Note Regarding Presentation of Non-GAAP Financial Measures

The financial data contained in the Company's public documents may include non-GAAP financial measures, including the Company's adjusted earnings per share, leverage ratio, Adjusted EBITDA, and adjusted free cash flow.

The Company is providing adjusted earnings per share from continuing operations attributable to Encompass Health ("adjusted earnings per share"). The Company believes the presentation of adjusted earnings per share provides useful additional information to investors because it provides better comparability of ongoing operating performance to prior periods given that it excludes the impact of government, class action, and related settlements; professional fees—accounting, tax, and legal; mark-to-market adjustments for stock appreciation rights; gains or losses related to hedging and equity instruments; loss on early extinguishment of debt; adjustments to its income tax provision (such as valuation allowance adjustments and settlements of income tax claims); items related to corporate and facility restructurings; and certain other items the Company believes to be non-indicative of its ongoing operating performance. It is reasonable to expect that one or more of these excluded items will occur in future periods, but the amounts recognized can vary significantly from period to period and may not directly relate to the Company's ongoing operating performance. Accordingly, they can complicate comparisons of the Company's results of operations across periods and comparisons of the Company's results to those of other healthcare companies. Adjusted earnings per share should not be considered as a measure of financial performance under generally accepted accounting principles in the United States ("GAAP") as the items excluded from it are significant components in understanding and assessing financial performance. Because adjusted earnings per share is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, it may not be comparable as presented to other similarly titled measures of other companies. The Company reconciles adjusted earnings per share below.

The leverage ratio referenced therein is defined as the ratio of consolidated total debt to Adjusted EBITDA for the trailing four quarters. The Company believes its leverage ratio and Adjusted EBITDA are measures of its ability to service its debt and its ability to make capital expenditures. Additionally, the leverage ratio is a standard measurement used by investors to gauge the creditworthiness of an institution. The Company's credit agreement also includes a maximum leverage ratio financial covenant which allows the Company to deduct up to $300 million of cash on hand from consolidated total debt. The Company reconciles Adjusted EBITDA to net income and to net cash provided by operating activities below. Adjusted EBITDA for the Company's reportable segments is reconciled to net income from continuing operations before income tax expense below.

The Company uses Adjusted EBITDA on a consolidated basis as a liquidity measure. The Company believes this financial measure on a consolidated basis is important in analyzing its liquidity because it is the key component of certain material covenants contained within the Company's credit agreement, which is discussed in more detail in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations,* "Liquidity and Capital Resources," and Note 10, *Long-term Debt*, to the consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2019 (the "2019 Form 10-K"). These covenants are material terms of the credit agreement. Noncompliance with these financial covenants under the credit agreement—its interest coverage ratio and its leverage ratio—could result in the Company's lenders requiring the Company to immediately repay all amounts borrowed. If the Company anticipated a potential covenant violation, it would seek relief from its lenders, which would have some cost to the Company, and such relief might be on terms less favorable to those in the Company's existing credit agreement. In addition, if the Company cannot satisfy these financial covenants, it would be prohibited under the credit agreement from engaging in certain activities, such as incurring additional indebtedness, paying common stock dividends, making certain payments, and acquiring and disposing of assets. Consequently, Adjusted EBITDA is critical to the Company's assessment of its liquidity.

In general terms, the credit agreement definition of Adjusted EBITDA, therein referred to as "Adjusted Consolidated EBITDA," allows the Company to add back to consolidated net income interest expense, income taxes, and depreciation and amortization and then add back to consolidated net income (1) all unusual or nonrecurring items reducing consolidated net income (of which only up to $10 million in a year may be cash expenditures), (2) any losses from discontinued operations, (3) non-ordinary course fees, costs and expenses incurred with respect to any litigation or settlement, (4) share-based compensation expense, (5) costs and expenses associated with the issuance or prepayment debt and acquisitions, and (7) any restructuring charges not in excess of 20% of Adjusted Consolidated EBITDA. The Company also subtracts from consolidated net income all unusual or nonrecurring items to the extent they increase consolidated net income.

The calculation of Adjusted EBITDA under the credit agreement does not require us to deduct net income attributable to noncontrolling interests or gains on fair value adjustments of hedging and equity instruments, disposal of assets and development activities. It also does not allow us to add back losses on fair value adjustments of hedging instruments or unusual or nonrecurring cash expenditures in excess of $10 million. These items and amounts, in addition to the items falling within the credit agreement's "unusual or nonrecurring" classification, may occur in future periods, but can vary significantly from period to period and may not directly relate to, or be indicative of, the Company's ongoing liquidity or operating performance. Accordingly, the Adjusted EBITDA calculation presented here includes adjustments for them.

Adjusted EBITDA is not a measure of financial performance under GAAP, and the items excluded from Adjusted EBITDA are significant components in understanding and assessing financial performance. Therefore, Adjusted EBITDA should not be considered a substitute for net income or cash flows from operating, investing, or financing activities. Because Adjusted EBITDA is not a measurement determined in accordance with GAAP and is thus susceptible to varying calculations, Adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. Revenues and expenses are measured in accordance with the policies and procedures described in Note 1, *Summary of Significant Accounting Policies*, to the consolidated financial statements accompanying the 2019 Form 10-K.

The Company also uses adjusted free cash flow as an analytical indicator to assess its performance. Management believes the presentation of adjusted free cash flow provides investors an efficient means by which they can evaluate the Company's capacity to reduce debt, pursue development activities, and return capital to its common stockholders. The reconciliation of net cash provided by operating activities to adjusted free cash flow is below. This measure is not a defined measure of financial performance under GAAP and should not be considered as an alternative to net cash provided by operating activities. The Company's definition of adjusted free cash flow is limited and does not represent residual cash flows available for discretionary spending. Because this measure is not determined in accordance with GAAP and is susceptible to varying calculations, it may not be comparable to other similarly titled measures presented by other companies. See the consolidated statements of cash flows included in the 2019 Form 10-K for the GAAP measures of cash flows from operating, investing, and financing activities.

	Q4		**Year Ended**	
	2019	**2018**	**2019**	**2018**
Earnings per share, as reported	**$ 0.68**	**$ 0.26**	**$ 3.62**	**$ 2.92**
Adjustments, net of tax:				
Government, class action, and related settlements	—	0.52	—	0.52
Mark-to-market adjustment for stock appreciation rights	0.11	0.03	0.47	0.21
Transaction costs	—	—	0.02	0.01
Income tax adjustments	0.02	(0.02)	(0.10)	(0.03)
Loss on early extinguishment of debt	0.04	—	0.06	—
Change in fair market value of equity securities	—	0.01	(0.01)	0.01
Gain on consolidation of Yuma	—	—	(0.14)	—
Payroll taxes on SARs exercise	—	—	0.01	—
Adjusted earnings per share*	**$ 0.85**	**$ 0.80**	**$ 3.91**	**$ 3.63**

	For the Three Months Ended December 31,		For the Year Ended December 31,	
	2019	2018	2019	2018
	(In Millions)			
Net income	$ 90.2	$ 47.7	$ 445.8	$ 375.4
(Income) loss from discontinued operations, net of tax, attributable to Encompass Health	—	(1.5)	0.6	(1.1)
Net income attributable to noncontrolling interests	(22.6)	(19.6)	(87.1)	(83.1)
Provision for income tax expense	27.3	29.4	115.9	118.9
Interest expense and amortization of debt discounts and fees	44.5	36.7	159.7	147.3
Depreciation and amortization	58.4	52.9	218.7	199.7
Government, class action, and related settlements	—	52.0	—	52.0
Loss on early extinguishment of debt	5.4	—	7.7	—
Loss on disposal of assets	7.8	3.5	11.1	5.7
Stock-based compensation expense	27.4	20.3	114.4	85.9
Transaction costs	0.1	—	2.1	1.0
Gain on consolidation of Yuma	—	—	(19.2)	—
SARs mark-to-market impact on noncontrolling interests	(0.7)	(0.4)	(5.0)	(2.6)
Change in fair market value of equity securities	0.4	0.8	(0.8)	1.9
Payroll taxes on SARs exercise	—	—	1.0	—
Adjusted EBITDA	$ 238.2	$ 221.8	$ 964.9	$ 901.0

	For the Three Months Ended December 31,		For the Year Ended December 31,	
	2019	2018	2019	2018
	(In Millions)			
Total segment Adjusted EBITDA	$ 274.7	$ 255.8	$ 1,095.4	$ 1,034.3
General and administrative expenses	(64.0)	(54.3)	(247.0)	(220.2)
Depreciation and amortization	(58.4)	(52.9)	(218.7)	(199.7)
Loss on disposal of assets	(7.8)	(3.5)	(11.1)	(5.7)
Government, class action, and related settlements	—	(52.0)	—	(52.0)
Loss on early extinguishment of debt	(5.4)	—	(7.7)	—
Interest expense and amortization of debt discounts and fees	(44.5)	(36.7)	(159.7)	(147.3)
Net income attributable to noncontrolling interests	22.6	19.6	87.1	83.1
SARS mark-to-market impact on noncontrolling interests	0.7	0.4	5.0	2.6
Change in fair market value of equity securities	(0.4)	(0.8)	0.8	(1.9)
Gain on consolidation of Yuma	—	—	19.2	—
Payroll taxes on SARs exercise	—	—	(1.0)	—
Income from continuing operations before income tax expense	$ 117.5	$ 75.6	$ 562.3	$ 493.2

	For the Three Months Ended December 31,		For the Year Ended December 31,	
	2019	2018	2019	2018
	(In Millions)			
Net cash provided by operating activities	$ 215.6	$ 178.4	$ 635.3	$ 762.4
Interest expense and amortization of debt discounts and fees	44.5	36.7	159.7	147.3
Equity in net income of nonconsolidated affiliates	1.2	2.3	6.7	8.7
Net income attributable to noncontrolling interests in continuing operations	(22.6)	(19.6)	(87.1)	(83.1)
Amortization of debt-related items	(1.4)	(1.0)	(4.5)	(4.0)
Distributions from nonconsolidated affiliates	(1.8)	(2.8)	(6.6)	(8.3)
Current portion of income tax expense	8.1	30.5	75.9	128.0
Change in assets and liabilities	(5.3)	1.1	180.1	(46.0)
Cash (provided by) used in operating activities of discontinued operations	(0.2)	(1.5)	4.4	(0.8)
Transaction costs	0.1	—	2.1	1.0
SARS mark-to-market impact on noncontrolling interests	(0.7)	(0.4)	(5.0)	(2.6)
Payroll taxes on SARs exercise	—	—	1.0	—
Change in fair market value of equity securities	0.4	0.8	(0.8)	1.9
Other	0.3	(2.7)	3.7	(3.5)
Adjusted EBITDA	$ 238.2	$ 221.8	$ 964.9	$ 901.0

	For the Three Months Ended December 31,		For the Year Ended December 31,	
	2019	2018	2019	2018
	(In Millions)			
Net cash provided by operating activities	$ 215.6	$ 178.4	$ 635.3	$ 762.4
Impact of discontinued operations	(0.2)	(1.5)	4.4	(0.8)
Net cash provided by operating activities of continuing operations	215.4	176.9	639.7	761.6
Capital expenditures for maintenance	(62.0)	(47.6)	(167.1)	(152.9)
Distributions paid to noncontrolling interests of consolidated affiliates	(22.2)	(18.9)	(79.8)	(75.4)
Items non-indicative of ongoing operations:				
Cash paid for government, class action, and related settlements	5.6	—	52.0	—
Transaction costs and related assumed liabilities	0.1	2.9	2.1	0.5
Cash paid for SARs exercise	—	—	69.6	4.3
Adjusted free cash flow	$ 136.9	$ 113.3	$ 516.5	$ 538.1

For the three months ended December 31, 2019, net cash used in investing activities was $145.7 million and resulted primarily from capital expenditures. Net cash used in financing activities during the three months ended December 31, 2019 was $424.1 million and resulted primarily from net debt repayments, cash dividends paid on common stock, and distributions to noncontrolling interests of consolidated affiliates.

For the three months ended December 31, 2018, net cash used in investing activities was $98.2 million and resulted primarily from capital expenditures. Net cash used in financing activities during the three months ended December 31, 2018 was $67.7 million and resulted primarily from net debt repayments, cash dividends paid on common stock, and distributions to noncontrolling interests of consolidated affiliates.

For the year ended December 31, 2019, net cash used in investing activities was $657.4 million and primarily resulted from the acquisition of Alacare and capital expenditures. Net cash provided by financing activities during the year ended December 31, 2019 was $48.2 million and primarily resulted from the issuance of $1.0 billion of senior notes offset by repayments on the Company's revolving credit facility and 5.75% Senior Notes due 2024, the purchase of one-third of the rollover shares held by members of the home health and hospice management team, dividends paid common stock, distributions paid to noncontrolling interests of consolidated affiliates, and repurchases of common stock.

For the year ended December 31, 2018, net cash used in investing activities was $424.5 million and resulted primarily from capital expenditures and the acquisition of Camellia Healthcare. Net cash used in financing activities during the year ended December 31, 2018 was $321.2 million and resulted primarily from cash dividends paid on common stock, net debt payments, distributions to noncontrolling interests of consolidated affiliates, and purchasing one-third of the Rollover Shares held by members of the home health and hospice management team.