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Enhabit Home Health & Hospice

Q3 2024 Earnings Call

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CORPORATE SPEAKERS:

Jobie Williams

Enhabit Inc.; Senior Vice President of Strategic Finance, Treasurer

Barb Jacobsmeyer

Enhabit Inc.; President, Chief Executive Officer

Crissy Carlisle

Enhabit Inc.; Chief Financial Officer

PARTICIPANTS:

Brian Tanquilut

Jefferies; Analyst

A.J. Rice

UBS; Analyst

Ryan Langston

TD Cowen

PRESENTATION:

Operator^ Good morning everyone and welcome to Enhabit Home Health and Hospices Third Quarter 2024 Earnings Conference Call. At this time, I'd like to inform all participants that their line will be in a listen only mode. (Operator Instructions)

Today's conference call is being recorded. If you have any objections, you may disconnect at this time. I will now turn the call over to Jobie Williams and Habit, Senior Vice President and Treasurer.

Jobie Williams^ Thank you, Operator, and good morning everyone. Thank you for joining our call today. With me on the call is Barb Jacobsmeyer, President and Chief Executive Officer and Crissy Carlisle, Chief Financial Officer.

Before we begin, if you do not already have a copy, the third quarter earnings release supplemental information and related Form 8K filed with the SEC are available on our website at investors.ehab.com. On page two of the supplemental information you will find the Safe Harbor statements which are also set forth on the last page of the

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earnings release. During the call we will make forward looking statements which are subject to risks and uncertainties, many of which are beyond our control.

Certain risks and uncertainties that could cause actual results to differ materially from our projections, estimates and expectations are discussed in our SEC filings, including our annual report on Form 10K which are available on our website. We encourage you to read them. You are cautioned not to place undue reliance on the estimates, projections, guidance and other forward looking information presented which are based on current estimates of future events and speak only as of today. We do not undertake a duty to update these forward looking statements.

Our supplemental information and discussions on this call will include certain non GAAP financial measures. For such measures, reconciliation to the most directly comparable GAAP measure is available at the end of the supplemental information and the earnings release. With that, I'll turn the call over to Barb.

Barb Jacobsmeyer^ Thanks, Jobie.

Good morning and thanks for joining us. Quarter three 2024 marks our fourth sequential quarter demonstrating the success of our volume growth strategies. At the start of this year we laid out our 2024 priorities and I want to provide an update on the status of those and the ongoing and new initiatives to return our business to revenue growth and improve our profitability and margins. We are pleased with the continued progress of our hospice segment and anticipate continued growth. Our priority has been on growing census and gaining operating leverage against the fixed cost structure associated with the case management staffing model.

Our average daily census continues its sequential growth each month since January 2024. In the third quarter, our average daily census increased 6.9% year over year. Completing the transition of all branches to our centralized admission departments this year with the focus on timely responses to our referral sources has been successful as evident with both our increased admissions and an increase in our referral conversion rate from 74.2% last year to 77.4% this year. The flat cost per day year over year is the outcome we expected as our increased census offset the fixed costs that were added in 2023 to implement our case management model. The build out of our business

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development teams and their local strategies are finding the right balance of referral sources to increase admissions to Enhabit and grow our average daily census.

Our case management model and our use of technology ensures we are there throughout the patient's length of hospice stay and present when they need us most, as evidenced by our visits in the last days of life, which are 53.2% higher than the national average.

For our home health segment, we are pleased with the progress of our team's successful use of pulse to manage our just right care plan. Use of pulse allowed us to be more efficient with Medicare visits per episode, declining from 14.9 to 14.4 from the same period a year ago. Thus increasing revenue per visit.

In addition, leveraging predictive analytics bolsters our ability to deliver a better way to care for patients in a more efficient manner without compromising patient outcomes. This improves the utilization supported strong admission growth in the quarter of 5.6% versus the 1.6% last year. The ability to utilize these additional visits for starts of care for new patients is a continued focus for our branch leaders.

Medicare fee for service has stabilized at 44% of our home health admissions over the past three quarters. Growing Medicare fee for service continues to be a top priority for our leadership team. While we saw sequential decline in fee for service admissions, we continue to see improvement in trends. Fee for service admissions declined 2.5% from quarter two to quarter three compared to a 4.7% sequential decline in 2023. Half of our branches had sequential improvement in quarter three over quarter two.

We continue to focus on deploying best practices utilized by these branches to all of our branches in an effort to retain and grow our fee for service Medicare volume. We are actively evaluating consolidation or closure of branches that we believe will not reverse their fee for service Medicare decline and that are not producing acceptable returns for our shareholders. I will discuss this more later in the call.

Our payor innovation strategy continues to foster non-Medicare growth. Non-Medicare admissions grew 20.1%, driving total admissions growth of 5.6% year over year. In the third quarter of 2023, 19% of our-non Medicare business were in payor innovation

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contracts. That rate grew to 45% in the third quarter of 2024. In the third quarter of last year, 63% of admissions were in combined Medicare fee for service and payor innovation contracts. In the third quarter of this year, the percent of our admissions in Medicare fee for service and payor innovation contracts has grown to 73%. Considering our termination notice with United, we expect the shift of payor innovation contracts may accelerate.

I would like to provide an update on negotiations with UnitedHealthcare. We have maintained an ongoing dialogue with United and have (technical difficulty) focused the conversation on the value of care that we provide them and their members. While we have not yet executed an agreement, we have made significant progress on aligning terms with United that would be acceptable to us. Until we have an executed agreement, we will maintain our strategy of replacing United Census.

We are on track with our plan to replace this volume. And in fact, since giving notice on August 1 through October, our total payor home health census across all payor types grew by 884. While our United Patient census declined 1,022. Our teams are doing a great job replacing these admissions with payors that recognize our strong clinical value. Our conversations with many of our other payors reinforce that their focus is on timely access to high-quality home health providers in order to manage their overall costs.

Despite all these positive trends related to admissions and growing our payor innovation contracts during the third quarter, our home health segment continued to see a decline in recertifications. Several factors contributed to the decline but the primary drivers were an increase in admissions from acute care facilities with shorter predictable length of stay and the ongoing payor mix change within congregate living settings.

The latter is particularly impactful because admissions in those settings typically recertify at a higher rate due to the combined effects of their age, chronic illness burden, and functional impairment levels. We have already begun to mitigate these challenges and are focused on expanding and diversifying sources of referrals.

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In regards to the final home health rule, CMS finalized a permanent adjustment cut that will result in a negative 1.8% impact offset by a positive market basket update of 3.2%. After productivity adjustments and fixed dollar loss ratio adjustments, the result is a 0.5% increase versus the proposed negative 1.7%. The continued cuts to home health reimbursement are destabilizing the home health landscape and are detrimental to larger policy goals of providing equitable, high quality health care to seniors in their homes.

On the advocacy front, the alliance for Care at Home, formerly Max, the National Association for Home Care and Hospice and PQHA, the partnership for quality home health care have continued to work with our congressional allies on relief to include in a legislative vehicle. We remain actively engaged with our trade associations and the industry on these advocacy efforts.

While other health care sectors are repeatedly receiving meaningful positive annual payment updates, this is the third straight year where the CMF home health rule establishes rates that fail to keep up with inflation and instead present a significant headwind to revenue growth. This reality means we have to make some difficult decisions. Given the current pricing environment and mix shift we have experienced, we have undertaken a more exhaustive review of all of our home health and hospice branches.

While the operational performance review of each of our home health and hospice branches occurs on an ongoing basis, our current review has indicated that we should take steps to consolidate or close approximately 8 to 10 underperforming branches by early 2025. For branches that we do not close, that are not performing as well as we expect, we will further remediate their underperformance with additional corrective actions.

We will have more details on the number of branches and profit enhancement measures undertaken in the remaining locations along with the anticipated impact the 2025 EBITDA on our quarter four earnings call. With our focus on profitable revenue growth, we continue to strategically invest in our de novo strategy. This strategy complements our organic growth strategy in both segments and allows us to enter a new market at a low capital cost.

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We do a thorough analysis of markets including Medicare CAGR, Medicare Advantage penetration, and access to clinical labor as we prioritize our de novo locations.

In addition to the three de novo locations already open this year, we currently have three locations awaiting CMS approval and nine additional active projects. The EBITDA from the de novos that were open in 2022 and 2023 is funding the 2024 de novo projects year-to-date.

Before I turn it over to Crissy, I want to thank our teams for their heroic efforts and teamwork, serving our patients and supporting each other during Hurricane Helene and Milton. Twenty-nine of our home health branches were impacted by Hurricane Helene and 21 were impacted by Hurricane Milton with 12 of those branches impacted by both. We will discuss the financial impact of these hurricanes more during our guidance update. Although the hurricanes did impact us financially as well as impacting our teams personally, I am glad to report that all of the affected branches are back to serving patients in the affected areas.

And now I will hand it over to Crissy.

Crissy Carlisle^ Thanks, Barb.

Consolidated net revenue was \$253.6 million for the third quarter down \$4.7 million or 1.8% year over year. Consolidated adjusted EBITDA was \$24.5 million up \$1.3 million or 5.6% year over year.

In our home health segment, our payor innovation strategy continues to foster non-Medicare growth. Non-Medicare admissions grew 20.1% driving total admissions growth of 5.6% year over year with 5.5% growth on a same store basis. Forty-five percent of non-Medicare visits are now in payor innovation contracts at improved rates.

As Barb discussed, while our emissions are growing, our recertifications are declining. This decline in recertifications was the primary driver of the \$9.9 million or 4.7% decrease in home health revenue year over year. As Barb mentioned, we have taken steps to remediate this issue.

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We also had a modest \$1 million net increase to our home health revenue reserves during the quarter, which negatively impacted revenue and adjusted EBITDA. We are pleased with the progress we've made with our revenue cycle management and while no assurances can be provided, we expect our cash collection trend to continue to improve and result in a decrease in our reserve rate over time.

Home health adjusted EBITDA decreased \$5.3 million or 12.7% year over year primarily due to the decrease in revenue. Cost per visit increased a modest 1.1% on a year-to-date basis, our cost per visit is flat compared to the prior year.

In our hospice segment, revenue increased \$5.2 million or 11% year over year due to an increase in patient days and increased Medicare reimbursement rates. We have grown our census every month since January 2024 with our average daily census increasing 6.9% in Q3 compared to the prior year with 5% growth on a same store basis.

Hospice suggested EBITDA increased \$2.3 million or 29.9% year over year primarily due to the increased revenue. Cost per day was flat year over year as we gained operating leverage against our fixed cost structure with increased volumes. We continue to expect patient volumes to increase without the need to hire a significant number of additional staff.

Our home office general and administrative expenses decreased \$4.3 million year over year to 8.7% of consolidated revenue primarily due to lower incentive compensation and the cost control initiatives we undertook in the second half of 2023 and throughout 2024.

Now, I'll turn it over to Jobie to discuss the balance sheet.

Jobie Williams^ We have focused this year on accelerating cash and paying down debt and our success can be seen in our results. Our leverage decreased for the third quarter in a row. We ended the third quarter with a leverage ratio of 4.8 times.

Our cash balance at the end of September, a component of the ratio benefited by approximately \$18 million from the timing of payroll. In September, we paid down \$10

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million of debt including a voluntary \$5 million payment to reduce the outstanding balance of our revolving credit facility. And due to the continued strong cash flow, we made an additional \$5 million voluntary payment on our revolving credit facility in October.

This year end, our available liquidity has grown from approximately \$61 million to approximately \$94 million which we believe is adequate to support our operations including our de novo strategy.

Our free cash flow remained strong. For the year-to-date through September, we generated approximately \$59 million of free cash flow. A free cash flow conversion rate of 79%. Adjusted free cash flow in the year-to-date period of 2024 benefited from working capital changes primarily around accounts receivable and the timing of payroll. Our free cash flow conversion target for the full year remains at approximately 50%.

I now turn it back to the Barb.

Barb Jacobsmeyer^ The devastation caused by Hurricane Helene began impacting our volumes the last week of September and continued impacting volumes well into October. We estimate we lost 125 to 150 admissions in the last week of September, which would have made our quarter three 2024 admission growth 5.9% year over year.

While the timing of these lost admissions had minimal impact on revenue in the third quarter, it resulted in a lower census entering October. The landfall of Hurricane Milton during the month of October put further pressure on our home health census through lost admissions.

In October, we estimate we lost an additional 425 to 450 admissions from the impacts of both hurricanes. Our admission volumes are dependent on referral sources and patients returning to the impacted areas as well as doctors being able to reschedule procedures. All in, we estimate the hurricanes will negatively impact our fourth quarter revenue and adjusted EBITDA by approximately \$2 million.

Based on the impact of lower recertifications in the third quarter and the impact from the hurricanes, we revised our guidance ranges for full year 2024. Our outlook for net

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service revenue is now \$1,031 million to \$1,046 million. And our outlook for adjusted EBITDA is now \$98 million to \$102 million. We expect to generate \$47 million to \$55 million of free cash flow in 2024 as the full year normalizes for the impact of working capital changes in the third quarter.

I want to now turn to some of our plans to reignite revenue growth including some favorable trends in the environment. I will summarize actions either completed or in process that we expect will increase our profitability and margin profile going forward.

Regarding revenue growth, we are seeing several positive trends within our space that should be tailwinds for revenue. Approximately 20% of our revenue comes from hospice and effective October 1, we received an approximate 4% increase to our reimbursement rates for this revenue base. Using our current census, we estimate this increase is worth approximately \$8 million annually.

Based on current trends and results from our investment in the case management model and the buildout of our business development team, we currently expect hospice volumes and revenues to grow at a mid to high single digits in 2025. Within home health, based on the final rule and the industry impact of the 0.5% net payment increase, we estimate our Medicare revenue base will increase by approximately \$2 million to \$3 million annually. Our analysis of the specific impact to Enhabit is underway.

As I mentioned earlier, our payor innovation strategy and shift of our patient census from lower paying Medicare Advantage contracts to higher paying contracts is beginning to build a solid foundation for revenue growth.

In regards to home health volume, when we consider demographic trends, our payor innovation strategy, our clinical capacity, and the ability to continue to manage visits per episode as experienced in our 2024 trends, we expect to continue to grow home health admissions at a mid to high single digit growth factor. Based on admissions and census growth, Medicare pricing and continued shift to better paying Medicare Advantage plans are targeted to grow home health revenues by low to mid-single digits in 2025.

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In addition to growing our revenue and related earnings through organic revenue growth, we are also focused on streamlining and reducing our current cost structure. Specifically, we have implemented several key profit improvement initiatives throughout the third quarter. We restructured our care management department and made changes to our regional leadership structure that in combination with restructuring changes implemented in the first half of 2024 we expect will result in annual savings of approximately \$3 million with the full benefit being realized in 2025.

In addition, after the completion and positive results from a piloted outsourcing our coding functions, we will move all branches off our centralized coding platform to this outside resource by the end of the first quarter of 2025. We expect this to result in an additional annual savings of approximately \$2 million with approximately \$1.5 million realized in 2025.

Identifying opportunities like these are critical as we face another year of price pressure from CMS. While we are not prepared to quantify the impact at this time, we continue to evaluate ways to use technology and AI to reduce inefficient and redundant tasks and believe more enhancements will happen in 2025.

And as I mentioned earlier, we are actively evaluating closing or consolidating eight to 10 branches and improving the profitability of the remaining lower performing branches. We expect these actions to drive additional EBITDA and margin improvement in 2025. We expect to summarize the 2025 financial impact of all these actions on our fourth quarter earnings call.

Before I open it up for questions and answers, as announced this morning, we have hired Ryan Solomon as our Chief Financial Officer. Ryan brings over 20 years of experience including CFO experience within and outside our industry. Ryan's experience building finance teams, financial planning, revenue cycle, management, and accounting make him ideally suited for Enhabit's as we advance our position as a leading National Home Health and Hospice provider. Ryan will assume his role on December 9. We're very appreciative of all of Crissy's work to ensure a smooth transition.

And with that, operator, we will open the line for questions.

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Operator^ Thank you.

And we'll now begin the question and answer session. (Operator Instructions) And your first question comes from the line of Brian Tanquilut, Jefferies.

Brian Tanquilut^ Hey, good morning guys.

Maybe Barb first question, I appreciate the comment here in the United situation. So, just to clarify. So no sign agreement, but you sound more positive. So as we think about that, I mean, right now, it sounds like you're strategizing and operating as if that's not signed yet, right? Like that's not going to happen.

So maybe if you can share any qualitative commentary on the progress you're making in terms of shifting capacity to these payor innovation contracts and the success you're seeing there. And then maybe the flip is what is an acceptable agreement for you guys as it relates to United?

Barb Jacobsmeyer^ Sure. Well, I mean, as I mentioned, the good news is we watch census every day and as we have seen our census grow, that has not -- the decline in the United Census of over 1,000 has not impacted the total census. We've seen that actually grow from August 1 when we gave notice through the end of October. So we watch that every day to make sure that there's not a negative impact to that.

The team does continue to work in the field to move the business. But they are consistently being asked by our referral sources, if we're making progress. We do right now tend to only take the patients that we anticipate, have a shorter length of stay. So that there's not the big list in January. Now that all being said, we do feel really good where we are with the negotiations with United. They know that we have to continue this effort because January 31 is not that far away, but I would say that both of us would say that we are very close to coming to terms.

Brian Tanquilut^ Got it. And then maybe just in the comments in 2025 I mean, as I sit here and think about a mid-single digit home health volume outlook that you shared, looking at the hospice rate, Barb, looking at home health with a 50 basis point improvement there from CMS and more patients going through parent innovation

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contracts plus the success you've had with corporate overhead. I mean, so is it correct to think if we build all that up that points to a decent level of EBITDA growth next year? I mean, maybe is that the right way to think about it? And then any headwinds you want to call out that maybe have not describe or called out yet.

Barb Jacobsmeyer^ Sure. So again, obviously, we'll give a lot more detail on our fourth quarter call. But you're right when we look at the hospice pricing now, having a positive while little home health pricing, both of those help us what I would say, the biggest headwind always right is keeping in line with our merit increases to try to remain competitive in our markets. And so, that's the biggest headwind that you -- that we really like to focus on offsetting and we believe that we will be able to do that with those pricing improvements. And so then it really comes down to the G&A savings that I talked about. So between G&A savings and then the growth side of things. Yes, we're confident we'll be able to grow EBITDA in 2025.

Brian Tanquilut^ Awesome. Thanks, Barb.

Operator^ And your next questions comes from the line of A.J. Rice with UBS. Your line is open.

A.J. Rice^ Hi, everybody. On the branch closures, I think you said you were looking at potentially 8 to 10 closures. I wondered if you could give us some parameters around how much revenue that might represent overall. And are those branch closures in areas where you would have another branch that might pick up some of that volume or with those closures, would it pretty much all go away?

Barb Jacobsmeyer^ Yeah. We don't have all the details and we will have those by the time we get to the fourth quarter call because there are some that we would be looking to consolidate versus close. And so, looking at all of that and saying, well, what volume then do we believe we could pull to the consolidated versus the clothes are going to be important details to have as we talk about that impact on emissions revenues, that thing. So we will have all of that by our fourth quarter call.

A.J. Rice^ Okay. And my follow up, I guess on the comments on '25 on the revenue line, those are helpful and obviously that will impact somewhat your margin, how much

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leverage you can get from growing the top line. But you've done well this year and your cost per visit, metrics on both sides of the business, home health and hospice, do you have any early thoughts on what you can do on that metric going forward? Should we assume that it's more of inflationary updates going into next year? Is there any reason to think you can hold the line as you've done this year again next year?

Crissy Carlisle^ Yes. A.J., this is Crissy. I think when you think about 2025 the biggest component of our cost of services is labor. And so I think we still feel comfortable with that 3% wage increase being in reasonable range to help us not only recruit additional staff but to retain our existing staff. And then of course, beyond that, as our volumes grow, you receive that operating leverage. So there would be some offsets there through continued improvements in productivity and optimization.

A.J. Rice^ Okay. So 30% would be the high end and you'd be, through leverage, you could potentially bring it down somewhat.

Crissy Carlisle^ That's right. That's right.

A.J. Rice^ Okay. Thanks.

Operator^ (Operator Instructions) And your next question comes from the line of Ryan Langston, TD Cowen.

Ryan Langston^ Hi, great. First of all, just say thanks Crissy for everything, really appreciate it and enjoyed working with you. I guess on the business development side for hospice, obviously generating pretty positive momentum there through the months. I guess, what tactics are you employing that are driving that success? Is it just strengthening relationships, finding new referral sources? Anything else specifically you would point to?

Barb Jacobsmeyer^ I would say it is a combination. We certainly increased the count of our business development team members so that we can cover more territory. It has been really focusing on using our Trella data to develop the books of business on where our sales team members are spending their time.

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And as we've been talking for a couple of (inaudible) is really about diversifying those referral relationships so that you can manage and have your shorter and longer length of stay and meet all the needs of the hospice patients in the community. So I think the team has done a great job building out that book of business. One of the things that they had heard last year was just that it took us a while to get answers. And so we rolled out the centralized admission departments in each of the regions so that we really had someone focused on only looking at that referral and getting an answer to the referral source. So that they weren't being distracted at the branch level with all the other things that are happening. I think the teams would say that the quickness and response has really also helped their referral sources, see them as a good provider.

Ryan Langston^ Got it. And then just real quick on UNH, I think to Brian's earlier question sounds like you might be a little bit more positive. I guess, I think you said you were down about 1,000 on that particular payor. But if you, I guess, come to an agreement that you're satisfied with -- do you have capacity to retake a bunch of that volume like back in the near term or is that just more of a slower turn that side back on? Thanks.

Barb Jacobsmeyer^ Yeah, I think it's a slower term mean if -- when we, and if we come to an agreement and get an executed agreement, I think the biggest thing that will happen is we will turn that back on, right? Right now, we are actively turning away the referrals. And so I think just being able to turn it back on and get back to a cadence of accepting, I think will be beneficial to United and to our referral sources. So it really will be about managing it as part of the census of being able to be able to continue to accept them.

Operator^ And ladies and gentlemen, with no further questions at this time, I would like to turn the call back over to Jobie Williams for closing remarks.

Jobie Williams^ Thank you, [Abby]. If you have additional questions, please email InvestorRelations@ehab.com. Thank you again for joining today's call.

Operator^ And ladies and gentlemen, this concludes today's call and we thank you for your participation. You may now disconnect.