THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

LHCG - Q1 2019 LHC Group Inc Earnings Call

EVENT DATE/TIME: MAY 09, 2019 / 1:00PM GMT

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

Benjamin Whitman Mayo *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

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

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

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

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

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

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

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the LHC Group Q1 2019 Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded. I would now like to introduce your host for today's conference call, Mr. Eric Elliott, Senior Vice President of Finance. You may begin, sir.

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

Thank you, Kevin. And welcome, everyone, to LHC Group's earnings conference call for the first quarter ended March 31, 2019. Everyone should have received a copy of our earnings release last night. I would also like to highlight that we have posted some supplemental information on the quarter and our guidance for 2019 on the Quarterly Results section of our Investor Relations page. The supplemental deck as well as a copy of the earnings release, the 10-Q, and ultimately a transcript of this call, when available, will be found on this page. Our supplemental deck includes all of our reconciliations and breakdown of the adjustments. We will refer to these non-GAAP measures during our call today. In a moment, we'll have some prepared comments from Keith Myers, Chairman and Chief Executive Officer; Josh Proffitt, Chief Financial Officer; and Don Stelly, President and Chief Operating Officer.

Before we start, I would like to remind everyone that statements included in this conference call, in our press release and in our supplemental financial information 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 2019 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 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.

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

Thank you, Eric. And thank you, everyone, for dialing in and participating in this morning's call. Right off the top, I want to take a moment to directly thank our 32,000 team members serving at locations around the nation. Each and every day, this dedicated, hard-working group makes a difference in the lives of so many patients, families and communities we are blessed to serve. Our employees cultivate and sustain our unique culture, and our culture is the one aspect of our organization that truly sets us apart from our competitors, and it has done so for 25 years. Our employees' dedication to our 6 pillars of excellence reinforces the strength of that culture, ensuring it resonates in every corner of our LHC Group organization.

I'd also like to wish all our nurses', clinicians and caregivers a happy Nurses Week, a week reminding us it's these folks who deliver hands-on care to those we are privileged to serve. They are the backbone of our company and our distinctive culture we cherish here at LHC Group. It's our nurses, clinicians and caregivers who provide hands-on care to those we are privileged to serve and who ensure that our standards of excellence are met and surpassed every day. So thank you, thank you for all that you do.

LHC Group is a clinically driven company, and we give all we've had a commission in charge of day-to-day operations, beginning with my wife (inaudible) then John and Bess, a registered nurse who continues to serve on our Board and chair our Quality Committee. And of course, since 2009, Don, who is registered nurse and former hospital CEO, we have a long history of highly valuing clinical leadership in the boardroom, C-Suite and throughout our LHC Group family. Clinical quality and patient satisfaction are our anchors. And of course, clinical quality and patient satisfaction is a direct result of the people planning and delivering care. Our people are the only asset capable of creating the spirit of camaraderie, enthusiasm and empathy required for our organization to consistently achieve high levels of quality and patient satisfaction.

And because of lower corporate tax rates, we have been able to invest even more in our people by increasing merit raises for field staff, absorbing more employees' health care premiums and investing more in technology and education. We also remain highly efficient in controlling nonpatient care costs, which has been a long-standing hallmark of our clinically driven operating model.

Our commitment to quality and efficiency and our proficiency in maximizing both of these vital measures has a direct impact on our organic growth and ability to generate margin growth from acquisitions and joint ventures while at the same time improving quality outcomes and patient satisfaction. Our first quarter provides an excellent example of how we continue pursuing growth in different ways, leveraging our commitment to quality at -- as an established national platform that span the full continuum of post-acute care, with an industry-leading reputation as the preferred partner for hospitals and health systems and an increasing number of leading payers across the country.

In every market we serve, our goal is to co- or tri-locate hospice and other services in markets where we currently provide home health. Today, our market platform extends across 35 states and the District of Columbia, reaching 60% of the population aged 65 and over, and we have just begun to tap that potential. In each market we serve, we typically lead with home health with the goal of becoming the market leader in quality and patient satisfaction. Once home health is established, the primary push is to colocate hospice with home and community-based services following as the third leg of the strategy.

Our dedicated and experienced in-house corporate development team is constantly scouring markets for tuck-in acquisitions in hospice and home and community-based services to colocate with our home health operation. As the record shows, we were active on the acquisition front in 2018 and maintain a new acquisition target of $100 million to $150 million each year. We expect to complete a number of these acquisitions this year.

Our joint venture activity has been our most active growth front to date this year. The first phase of the Geisinger joint venture, which included the home health and hospice locations in Pennsylvania, closed on April 1. The second phase, which includes the home health and hospice location in New Jersey, is scheduled to close on June 1. We discussed this joint venture on our last call. With its annual revenue contribution and the inclusion of both home health and hospice along with incredible brand credibility that Geisinger name provides, it certainly is the type of joint venture LHC Group is known for.

A unique aspect that sets this partnership apart is Geisinger's health plan. Being in the same room with the hospital and the payer creates alignment and provides an opportunity for us to work closely to develop value-based reimbursement models for managed Medicare and managed Medicaid populations. The joint venture we announced last week with Capital Region Medical Center is another example of what we have accomplished

with other partners. Together, we are growing and expanding into new markets in Missouri, reaching an agreement to acquire 2 home health agencies and 1 hospice agency from SSM Health expected to close on June 1.

Our prudent business model, strong integrated operations and proven ability to adapt to changes in reimbursement models more efficiently than most positions us for robust growth. Over time, our industry will continue to shift to more value-based reimbursement models. This transition plays directly to our strength, and we have embraced this.

A great example is CMS' recent announcement of a new voluntary risk-based initiative called the Primary Care Initiatives or PCI. More details will come over the next few months, but this initiative reinforces what LHC Group has been saying all along that care delivered in the home will have a preeminent role in value-based models moving forward.

PCI calls for better alignment and coordination of care and an emphasis on quality. Once again, this falls directly into our expertise and strength, and we are well positioned to take advantage of this. Any shift of care into the home and any payment model built on delivering value should prove to be a net gain for LHC Group.

In some ways the same can be said for PDGM, our new payment model set to begin next year. Our constructive dialogue with CMS and our work with Congress will continue to develop ways to improve PDGM for the benefit of our patients. A good example is the bipartisan Home Health Payment Innovation Act of 2019 that representative Su introduced yesterday along with 10 other Democrats and Republican sponsors to preserve Medicare recipient access to home health care and provide a pathway for innovative approaches to using the services. H.R.2573 is the companion bill to this legislation introduced earlier this year by Senator Collins and Jones. As Don will discuss later, our preparations for PDGM have accelerated and been incorporated into our normal processes for driving further efficiencies in implementing care.

Now here's Josh to provide some color on our financial results and 2019 guidance. Josh?

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

Thank you, Keith. And good morning, everyone. Thank you all for joining our call. As always, I like to begin my prepared remarks by saying how much I appreciate all of our clinical professionals across the country in what they do each and every day. It is a privilege to serve you as you tirelessly serve others. I would also like to thank our home office support teams whose level of commitment and service to the field is greatly appreciated.

Our supplemental financial information posted on the website provides more detail on the breakdown among sector performance, guidance and assumptions. I will reference that supplemental deck in my summary remarks this morning.

For the first quarter financial results, here are the big takeaways. With $0.98 of adjusted earnings per share in the first quarter, we have a strong start to the year and early indication of more growth as the year progresses. Based on these results, additional operational efficiencies and a lower estimated effective tax rate, we've raised our 2019 guidance. We are now expecting adjusted earnings growth of over 21% on a per share basis at the midpoint compared to last year. We realized a total of approximately $7.4 million in pretax cost synergies in the first quarter from the acquisition of Almost Family, which brings the cumulative amount to just over $21.5 million.

Incremental margin improvement has continued across our segments on a year-over-year basis across every operating segment within the company. Organic growth was strong at home health and hospice yet again as we maintained our industry-leading quality and patient satisfaction scores and continue to raise the scores at legacy Almost Family locations.

I would also like to briefly touch on the Q1 revenues. While the approximate $503 million consolidated revenue that we generated during the quarter met our expectations and our modeling, we were ahead of home health revenue consensus but slightly below in HCBS revenue. Don will provide more color on our plans for HCBS improvement in a few moments.

Turning to Page 9 of the supplemental deck, I would note that our adjusted consolidated gross margin of 37.1% in Q1 was a 190 basis point improvement year-over-year. Consolidated adjusted G&A expense as a percent of revenue was 27.8% in the first quarter, which was down 80 basis points from the 28.6% in the same period a year ago. Our adjusted consolidated EBITDA was 9.2%, which is up 250 basis points year-over-year.

One important point to highlight in our first quarter results was the $6 million noncash impairment charge we took during the quarter related to the discontinuation of the home health moratorium over 4 states by CMS in the first quarter. Also, as part of our strategy to optimize the portfolio, we closed 8 locations in Q1 that represented a total of $7.4 million in revenue and an annual contribution loss of $714,000. We also incurred some severance costs, lease termination fees and impairment costs related to these closures. All of these costs were accounted for in our adjustments set forth in the supplemental deck, which are detailed on Page 10. This improvement across all metrics was broad-based. Pages 8 through 15 of the supplemental deck highlight the results, and Page 7 notes the key stats by segment.

Turning to Page 21 of the deck, we've outlined a number of our debt and liquidity metrics, including the fact that adjusted free cash flow was $34.1 million for the first quarter as compared to $19.5 million in Q4. DSOs improved to 47 days from 51 days in the first quarter of last year as we continue to improve our collections on managed care receivables and receivables from the Almost Family acquisition. Recall that we are expecting DSOs to remain close to this range, if not slightly below throughout 2019.

Our balance sheet remains strong with net leverage at 0.92x adjusted estimated EBITDA for 2019. With $231 million available on our credit facility and an accordion feature that can provide an additional $200 million of capacity, we are well positioned to remain in growth mode on the joint venture and acquisition front for the foreseeable future.

As I noted earlier, we are increasing each of our revenue, adjusted EPS and adjusted EBITDA guidance for 2019. The details of this guidance raise are on Pages 16 and 17 of the supplemental deck. At the midpoint of this range, we're expecting adjusted EPS growth of 21.1%, net service revenue growth of 16.9% and adjusted EBITDA growth of 34% as compared to 2018.

In summary, we are very pleased to be raising guidance as we are coming out of the gate strong in 2019. We are generating strong organic growth, realizing expected synergies, driving incremental margin improvement, working with an increasing number of managed care payers and creating new growth opportunities. All of these efforts are a good indication that we are in growth mode and focusing on what we do best at the clinical and home office levels.

That concludes my prepared remarks, and I'm happy to further address and answer any questions during the Q&A section. 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 are off to a good start for 2019, and that's a direct result of the hard work and commitment from our team each and every day. I do want to wish all of our nurses, clinicians and caregivers a very happy Nurses Week. As someone who started his career as a nurse, I have great fondness and connection to all of you who care for the patients and families we are privileged to serve. Simply put, thank you.

I want to focus my time this morning on some quick updates on the Almost Family integration, our organic growth, quality scores and how we are responding to the recent CMS rulings. First, on Almost Family, all of our KPIs continue to trend in the right direction, and we've outlined those on Page 18 of the supplemental deck. The contribution margin is increasing and the quality star ratings of Almost Family agencies was up to 3.86 in the CMS April preview compared with 3.63 in January and 3.61 in October. Patient satisfaction star rating was also up in the Almost Family agencies in the April preview to 4.04 as compared to 3.66 in January and 3.57 in October.

As you heard from us many times before, quality and patient satisfaction comes before sales in the market, so this continued improvement in quality is important to the maximization of growth from this acquisition. With the 1-year anniversary now behind us, we are on track with conversion to our instance of home base and feel good about where we are in the integration after the first 12 months. Across our legacy markets and in recent joint ventures, we have demonstrated a strong correlation between quality and the product that we offer to the referral community and to the

patients we are serving that result in organic growth, and we see the same opportunity with Almost Family as we build on this quality improvement. We truly expect to see more of this over the next 3 to 5 years.

The incremental growth opportunities Keith mentioned earlier through market expansion and extension of our co-located and tri-located service offerings remain a top priority as well. A great example would be in Florida where we have the opportunity to now engage and negotiate with managed care payers, but also with potential joint venture partners. We have called out before how much success we have had in other states along these lines. In addition, prior to its joint venture with Community Health Systems, Almost Family did not really have the history that we have here at LHC Group. So we believe there is great opportunity to utilize our assets in Florida to partner with hospitals in the state. Turning to our organic growth for the quarter, we are in our usual 5% to 7% annual target range, with home health admissions up 5.7% and hospice admissions up 6.2%.

From our segment results on Page 14 of the supplemental deck, you can see that our home and community-based service segment has not performed as well as the others post-integration with Almost Family, as there is much opportunity that we left on the table. But similar to the path that we took in hospice, a path that I illustrated last year, we made some changes in the structure of the home and community-based business to quickly address the issues, and we expect to see improvement over the next quarters just as we've seen in hospice in the results of today.

For our quality scores, which are outlined on Page 20 of the supplemental, we continue to see improvement with same-store LHC quality scores up in the April preview to 4.67 in April from 4.59 in January, which includes all recent acquisitions exclusive of Almost Family. One other topic that comes up a lot in our discussions and has been a particular focus this earnings cycle is PDGM. I can tell you that we meet weekly on PDGM, and we will be thoroughly prepared no matter how the final rule develops. This preparation has been an excellent exercise that we've incorporated into our management operating reviews.

We obviously can't go into specifics of how we intend to respond and evolve but, rest assured, we have done this each time there's been a reimbursement change, and this will be no different than the others. The fact is, absent the behavioral assumptions, we are fully embracing PDGM. Again, make no mistake, we will be ready either way and are well down the path in our preparations.

Now I'd like to offer just a few comments on last month's proposed rules by CMS for hospice and health tax for 2020. In order to better align reimbursement with the cost of continuous home care, in-patient respite care and GIP care, CMS is significantly increasing payments for the 3 levels of hospice service for fiscal 2019 in proposing a cut to routine home care rate by 2.7% to achieve budget neutrality. While the majority of the hospice revenues fall under the RHC category, the impact to LHC Group is slightly positive according to the CMS impact file. As a reminder, hospice currently makes up 10.3% of our total revenue.

Keith mentioned earlier the primary care initiative program for CMS. This program will help our hospice offering as well as it places an emphasis on better integrating hospice with other care and encouraging other payers to align payment, quality and reporting, which would of course play to our strengths. CMS also proposed a rate increase for LTACHs that would be more favorable than the final rule for fiscal 2019. The bottom line would be a 0.9% rate increase.

Regular LTACH cases are expected to see an increase of 2.3%, which reflects the 2.7% standard February rate update less decreases for outlier payments and other factors. LTACH PPS payments for cases continuing to transition to site and (inaudible) payments are expected to decrease by approximately 4.9%. This accounts for the LTACH site-neutral payment rate cases that will no longer be paid at blended payment rate as the rolling statutory transition period ends for LTACH discharges occur in cost reporting periods beginning in fiscal year 2020, which for us will begin 6/1/2020 for 2 of our hospitals and the remainder of them beginning 9/1/2020.

Thank you, again, to all of my fellow colleagues. And thank you for listening in on our call today. Operator, we are now ready to open the floor for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Brain Tanquilut with Jefferies.

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

Congrats on the quarter. I guess my first question, just housekeeping, Josh, just to reiterate the $0.10 guidance increase in EPS, how is that broken out again between tax -- or is it all tax and what's operational in there?

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

Yes. No, Brian. Thanks, and good morning. Great question. The EPS raise of $0.10 is really split about half and half. About half is due to the lower effective tax rate that we're now estimating, so call that about $0.05. And then the other $0.05 raise for the EPS side is directly attributable to our continued operational efficiencies and better margins really across all segments. If you look at the margin improvement year-over-year across every segment within the company and having some visibility into how April's pacing and where we're coming out of the gate even in May, we definitely feel like from an operational perspective that we need it to raise, which is set forth in our $2 million guide raise on EBITDA as well.

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

Good color there. So that was going to be my next question. So as I think about the fact that you're raising guidance very early in the year, margin performance was strong in the quarter, I mean, what other margin levers left or where do you see incremental margin opportunity as we progress throughout the year?

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

Yes. I mean there are definitely still some incremental margin levers remaining, Brian, on the Almost Family side, for sure. Very pleased with the 260 basis point margin improvement across that portfolio year-over-year. But to get a little bit more granular, I would say, piggybacking on what Don mentioned earlier, we expect to start seeing some incremental margin improvement in the home and community-based services segment. I wouldn't expect a lot of that in Q2, but as we continue to implement the things Don alluded to, I think you'll start seeing that in Qs 3, 4 and going into 2020, similarly to how we turned the hospice around.

And then there's a little bit left in the hospice segment as well. I couldn't be more proud of our operational team for where they've gotten that segment, but I think there's a little bit of a lever there, so to speak. Don?

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

Yes. Brian, just a little bit more color, let's go to the home and community-based services. The results that we put out there are not at all a surprise to us. And I want to give you a little color. The state of Ohio was to the legacy Almost Family CVS business as honestly Florida was for their skilled nursing. Those were the 2 states respectively that really drove that portfolio. We saw it early, and we made substantive changes organizationally, regulatory-wise, just a gaggle of things, I would say, in Ohio. And we see that Josh alluded to where we are in May, we see that already taking shape. So we truly believe at a low mark, we've got 150 basis point improvement on the table for HCBS. You all know me by now, I'm pretty conservative, but I think it's 200 basis points as we go out and run the rest of the year. And then I would go back to Florida. Let's just forget growth in Florida for a second. If we grow it not at all, we know that we have at least 200 basis points on that $100 million. So those are big levers, back to your question. And we still have, what I would call, the normal smaller operational levers that we're going to continue to pull as we prepare for PDGM.

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

And Don, just to follow up on that comment, so as I think about the AFAM, obviously 1 year in the fold now. I'm thinking about organic growth, they're now the same-store base, so should I expect at least near term some sort of deceleration reported same store? Like you said in your prepared remarks, 3 to 5 years, this is your long-term growth driver, it will be one of the key long-term drivers. Is that a good way to think about that?

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

Yes, it really is. Keith alluded to something earlier that I really -- I want to bring back. He talked about the clinical practice of the model generating that anchor. And our Chief Analytics Officer, who ran some stats for us coming into this, the value creation really is defined as lower cost and higher quality. When you look at our comps, we're definitely doing that. And with Almost Family converting to the one instance, getting the ContinuLink into the home and community-based services and then certainly cascading our PlayMaker CRM, so we can see where sales is and what they're doing, those things are almost at maturity right now. But Brian we've been together a long time now on these calls, I've always said that new acquisitions take shape in about 12 or 18 months transactional -- post transaction. This time it was big and it's ahead of that. If you just -- we can't lose sight because we've been talking about Almost Family so long, it appears, we just finished the year mark. So you're absolutely thinking about it right. This is going to be huge fuel for this engine going into 2020.

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

And then last question for me, Josh. Just on the quarter, I know you don't give quarterly guidance, but seems like there was a little bit revenue mismodeling in Q1. So how should we be thinking about just the Q2 progression from Q1, especially given the fact that you shutdown 8 locations during the quarter?

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

Yes. No, great question, Brian. And won't lay out specifics on the quarter, but you can definitely expect revenue improvement in Q2. Part of that is mismodeling, I would maybe agree with, but part of it is also just where the census is today versus where it was, where we started out the year. So you're definitely going to see incremental period-over-period revenue growth throughout the year and likewise with EPS and EBITDA as well.

Operator

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

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

So just to follow up on the 8 locations that you closed, it's smaller than I guess what happened in Q4. But what was decision behind closing these, and which segments those assets were included in?

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

Yes. Joanna, this is Josh. Don and I can tag team this one as well. As you know, it was significantly less locations than were closed in Q4. And I believe as we mentioned even on our last call, you're going to continue to see, as we always do, some portfolio optimization at lesser tranches as we're moving forward. The 8 that were closed that account for about 7.4 million, I want to say 5 of them were home health. One was an old legacy BME company that we had just -- you kind of had within the portfolio that was starting to drag on us, and then a hospice or 2.

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

All right. So sounds like there could be maybe potentially some incremental closures, but sounds like you did a lot of the closings in Q4 and now a couple in Q1.

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

Joanna, this is Don. You're absolutely right. I would say that you're always going to see some closure activity in the company. Twofold, one, there are market changes that smaller synthesis tend to make it a drag, and we look at that during MORs. But don't forget, we're so acquisitive that we bring all of these things in, and whether it's political or it's community related, we've got to take them and gain credibility before we actually close those, especially in overlapping markets. So some companies wait to do it all in one time and make this big bang. We do it as just part of the operations of culling the assets that are going to drag. And I would absolutely think you're going to continue to see that, and we always have.

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

Yes, that makes sense. And then my question, you mentioned you continue growing your relationships with MA plans. And obviously 2 months ago you start talking more about this new payment models you are developing with some of the MA plans, so any update there in terms of where you stand? Any incremental new contracts you signed? And also anything to add in terms of the negotiations of executing contracts with MA plans? I guess last time you were flagging some of incremental improvements for legacy AFAM business as well as legacy the LHC business. So any color overall on the relationships and how the rates are progressing with MA plan?

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

Sure, Joanna. This is Josh. Great question. And I'll attack it in the same three-prong nature that I've attacked this topic over the past several calls. We continue to have a strong focus on not only rate improvement, which I would say is the first prong and one of the topics you're alluding to, and we continue to see incremental period-over-period improvements there just by negotiating better rates and doing a better job of identifying some of the Almost Family contracts. Then I would say better operationalizing the contracts that we have both in the field as well as back office. And I alluded to this earlier in my prepared remarks, we continue to see the back office cost being better leveraged for that book of business, lower bad debt, lower cost of revenue cycle management around those contracts. And then third, which I think is at the heart of your question, the new payment models. And as far as incrementally, since the last time we spoke, we've got 2 new ones in queue since our last earnings call. One that I really couldn't be more excited about is in connection with our new joint venture with Geisinger that we've talked about and we're working on a very innovative payment model layer.

And then the other one, I won't get into the specifics, but we've negotiated a good base rate from the payer, and then we have upside bonus potential based on reductions in total cost of care. And this is the first of its kind of where we're truly evaluating patients that we take on service, looking at a baseline benchmark of the total cost of care leading up to that and then whatever we can generate in savings, us getting a piece of that. So that upside is being in the works for negotiation as well.

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

That's helpful. And just to follow up on that, so how would you describe on average the delta between the MA -- a plan's pricing on average versus your service book? And how does it compare a year ago?

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

Yes. I mean, as you know, it's slightly below the Medicare rate and there's a lot of factors for that, right? I mean there's different requirements that are required under the Medicare patient population that aren't required under the MA. But I mean, as you know, that delta, that gap from really

2016 to now year-over-year continues to close, which is how we've been able to better marginalize and leverage that business. And we're very specific in how we negotiate and what contracts we execute. We're not going to execute contracts that are far below Medicare. We're only going to execute the ones we know that we can operate.

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

Great. If I may squeeze last one on the innovation segment, so adjusted EBITDA there, I know it's very small part of your business, but I guess it's somewhat similar to we just talked about. The EBITDA turned positive, so can you just give us a couple of thoughts on what's going on in that business and any kind of seasonality we should think about, bonus payments or things like that?

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

Yes. No. Really couldn't be more excited about the incremental turnaround, if you will, in the HCI segment, as most folks that were familiar with the legacy Almost Family business, they really ran that as a loss leader 3 quarters out of the year. And then when they got the Medicare shared savings payment in Q3 that was the big bump that they received. Don really set forth a challenge to all the leaders within that segment several months ago to run and operate each of those segments as a stand-alone profitably on a month-over-month basis, and not just wait to be lifted by that MSSP payment in October. And I really think they're performing well in doing that. Don?

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

Yes. That's a really good -- a hats off to our Imperium group as well as our advanced care -- house call group. They were combined losing roughly $500,000 a month when we did the merger. And I think all of you know our philosophy here, everything has to live within itself and live on its own. And we essentially said that's how we're going to operate and they did it. So the upside for this segment is truly huge and they're doing a phenomenal job. So while it's a smaller part right now, it's integral into our strategy going forward into the '20s.

Operator

Our next question comes from Kevin Elitch with Craig-Hallum

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

Have a couple of questions for you guys. I guess, Don, starting off with Almost Family, Homecare Homebase, wondering where that stands and are you on track to complete that transition in Q3? Is that right?

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

Yes. It is. Right now we're slated for mid-November to complete it. So we're just under 70% completion. And even though the largest book of business with the highest profitability is going last, I don't expect any income from that at all, and that's our Northeast division. So we'll be fully buttoned-down as we go into Thanksgiving. That's been our goal all along.

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

Got it. And then -- I mean have you seen any or much disruption from that? And then thinking about Almost Family having Homecare Homebase, how much margin expansion or improvement should we expect once that transition is down?

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

I'm going to admit this that even though we've been able to accrete the margin, it has been more disruptive in 2 of the divisions than I thought it would be, and it's only because the instance that Almost Family was using wasn't the same inside of itself. And so the more similar the instance is, the more congruent with the operating process is we found. And so all of that to say that I talked about the margin improvement in Florida, that is the biggest driver. The northeast is doing extremely well. They're actually comped to legacy LHC Group. And the rest falls somewhere in between. So I'd probably take that, as I said, with Florida being the biggest driver. If you look, and it's just rudimentary, about $110 million, roughly about 200 basis points, we see that being able to be captured right now. And that's why honestly we decided to do Florida first.

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

Got you. That's helpful. And then looking over to the LTACH facility-based business, looks like occupancy was down to about 70%. I know I think you had a closure or so in that segment. Just wondering why occupancy is down about 10% this quarter on a year-over-year basis.

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

Yes. The 2 hospitals did attribute to that, but honestly that was pretty good execution on our part. We had too many site-neutral people in the beds about a year ago. So we made a concerted effort. We brought a sales guy in and said we've got to go after more so the qualified patients. And that's what you're seeing. It's a healthier census. You can see it in the margins and you can see it in the case mix.

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

Got you. That's helpful And then, also, you've had a lot of commentary on the HCB business, but it also looks like revenue per billable hours down on a year-over-year basis, but kind of flat sequentially. Is this -- the $23 or whatever kind of the rate we should be thinking about or how should that tread?

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

Yes. That's a really good pickup. It is how we should be thinking about it. Because remember, on the legacy side for LHC, our Elk Valley asset was by far more skilled care than normal across the country, by the way, not just us, home and community-based services. So all you see is a dilutive effect of bringing in the AFAM assets over on top of the legacy. So that is a good number. And as we grow the billable hours, I would not change that number. I think that's what we're going to see.

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

Got you. And then I do have one for Keith. Clearly, you've had some nice JV activity to start off the year. Wondering how the pipeline looks and should we expect now that Almost Family is annualized, wondering if you've got some bigger deals in the pipeline we should be thinking about, given your liquidity.

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

Yes. So -- yes, absolutely. The pipeline I think we've said before, the Almost Family merger had no impact on the pipeline, the way it was structured. So the pipeline remains robust and I think Geisinger is a good example of the type of joint ventures you see us moving more and more toward multihospital systems as opposed to single -- as many single hospitals, which still -- those are highly accretive and we continue to focus on those smaller hospitals, stand-alone or small groups, but just on maturity, we see more of the larger systems in the pipeline.

Operator

Our next question comes from Matt Larew with William Blair.

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

I just want to ask briefly about guidance. I know you're only one month into the phase one, so you probably don't have big takeaways. But can you just maybe give us a sense for conversations you're having relative to opportunity with the health plan, but what are you picking out as targets for success over the next 12 to 18 months? What can you describe as the game-changing opportunity?

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

Yes. Matt, great question. This is Josh. I'll start and let Don get into the specifics operationally. But to go back to even one of my answers to Joanna, we are already at the table working with the health plan to put in some innovative payment models both on the managed Medicare and commercial patient population but also on the managed Medicaid patient population. So to already be at that place this close to the initial closing date of April 1 is a really good place, a little bit ahead of schedule where we would normally be in a joint venture. And that's directly attributable to the strategic nature of the partnership and the fact that this is a partner that has its own health plan. Don?

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

Yes. This is going to be really a great joint venture for our company. And I say this maybe just with a smile. Getting to 0 here was a big win for us. They were losing a lot of money. And already our team has done a phenomenal job, but our first milestone was just break it even. And we've gotten to that point, we're very close to that point. So if we can continue to model that and then overlay our June run, we think it can start being accretive in the fourth quarter.

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

A couple more, just the -- couple of questions here on the home health side. Is there anything you would call out in terms of the home health Medicare revenue per episode strength as well as same-store Medicare admissions maybe a little bit lower than we anticipated? So just anything you would out call out on that side of business.

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

Yes. Matt, on the revenue per episode side, as you often do when you start the year, you come out on the gate in January, in beginning of February, with payer changes and different attributes that might lead to a little bit lower case mix coming out. But we actually finished the quarter in a little bit stronger place from a case mix and a pricing perspective for Q1 than in prior years. And as we're sitting here, let's call it almost the middle of May, got some really good visibility in how that's continuing to trend. So from a -- just a pricing perspective feel really good about where we are on the Medicare side of the business. Don, you want to talk about admissions?

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

Yes. Well, I'll admit this, the first 2 weeks in January, we did not have great admission runs. But I would also say that, that Medicare number right now, I mean we all know what our comp is here. We had a phenomenal last year. And so we're up against every quarter with the highest comps in our history, and we're still turning that in. But I do want to caution, we are all, every company in home health is seeing true shift to these payments that Josh talked about earlier, to MA. And so when you're looking at a 2% and 3% number for LHC Group with the comps we've got, we're really pleased with that, because I want to go back to the 5% to 7% as total. And although, and Joanna hit this on her question that it may not be quite

at the rates, we've done a much better job of proportionately dropping our cost on that. And so those are the 2 factors on growth that I really wanted to point out. So I appreciate the question.

Operator

Our next question comes from Matthew Gillmor with Robert Baird.

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

I wanted to follow up on that last point. So stronger nonfee for service volumes, but you still had great margin performance in the home health segment. What are the -- Don mentioned able to control the cost better. Can you maybe just help us understand where you're able to control the cost better? Is it from a revenue cycle perspective that they're just easier to deal with or are you better utilizing your clinical resources to the rate that those plans offer?

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

It's both.

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

Yes, Matt. It is both, Matt. As I mentioned earlier, I want to tip my cap to the entire team upstairs. We're sitting on the second floor and on the third floor our entire revenue cycle billing and collections team and they have really done a good job of realigning their part infrastructure by payer. We've gotten smarter. We've gotten more clean and efficient in how we bill and collect and our bad debt is improved. But also you hear us talk about extender utilization a lot. I think we are doing a much better job in the field of providing the right clinical resources for those patient populations.

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

Yes. And I'll just -- the stat that I would tag along as we look at the LPN usage, and it's 44.5% in this first quarter, it was a really good number for us. So it's both of them. The last thing is our team, with (inaudible) and that team did a great job of -- by provider really illustrating what those contracts are asking, what those managed care payers are asking, because too many times, admittedly, we were just doing a broad brush and providing the same type of service regardless of what the actual term and condition of the agreement asked for. So it's kind of all of that stuff kind of baked into one.

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

Got it. That's really helpful. And then following up on the Almost Family organic growth, and Brian asked part of this earlier, and I didn't hear the direct sort of answer to it. Can you give their organic growth number? And then as the sort of second part of the question, I know you all target 5% to 7% volume growth, and Almost Family will get there hopefully in 2020, but where should we think about that kind of shaking out over the next quarter or 2 as they fold into the same-store base?

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

Well, that's great question. They're flat now, and I would think the same thing going into the next couple of quarters. Twofold, one, Florida is a big part of that, and I've got to push those up. And I'm going personally there for a couple of meetings next month, but then we're not finished the

conversion. And so with that and the Playmaker, still a lot of ingestion that we're pushing down on the asset base. I would actually then flip around into 2020 and model them very similar on Medicare to us. I see no reason not to do that.

Operator

Our next question comes from Dana Hambly with Stephens.

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

Don, you mentioned on the home and community-based care the changes in Ohio, what were those changes in Ohio?

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

I'll try to stay as high level as I can. The bottom line is that the way that some of those assets were structured were underneath the home health providers and being operationalized poorly, to be candid with you. So we've actually busted that outcome like you bust out departments in a hospital to create better visibility. That's number one. Number two, the operations leadership of that was under one, and we busted that out too, so it gave a lot more time and attention to a higher-level set of skill, if you would. And both of those together are actually -- we stopped the bleeding because they were going down and down and down for 2 years in a row. So our first goal was to do all of this, convert them and then stop the downward slide. And we just finished that in actually April. So we think May is going to be a lot better for them.

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

Okay. I think you mentioned margin improvement there, the rest of this year, 150, maybe 200. But the longer-term goal I thought had been more like a 9%, maybe even 10% margin for that segment. Is that still the longer-term thinking?

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

Yes. Dana, we're at an adjusted EBITDA margin of about 4%. As Don alluded to, we've got line of sight to get that up to about 6%. And I would say somewhere between 6% and 8% is where I would peg home and community based for probably going into 2020 as well.

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

Okay. And then on the -- I know in the proposed legislation in the Senate and now the House, the focus is more on the behavioral assumptions. But could you talk the homebound requirement loosening the restrictions there? How influential that is or how big an opportunity that is for the home health industry?

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

Yes. I think it's a huge sign, a signal, if you will, of where we're going. This is not a new concept. I was -- I think I shared that before on a call probably a decade ago, thereabout a group of us were in a meeting with Mark Miller at MedPAC. And he opened the conversation by saying that he supported lifting -- he would support the lifting of homebound criteria for patients with multiple chronic conditions. What the challenge was how to guarantee the savings and who was going to take the risk. And that was prebundled in all of that. But I clearly see that, that's where we're going. And we see it in a very real way with referral sources who routinely tell us about patients who are elderly and/or frequent fliers in and out of the hospital and desperately need home health services. And home health could be leveraged to avoid those rehospitalization, but they don't qualify because they drive to church on the weekends or something like that. It's just an outdated policy. But I can understand their reluctance to open it up because

they worry about how to contain it and make sure it's not just an additional spend without savings. As we move more to value-based purchasing, I think that's just a given.

Operator

Our next question comes from with Whit Mayo with UBS.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

Maybe a question for Don or Keith. I'm just kind of curious, the conversations you're having with your health system partners as it relates to PDGM in maybe how they're preparing and how they're thinking about their discharge programs. And I guess as long as I've done this, I've heard getting an ICU nurse or a discharge planner to change their behavior is nearly impossible, so I mean you're uniquely positioned to understand, I think, a lot of the strategies that we'll see evolve with hospitals, so just any insight would be helpful.

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

I don't want to get into the specific strategies, but one thing that's different about us is we -- we're a our joint venture partner, but we're branded with all of our hospital partners and we function more like a department of a hospital than an external home health agency. So we're involved in the hospital in helping to develop models and transition to the home so that there are a lot of opportunities. Each hospital has a little bit different strategy depending on their payer mix and whatnot. But clearly, they think any change in home health reimbursement or regulations through our partnership, they're keenly aware and interested on top of it as opposed to -- I hate that this sounds like I'm giving a history lesson here, but a decade ago hospitals largely were unaware of anything going on in the home health industry. So that's much different in the hospitals that we joint venture with.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

No. That's helpful. I think just when we talk to various agencies and other providers, it seems like everyone sort of has a strategy on how we're going to get more stroke, how we are going to get more complex nursing, so I was just so trying to think from a hospital perspective how they would be responding to some of the market changes in provider strategy.

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

Yes. I think the -- everyone is looking to for opportunities to move patients to the home more quickly. And from -- in a hospital setting when the patient is discharged from a hospital, the first thought is, can this patient go to their home? And if they go somewhere other than to the home, it's by exception. And it used to be exactly the other way around, there was a step down that patients would go to the next highest-cost setting and then the next highest-cost setting and step down through all of the different settings to get to home health.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

Okay. And maybe just one last one for me on PDGM. I'm just sort of curious, Don, as you travel around and talk to some of the acquisition targets and do your diligence, I mean I've been a little surprised by the lack of knowledge with many in the market. So I'm sort of curious how some of these changes are shaping the acquisition landscape and perhaps maybe your pro forma view on the earnings for some of these targets.

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

That's a really good question, and I think you're absolutely spot on. The true understanding of the effects of this rule, for those of us that don't live it every day, is very minimal. So that's of course, like we always do, we spin that into an opportunity to educate them, and in the case of Geisinger and others, show why we are the people can come in and better that.

But I've got to tell you, we're not looking at the margins and improvement trajectory of those any differently on the PDGM. I have no reason to believe that. As a matter of fact, and I said in my prepared comments, although we're not going to go into detail, I mean how can we not like a payment model that's centered around patient characteristics versus the type of service you provide? That's what we do. So it's just yet another reason that we are very fortunate now that hospitals are calling us because they know that we can mitigate this, they know that we can live within it and be adjunctive to their strategy, because Keith alluded to, each one of our partners are so different, some of them are running their own plans. And the way we need to use home health is quite different than some of them who are still very centric to fee for service.

But in any case, I want to reiterate what Keith said earlier, we are clearly known as the anchor service now. And first, we have to have the box checked that we are not appropriate. And that's not a position we've always been in as long as I've been here for at least 14 years. So we really see, while PDGM is not all good, we do not like the behavioral adjustment, we've embraced it and we're going to use it as an opportunity when others are scrambling.

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

Yes. This is Josh. The only thing I would really tag onto that, and I'm thinking about certain ones that are actively being diligence than work that are within the pipeline, not just joint ventures but even freestanding opportunities. The lack of a smaller provider being able to have the dedicated resources that someone like an LHC Group has and all the work streams that Don described earlier and the sophisticated systems to be able to prepare this many months ahead of a change like that does provides a lot of opportunity for us when we come in.

Benjamin Whitman Mayo - *UBS Investment Bank, Research Division - Equity Research Analyst of Healthcare Facilities and Managed Care*

Maybe just one last one, sorry, and I'll hop off. I was just curious, I know it's really early and there's a lot that can change between now and next year, but any changes in sort of, like, the workforce looking at nurses? Just any new pain points? I guess I'm just trying to understand whether or not we're seeing providers downshift or change how they're looking at their clinical staffing model and how maybe that's impacting any wages or just -- anything around my compensation would be sort of helpful.

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

I got to tell you, no. We have not seen that. Now I will say that, I alluded earlier to the Geisinger issue, the wage indices there in the market is higher than I've seen, and the supply and demand a little bit on the worse side than we've seen. But other than that, I got to tell you, we're just not really encountering that as a problem right now. And I -- we'd like to think it goes back to our culture, but I -- while I can't attest to what other people are seeing, I really -- I can't tell you that we've seen that.

Operator

And I'm not showing any further questions at this time. I turn the call back to Eric.

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

Yes. Thank you, everyone, for participating this morning, for all the great questions and the conversation. As always, we will make ourselves available whenever you need us. So have a great day and great week. Thanks.

Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.