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LHCG - Q2 2018 LHC Group Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the LHC Group Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded.

I'd now like to introduce your host for today's conference, Mr. Eric Elliott, Senior Vice President of Finance. Sir, please go ahead.

Eric C. Elliott - *LHC Group, Inc. - SVP of Finance*

Thank you, Liz. And welcome, everyone, to LHC Group's earnings conference call for the second quarter ended June 30, 2018. Everyone should have received a copy of our earnings release last night. If not, you may obtain a copy along with other key information about LHC Group and industry on our website.

In a moment, we'll hear from Keith Myers, Chairman and Chief Executive Officer; Josh Proffitt, Chief Financial Officer; and Don Stelly, President and Chief Operating Officer of LHC Group.

Before that, I would like to remind everyone that statements included in this conference call and in our press release may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These statements include, but are not limited to, comments regarding our financial results for 2018 and beyond. Actual results could differ materially from those projected in forward-looking statements because of a number of risk factors and uncertainties, which are discussed in our annual and quarterly SEC filings. LHC's Group shall have no obligation to update the information provided on this call to reflect subsequent events.

Now I'm pleased to introduce the Chairman and CEO of LHC Group, Keith Myers.



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Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Thank you, Eric, and good morning, everyone. We are very pleased with our strong growth for the second quarter and with the progress we are making in postmerger integration of Almost Family locations, as we deploy the same company-wide commitment to quality, growth and efficiency that has led to industry-leading performance and to decades of success in partnering with hospitals and health systems.

Our results to date demonstrate that the integration is on track and that our overall growth strategy is delivering on multiple fronts. The opportunities for growth across all service lines are as strong as ever, as we continue to leverage our scale, clinical and operational expertise and our national in-home health care platform to deliver measurable value for partners, payers, and most importantly, for patients, families and communities we are privileged to serve.

Since our founding, we have focused on exceeding the expectations of those we are privileged to serve by delivering exceptional clinical care. The company-wide commitment to this excellence is resulting in industry-leading quality, strong organic and earnings growth as well as an ever-increasing number of opportunities to build on our national scale organically and capitalizing on a growing pipeline of acquisitions and joint ventures.

We've extended this level of commitment to our integration activity related to our transaction earlier this year with Almost Family. The significant amount of work we did in advance with Berkeley Research Group and other partners, the small overlap of our existing footprints and our shared cultures have created a great foundation to support us through this months-long process.

We are on track and haven't run into any surprises. As Josh and Don will mention later, we are instilling operations and sales disciplines across Almost Family platform, and there's a definite willingness to share best practices and collaborate with a priority toward continual improvement across each of our 6 pillars of excellence among all leaders throughout our combined company.

I can't stress enough how much this disciplined attention to detail enables us to generate growth opportunities on multiple front with the -- without the typical distractions we've all seen from large integrations. That same attention to detail is the secret behind our successful track record in delivering industry-leading quality and patient satisfaction. There is no doubt we have more work to do in 2018 and 2019, but we're moving right along.

We've shown that there is a direct correlation between our commitment to quality and our ability to drive organic admissions growth and market share penetration. Quality and patient satisfaction trumps all in making this happen. We do a great job of selecting good markets to go into, and we have a great culture and sales strategy. And we have the opportunity to leverage these if we consistently deliver the highest quality of patient satisfaction in the market. That's what we anchor ourselves to in every community we serve.

We'll continue to focus on going after market share as well as the additional synergies with Almost Family. There are 3 primary growth levers we have today, and those are greatly enhanced with our expanded size, geographic reach and service line diversification.

We continue to focus on growth in our core markets by aggressively going after market share through our market-by-market differentiators and multiple service line co-location strategy, pursuing wholly owned opportunities, primarily [as a certificate in the east states] and, of course, our very successful joint venture strategy.

The Healthcare Innovation's business is also now a separate segment in our reporting, as you will see from our earnings release. And we've only just begun to tap the potential of the head start that William Yarmuth created under his leadership, by establishing the HCI segment of Almost Family and expanding the service offering to include ACO development and management, technology-enabled engagement, assessment in care coordination, including PS assessments for managed care payers, and primary care services through nurse practitioners for patients who are homebound or home limited.

By recently adding Bruce Greenstein as our Chief Innovation and Technology Officer, we have someone who is -- who helps us be better prepared to develop and implement alternative payment models, value-based models and risk-based partnership arrangements with our managed care partners, many of which we interact with because of our joint venture strategy. We'll be investing more time and energy into creating structures that allow us to create value through partnerships under Bruce's leadership.



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We fully intend to leverage the momentum we have as the leading partner of choice for hospitals and health systems across the country. We have a pipeline that's as robust as ever, comprised mostly of joint ventures with both large and small health systems as well as individual hospitals.

We have been very selective and strategic in picking the market that we want to move into. And at any given time, we are analyzing 15 to 20 different opportunities. Some are quite large and we have substantial experience there, but we've proven time and again, that the smaller transactions in the right locations create a lot of value such as St. Mary's in Reno and Capital Region in Missouri, which we closed on and announced yesterday morning.

We have substantial dry powder to continue this growth and a growing base of joint venture partner. One in particular has gotten a lot of attention of late, and that's LifePoint. In addition to the 1 acquisition we have already closed on and integrated into our joint venture with LifePoint and the ones we are currently evaluating that are in our pipeline, LifePoint's footprint will likely expand and -- even more, and we anticipate that to result in great opportunity for us to continue to build upon what is proving to be a very strong growth-oriented partnership.

One last topic I'd like to briefly cover is the regulatory front. Since our last call in May, there have been a few pronouncements. The largest, of course, was the July proposal from CMS on the Patient-Driven Grouping Model, or PDGM, that would be implemented in January 2020. The final ruling is expected in November, but there will be a lot of effort by the industry between now and then to work with CMS, much like we did with the HHGM proposal last year.

On a positive note, unlike last year, the Balanced Budget Act of 2018 mandates that any changes made to home health reimbursement be done in a budget-neutral manner. The home health industry is more unified than ever in its messaging and lobbying effort, and we will, of course, continue to be heavily involved in the advocacy efforts on behalf of the industry. The opportunity for growth and expansion of in-home health care has never been greater. The environment is conducive to constructive work with government health care programs and managed-care payers, to expand the role of in-home health care as a means to delivering patient-preferred quality outcomes in the home at significant lower cost than institutional care.

As our history has proven, we remain uniquely well prepared to fulfill the growing demand from hospitals and integrated health systems for an experienced and proven comprehensive in-home health care partner.

We are committed to being a 24/7, 365, healthcare organization that never sleeps and that can be counted on to always be there to meet the needs of those we are privileged to serve in communities throughout our country. We are able to honor and consistently deliver on this commitment only because of the dedication and exceptional efforts of our many clinicians and administrative support personnel who consistently exceed expectations in their respective areas of responsibility. I am so grateful to all of you. Thank you. Our LHC Group family is blessed by your personal commitment to go the extra mile to deliver on our promise. Thank you for all that you do each and every day for the many patients, families and communities we are privileged to serve.

Now here's Josh to provide some color on our financial results and our guidance for 2018. Josh?

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

Thanks, Keith, and good morning, everyone. Thank you all for joining our call. As always, I'd like to begin my prepared remarks by saying how much I appreciate all of our clinical professionals and what they do each and every day. Every quarter, we have been able to share industry-leading quality and patient satisfaction star ratings from CMS, and this is due to the high quality and exceptional service that you provide to the patients, families and communities that we are blessed to care for. I would also like to thank our new family members from Almost Family and our home office support teams who have worked tirelessly to ensure a smooth transition with the merger. To you all, a very heartfelt thank you for all that you do that makes our LHC Group family so special.

With regard to our second quarter financial results, here are the big takeaways. First, net service revenue increased to a record of \$502 million and adjusted net income increased 128% compared to the same period of 2017. Adjusted net income was \$0.84 per diluted share, which excludes merger and other transaction-related costs, expenses related to serving closures and relocations and the income tax effect of adjustments to



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income due to certain deal and transaction costs that are not deductible in the aggregate amount of \$9 million after tax or \$0.29 per diluted share. That's a 33% increase over the prior year.

The \$9 million after-tax adjustment consists of the following: Almost Family transaction expenses and transition cost of approximately \$5.9 million, which includes items like consultant fees, legal fees, severance payments, stay-on bonuses and other transition-related expenses; expenses associated with the closure, relocation or consolidation of 4 home health agencies and 2 long-term acute care hospitals of approximately \$2.5 million after tax. These costs include \$1.5 million for intangible impairments and lease termination charges associated with the closure of 1 LTACH in a rural Texas community and the consolidation of 2 LTACHs in Beaumont, Texas. We also relocated 2 of our legacy LTACHs into 2 new host hospital facilities during the quarter where we expect the benefits of higher capacity from ICU patients and better collaboration with the host hospitals and other referral sources.

Lastly, our effective tax rate increased to 29.9% due to certain deal and transaction costs that are not deductible related to the Almost Family transaction. We continue to anticipate a normalized effective tax rate of 28% to 29%.

Home health same-store revenue grew 9% in the second quarter due to our growth in same-store admissions in home health of 7.9% and an increase in our patient acuity in the quarter as compared to the same period last year.

Now moving on to margins. On a consolidated basis, our gross margin was 34.3% in the second quarter as compared to 37.4% last year. Adjusting for the transaction-related and other costs and expenses I just described, our consolidated gross margin was 34.6% while LHC Group stand-alone gross margin was 37.8% in the second quarter, which is an increase compared to last year.

Home health gross margins were 36.1% for the quarter compared to 38.9% for the same period last year. However, it's important to note that LHC Group stand-alone home health gross margins are up to 39.4% of revenue in the quarter, up from 36.1% in the second quarter of last year and sequentially up from the 36.3% last quarter.

Home health adjusted EBITDA margin in the second quarter was 10.3% compared to 10.1% in the second quarter of 2017. On a stand-alone basis, LHC adjusted EBITDA margin was 10.6%, again up from last year's 10.1% and sequentially up from the 7.4% last quarter.

Hospice gross margins of 33.7% for the quarter compare to 35.3% for the same period of last year. LHC Group standalone hospice margins are up to 36.3% in the quarter, up from the 35.3% last year, and again, sequentially up from the 34.3% last quarter.

Moving on to EBITDA for hospice. Our adjusted EBITDA margin for the second quarter was 7.1%, which was the same as it was last year in the second quarter. LHC stand-alone was 7.9%, up from the 7.1% last year and sequentially up from the 5.8% last quarter. We continue to see great improvement in our hospice service line, as expected and are pleased with this positive trajectory.

The facility-based EBITDA margin came in at a negative 4.1% for the quarter compared to 2.4% last year. However, included in that margin was \$2.9 million in cost associated with the closing of the 2 LTACHs and the relocation of the 2 others that I described earlier. Adjusted EBITDA margin for the facility-based segment is up to 6% for the second quarter, which is up from the 2.4% in the second quarter last year and sequentially up from the 5.3% last quarter.

Home and community-based EBITDA margin was 1.7% for the quarter as compared to 5.6% in the same period last year. On an adjusted basis, the EBITDA margin for that segment is 3.5% while standalone LHC Group was 5.6%, which is in line with our quarter last year and sequentially up from the 3.5% in the first quarter.

As illustrated by the breakdowns in the margins that I just discussed, we definitely see upside opportunity and improved margins across all segments of the legacy Almost Family business. During the first quarter post-closing and throughout the balance of 2018, our priorities have been, and continue to be, a smooth back-office integration along with a focus on growth and operational stability, but we do expect to see the benefits from margin expansion across all segments of the business as we head into 2019.



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Now for an update on our 2017 acquisitions. We continue to see and are very pleased with the sequential improvement each quarter in the consolidated gross margin for the deals we brought in last year, which were, as previously reported, 17.6% in the third quarter of last year, up to 28.5% in the fourth quarter, up to 30.5% in the first quarter of this year, and they came in at 32% this quarter.

Moving on to general and administrative expense. Our G&A was 28.2% of revenue in the second quarter as compared to 28.6% for the same period last year. Adjusting for transaction-related and other costs, our consolidated adjusted G&A expense as a percent of revenue was down to 26% or a 220 basis point reduction to G&A expense as a percent of revenue from Q2 of last year.

Moving on to bad debt or implicit price concessions. Our reduction to revenue from implicit price concessions represented 1.5% of revenue in the second quarter as compared to 1% in the second quarter last year. LHC Group stand-alone implicit price concession was 1.3%, which is within our expected range for the year.

Free cash flow was negative \$18 million in the second quarter, and that was caused by an increase in accounts receivable of \$25.7 million in connection with the Almost Family transaction and an increase in cash outlays related to new IT investments and insurance renewals of approximately \$6.8 million, all related to the merger. Excluding those items and the transaction costs that I've described earlier, free cash flow would have been a positive \$26.7 million for the quarter.

Turning now to our annual guidance. We are reaffirming our guidance for fiscal year 2018, which was issued back on May 2. We continue to expect net service revenue to be in the range of \$1.81 billion to \$1.86 billion and adjusted earnings per diluted share to be in the range of \$3.45 to \$3.55.

This guidance assumes the following: one, the company expects to achieve a total of \$25 million in pretax synergies in connection with the Almost Family transaction with \$8 million to \$12 million realized in 2018, of which approximately \$2 million has been realized through the second quarter. Second, an estimated effective tax rate of 28% to 29%, which reflects the positive impact from the passage of the Tax Cuts and Jobs Act of 2017; and lastly, weighted average diluted shares of approximately 28 million for the year.

Let me pause and comment a little further with regard to the \$2 million realized synergies in the second quarter. First of all, this amount was in line with our expectations prior to closing the transaction and was factored in to our \$8 million to \$12 million range that we provided earlier in the year. Also, we do expect a higher number of realized synergies in Q3 and realized synergies to continue to escalate in Q4.

Now back to guidance. Our guidance ranges do not take into account the impact of future reimbursement changes, if any; future acquisitions, if made; de novo locations, if opened; or future legal expenses, if necessary.

Due to the difficulty in estimating the cost of the transaction with Almost Family and its impact on GAAP net income per diluted share, we are only providing guidance to adjusted net income for 2018.

That concludes my prepared remarks, and I am happy to further address and answer any questions during the Q&A session.

I'm now pleased to turn the call over to Don.

Donald D. Stelly - LHC Group, Inc. - President & COO

Thank you, Josh. And good morning, everyone. We have maintained the strong momentum established earlier in the year and I, too, would like to thank our team members who make up our LHC Group family. Goodness, what a year so far.

Now drilling down into our second quarter results, I'll begin with home health. In this service, our organic admissions were up 7.9% over the same period prior year, with acuity up among these admissions as well. Now that LHC and Almost Family are combined, it's a bit more instructive to look at same-store admissions for each, although separate this quarter.

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For LHC, same-store admissions were up 7.9%, and Medicare same-store admissions were up 5.4%. And for our merged agencies, that same-store total was 6.1% while same-store Medicare was 0.5%. Combined with all other recent acquisitions, that leads us to a 98% increase in admissions. Strong, indeed, but growth that we clearly will build upon as structural and programmatic changes become norm and concurrent monitoring and management take hold across all acquired and merged assets.

Quality has been, and is, our #1 differentiator. And it's a primary driver of organic and nonorganic admissions. To underscore this with a little more detail, I'm pleased to report that, again, we excelled in the most recent CMS STAR ratings for both quality of care and patient satisfaction. For home health quality of care, 98% of our same-store LHC locations have 4 stars or greater, and for patient satisfaction, that number is 92%.

On a stand-alone basis for LHC for the quality rating, we produced a score of 4.70, excluding recent acquisitions, while the July report, which is an improvement over the 4.68 score from the April release.

This compares favorably with a national average that has been within a range of 3.25 to 3.28 for the last 5 quarters. Our most recent patient satisfaction STAR rating was a score of 4.36 as compared to the industry average of 3.70.

For the newer merged agencies, the quality score in this most recent release is 3.63 and a patient sat STAR rating of 3.82 stars, as this compares with their 3.61 and 3.83, respectively, for the April report. Again, one of the more compelling opportunities that we have as a combined company is to now bring these scores up to what we expect at LHC, and we'll keep you informed as we do so.

In our hospice segment, we continue to make improvements since changing structuring processes in the fourth quarter of 2017. There's a work ahead, but we are pleased with the 210 basis point improvement in margin from our last quarterly report and our 2.5% organic growth in this Q2 still allows us to hit the 5% mark for the full year that I talked about last quarter.

Hospice is vital to our continuum and our commitment to improvement, and operational excellence could not be more evident from our team.

Next, you may have noticed in our earnings release that we have renamed what historically LHC Group called community-based services, and what Almost Family historically called personal care. Now a combined segment, we refer to it as home and community-based services. This naming follows the CMS definition for providers that offer services ranging from skilled to nonskilled and will allow us to broaden these offerings as we build out our in-home service network across the country.

Next, I'll touch on integration. From a joint-venture standpoint, LifePoint, CHRISTUS and Baptist are entirely in model, so now we focus on the fundamentals supporting financial and quality improvement. Along the way, as Keith mentioned, we will seize the opportunities that come with the expansion along with partnering with these great health systems.

Sticking with the JV front, Erlanger, which we completed on December 1, 2017, is fully integrated, and our May joint venture with St. Mary's health network is ahead of plan, both allowing a seamless integration of the 2 joint ventures we just announced.

As it relates to the recent merger, let me say that specifics, of course, of any sort can be addressed during Q&A. There is so much involved. So rather than go into detail during these prepared commentaries, I'll simply say that integration plan and its planning is right on track. Leadership is in place, the support infrastructure assigned, and our team is focused clearly on the plans created alongside BRG. The good news is we're already seeing collective efforts show up at several key areas such as growth, margin improvement and quality improvement, but even better and great news is that this merger sets up a nice back half of this year, positions the company very well in 2019 and beyond.

In closing, I do send a sincere thank you to all of my fellow LHC Group family members, and also thank everyone for listening in on our call this morning thus far.

Liz, we're now ready to open the floor up for questions.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Kevin Ellich with Craig-Hallum.

Kevin Kim Ellich - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

I guess, Keith, first of all, thanks for the regulatory update, but could you give us a little bit more detail as kind of how you're viewing not just home health and what the industry is doing to get whatever changes you need done for PDGM in 2020?

Keith G. Myers - *LHC Group, Inc. - Co-Founder, Chairman & CEO*

Yes, sure. Well, of course, we are working through the partnership and in collaboration with NOC and all the state associations in preparing formal comments to submit to CMS. We're also pursuing legislation on the Hill to -- as a Plan B in advance of those efforts and our comments aren't successful. But we're encouraged with it. I'm encouraged with the tone and dialogue we're having with CMS and HHS. I think they genuinely are listening to us at a level that wasn't there 10 years ago, maybe not even 5 years ago. We just really, really have a seated table, so I'm encouraged by that. There's nothing in the rule that, in its current form, even that keeps us up at night but there are opportunities to improve it. And these are fresh comments. I'm just back from Washington, D.C. I was in Baltimore yesterday morning and Washington yesterday afternoon, so I feel really good about it.

Kevin Kim Ellich - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. That's great. And then, I guess, we've seen the nice gross margin improvement in the 2017 acquisitions that Don talked about. What's been the real success and main drivers behind the LifePoint JV and the expansion that you're seeing there?

Donald D. Stelly - *LHC Group, Inc. - President & COO*

This is Don. I think the first thing is that the LifePoint JV was announced as one, but it was such a multitude thing that we found as we went across the portfolio of LifePoint. So getting that consistently in the model, in a consistent in the vernacular and the way we concurrently manage the sales force, it really gave us a boost in the top line. And then, of course, when you execute the operate model, it becomes pretty predictive in margin. Then I think the last thing is -- that I would offer to the LifePoint team is that they were poised and ready. They really understood some of the concepts of concurrent management, managing the P&L and the metrics, whereas sometimes in other joint ventures that may be not up to speed in that realm, take us a little bit longer. So I guess, all told, they were poised for this readiness a little bit more so than we see and that's why the turnaround happened a little quicker for such a big asset.

Kevin Kim Ellich - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Okay. And Don, since I have you, really nice improvement on the quality scoring and STAR ratings, but I guess, what's your plan to improve the STAR ratings and qualities for the agencies acquired from Almost Family?

Donald D. Stelly - *LHC Group, Inc. - President & COO*

It's a great question. It starts with structure. And I'll jump to sales, although you didn't ask that. In the Almost Family structure, both the quality improvement and performance improvement team as well as the sales team were undertucked in the operation's leg, meaning that the division presidents of Almost Family had direct line responsibility. We've been doing this for a bit, and there are different ideas and thoughts there. We found that taking it outside structurally of operations is a better way to go. We've already done that for quality. So that's going to prepare us to be



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able to execute what we call these anchor duties and some of the things that are statistically correlated to the betterment. And so we did that even before converting the Homecare Homebase so that we could improve the quality faster as we then got ready to start growing and putting the model in through the next 6 to 8 months. And it's similar to sales, I won't go into that unless somebody has a specific question. So then the last comment about that is using the data for concurrent management. So many people -- we announced today the CMS ratings that were released in July. The key is don't look at that concurrently to managing this business. Use SHP or your reporting, and some of the things that we've created internally to manage the episodes today so that you keep that trend going and you don't lose ground. So at a high level, those are the 2 things: the structural improvement and the process flows that we put, both that are proprietary and not.

Kevin Kim Ellich - *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*

Got you. Let me sneak one in with Josh real quick. On the LTACHs, you announced a couple of closures and, I guess, consolidation but it looks like the operating income and profitability turned. Is that -- does that have to do with the merger? Or is there something else going on with that segment?

Joshua L. Proffitt - *LHC Group, Inc. - Executive VP, CFO & Treasurer*

Yes, it has nothing to do with the merger, Kevin. It really is just a lot of the things we put into place last year adjusting to the new reimbursement model and the ICU percentages and all that, we're starting to really see bear fruit. I would also comment that when we brought in the CHRISTUS LTACHs, we had some opportunity to improve them and operationalize and get better margins out of those, which we're seeing. So if it wasn't for the noise around the closures and the rels, as you can see in our adjusted numbers, the LTACHs are really performing well right now.

Operator

Our next question comes from Frank Morgan with RBC Capital Markets.

Frank George Morgan - *RBC Capital Markets, LLC, Research Division - MD of Healthcare Services Equity Research*

I was hoping to maybe get a time line on this expected improvement in the margins in the AFAM portfolio relative to you. Can you kind of give us some timing milestones of kind of how that plays out? And then secondly, in relation, Jeff (sic) [Josh], to this pending LifePoint transaction with both RegionalCare and Capella, just -- you alluded to this, but maybe some more color around what the opportunity may be there in terms of additional expansion in home health in their markets? And maybe are you already overlapping with either Capella or RegionalCare to date?

Joshua L. Proffitt - *LHC Group, Inc. - Executive VP, CFO & Treasurer*

Yes, Frank, this is Josh. I'll take the first one and then kick it over to Don and Keith to jump in on the LifePoint piece as well. As far as the expectations for the kind of period-over-period incremental improvement in the margins for Almost Family, as I mentioned in my prepared remarks, we've really been focusing on, as you would expect, ensuring a smooth transition, ensuring a positive growth trajectory, which Don spoke about, and really making sure that the operations are stable. I would tell you this, we've now been through 4 cycles of monthly operation reviews, or MORs, with our new division president colleagues from Almost Family. And their readiness, their eagerness, the receptiveness to wanting to concurrently manage the business a little bit differently than they had in the past and utilizing the tools that we utilize in some of the dashboards and some of the concurrent reporting that we do, they're hungry for it and they're running toward it. We're actually keeping that at a pace to ensure that we do the first things I mentioned, which is integrate smoothly and grow the business. So I mean, I think you'll see some incremental improvement in the back half of the year, but I'm really excited about what that's going to mean for 2019 and beyond because there's some real opportunity there.



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Donald D. Stelly - LHC Group, Inc. - President & COO

And Frank, this is Don. I'll add is we're not ready to say how much improvement we'll see on the back half but just in the drag elimination alone, which is even before any home-office allocation, our last MOR qualified that to start going away as we go into fourth quarter. And then the other component that we're really excited about is that the sales cost as a percent of net revenue we believe is about 250 basis points too high. It's not because they have too many people. They have too many people right now not producing the margin that we know that they can when we put in some of our things such as PlayMaker. So those 2 are going to give us a little shot in the arm in the back half, but I agree with Josh. The fully recognized SWB and the G&A that we are working on takes a little longer, so I would look to really see that mature in the first quarter of next year and beyond.

And I guess, Keith, I'll jump out and you talk about the LifePoint Capella.

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Yes. So we were delighted to see the LifePoint Capella track announcement. So we've had discussions in the past with Regional. Marty Rash there, as you may not know, is a former colleague of Don. Don worked, was a CEO in their system. So we had discussions. We never really got anywhere. I think they were just a bit distracted; they were interested in moving directionally toward something. So when this got announced, David and Bill still being in the leadership role of the combined organization is a huge positive for us because I think they're going to move forward more quickly to take advantage of the opportunities in the Regional or Capella footprint.

Operator

Our next question comes from Matt Larew with William Blair.

Matthew Richard Larew - William Blair & Company L.L.C., Research Division - Analyst

I wanted to ask about the timing of some of the synergies with AFAM. You mentioned that the \$2 million was on track with your schedule but perhaps I incorrectly assumed to be a bit more ratable throughout the year. That must mean you have a pretty good line of sight to what's going to occur here in the back half. Can you give us a sense on what you're seeing and what you're projecting for? What those synergies are in the back half of the year?

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

Sure. Absolutely, Matt. We're anticipating somewhere between \$3 million and \$4 million in the quarter of Q3 and then somewhere between probably \$4 million to \$4.5 million in Q4 to get you around the middle of \$8 million to \$12 million. I feel pretty confident and I would still want to bracket the range of \$8 million to \$12 million, but we got a pretty good line of sight for around a \$10 million number. But if you got \$2 million in Q2, call it \$3.5 million or so in Q3 and \$4.5 million or so in Q4. And that's not just spitballing. I mean, there's a very detailed plan that we are executing upon, which is why I wanted to make sure in my prepared remarks to say that the \$2 million was in line with the plan. One nugget I'll give you. There was a pretty significant number of back-office team members that we let go on June 29. So we needed them to help in the transition but they were let go on June 29. Their dollar figures, obviously not a synergy in Q2, but I can already quantify that and see it with clarity in Q3. So I feel really good about the numbers.

Matthew Richard Larew - William Blair & Company L.L.C., Research Division - Analyst

Okay, I appreciate the detail, Josh. Keith, I just wanted to get your perspective on HCI and what Bruce is going to be focusing on. Obviously, from a revenue standpoint, right now isn't all that meaningful but perhaps incorporating the broader strategy over time, it sounds like you have some interesting ideas.



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Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Yes. So the core competencies at Imperium, the ACO development management company within HCI, that's the same skill set and the same approaches we use in all of the value-based models or alternative payment models. And I think there's huge opportunity to expand that part of our business, not only in ACOs but in value-based arrangements that we will structure with managed care providers. So Bruce comes with experience and skill set that has him uniquely prepared to accelerate our progress in that area.

Matthew Richard Larew - William Blair & Company L.L.C., Research Division - Analyst

Okay. And I did want to ask about hospice. I know you made a number of changes in Q4, but obviously still a bit below. And Don, maybe you could just help us understand why you're comfortable that, that 4% to 5% is an achievable number here in the back half of the year.

Donald D. Stelly - LHC Group, Inc. - President & COO

Yes. With the changes that we made, we specifically didn't increase the sales force as we did on the home health side. Specifically, we're only up 3 account executives from the beginning of the year until we got our operational legs back under us. Now that we have that, we have 15 planned between now and the end of this year and another 25 planned between January 1 and June 30 of next year already. And those plans are very specific to the markets, our market share and the operational readiness. So yes, it really did. And I cautioned everyone and I was extremely transparent on our last call with the progress so I'm really pleased. And my last nugget, for example, is that the number of locations in the footprint now we split that entire book of business into 2 separate -- internally 2 separate divisions, and we do not even have our sales leader. We're in final interviews right now, our sales leader for the second 1 of those 2. So I feel really good that we've got the people, we know how to do it and the results will trail as we go forward into the fourth quarter. And really, this division is poised to attribute more so than ever before as we turn into next year.

Operator

Our next question comes from Joanna Gajuk with Bank of America.

Joanna Sylvia Gajuk - BofA Merrill Lynch, Research Division - VP

In terms of the home health performance, can we just talk a little bit about that? As the organic growth continues to be quite impressive -- 9%, right? But in the past, you talked about the 5% to 7% for the year. So should be kind of assume that -- are you going to beat that number again this year?

Donald D. Stelly - LHC Group, Inc. - President & COO

Well, we could exceed that, Joanna, but remember, we're going into the hardest part of seasonality, especially when we bringing on Florida's AFAM book of business. So for right now, I'd caution against getting too far ahead of that because I -- under our watch, to be candid, I don't know what to guide you to on Florida's -- of the AFAM Florida right now. So because of that, we didn't want -- I didn't want to come out and go higher than that 5% to 7% range.

Joanna Sylvia Gajuk - BofA Merrill Lynch, Research Division - VP

No, that makes sense. And then for the Medicare, you said the Medicare same store was up 5% or so. So sounds like the non-Medicare business growing. So can you just give us an update on where you stand with the MA plans, with Medicare Advantage plan? Any progress on shifting to more of the risk-based contracts? Or at least episodic-based contracts? Any color you can give us there will be great.



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Donald D. Stelly - LHC Group, Inc. - President & COO

Well, Josh will give you specificity on that. But what I am excited about is right at a year ago at this time, we said we want to be very strategic on that selection and we were going to gear towards some of those rates and I think Josh will allude to that right now. But I don't want anyone to think that, that's just a free flow and it's unplanned to have that mix disparity. It is extremely planned out of where we go and which ones we take. Josh?

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

Yes. No, Don, it's a great lead in. And Joanna, great question. And I'll attack it from a couple vantage points. First and foremost, on just the core business. You asked are we seeing anything innovative, any risk-based value upside models? The short answer there is we've got a few pilots in place and we continue to have a seat at the table and engage in those conversations. I'll tell you the receptiveness of the payers and the level of conversation we are having is at a place we've never seen before. So I'm very confident that some of the pilots that we're going to be able to prove the incremental value within can then turn into something greater in the future. But we're not there yet in any kind of large scale. But I want to really applaud our operations team across the entire company because over the last 1.5 years, as we've seen some of that mix shift that Don just spoke to our intentionality about, it's not just intentional about how you throughput it. It's also the efficiencies from a back-office standpoint. Our collections are better than ever before. Our DSOs are going down in that business, and so our bad debt has improved. We have seen a little bit improvement in the rates. So our team is doing a great job of negotiating the contracts and year-over-year, our rates have gone up and our direct cost per visit have gone down. So we are better marginalizing that business throughout the course of the year while we look toward the future and some of these value-based arrangements that we're going to enter into.

Joanna Sylvia Gajuk - BofA Merrill Lynch, Research Division - VP

That's great color. And then on the PDGM proposal, I appreciate the comments that it looks much better obviously than what was proposed last year. Any comments in terms of how you plan to prepare? Are you starting already or are you kind of waiting for the final rule to come out before you do? And also can you just clarify. So given the fact that it's effective January 1, 2020, will there be situation where you will kind of have to have 2 systems going on because some of the patients admitted prior to January 2020 will stay with you, right? So they will be paid under the prior system and then those admitted after January 1 will be under the current system. So does that create some sort of disruption because of that? Are you guys thinking about it? Are you preparing for that?

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Okay, thanks, Joanna. So I'm going to -- I hear that as 2 distinct questions. One is as the rule is currently proposed, I think you're essentially asking how disruptive that would be in its current form if it got implemented in January 2020. Don will take the first half and I'll take the second.

Donald D. Stelly - LHC Group, Inc. - President & COO

Well, I guess, Joanna, how you define disruptive is important in my answer because on one stretch, I don't want to lead you to think that it's a nonevent and a nonissue, but on the other side, I also want to caution that, that's what we do, is when we see these issues, we've got to underscore the plans of care accordingly. What I would say on that is that, since I've been with Keith here for 13 years, regardless of the rule, the patient plans of care are going to coincide with our disease management processes. Our expected outcomes are still going to be [saturated] whether it's [36P] or whatever kind of payment methodology they're going to choose. So while we can't score that right now, obviously, it's going to be operational changes that have to coincide with it. But I don't think right now I would just say it's totally disruptive and in any way offsets the way we provide care to the patients. I really don't.



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Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

I think maybe this will help clarify it. So our analysis indicates that if it were implemented now with our current patient base under our operations as they are today, the impact to us would be a negative 1.5%? 1.2%, Eric's telling me. But then that would be offset by a market basket. So at a higher level, when I say that even in its current form, it's not as good as it could be, it should be, but it's not something that's keeping us up at night for that reason, Joanna. If that make sense.

Joanna Sylvia Gajuk - BofA Merrill Lynch, Research Division - VP

But any comments in terms of when you will start to -- or are you planning to change how you, I guess, operate under the current model? Are you making some plans already this year? Or it's more sort of waiting to see the final reg and then you start to work your way through it next -- earlier next year?

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Yes, so let's talk about that a minute. For -- LHC's approach to the benefit has long been a middle-of-the-road approach. So we don't target any specific patient groups that have better margins than others. I've had certain mentors along the way, 2 of which are -- 2 of our board members, former board member, Senator Breaux, and Chairman Tauzin is our lead independent, and back in the '90s, they would tell me that not -- to be careful not to allow the organization to start focusing on any 1 group because government payers will eventually identify those opportunities to reduce costs in certain groups and they'll rebound. So our patient distribution mirrors the average distribution of all home health beneficiaries that receive home health, which protects us from having any disproportionate hit, if you will, when they target an area. So that means that there's not a lot of opportunity in our model to pivot from focusing on 1 group of patients to another group of patients, but we also don't -- the impact to us is, is -- the risk is less in these kind of situation. All of that said, certainly there are always opportunities to improve our operations. And we have a long track record of, I believe, of being able to adapt to change, at least as well as anyone else in the industry.

Donald D. Stelly - LHC Group, Inc. - President & COO

And Joanna, there's that -- I know Keith and I are going back and forth because, I guess, we're -- I would say this, there is no master plan because there's no great necessity to have it. It's more of how you live within a framework. And it's the same thing with the way OASIS (inaudible) do this coming through. It's disruptive, but it's just what we do. You've got to mitigate that through knowledge, education and stick with the plans of care.

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

I think I would say that would be potentially disruptive because, I mean -- but that's just -- that's what management is all about in this business. You have to be always ready for change and be able to adapt.

Donald D. Stelly - LHC Group, Inc. - President & COO

Exactly.

Joanna Sylvia Gajuk - BofA Merrill Lynch, Research Division - VP

That's great color. I appreciate it. If I may squeeze a very quick question. The CapEx was high this quarter, \$11 million. I guess, there must have been something unusual. So how should we think about the CapEx sort of a run rate number under the combined entities?



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Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

Yes, Joanna. This is Josh. I'll take that. As you're familiar, our CapEx run rate any given quarter usually stays between \$2 million and \$3 million. This quarter, it was unusually high. I spoke in my prepared remarks about a lot of investments in IT, on putting some new platforms in place, so with the Almost Family side of the business. So we have definitely seen an increase in CapEx this quarter around the Almost Family transaction. From a run rate standpoint, I think you'll see us going back down into kind of the probably \$3 million to \$5 million for the remainder of the year. It will be a little bit higher than it has been historically just because of the size change in the company, but I think this quarter was a little bit of an anomaly.

Operator

Our next question comes from Matt Gillmor with Baird.

Matthew Dale Gillmor - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

I just had a couple of follow-ups. On the JV pipeline, I think Keith mentioned there were several large opportunities, and it seemed like that was in addition to LifePoint and RegionalCare. So I was hoping you could kind of characterize those conversations and sort of size up how meaningful some of those larger ones may be.

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

I'm going to let Josh take that because he's also the attorney in the room.

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

Matt, this is Josh. I'll tell you at a high level, the top line is very robust and full. As Keith mentioned in his prepared remarks, there are some freestanding opportunities in there that we're currently looking at and kicking the tires on, so to speak. But on the JV side, we've got a top line that ranges from individual hospitals that have anywhere from \$2 million to \$10 million of TTM revenue for home health hospice or both, all the way up to a few systems that we're actively engaged in conversations with that would have somewhere between, call it, \$15 million and \$50 million in revenue, just to kind of put a few ranges out there. They're all at different stages of maturity in the conversations, so I don't want to be making any promises of when you're going to see those get announced but feel very good about the conversations that we're having and the pipeline that we're working through.

Matthew Dale Gillmor - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Got it. That's helpful. And then a follow-up on the group or model changes. I think Keith had also mentioned that you may turn to legislation if some of the comments that you intend to make are incorporated in the final rule. I was just kind of curious what elements of the rule you'd like to see changed through the legislation? Are we talking about the budget neutrality? Or the behavioral change adjustments? Or are there other areas that you're really focused on?

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Yes, I mean, so it's a great question. Thanks for the opportunity to clarify that. So I think I would describe what we're pursuing through legislation as a really clarification and technical corrections. So around budget neutrality, we truly believe the intent is to not adversely impact reimbursement to the extent that it would slow or interfere with the momentum we have in moving patients downstream from more costly inpatient settings to home health. We think that's the intent. But as written, it could be interpreted as an aggregate cap on home health spending. Meaning that if more patients come to home health, we want to make sure that -- that there would be no cap on spending for home health. And everyone we talked to says, "Well, of course, that's what we mean," but it's not clear. And then we'd like additional clarification around the 30-day payment periods to

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more specifically state that, that's not a 30-day certification period, but 2 30-day payment period within 1 60-day certification period. And then that's all about ensuring that we don't have to go back to a physician every 30 days for a certification, which could be another process at a cost.

Operator

Our next question comes from Brian Tanquilut with Jefferies.

Brian Gil Tanquilut - *Jefferies LLC, Research Division - Equity Analyst*

Keith, just taking a step back and looking at the organic growth performance that you guys have put up in the legacy business and the margin improvements, where do you sit today? I mean, how do you think about the sustainability of this mid- to high single-digit organic growth? And then cost per visit, you've done a good job there. I mean, how many -- what else is there to pull in terms of leverage so that you can keep driving that better?

Keith G. Myers - *LHC Group, Inc. - Co-Founder, Chairman & CEO*

So I think the -- that these levels of growth, mid- to high levels single digits, I think it's sustainable for this reason: with the quality scores, as Don mentioned, I mean, we're taking -- certainly taking market share as we should be from lower quality providers. That's how it should work. But we also have more patients coming to home health. Patients that previously went to -- primarily to [sniff.] That's -- everywhere we go, that's a conversation that's being had at all hospital systems and even in Washington. So I think there is a lot of room left for us to harvest that. Don, maybe you want to...

Donald D. Stelly - *LHC Group, Inc. - President & COO*

Brian, just to put a little data behind Keith's words. In preparing for the call, I reran these numbers. Year-to-date in the combined newco, we received patients from 1,143 counties in our portfolio. Of that, 111 of those counties generate roughly 50% of our admissions. And so we see a tremendous opportunity which coordinates into that sales force increase that I talked about to really go out in these tangential markets. And so your point is -- and listen, I actually appreciate your point because we have put up industry-leading growth quarter over quarter over quarter for years. So to do 1 or 2 quarters in a year and pop it out is one thing. To sustain it is your point. And what I'm really happy about is this data that we just ran shows that it is, in fact, sustainable going out to the next few years.

Brian Gil Tanquilut - *Jefferies LLC, Research Division - Equity Analyst*

And then in margins, Don, what are your thoughts on that one?

Donald D. Stelly - *LHC Group, Inc. - President & COO*

Again, that's really not attributable just that -- to that growth. It's really cleaning up some of these things as you get this big, that old 80-20 rule. At any given time we have 20% of our portfolio, we know we can better marginalize the business coming through the door today. So as you do that and as you continue to grow, those same trends will follow. So I think we've seen the floor certainly with our Almost Family merger. It is really an exciting time to marginalize what's coming through our doors.

Brian Gil Tanquilut - *Jefferies LLC, Research Division - Equity Analyst*

And then, Don, if I shift gears to AFAM, to the AFAM side, I mean, as I look at it, I mean, growth there was probably flattish through -- just slightly up on an organic basis. And I know you've got 1 quarter and you guys have done a good job. You are stabilizing it and integrating it without any



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big hiccups. So how should I be thinking about your ability to accelerate that growth, and what's your thinking in terms of the cadence, timing of accelerating growth at AFAM?

Donald D. Stelly - LHC Group, Inc. - President & COO

Well, then, if you look at their 0.5% right now, that's absolutely the floor because -- and I don't want to go into too much detail but even the way the incentive plans are structured, it's not conducive to some of those things that we're seeing. So I wouldn't bake in much right now because, remember, we're still putting in the Homecare Homebase single instance. We now have to turn our attention towards OASIS (inaudible) clinically. I think you really start seeing this accelerate in Q1 and beyond. And I don't see any way that we're not up at that 5% to 7% growth as we go into the summer months of next year.

Brian Gil Tanquilut - Jefferies LLC, Research Division - Equity Analyst

Got you. And last question for me. Josh, as I think about the seasonality and the innovations business, there used to be seasonality when it was run by AFAM. How should we be thinking about that for the rest of the year?

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

For those on the call that followed AFAM, I mean, you clearly have a historical line of sight that tells you that the second half of the year, you have a pickup from the ACO business from Imperium. And the way that works is throughout the course of the year, you're getting a PMPM, but a lot of the revenue comes in, in Q3 and/or 4, it's varied from year to year on the MSSP, which is the Medicare Shared Savings Program piece to the revenue. So as you saw with them, I would expect the same with us, that we'll see some increased revenue there either in Q3 or Q4.

Operator

Our next question comes from Bill Sutherland with The Benchmark Company.

William Sutherland - The Benchmark Company, LLC, Research Division - Equity Analyst

Just I think 1 or 2 at this point. Don, you mentioned Homecare Homebase, the rollout there since I think it was just beginning to be implemented by AFAM. How should we think about the impact and the time line on getting that really turned up as you have with your home system years ago?

Donald D. Stelly - LHC Group, Inc. - President & COO

Good question, Bill. Thank you. The rollout is complete, so Homecare Homebase is inside of the existing portfolio. My commentary was about a unified, what we're calling instance. In other words, Homecare Homebase is the vehicle but the configurations of the workflow are not like the legacy LHC Group. The timing of that is probably going to go through Q1. But unlike in previous, we don't expect any margin decay as we do that. And so Josh's numbers that he's guided to incorporates that. And I think it will be upside when we announce our guidance next March.

William Sutherland - The Benchmark Company, LLC, Research Division - Equity Analyst

Upside in what sense, Don?

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Donald D. Stelly - LHC Group, Inc. - President & COO

In the margin that we keep talking about. For example, the 200 basis point SWB, it's going to be directly attributed to all of that being in place as we begin 2019.

William Sutherland - The Benchmark Company, LLC, Research Division - Equity Analyst

Okay. And real quick, Josh. I think I may have missed when you talked about ARs at [6 30.] The reason they were up and the outlook there for AR.

Joshua L. Proffitt - LHC Group, Inc. - Executive VP, CFO & Treasurer

I know it's just a factor of timing with the transition and what's on the balance sheet and the cash flow statements, there's nothing unusual happening within AR. It's just the AFAM AR that came over. So we expect quite a bit of cash flow coming through the door here in Q3 through that. DSOs were solid. Collections were really good.

Operator

And our last question comes from the line of Dana Hambly with Stephens.

Dana Rolfson Hambly - Stephens Inc., Research Division - Research Analyst

Just a clarifying question and then a follow-up. Don, on the -- I think you said 200 to 250 bps on the SW and B. You're talking about improving AFAM's legacy by 200, 250 basis points, and that's all margin to you, is that correct?

Donald D. Stelly - LHC Group, Inc. - President & COO

It is, Dana, and we expect that to drop straight down, yes.

Dana Rolfson Hambly - Stephens Inc., Research Division - Research Analyst

Okay. And that's separate from the \$25 million in synergies, correct?

Donald D. Stelly - LHC Group, Inc. - President & COO

It is.

Dana Rolfson Hambly - Stephens Inc., Research Division - Research Analyst

Okay. All right. And then just -- you talked about going into the merger, the importance of culture and how the 2 companies shared a similar one. And I do think it's very important, but it is difficult for us on the outside to measure. So I was wondering maybe if we could just talk about it, I think employee turnover would be an indicator. Can you just talk about how employee turnover has trended since the deal closed just a few months ago?



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Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Yes. So we couldn't be more pleased with the cultural integration. This is Keith. And that's an area that we all spend a lot of time on but I specifically do. I think a lot of it has to do with the culture at Almost Family that William created over a number of years and how we brought the 2 organizations together. So everything else mattered. How we handled the employee integration, how we approached the challenging issues such as benefits. So as we went through the process with BRG, we -- by starting back in November and doing all that work ahead of time, we identified people that would fall through gaps, our groups, and we were able to proactively address those. That lessened the percentage of people that had issues whenever we transitioned everyone to 1 common platform. But then even for those, the ones that where there were issues, we had people working around the clock on weekends to respond to those people immediately. And we've gotten just so much positive feedback from employees about how much they appreciate it. That and just thought that the organization as a whole just went above and beyond to make sure that no one fell through the cracks. I think super proud and appreciative of everybody in our team that made that happen. And I think the benefit is that we've gained a lot of goodwill with our employees and built incredible trust. I'll close by saying in a very real way, our confidence level goes even higher when we have organizational meetings with all leadership in the combined organization together. Leaders that were formerly either LHC or Almost Family but now really in a room together working as 1 team, so much so that no one on either side wants to refer to any location as formerly being legacy LHC or legacy Almost Family. So I just don't think it could have gone better. I think -- so happy that we engaged BRG and that we went about this the way we did because I admit, that was our biggest concern as we began to contemplate this transaction was how we would integrate and make it be as it is today, especially having knowledge of larger integrations that didn't go so well in other organizations in the past.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. Myers for closing remarks.

Keith G. Myers - LHC Group, Inc. - Co-Founder, Chairman & CEO

Okay. Thank you, operator. Thank you, everyone, for joining us this morning. I look forward to talking to you again next quarter. As always, in the interim, if you have any questions or would like to speak to myself or anyone from the management team, please contact Eric Elliott, Investor Relations, who will make himself available to you. Thanks for joining us and thanks for your confidence and support.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.

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