PARTICIPANTS

Corporate Participants

Crissy Buchanan Carlisle – Chief Investor Relations Officer, Encompass Health Corp.
Mark J. Tarr – President, Chief Executive Officer & Director, Encompass Health Corp.
Douglas E. Coltharp – Chief Financial Officer & Executive Vice President, Encompass Health Corp.
April K. Anthony – Chief Executive Officer, Home Health and Hospice, Encompass Health Corp.
Barbara Jacobsmeyer – President, Inpatient Rehabilitation, Encompass Health Corp.

Other Participants

Matt Larew – Analyst, William Blair & Co. LLC
Kevin Mark Fischbeck – Analyst, Bank of America Merrill Lynch
Frank Morgan – Analyst, RBC Capital Markets LLC
A.J. Rice – Analyst, Credit Suisse Securities (USA) LLC
Per Ostlund – Analyst, Craig-Hallum Capital Group LLC
John W. Ransom – Analyst, Raymond James & Associates, Inc.
Chris Rigg – Analyst, Deutsche Bank Securities, Inc.
Sarah E. James – Analyst, Piper Jaffray & Co.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to Encompass Health's Fourth Quarter 2017 Earnings Conference Call. At this time, I would like to inform all participants that their lines will be in a listen-only mode. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] You'll be limited to one question and one follow-up question. 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 Crissy Carlisle, Encompass Health's Chief Investor Relations Officer.

Crissy Buchanan Carlisle, Chief Investor Relations Officer, Encompass Health Corp.

Thank you, operator, and good morning, everyone. Thank you for joining Encompass Health's fourth quarter 2017 earnings call. With me on the call in Birmingham today are Mark Tarr, President and Chief Executive Officer; Doug Coltharp, Chief Financial Officer; Barb Jacobsmeyer, President, Inpatient Rehabilitation; Patrick Darby, General Counsel and Corporate Secretary; Andy Price, Chief Accounting Officer; Ed Fay, Treasurer; and Julie Duck, Senior Vice President of Financial Operations. April Anthony, Chief Executive Officer of our Home Health & Hospice segment also is participating in today's call via phone.

Before we begin, if you do not already have a copy, the fourth quarter earnings release, supplemental information and related Form 8-K filed with the SEC are available on our website at encompasshealth.com.

On page 2 of the supplemental information, you will find the Safe Harbor statement, which are also set forth in greater detail on the last page of the 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, uncertainties and other factors that could cause actual results to differ materially from management's projections, forecasts, estimates and expectations are discussed in the company's SEC filing, including the earnings release and related Form 8-K and the Form 10-K for the year ended December 31, 2017 when filed. 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. Statements made throughout this presentation are based on current estimates of future events and speak only as of today. The company does not undertake a duty to update these forward-looking statements.

Our supplemental information and discussion 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, at the end of the related press release, and as part of the Form 8-K filed yesterday with the SEC, all of which are available on our website.

Before I turn it over to Mark, I would like to remind everyone that we will adhere to the one question and one follow-up question rule to allow everyone to submit a question. If you have additional questions, please feel free to put yourself back in the queue.

With that, I'll turn the call over to Mark.

Mark J. Tarr, President, Chief Executive Officer & Director, Encompass Health Corp.

Thank you, Crissy, and good morning to everyone joining today's call. The fourth quarter was a strong finish to 2017. Strong volume and top-line growth in both segments led to $208.2 million of adjusted EBITDA, a 4.7% increase over the fourth quarter of 2016.

Growth in our Inpatient Rehabilitation segment was driven by volume, with same-store discharges increasing 3.9% over the fourth quarter of 2016. This volume growth along with lower group medical and bad debt expenses yielded $207.1 million of adjusted EBITDA, a 4.8% increase over the fourth quarter of 2016.

Our Home Health & Hospice segment continued to experience strong organic volume growth, with same-store admissions increasing 10.1% over the fourth quarter of 2016. This strong volume, coupled with continued staffing productivity gains, generated $34.4 million of adjusted EBITDA in the fourth quarter of 2017, an increase of 22.9% over the prior year.

Growth in our home health same-store admissions has averaged 12.4% over the last eight quarters, and the only quarter where this segment did not experience double-digit same-store admission growth was the third quarter of 2017 when its operations were impacted by three hurricanes.

As we discussed throughout 2017, the success of our clinical collaboration within our overlap markets varies widely, and necessitated the identification and standardization of best practices to facilitate continued progress on our clinical collaboration rate.

In February of 2017, we launched the TeamWorks clinical collaboration project, and I'm pleased to report the full implementation of the newly redesigned process was completed across all our overlap markets in December of 2017. Our clinical collaboration rate for the fourth quarter of 2017 was 31.7%, a 350 basis points increase over the fourth quarter of 2016.

In addition, we continued to generate substantial free cash flow in 2017. While our full-year free cash flow of $467.6 million was $6.9 million or 1.5% lower than free cash flow in 2016, it was almost $100 million higher than the original estimate contained in our January 2017 guidance.

Free cash flow in 2017 resulted from strong operating performance and the favorable impact on net working capital, attributable to the decline in prepayment claims denials we described throughout the second half of 2017. These benefits were offset by the expected increase in cash taxes due to the exhaustion of our federal net operating losses in the first quarter of 2017.

As we look back on 2017, we're pleased with what we achieved. In terms of growth, we opened four new inpatient rehabilitation hospitals and expanded our existing hospitals by 166 beds. We also opened or acquired 15 home health agencies and 2 hospice agencies. While we fell short of our target of $50 million to $100 million in home health and hospice agency acquisitions, we are encouraged by a robust pipeline as we entered 2018.

Operationally, we focused on clinical collaboration in advancing our technology and predictive analytics capabilities. We've now completed the installation of ACE-IT, our rehabilitation-specific electronic medical records system, in substantially all of our hospitals. In addition, in August of 2017, we announced the formation of the post-acute innovation center with Cerner Corporation.

The post-acute innovation center will develop advanced analytics and predictive models for post-acute management, and will work to determine the metrics and methodology of an effective and efficient post-acute network. As a provider of care, we have the clinical expertise that is critical in developing clinical decision support tools that are patient- and outcome-focused.

Our clinical expertise, combined with Cerner's technology, will allow us to assume a leading position in the development and utilization of market-specific clinical decision support tools, which will position our company to manage post-acute population for acute care hospitals and payers.

Other groups attempting to do so similar do not have direct experience caring for patients. So, while others may attempt to induce changes in behavior via the economic implications of patient flow, we can actually modify behavior in both facility- and home-based settings, as we identify improvements to clinical protocols and pathways, while considering both costs and high-quality outcomes.

Our priorities for 2018 build on momentum carrying over from 2017. Our growth pipeline is strong. Currently, we have seven IRF projects underway, with four of these hospitals scheduled to open in 2018. One of these new hospitals will be in the State of North Carolina, which is a new state for us.

On the Home Health & Hospice side, we plan to deploy $50 million to $100 million for expansion in 2018. As I mentioned previously, we entered 2018 with a robust pipeline. We will continue to prioritize market opportunities that create overlap markets with our inpatient rehabilitation hospitals.

We have also grown increasingly confident in our ability to operate high-quality and profitable hospice agencies. We believe the demand for hospice services will continue to grow based on demographic trends, societal acceptance and continued focus on reducing end-of-life care costs. Accordingly, we will seek opportunities to build a larger scale hospice business.

Our operational initiatives in 2018 include our rebranding and name change. Our new name reinforces our strength as one company, reflects our expanding national footprint and underscores our strategy to deliver high-quality, cost-effective care across the post-acute continuum. Field operations of both segments will begin transitioning to the Encompass Health name on April 1, with the rollout expected to be completed by the end of the first quarter of 2019.

In 2018, we will also continue to enhance the clinical collaboration efforts between our two segments and refine and expand our predictive analytics to further improve patient outcomes. We also plan to increase our participation in alternative payment models.

With these growth and operational initiatives underway, we are reaffirming our 2018 guidance communicated in January. Full-year 2018 guidance for net operating revenues is between $4.15 billion and $4.25 billion, while full-year guidance for adjusted EBITDA is between $830 million and $850 million. Full-year adjusted EPS guidance is between $3.25 and $3.40 per share.

A list of guidance considerations can be found on page 17 of the supplemental information included with our earnings release. As you can see on this page, we faced a challenging pricing environment in both segments in 2018 based on MACRA and the home health coding intensity adjustment. Given market conditions for skilled clinical labor and an anticipated reversion to the mean in group medical expenses, our guidance for 2018 assumes some de-leveraging against salaries and benefits.

Our adjusted free cash flow assumptions for 2018 are included on page 18 of the supplemental slides. We expect to continue to generate a significant amount of free cash flow in 2018 and to invest our free cash flow for the benefit of our shareholders. We will continue to prioritize the deployment of free cash flow to growth opportunities in both business segments and seek to augment the returns generated on operating investments with shareholder distributions.

We currently expect free cash flow in 2018 to be in the range of $325 million to $425 million. While our effective tax rate is expected to be lower in 2018 due to tax reform, our cash taxes are expected to increase over 2017 due to the aforementioned exhaustion of our federal NOL. Working capital is expected to increase in 2018, as we assume Medicare prepayment claim denials return to recent historic levels causing accounts receivables to increase.

I want to briefly turn our discussion to Washington. Earlier this month, Congress passed and the President signed into law the Bipartisan Budget Act of 2018 that funds the federal government for 2018 and 2019. This legislation impacts both of our segments by extending the existing 2% annual sequestration reduction for Medicare by an additional two years through 2027.

Other changes within the legislation impacted our Home Health segment. Pricing changes in the legislation include a hardwired home health market basket update of 1.5% for calendar year 2020 and the elimination of any productivity adjustment to the market basket for that year, and the extension of the rule add-on through 2022, albeit declining in amount along the way.

The remainder of the changes involves home health payment reform more broadly. For example, the legislation requires the Department of Health and Human Services to establish a 30-day unit of service in a budget-neutral manner to displace the current 60-day payment unit beginning 2020. The legislation also requires convening of a technical expert panel to identify and prioritize recommendations regarding home health grouping model and the panel's recommendations forwarded to relevant congressional committees no later than April 1, 2019. It also requires HHS to conduct notice and comment rulemaking on a revised home health case-mix system before the end of 2019.

Additionally, for calendar years 2020 and thereafter, therapy thresholds will no longer be used as a case-mix adjustment factor under the home health prospective payment system. It's important to note that this legislation requires home health payment reform to be developed and implemented on a budget-neutral basis. We will continue to work individually and as part of the partnership for quality home health care with Congress and CMS on payment reform.

Also released recently the President's fiscal year 2019 budget proposal includes various healthcare provisions, one of which is a legislated proposal calling for the implementation of a new post-acute care payment system starting 2024. The details of this proposal were not extensive. It would require Congress to pass legislation to reduce annual payment updates for post-acute providers for 2019 through 2023. Congress would also need to pass legislation authorizing CMS to implement the proposed unified post-acute payment system in fiscal year 2024.

I remind you that unified post-acute payment and site neutrality are legislated proposals that have been discussed for years, and this isn't the first time we've seen it included in our President's budget proposal. It will take significant time and effort to standardize patient assessment data and for the potential payment policies to be developed, tested and promulgated.

And major purpose of the IMPACT Act, which remains a work in progress, is to generate data and evidence towards understanding the viability of these types of proposals. We believe any post-acute payment system, that is data driven and focuses on the needs and underlying conditions of post-acute providers, ultimately will be a net positive for providers like Encompass Health who offer high-quality, cost-effective care.

As you review information coming out of Washington, remember the solid fundamentals of our business. Encompass Health provides necessary services to an aging population and consistently produces high-quality patient outcomes in a cost-effective manner. As the population continues to age, the demand for our facility- and home-based services will grow. We've made and continue to make the necessary investments in our business to meet this growing demand in an evolving healthcare delivery environment.

We started 2018 under a new name and brand that reflects our company's strong business proposition and sustainable business fundamentals. Encompass Health is poised for success with strong operating and financial platforms and substantial free cash flow to deploy to continuing to grow the business.

With that, I'll turn it over to Doug.

Douglas E. Coltharp, Chief Financial Officer & Executive Vice President, Encompass Health Corp.

Thank you, Mark, and good morning, everyone. As Mark just outlined, we had a nice finish to 2017 as Q4 was marked by strong volumes in both business segments and benefited from better-than-expected results in group medical expenses and in IRF segment bad debt.

Our Q4 consolidated revenues increased 7.3% and consolidated adjusted EBITDA increased 4.7% to $208.2 million. Included in Q4 adjusted EBITDA were $2.9 million of operating expenses related to rebranding and the TeamWorks clinical collaboration. Consolidated adjusted EBITDA for 2017 of $823.1 million exceeded the top end of our guidance range, primarily due to the aforementioned better-than-expected group medical and IRF segment bad debt expenses.

I'll take a moment to elaborate here. We had very favorable group medical performance in 2017 owing to factors such as a lower incidence of high-dollar claims in the absence of any new high-priced specialty drugs. In fact, our 2017 group medical expenses on both an aggregate and per-FTE basis declined year-over-year. These outcomes were not precipitated by any significant changes to our benefits program design or to our covered lives population.

Accordingly, it can be seen in the 2018 guidance considerations on page 17 of the supplemental slides, we expect group medical expenses for the current year to revert towards the mean, which will result in an increase in the 8% to 12% range.

Similarly, as discussed on our Q3 call, we experienced a significant decline in IRF segment bad debt expense in the second half of 2017, which stemmed from the reduction in prepayment claims denials related to the implementation of TPE and the transition of the Cahaba contracts to Palmetto, which was completed earlier this month.

IRF segment bad debt expense for Q4 declined to 1% of segment net operating revenues. While we would love to be able to say this represents the new normal, we simply do not have enough experience with Palmetto or with TPE to assess the sustainability of this recent level.

Additionally, Q4 was another quarter with no progress on resolving the backlog of previously denied claims awaiting adjudication at the ALJ level. As such, our 2018 guidance considerations assume that IRF segment bad debt expense will fall within the recent historical range of 1.6% to 1.9%.

As Mark mentioned, adjusted free cash flow for 2017 was $467.6 million, down modestly from last year primarily owing to higher cash taxes but, as Mark stated, substantially higher than our expectations at the outset of 2017. The outperformance versus our initial expectations was primarily related to the decrease in working capital, much of which stemmed from the improved AR collections in the second half of the year.

We continued to prioritize free cash flow towards value-creating growth opportunities in both of our business segments and deployed nearly $150 million to such opportunities in 2017. These investments were complemented by shareholder distributions of approximately $130 million. Our balance sheet at the end of 2017 remained very strong with a leverage ratio of 3.1 times, down from 3.8 times at the end of 2016.

Turning now to segment results. IRF segment revenues increased by 5.6%, driven by higher volumes. Discharges grew 5.9% in Q4 with same-store growth of 3.9%. Net revenue per discharge was flat year-over-year. This past holiday season, both the Christmas and New Year's holidays fell on Mondays. This tends to accelerate discharges as both patients and attending physicians seek to be home for the long holiday weekends. The resulting discharge pattern benefits discharge growth for the quarter, but results in a lower length of stay which decreases revenue per discharge.

Outpatient and other revenue decline modestly in Q4, as the decline in revenue from outpatient services was largely offset by an increase in provider tax recoveries. IRF segment adjusted EBITDA increased 4.8% to $207.1 million for Q4. SWB was flat at 50.3% as lower group medical expenses offset compensation increases and the impact from the ramping up of new stores. Labor productivity was flat year-over-year with EPOB of 3.50.

As noted on slide 9, the increase in other operating expenses as a percent of revenue was primarily attributable to higher provider tax expenses in Q4 2017. That was an offset to the recoveries included in other revenue as well as the impact of favorable franchise tax recoveries which incurred in Q4 of 2016.

Moving on to our Home Health & Hospice segment, Q4 total segment revenue increased 14.6%. Q4 was another strong volume quarter for home health with admissions of 13.6%, including same-store growth of 10.1%. Approximately 120 basis points of the same-store growth resulted from clinical collaboration with Encompass Health IRFs. As Mark cited, the clinical collaboration rate increased by 350 basis points in Q4 to 31.7%, reflecting in part the rollout of our TeamWorks protocols.

Revenue per episode for Q4 declined 1.1%, as Medicare reimbursement rate cuts were partially mitigated by changes in our patient mix as well as reconciliation payments related to cost-saving sharing in various alternative payment models in which we are a participant.

Hospice revenue increased 26.3% in Q4, benefiting from prior-period acquisitions. As Mark discussed, we are looking to add scale to our hospice business in 2018 and beyond. Home Health & Hospice segment adjusted EBITDA of $34.4 million increased 22.9% over the prior year.

Cost of services as a percent of revenue declined 270 basis points in the prior year, primarily due to productivity gains. As an example, visits per episode declined from 18.4 in Q4 2016 to 17.3 in Q4

2017, more than offsetting a modest increase in cost per visit from $76 to $77. Support and overhead costs increased 90 basis points in Q4 over the same quarter last year, as we continued to make investments in additional sales and marketing associates.

In the 8-K accompanying our earnings release, we noted that April and our other Home Health & Hospice segment teammates, who are holders of rollover shares, elected to exercise their put option on the first third of those shares. This put option became exercisable on January 1 of this year. The second third of those shares will become puttable after January 1, 2019 and the final third after January 1, 2020. Further detail on the rollover shares is provided on slide 30 of the supplemental slides.

Encompass Health Corporation purchased those shares earlier this month for an aggregate of approximately $65 million in cash, thereby increasing EHC's ownership of the Home Health & Hospice subsidiary from 83% to approximately 89%. The value of the rollover shares is established using a market-based multiple applied to LTM segment EBITDA.

The ownership of the rollover shares resulted from April and other management shareholders choosing to reinvest a substantial portion of their individual proceeds from HealthSouth's purchase of Encompass Home Health & Hospice on December 31, 2014. April and the other management shareholders continue to hold two-thirds of their investment in the Home Health & Hospice subsidiary.

And now, operator, we'll open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Matt Larew of William Blair.

<A – Mark Tarr – Encompass Health Corp.>: Morning, Matt.

<Q – Matt Larew – William Blair & Co. LLC>: Hi. Good morning. And thanks for taking the question. I wanted to ask about home health same-store growth and just what you think the sustainability of these double-digit admission levels are in 2018 and beyond, and how you think your growth rates in local markets is compared to your local competitors?

<A – Mark Tarr – Encompass Health Corp.>: Matt, I'll ask April to weigh in on that.

<A – April Anthony – Encompass Health Corp.>: Well, Matt, I think if you look at our history, you will definitely see that we have experienced a long sustained period of strong organic growth. And we believe that there's a number of combinations that create that; our very focused strategy as it relates to relatively small territories for each of our sales people, which allows them to build loyal relationships with our referral accounts; our specialty program activities where we have dedicated focused areas, whether it be in orthopedics or neurology or whatever it may be, cardiology, dedicated focused efforts.

And then I think, as an organization, we've just been able to prove that those combined efforts have sustained strong organic growth in the double-digit level with the exception of the one hurricane quarter that we had in Q3. So, can't be a perfect predictor of the future, but I feel like our past is a good indicator that we have had a long sustained trend of that and we'll be able to continue to do so.

<Q – Matt Larew – William Blair & Co. LLC>: Okay. Thanks, April. And then, just on the comments about potentially increasing the size of the hospice business here, I just wonder if there's an appetite to move beyond the scope of that $50 million to $100 million contemplated, or if the comments are really just that, within that $50 million to $100 million, there might be more of a weighting towards hospice.

<A – Mark Tarr – Encompass Health Corp.>: $50 million to $100 million is a marker we put out there in terms of what we're targeting, but there are a number of other larger Home Health & Hospice, some together in the same business and some separate, opportunities that we think are going to be available because they're potentially transitioning from private equity ownership here potentially in 2018. And we would be a candidate based both on the scalability of our existing Home Health & Hospice segment platform and also based on the strength of our balance sheet to potentially acquire those businesses.

<Q – Matt Larew – William Blair & Co. LLC>: Okay. Thanks for the questions.

Operator: Your next question comes from the line of Kevin Fischbeck of Bank of America Merrill Lynch.

<A – Mark Tarr – Encompass Health Corp.>: Morning, Kevin.

<Q – Kevin Fischbeck – Bank of America Merrill Lynch>: Good morning. Thanks. I guess I wanted to dig into the labor outlook. In your guidance over the next couple of years, it looks like you've got labor relatively flat as far as a growth rate kind of in that 3% range. So I just want to understand why that was and I guess maybe dig into the productivity improvement that you talked about on the home health side. I guess, as you said 17.3 visits per episode, where can that number go, where can that productivity number go?

<A – Mark Tarr – Encompass Health Corp.>: April, do you want to start on the second part of that question?

<A – April Anthony – Encompass Health Corp.>: Yes. So, first, let me clarify that the 17.3 is visits per episode. It's not productivity per caregiver. And so our productivity per caregiver per week is higher than that threshold.

But, in any event, I think the improvements that we made in productivity this year are certainly sustainable. We still have some room, we believe, to further realize incremental productivity increases in the 2018 year. And I think it's really just a matter of tightly managing our workforce from a standpoint of using all the tools that are available to us in our Homecare Homebase technology in order to make sure that we are managing our full-time staff members up to the level of expectation that was committed to upon their hire.

And so we've been able to really kind of bear down on that area of focus, and that has proven to have strong benefits for us in 2017, and there is still remaining opportunity for us in 2018 to continue to improve upon that metric. And we think we will see some sustained improvement over the course of this year.

<A – Doug Coltharp – Encompass Health Corp.>: And then, Kevin, getting back to your first question; for both business segments, our current assumption is that we'll see the SW component of SWB increase about 3%. And that's a combination of kind of managing the merit budget as well as market adjustments with all of the other aspects in terms of skill sets and so forth that we have at our disposal.

The piece that's changed from our most recent assumptions this year is that increase in the benefits piece. Again, that relates largely to the fact that we had such a favorable year in 2017. We don't believe that that is sustainable, and therefore, we think we'll see a larger percentage increase in the benefits component for 2018 as the benefits cost per FTE reverts back towards the mean.

The SW piece here has kind of inched up a bit over the last several years from about 2.5% to 2.75% to 3%. 3% is the rate that we were at last year and we were able to manage to that level prior to this year. And really, at the outset of this year, we could assume that just based on healthcare inflation costs, which is the primary driver of benefits cost, we'd see annual benefit increases of 5% to 10%. And that remains a component of our three-year business outlook.

<A – Mark Tarr – Encompass Health Corp.>: Kevin, as you know, we've invested a lot in our labor systems over the years in regards to having the tools, whether it's Homecare Homebase on the home health side or on the inpatient side. We have systems that help our management team to manage the day-to-day shift-to-shift labor. We've also put a huge focus on our retention and recruitment efforts in the past years so that we can have some of the industry lowest turnover levels out there on both segments. So, all that goes into playing in terms of helping to keep our labor costs down on a manageable level.

<A – Doug Coltharp – Encompass Health Corp.>: And then a couple of other things just to consider when you think about IRF segment labor productivity. It seems like we talked about it for a long time but we have finally gotten past needing to reference the impact on EPOB and staffing levels that results from the conversion of the former Reliant hospitals over to our model.

And in addition to that, some of the other staffing additions that were required to make sure that, for instance, we were adhering to all of the new quality reporting requirements without detracting from our clinical care and also increasing the amount of therapy that was done on an individual versus a concurrent or group basis. All of those things are now fully reflected in our staffing model.

<Q – Kevin Fischbeck – Bank of America Merrill Lynch>: Okay. Great. That's helpful. I guess, moving over to the reimbursement outlook, you mentioned the new grouping model potentially coming out of home health. I wasn't sure if that had any influence at all into how you're thinking about the clinical collaboration that you're doing because I guess [ph] you're theoretically (35:30) going to be deemphasizing rehab.

Does that make you feel any differently about that model? And is there anything else that you might be doing structurally to kind of prepare for any kind of new types of patients that might become more attractive for you to be treating going forward?

<A – Mark Tarr – Encompass Health Corp.>: Yeah. Kevin, it's Mark. Our strategy has not changed regarding that. We believe very firmly that positioning the company to have the capabilities in these overlap markets and we continue to increase the number of our overlap markets where we can position ourselves for a future reimbursement based on episodic model, placing the patient whether that's in a facility-based or home-based setting of care, and having some sort of a lump sum payment based on a longer period episode of 90 days, is the direction we will continue to head and need to head to best position ourselves is where the payment models are going.

Operator: Your next question comes from the line of Frank Morgan of RBC Capital Markets.

<A – Mark Tarr – Encompass Health Corp.>: Hi, Frank.

<A – Doug Coltharp – Encompass Health Corp.>: Morning, Frank.

<Q – Frank Morgan – RBC Capital Markets LLC>: Good morning. Hey. This growing emphasis going toward hospice, could you give us any color about how you see valuations in hospice, say, versus what you've experienced to-date in home healthcare?

<A – Doug Coltharp – Encompass Health Corp.>: The hospice tends to trade at a slight premium to just pure home health businesses both in the public and the private transactions. I'll let April comment here as well, but I think we kind of see the same delta between larger public companies and the smaller private companies that we do in the home health business.

And a lot of it also, because it is also a highly fragmented business, relates to what specifically you're buying. What we've been able to demonstrate on the home health side is that many of our smaller acquisitions are really less about buying a true operating business and more about being able to buy a license or a CON to operate what we view to be an attractive geographical territory, either based on the specific demographics and competitive situation in that market and/or based on overlap with one of our IRFs.

But, again, I'll ask April to elaborate a little bit further on that.

<A – April Anthony – Encompass Health Corp.>: Yeah. I mean, I think we definitely see that the hospice sector kind of trades somewhere 1 turn to 2 turns more than a comparable home health asset. There is factors depending on CON, availability of the geography, other things like that that can impact whether it's on the low end or the high end of that incremental range. But there's also, I think, an opportunity for us to pursue that market at not a significantly different capital-investment level.

<Q – Frank Morgan – RBC Capital Markets LLC>: Got you. And you seem to indicate that you expected to see a higher level of just traditional home healthcare acquisitions this year. Is there something you're seeing in the marketplace? Do you think it's the spook we went through late last year about this group or model potential? Is that what you think might get some of the smaller

mom-and-pop operators on the home healthcare side to go ahead and sell? Is that [indiscernible] (38:46)?

<A – April Anthony – Encompass Health Corp.>: There's plenty of opportunity on the home health side with 12,000 provider numbers across the nation and about 11,000 decision-making entities roughly. There's always plenty of supply with the exception of CON states, which can be a little bit different dynamic.

But, generally speaking, I think last year's slowdown was a combination of both buyer- and seller-driven. I think, as the mid-year proposal came out, a lot of people sort of slowed down and said, boy, let me see how that's going to play out. As the course of the year went on and that we gained clarity around that, activity began to [ph] jump (39:21) back up again. And so I think we will – last year was a bit of an anomaly for us at the purchasing level we had last year, and I think we'll see a return to normality for us this year in that regard, and plenty of opportunities to pursue.

<A – Doug Coltharp – Encompass Health Corp.>: Frank, I would imagine that scare around HHGM. And by the way, as Mark alluded to in his comments, the things that were included in the Budget Act in the President's proposal certainly point to a more orderly process around any substitute for HHGM that might emerge. But I think that some of the new scare might have been at least a contributing factor to the decision by some private equity sponsor businesses to potentially seek a monetization event here in 2018.

<Q – Frank Morgan – RBC Capital Markets LLC>: Got you. One last and I'll hop in the queue. We've talked to a lot of home health care agencies who talked about declining recertification rate. So I don't know if I see that much of a trend for you. Looks like it was coming down, but then it's back up.

But is there anything that you're seeing out there either directly or from your competitors that's driving this recert rate change? And I guess, just to tag on to that question, this whole notion of going to a 30-day episode of care, how big a deal is that in – well, having, I guess, a recert after 30 days be that big a deal? Thanks.

<A – April Anthony – Encompass Health Corp.>: Yeah. So, if you look over in our supplemental slides, you'll see that if you look at the full year that the recert rate – if you would look at recerts as a percentage of admissions went from 77 in 2016 to 74 in 2017. And so it's not dramatically different. And as you look on a quarter-to-quarter basis, you see a little bit of just kind of an ebb and a flow in that recert rate.

I don't think we see anything that we think is sort of dramatically changing the market in that respect. Some of that may be just coming from an enhanced proportion in our case of hospital discharges, not only from our inpatient rehab hospital partners, but just from the acute care hospitals as well. And so we're seeing a little bit of shift in where our referrals are coming from, from more facility-based settings than from the community. And those tend to be more short-term acute patients, get-in, get-out in one episode kind of patients, versus those that are dealing with chronic comorbid conditions. So, that may be a factor in ours. I don't think we see anything systemically across the entire industry though that is really changing that posture.

As it relates to the 30-day episodes, there's still a lot of conversation going on in Washington as to whether or not that's a 30-day episode or a 30-day period. Our conversations with CMS through our work at the Partnership for Quality Home Healthcare as well as our conversations on The Hill would suggest that there is perhaps an unintended consequence there, that there was never really an intention to move to 30-day episodes but rather 30-day payment periods.

So we are working with CMS and with our legislative officials to perhaps get a clarification of that intent. And so far, in our conversations with CMS, we have no reason to believe that we view that

differently. Just the words didn't quite come out in this clearer way as they could have in that bill. And so, hopefully, we'll get a clarification resolution that makes it clear that we will not have 30-day episodes but rather 30-day payment periods, which will not increase the proportions of time we have to do a recertification.

Operator: Your next question comes from the line of A.J. Rice of Credit Suisse.

<A – Mark Tarr – Encompass Health Corp.>: Morning, A.J.

<A – Doug Coltharp – Encompass Health Corp.>: Morning, A.J.

<Q – A.J. Rice – Credit Suisse Securities (USA) LLC>: Hi, everybody. Just to maybe go over to the discussion around Palmetto and what you're seeing there. You said it was too early to really sort of change your thinking on accruals for this year. What are some of the gating factors or milestones that would make you say, hey, okay, with the claims processing improving, we have a little better outlook on something like bad debts and so forth?

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. So, A.J., it's Doug. Let me take that one. Let me begin by just kind of reminding you. So we began transitioning from Cahaba to Palmetto in the fall. During that period of time, Cahaba did not engage in essentially any new prepayment claims denials. So they were kind of just winding down their business and Palmetto hadn't picked it up yet.

Prior to the re-letting of the Cahaba contract on the IRF side of our business, we had a very small relationship covering only two hospitals with Palmetto. So we just didn't have a lot of history there. We had a more substantial history with our Home Health segment and that history was positive. There was a very productive dialogue that occurred on a regular basis, particularly between Palmetto's Medical Director and the Medical Director of our Home Health segment.

Our Home Health Medical Director facilitated some introductions in the transition process that allowed us to again have very good conversations, leading up to actually making the switch in early February. And I will say that the processing of claims and just payments and so forth thus far in the month of February has appeared positive and the relationship looks good.

Having said that, now Palmetto has the opportunity to start to engage, albeit subject to TPE, in incremental ADR probing activity. And we just don't know what the direction will be or what tone they will take in engaging in that process. And so we think it's appropriate to continue to have a cautionary outlook that assumes that we go back to the most recent historical trend. I think with each passing month, we'll get a better sense as to the volume of new probes under TPE that are being engaged in by Palmetto.

And additionally, for those other MACs that were not impacted by a transition that began probes under TPE in the fall, as that initiative was rolled out across those MACs, we'll get a better sense as to what happens once they've moved through those three cycles. And it's a combination of those two things that we need to have additional data and visibility on, before we think it will be prudent to revise our estimate for IRF segment bad debt.

<Q – A.J. Rice – Credit Suisse Securities (USA) LLC>: Okay. That makes sense. I want to go back to the question around FTEs. I appreciate the comments around productivity and so forth. But we were looking at the numbers. It looks like your FTEs in the IRF segment were up about just under 5%, 4.8%, but admittedly a much smaller base. But contract labor is up about 13%. I mean, it's only 250. But I just wondered, is there anything that's going on – is that a normal rate of increase in contract labor or are you seeing it little harder to find therapists as you need them?

<A – Barb Jacobsmeyer – Encompass Health Corp.>: No. This is Barb. I'll take that. So what we tend to see is particularly in new hospitals that have opened and we have like we did in the fourth quarter where we had nice volume uptick, many times our hiring practices are not caught up with that increase in volume. And so we need to use that agency labor to help us bridge that until we can get the labor pool where we need to be.

<A – Doug Coltharp – Encompass Health Corp.>: And when you combine the volume increase with it being the fourth quarter, the presence of the holidays, there's just more PTO that need to be covered through the contract labor.

<Q – A.J. Rice – Credit Suisse Securities (USA) LLC>: Okay. All right. That makes sense.

Operator: Your next question comes from the line of Kevin Ellich of Craig-Hallum.

<A – Mark Tarr – Encompass Health Corp.>: Hello, Kevin.

<A – Doug Coltharp – Encompass Health Corp.>: Morning, Kevin.

<Q – Per Ostlund – Craig-Hallum Capital Group LLC>: Thanks. Good morning. This is actually Per Ostlund on for Kevin today. Wanted to ask kind of a bigger picture question on the rebranding and realizing it's still very early in the transition to the unified brand. As you're going out to potential JV partners and the like, are you already starting to see an impact of having the unified brand on your discussions?

And I guess, sort of attendant to that, does it make a difference if it is a JV discussion you're having that's a competitive situation versus where you are sort of this solo post-acute provider coming into the picture?

<A – Mark Tarr – Encompass Health Corp.>: Yeah. This is Mark. And just overall, having the one name, the one brand was one of the driving factors that we saw that we needed to do, particularly on development meetings where we would go into a development meeting. But, yeah, we'd had two different business cards sitting on one side of the table representing us, one would be the HealthSouth and one would be the Encompass.

So, having one name, one brand, one strategy moving forward representing one overall organization, we do think that will strategically play to our favor in the long run. As you point out, it's early on, so I can't give you a specific circumstance right now that we've seen that went over during a meeting. But I can tell you, it's a much more coordinated presentation that we have now than what we've had in the past when we've had two different names moving forward.

<A – Doug Coltharp – Encompass Health Corp.>: And just anecdotally, to piggyback on what Mark said, the feedback we're getting from our business development team is that the reception to the new branding and the concept of bringing both business segments to bear into a market where we're contemplating a joint venture relationship has been received favorably across the board. We can't point any specific situations yet where it's actually been the tipping point in getting a new deal done. But we think it's going to have a favorable impact and increasingly favorable impact as we move forward.

<Q – Per Ostlund – Craig-Hallum Capital Group LLC>: That makes perfect sense. Following on to that, just thinking in terms of dollars and cents and realizing that we don't guide quarterly here, but as we think about the investment, the OpEx and the CapEx involved in the rebranding, how should we think about pacing throughout the year? Is it something where it's a little heavier early on as you sort of work through that initial wave of rebranding and then it steps down later in the year, or any more color there would be great? Thank you.

<A – Doug Coltharp – Encompass Health Corp.>: Yeah. It's a little hard to say specifically where the dollars are going to fall from quarter-to-quarter. We do have a launch date on April 1 in terms of the initial wave of rebranding some of our field assets. And so it's likely that we'll see a little bit more activity both in the months of March and April, but I don't have a quarterly breakdown for you just yet.

<Q – Per Ostlund – Craig-Hallum Capital Group LLC>: Fair enough. Thank you.

Operator: Your next question comes from the line of John Ransom of Raymond James.

<A – Mark Tarr – Encompass Health Corp.>: Morning, John.

<A – Doug Coltharp – Encompass Health Corp.>: Hey, John.

<Q – John Ransom – Raymond James & Associates, Inc.>: Hey. Good morning. Morning. Are we anywhere on this idea of doing post-acute risk-taking, particularly with commercial payers or Medicare Advantage payers? Is the new world going to get here in that sense or is it still you think going to be largely just episodic and fee for service?

<A – Doug Coltharp – Encompass Health Corp.>: I think it's moving more slowly than perhaps we had anticipated a couple of years ago, but we continue to make good incremental progress on that. First of all, we are an active participant through both business segments in a number of the APMs and ACOs that are out there. And as we talked, as part of reviewing the Home Health segment's performance for the fourth quarter for the second quarter in a row, we pointed to the contribution from reconciliation payments to the pricing and to the EBITDA in that segment. So, that's a positive.

We talked previously about the fact that we've got a pilot program that we launched in January with our JV partner, Trinity Mother Frances in the Tyler, Texas market. And some of the initiatives that are going to come out of the post-acute innovation center are going to position us, first, to take on more responsibility with regard to managing a wider array of post-acute patients over a longer episode of time; and then, ultimately, I think to carry that proposition of risk-taking of some type of relatively fixed payment to both Medicare Advantage and commercial players will be something that we'll be focused on down the road. But we're closer to the beginning than we are to the end of that.

<Q – John Ransom – Raymond James & Associates, Inc.>: Yeah. Yeah. I mean, I think it's all been slower than we thought. But just to be clear, are you in any contracts today where you're providing kind of all-you-can-eat care for a per member per month payment, or is it more simplistic than that?

<A – Doug Coltharp – Encompass Health Corp.>: I'm going to let April provide more details on this, but we do have one such contract in – pretty large contract in the Houston market that we've had some favorable results on.

April?

<A – April Anthony – Encompass Health Corp.>: Sure. So we do have one relationship in South Texas, but it's all-you-can-eat home healthcare. It's not combined across the two segments yet.

<Q – John Ransom – Raymond James & Associates, Inc.>: Okay.

<A – April Anthony – Encompass Health Corp.>: And so you're paid a per member per month fee to provide home healthcare to all the recipients of this particular health plan in the greater Houston area.

<Q – John Ransom – Raymond James & Associates, Inc.>: So, this is a commercial plan or Medicare Advantage?

<A – April Anthony – Encompass Health Corp.>: Medicare Advantage.

<Q – John Ransom – Raymond James & Associates, Inc.>: That's Medicare. Okay. I got you. And I guess the corollary to this is, and I'm sorry if I missed this, but is it still the case that your JV strategy has sort of had a speed bump with the bundling being all voluntary? So, hospitals are still kind of taking a step back and wanting to pursue those sorts of initiatives.

<A – Doug Coltharp – Encompass Health Corp.>: Our JV strategy hasn't hit a speed bump at all in terms of the role that it plays in our IRF development activity and also the fact that we think that that is a strong advantage in any market as we just think about more episodic payments and creating better results for the patients in that market. I think, specifically with the idea of trying to enter into collaborator agreements, which you'll recall was the defined term under the CJR program, yeah, I mean that's gone way down in terms of any sense of urgency from the acute care partners.

But as we've discussed before, what the discussions around our capabilities that we're tied to discussing collaborator agreements did generate was an increasing awareness by acute care hospitals, sometimes our JV partners, sometimes just other potential referral sources in particular market, about the strength of the capabilities and of our value proposition. So we think that that has really been – the silver lining here is that that's been a really productive strain of discussion.

<A – Mark Tarr – Encompass Health Corp.>: John, just a reminder, a third of our hospital portfolio are partnerships with acute care hospital systems. And that's been a strategy that we've had in place for over 20 years now. We're very proud to never had a partnership unwind in that timeframe.

<A – Doug Coltharp – Encompass Health Corp.>: And when I look at our IRF development pipeline, the percentage of JV opportunities versus solo opportunities has been relatively consistent over the last several years, where it'll kind of range anywhere from 40% to 60% of the pipeline.

Operator: [Operator Instructions] Your next question comes from the line of Chris Rigg of Deutsche Bank.

<A – Mark Tarr – Encompass Health Corp.>: Hello, Chris.

<A – Doug Coltharp – Encompass Health Corp.>: Morning, Chris.

<Q – Chris Rigg – Deutsche Bank Securities, Inc.>: Morning. Good morning. The second largest Medicare Advantage Plan operator out there is in the process of sort of legging its way into owning a home healthcare asset. Is that a source of concern for you guys at all that maybe that plan is a decent process? And I know MA is still relatively small, but is that something you're keeping your eyes on?

<A – April Anthony – Encompass Health Corp.>: We certainly think that Humana's entry into the home care space is positive indication for the industry at large that the payers beyond the Medicare program are seeing the value of home healthcare.

We get such a small amount of our business from Humana currently that we're not particularly concerned about the impact of what might happen in the long-term. Relative to our Humana referrals, I think in the short-term we'll see very little disruption and that, even with that partnership, they don't have absolute overlap and strong presence in all of the markets.

So I don't think we see any near-term concern whatsoever. And really, in the long-term, we think that it's really a tailwind that creates a recognition across multiple payers that home healthcare is really where they should be investing, instead of treating home care like a commodity that they try to use as infrequently as possible for a smaller dollar if possible.

So we think this is a good sign and one that will bring others to the table of recognition and the value of home care.

<Q – Chris Rigg – Deutsche Bank Securities, Inc.>: Makes sense. And then, just on the Home Health & Hospice acquisition spending in 2017, coming in a bit short of the $50 million to $100 million target, because it's still not clear to me whether that was driven by Encompass saying we're going to step off the accelerator now given the reimbursement uncertainty for several months during the year, or just any color on the dynamic there would be helpful. Thanks.

<A – April Anthony – Encompass Health Corp.>: Yeah. I really don't think that we – we were certainly aware of what was going on over the summer months with the proposed rule. We had a few transactions in the pipe that we were pursuing that didn't end up playing out by the end of the year.

So I think there was a variety of factors that affected that overall realization. But I don't think anything really strategically has changed for us either in our execution or our opportunity. It was just that this particular year included a lot of smaller transactions that got us into key overlap markets, but didn't include some of those bulkier acquisitions that can drive the value up.

We feel confident that our return to normal will occur in 2018 and that that pipeline that is existing currently will support strong performance so that, really, over the cumulative period we'll be comfortable with the outcome.

Operator: Your next question comes from the line of Sarah James of Piper Jaffray.

<A – Mark Tarr – Encompass Health Corp.>: Morning, Sarah.

<A – Doug Coltharp – Encompass Health Corp.>: Morning.

<Q – Sarah James – Piper Jaffray & Co.>: Good morning. Thank you. I'm going to stick on the topic of home health M&A. Can you talk a little bit about the competitive landscape? So it seems to me that post tax reform, some of the acquirers in the marketplace are looking to increase how much they're spending, which gives me concern over multiples. So, can you talk us through the dynamics of the competitive landscape in home health M&A right now?

<A – April Anthony – Encompass Health Corp.>: Sure. I think that is a wise assumption and that many of the providers in the public space in home healthcare are signaling return to an appetite for acquisitions that's stronger than in the past. And so I do certainly think that that will create a frothier market.

That being said, as I mentioned earlier, there are just so many opportunities out there and we don't frequently find ourselves in a head-to-head competitive process with our large public peers terribly often. Occasionally, we're pursuing the same asset, but there are just so many assets out there to pursue in the home health space, particularly that often times our acquisitions are coming because of relationships that we've developed with sellers over time. And so, just haven't found that to be something that I'm overly concerned with. And I think there's plenty of supply to support the demand that's out there for acquisition.

<A – Doug Coltharp – Encompass Health Corp.>: I think it's also worth noting that three of the larger players in the space are undergoing significant and transformative transactions in 2018 with

the acquisition of the Gentiva business by Humana and two private equity partners, and then the merger of equals between Almost Family and LHCG. And those can be a lot to work through and can potentially limit the appetite of those players to engage in any kind of significant M&A activity until they work through that transition period.

<Q – Sarah James – Piper Jaffray & Co.>: Okay. That's very helpful. And then just on that topic of tax reform, can you walk us through how you're deploying those savings?

<A – Doug Coltharp – Encompass Health Corp.>: Well, as Mark mentioned previously in his discussions, certainly the tax reform is positive for us in terms of what it otherwise would have been on a go-forward basis because it lowers our effective tax rate from what was previously 40% to an estimated 28%. However, given our unique position of still having a federal NOL which covered all of our cash tax obligation in the first quarter of 2017, it's not creating from 2017 to 2018 a windfall in terms of an increase in cash flow because we're actually anticipating that we will pay more cash taxes in 2018 than we did in 2017.

So, to some extent, the reduction in the tax rate, as our General Counsel, Patrick Darby, pointed out, is paying for a portion of our taxes and that's where it's going. As you can see based on slide 19 in the supplemental slides, our prioritization of free cash flow has not changed. We do benefit from continuing to generate high levels of free cash flow. We will deploy those first to the growth opportunities that we have in both of our business segments. And then beyond that, we'll look to continue to complement the returns that we're generating from our operating assets with shareholder distributions.

Operator: Thank you. I'll now return the call to Crissy Carlisle for any additional or closing remarks.

Crissy Buchanan Carlisle, Chief Investor Relations Officer, Encompass Health Corp.

If anyone has additional questions, please call me at 205-970-5860. Thank you again for joining today's call.

Operator: Thank you. That does conclude Encompass Health's fourth quarter 2017 earnings conference call. You may now disconnect.