HOME HEALTH OVERVIEW

February 2015
Home health is a rapidly growing $87 billion market.

- Several trends drive strong industry growth
  - Aging population results in strong demographic trends
  - Preference of patients to receive treatment at home
  - Low cost setting driving utilization by payors
- Industry landscape continues to favor players of scale, driving significant M&A activity

**HOME HEALTH EXPENDITURES**

Source: CMS.
CONTINUED NEED FOR INDUSTRY CONSOLIDATION

The need for greater scale and operational efficiency will drive continued consolidation among the home health agencies.

- Despite significant historical consolidation, the home health industry is highly fragmented across over 12,000+ agencies, with providers of scale accounting for less than 5% of the total provider universe
  - Only Top 5% of providers generate more than $5 million in annual Medicare revenue
  - Only Top 10% of providers generate more than $3 million in annual Medicare revenue

- Economies of scale and changing referral patterns will reinforce consolidation, as smaller providers are expected to face difficulties maintaining profitability

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### FRAGMENTED MARKETPLACE

<table>
<thead>
<tr>
<th>Agency</th>
<th>Home Health Market Share</th>
<th># of States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kindred / Gentiva</td>
<td>6.1%</td>
<td>47</td>
</tr>
<tr>
<td>Amedisys</td>
<td>5.3%</td>
<td>39</td>
</tr>
<tr>
<td>LHC Group</td>
<td>2.6%</td>
<td>26</td>
</tr>
<tr>
<td>Almost Family</td>
<td>1.9%</td>
<td>14</td>
</tr>
<tr>
<td>Encompass Health / HealthSouth</td>
<td>1.5%</td>
<td>17</td>
</tr>
<tr>
<td>Broncsnell</td>
<td>1.3%</td>
<td>36</td>
</tr>
<tr>
<td>AccessCare</td>
<td>1.2%</td>
<td>1</td>
</tr>
<tr>
<td>BAYADA</td>
<td>0.9%</td>
<td>10</td>
</tr>
<tr>
<td>Interim HealthCare</td>
<td>0.8%</td>
<td>22</td>
</tr>
</tbody>
</table>

Source: Health Market Science, Company websites.

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### DISCHARGES TO POST ACUTE SETTINGS

- Despite continued industry consolidation, the number of home health agencies is at an all-time high
- 95% of home health businesses generate less than $5 million of annual Medicare revenue

Source: MedPac.

(1) 2013 estimated based on agencies outstanding on June 6, 2014.
TRENDS IN REIMBURSEMENT RATES

Continued industry consolidation will benefit providers of scale as less efficient providers are disproportionately impacted by changes in reimbursement rates.

HOME HEALTH REIMBURSEMENT TRENDS

- In November 2013, CMS provided clarity on future reimbursement by issuing a final rule for rebasing, with an annual base reduction of 2.8% in 2014 and estimated annual reductions of 2.1 to 2.5% per year through 2017
  - Implementation of rebasing makes it less likely that home health would be targeted for cuts in a short-term doc fix bill
  - Rebasing and additional productivity adjustments are expected to offset mandated market basket updates, which average a 2.5% increase annually
- Reimbursement clarity provides optimism for the future environment and reflects the need for home health as the low cost solution for an aging population

Source: CMS, Marwood Group.
INCREASED REGULATION AND REDUCED REIMBURSEMENT

Providers are accelerating adoption of technology to comply with regulatory mandates, in response to reimbursement pressures, and achieve greater operating efficiency.

INCREASED REGULATION

- Regulatory requirements are tightening to minimize fraud and abuse within the industry
- Recent requirements and conditions for payment that are increasing the need for better documentation, reporting, and processes include:
  - Face-to-face and therapy requirements
  - Content requirements on Plans of Care and Certifications of Need
- Instituting procedures to ensure regulatory compliance has become essential to homecare providers

REDUCED REIMBURSEMENT

- Since 2009, Medicare homecare funding has been reduced by over 20%
- Recent rebasing changes in reimbursement policy is creating margin pressure on homecare providers

**IMPROVE EBITDA MARGINS**

Medicare Advantage enrollment numbers continue to climb.

- 15.7 million beneficiaries – 30 percent of the Medicare population – enrolled in a Medicare Advantage plan in 2014

- Payment rates for MA plans are 22% lower, on average, than for fee-for-service
  - Providers will need to weigh increased volume for potentially lower rates as they consider whether to contract with MA plans
  - Plans will need to evaluate how to “pay for quality” of outcomes to entice providers to accept their contracts
**Case Study: Encompass Home Health**

**Company Location:** Dallas, TX  
**Buyer:** HealthSouth Corporation

**COMPANY OVERVIEW**
- 5th largest provider of Medicare-focused (82% Medicare) skilled home health services in the U.S. with 140 locations across 13 states
- Founded in 1998 and based in Dallas, Texas
- Highly regarded management team with bench strength
- Best in class quality and operational efficiency
- Acquired 45 businesses since 2005
- Leading position in states across the U.S.
- LTM Revenue of $355 million and industry-leading margins

**INVESTMENT HIGHLIGHTS**
- Scale and density in attractive markets
- Highly integrated technology platform
- Best-in-breed management team
- Clinical excellence
- Sustainable and replicable culture
- Proven ability to consummate and integrate acquisitions
- Innovative partner to health systems, payors, and ACOs
- Exceptional financial profile and cash flow

**TRANSACTION OVERVIEW**
- $750 million purchase price
- Accretive upon closing with expected Adjusted EBITDA contribution of ~$75 million in 2015
- Transaction to be funded with cash on hand and debt — resulting in pro forma HealthSouth leverage of ~3.5x
- HealthSouth will create a new home health and hospice operating division
  - To be run by Encompass management
  - Retain Encompass trade name and headquarters
  - Existing HealthSouth home health agencies to be integrated into Encompass

Encompass presence, year of entry, and current market position
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