3.55%	4.17%	0.00%

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	B
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.

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