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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the LHC Group Q1 2018 Earnings Conference Call. (Operator Instructions) As a reminder, today's call may be recorded.

I would now like to introduce your host for today's call, Mr. Eric Elliott, Senior Vice President of Finance. Sir, you may begin.

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

Thank you, Cherie, and welcome, everyone, to LHC Group's earning conference call for the first quarter ended March 31, 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 the industry on our website.

In a moment, we'll hear from Keith Myers, Chairman and Chief Executive Officer; Don Stelly, President and Chief Operating Officer; and Josh Proffitt, Chief Financial 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 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. Good morning, everyone, and thank you for joining us. You'll hear from all of us today on the strong first quarter across all segments, the success we're having with the integration of Almost Family, our strong outlook for 2018 and new growth opportunities we're pursuing across a much broader in-home healthcare platform.

I want to focus my comments this morning on a few topics, mainly, the significant tailwind behind our business, our commitment to integration efforts and our growing pipeline of acquisitions and joint ventures that is as robust as it's ever been.

Nearly 25 years ago, our story began as a mission of service with the goal of being an asset to the community by making a difference in the lives of others through the delivery of high-quality individualized, compassionate healthcare services in the home. Over the years, we developed a long-standing and proven track record of success as an operator and consolidator in the industry. It was a natural evolution of our story and business model to pursue this strategic merger of equals with Almost Family, which nearly doubled our geographic service area and further enhanced our position as a recognized leader in our industry's transition to value-based reimbursement and highly coordinated care.

It is increasingly clear to health systems, payers and policymakers that comprehensive high-quality in-home healthcare services plays a vital role in the continuum of care. This is especially true when the goal is to reduce unnecessary spending in higher cost subacute inpatient settings and thus lowering the overall cost of care, while at the same improving quality outcomes and patient satisfaction.

A recent study by the Congressional Budget Office projected another decade of strong growth in home health spending, reaching $32 billion by 2028. The CBO didn't include any specific data on hospice or personal care community-based services, but the well-documented wave of the aging baby boomer population that will increase Medicare enrollment over the next decade will increase demand for hospice and personal care as well.

I would also note that there was a recent industry report calculating the impact higher quality scores have on rate adjustments through CMS' value-based payment model that showcases how much more those of us who rank high in quality can benefit in terms of reimbursement and market share gains, precisely because our ability to deliver high-quality care does lower cost.

Let's now turn to our integration activity relating to the Almost Family merger. Along with quality scores, our ability to smoothly integrate merger transactions is where we regularly set ourselves apart. It is also what gave us the confidence we could do a transaction like the merger with Almost Family, while at the same time, staying focused on existing operations and our joint venture growth strategy.

I mentioned last quarter that we had identified separate work streams involved in the merger integration and that we had lined up a number of third-party advisers early on in our due diligence efforts. These advisers continue to play an important role, but our biggest partner in this effort has been Berkeley Research Group, who has helped with the planning and implementation efforts that complement what we are instilling from an operation and sales perspective across the combined platform. Don will outline some specifics on where we stand with the integration efforts and what is left to be done. But I can assure you that there haven't been any significant surprises from the initial plan. We're on track and the excitement level across the company as we've introduced many of our operational, sales and support initiatives has been tremendous.

All of this hard upfront work on integration activity, the small overlap of our existing footprints and the shared cultures of our 2 companies have enabled us to stay laser-focused on growing our acquisition and joint venture pipeline. Coming off of a record year in 2017 and having already completed the Almost Family merger in 2018, it might be tempting to sit back a bit and rest on our laurels, but that's not in our DNA. We've been able to continue developing our pipeline in parallel with the merger integration and actually accelerated due to the broader geographic reach and increased operational capacity.

Our pipeline is currently comprised of joint ventures with large health systems and individual hospitals across our 37-state service area as well as tuck-in acquisitions that can accelerate our colocation strategy.

With ample capacity on our new expanded credit facility, we have substantial dry powder to continue this growth. With 76 hospital systems consisting of 33 -- 336 partnered hospitals to date, we have a growing base of joint venture partners that can attest to our ability to work closely with them to drive quality, patient satisfaction and efficiency through the creation of innovative, highly coordinated care models that drive organic growth for us and our partners. We look forward to reporting on our progress in the coming months.

One last topic I'd like to cover before turning it over to Josh is a brief comment on the regulatory front. There were a couple of important pronouncements that should have a positive impact. Last week, CMS released its fiscal 2019 proposed payment update for hospice agencies. They are proposing a 1.8% reimbursement increase from last year. And last month, CMS also released its proposal to increase the LTCH PPS rate by 1.15% for fiscal 2019. After accounting for their other policy changes such as the blended site neutral rate extension, that should result in a net increase of approximately 20 basis points in 2019. The highlight of this proposal is the elimination of the 25% rule in a budget-neutral manner, which is something the industry has been pushing for some time.

Given how much was cleared away in the preceding months on the reimbursement front with the Budget Act, we continue to believe we have much clearer runway to work with government healthcare program. The contract negotiations with managed care [payers] and fulfilled the critical demand of hospitals in integrated health systems for an in-home healthcare partner who is aligned with their desire for increased quality and patient satisfaction and coordinated care in home health, hospice and personal care settings.

Finally, to our 30,000-plus employees, thank you for your dedication and commitment and for all that you do for those we're privileged to serve. You make all this possible. Thank you for choosing to be part of our LHC Group family.

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

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

Thank you, Keith, and good morning, everyone. Thank you, all, for joining our call. As always, I must begin my prepared remarks by saying how much I appreciate all of our clinical professionals who continue to provide high quality and exceptional service each and every day to the patients, families and communities we are so blessed to care for, and all the LHC Group family members who support them on a daily basis. Because of all of you, we are able to report another successful quarter to our shareholders and are truly poised for future success in 2018 and the coming years. To you all, a very heartfelt thank you for all that you do that makes our LHC Group family so special.

I would also like to take a moment to say welcome to all of our new LHC Group family members from Almost Family. I appreciate the rapport and relationship that I've already begun developing with so many of you and very much look forward to working with and supporting you all in the months and years to come.

With regard to our first quarter financial results, net service revenue increased 19.2% and adjusted net income increased 18.9% compared to the same period of 2017 and adjusted net income was $0.63 per diluted share, which excludes merger and other transaction-related costs of $6.3 million after tax or $0.35 per diluted share. Home health same-store revenue grew 9% in the first quarter of 2018 due to our growth in same-store admissions in home health of 6.7% and an increase in our patient acuity in the quarter as compared to the same period last year.

On a consolidated basis, our gross margin was 35.2% of revenue in the first quarter as compared to 36.8% of revenue in the first quarter of 2017. The decrease in gross margin year-over-year is due to a couple factors. One, lower-margin contribution from acquisitions that closed in 2017 the gross margin for our more mature agencies. Excluding those 2017 acquisitions, our consolidated gross margin would be 36% for the first quarter. Second, an approximate 1% reduction to our 2018 Medicare rates from the 2018 home health reimbursement rule; and finally, an increase in the implicit price concession formerly known as the provision for bad debt of 70 basis points over Q1 of '17. This is now included in revenue, which I will touch on in a moment.

Home health gross margin was 36.3% for the first quarter compared to 38% for the same period in 2017. However, again, when you adjust for recent acquisitions, the adjusted home health gross margin for the first quarter was 36.9%. The remaining difference is attributable to the 1% reduction for the Medicare rates and the difference in the implicit price concession that I just mentioned.

Hospice gross margin was 34.3% for the first quarter of '18 compared to 35.3% for the same period in 2017. On a sequential basis, hospice gross margin is up 210 basis points from 32.2% in the fourth quarter. Once again, when adjusted, our hospice gross margin for the first quarter was 35.3%. We continue to see improvement in our hospice service line as expected and are pleased with the positive trajectory of our hospice service line in general, as you'll hear more from Don in just a few minutes.

While gross margins from 2017 acquisitions are still depressing the consolidated margins, we are seeing a sequential improvement each quarter on those acquisitions as we previously reported to you. Gross margins for the 2017 acquisitions were 17.6% in Q3, 28.5% in Q4 and up to 30.5% in Q1 of this year. We have a lot of confidence that, that positive trajectory in gross margin improvement on those acquisitions will continue into the second and third quarters of this year.

Moving on to general and administrative expense. Our G&A expense was 31.6% of revenue in the first quarter of 2018 as compared to 29.5% in the same period last year. The increase in G&A as a percent of revenue year-over-year is due to $8.8 million in Almost Family merger and acquisition expenses that was recorded in G&A. Excluding these costs, our consolidated G&A expense as a percent of revenue would be 28.6% for the first quarter, down 90 basis points from Q1 of '17.

Now moving on to the expense category, once again, formerly known as the provision for bad debts. The company adopted ASU number 2014-09 called revenue from contacts with customers on January 1, 2018, on a full retrospective basis, which required the company to present the prior comparable period as adjusted. The adoption of the standard did not have a material impact on the company's financial statements. All amounts previously classified as provision for bad debt are now classified as implicit price concessions in determining the transaction price of the company's net service revenue.

For the 3 months ended March 31, 2018, we recorded $4.9 million of implicit price concessions as a direct reduction of net service revenues that would have been recorded as provision for bad debt prior to the adoption of the new standard. Our reduction to revenue from implicit price concessions represented 1.7% of revenue in the first quarter as compared to a provision for bad debt of 1% in the same period of 2017.

Included in the implicit price concession in the first quarter of '18 was approximately $715,000 of adjustments related to recent acquisitions. Excluding these adjustments, our implicit price concession as a percent of revenue would have been 1.4% for the quarter, which is within our expected range for the year.

I would like to echo Keith's comments earlier and cannot be more excited about the momentum we are seeing in our discussions with potential new hospital and health system partners and our overall pipeline of potential joint ventures and freestanding opportunities. On April 1, we entered into a new $500 million 5-year senior secured credit facility led by JPMorgan Chase Bank, which includes an additional $200 million accordion expansion feature. This new credit facility gives us plenty of capital to continue our M&A strategy and take full advantage of the momentum we are currently experiencing in our pipeline. I would like to take a moment to thank each of the banks in our bank group for your partnership and your confidence in us.

Turning now to our annual guidance for 2018. We are reaffirming our guidance for fiscal year '18, which was previously issued on April 2 in conjunction with the completion of the Almost Family merger. And this includes the Almost Family financial results for the final 3 quarters of 2018. The guidance now includes the recent adoption of ASU 2014-09 regarding revenue recognition, which has an impact of approximately $22 million to $30 million on previously projected net service revenues, but no effect on earnings per share.

Net service revenue is expected to be in the range of $1.81 billion to $1.86 billion and adjusted earnings per share per diluted share is expected to be in the range of $3.45 to $3.55. This guidance assumes achieving a total of $25 million in pretax synergies related to the merger with $8 million to $12 million realized in 2018; 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 a weighted average diluted shares of approximately 28 million for the year.

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 merger for Almost Family and its impact on GAAP earnings, we are only providing guidance to adjusted net income earnings for 2018.

Normally, this is the section in my prepared remarks where I would give guidance on certain of our margin ranges to help you all with your modeling. However, due to the fact that the second quarter will be the first time that we report combined financials post merger, and we are still working on mapping of some of the different classifications between cost of service and general and administrative expenses between legacy LHC Group and Almost Family, we're going to hold off on providing those ranges until next quarter.

That concludes my prepared remarks, and I am happy to further discuss during Q&A. 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 strong start for 2018, and that's a direct result of a lot of hard work and commitment by 30,000-plus team members who make up our one company, one family, one focus new way of life. My sincere thanks, and congratulations to you all.

Turning to our first quarter results, we are very pleased and excited to say that they reflect what we promised going into the year. For the last few quarters, we've committed to consistent and predictable results in our home health segment. We laid out the expected turnaround in hospice, and we got it to steady contributions from our facility-based division.

To add color to these quarterly results, I'll begin with home health. In this service, our organic admissions were up 6.7% over the same period prior year. When combined with the growth from recent acquisitions, the quarter saw a total increase in admissions of 12.3%. Quality continues to be the #1 differentiator and is behind the growth in both our organic and nonorganic admissions. And I'm pleased to report that once 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 LHC stand-alone locations have 4 stars or greater. And for patient satisfaction, that number is 90%.

On a stand-alone basis for LHC, for the quality rating, we produced a score of 4.68 and excluding recent acquisitions for the April report, which is an improvement over 4.55 from the January report. This, of course, compares favorably with the 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 4.32 stars compared to the industry average of 3.70.

In our hospice segment, consistent with what we laid out last quarter, admissions and census were up year-over-year and up sequentially from the fourth quarter. Organic admissions grew 4.6%, which is in line with the 5% to 7% growth that we've targeted for the year, and I laid out last quarter. We're happy with the pivot from a few months ago and feel that we have the right team in place to continue this growth and scale up as part of our trilevel market strategy.

As a side note to this trilevel strategy, of the 319 legacy home health locations at quarter-end, only 41 were colocated with hospice, but yet we've identified 130 as ideal for colocation. Now bring aboard Almost Family, including a solid personal care platform, this approach to building out markets using home health as our anchor, provides tremendous internal growth opportunities going into the months and years ahead.

Next, and on to integration. LifePoint and CHRISTUS are fully integrated into our point-of-care model, and Erlanger, which was added in fourth quarter of last year, is just shy of that mark as well. With each of these new partnered operations, we now turn our attention to margin and quality improvement, care innovation and portfolio expansion through a build and buy approach. These are great partners and have been extremely supportive during our modeling period. We look forward to their contribution as we go into the back half of this year.

Lastly, and in regards to the merger with Almost Family. As Keith touched on, it's our attention to integration detail that gave us the confidence to stand alongside of our Almost Family colleagues and get to the point where to date, I can say that we're right on track with our master plan. A plan that has each work stream group following a detailed first 100-day road map. BRG is riding sidesaddle with each work stream lead, and we'll do the same when pull out the post 100-day plan in the weeks and months ahead.

Just a few details to note, merger to date. Hospice is now inside of a unified structure. Personal care is also a consolidated division, and we've already conducted the first detailed operations review for every service in the merged company and have specified operational priorities for each.

And lastly, as Keith alluded, we're leveraging 2 great cultures to begin sharing best practices as we enhance service and quality to thousands of patients on service to date and futuristically. Without question, we have a lot of hard work ahead, but with every passing day, we are celebrating the wins and turning what was a transformative opportunity into something transformational.

So again, a sincere thank you to all of my one family colleagues and thanks to all of you for listening in on our call today.

We will now, operator, turn the floor over for Q&A.

QUESTIONS AND ANSWERS

Operator

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

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

Keith, thank you for all the color on the integration process, but I just wanted to ask, as we think about where you are today, 1 month after the close of AFAM, what do you see in terms of the big remaining lift that you guys -- that your team needs to do? What surprises have you seen? And then what sort of reaction or disruptions can you call out at the ground level, whether it's regional management or at the agency level?

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

Take the first part, Keith? So surprise -- surprises, I mean, Brian, honestly, I don't think I've seen a surprise. I feel like I should be able to come up with something, but I mean, there have been challenges that you have to overcome in integration, but I would say that none that were not anticipated and within the 23 work streams and dealt with just from a process approach. Don, anything I missed?

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

No. I agree, Brian. And again, hats off to everybody that we had in the fold on the diligence process and honestly, hats off to the AFAM colleagues because they are riding along with us. Here's how I would think about it. In this first 100 days, the big lift is to go from their CLASS system to the lawsuit system, which affects some payroll really processes but nothing in the field because their own Homecare Homebase. The next thing that I would say is that even though that Almost Family is on Homecare Homebase, they have 3 different instances which are, of course, different than ours. And I've told people it's kind of like having the same dimensions of a home but the walls and the rooms inside of it, a little bit different. And so when we overlay our operating model, it's going to require a few tweaks, but we are sequentially getting to that point, so there's no flip of the switch. And I think my last comment is that on the sales and the growth side, we have tools, including, but not limited to, our CRM product and some of our reporting that we're trickling through so that their cost of sales, their percent as a net revenue number is quite different, I mean it's much higher than ours. So we really see an opportunity to look at the capacity of those agencies and map out some census growth. But I say all of that to say that in this circumstance, going too quickly and without true methodical planning is a risk that we're not willing to take, and I think the first 30-plus days have shown that, that's been proven effective. So no surprises, on track, a lot of heavy-lifting and a lot of upside.

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

Let me -- Brian if I can, because from -- in my perspective, the biggest risk in a transaction like this is if there's not cultural alignment and synergistic energy between the 2 teams because of the new -- the varying geographies and lack of overlap and the cultural alignment between these 2 organizations that Don mentioned MORs earlier, it was great to have to see all of the leaders from around the country in a room together, working together as a team already less than 1 month in. That's what we hoped for and from my perspective, it's even better than I could have hoped for.

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

That's good. Just a follow-up on that. I guess, for Josh. If you were to look at the financial performance of AFAM in Q1 obviously, it's not reported in your financials. And it's kind of like a black box. Even just qualitatively, where would you put AFAM's Q1 versus what you had been modeling or expecting?

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

Yes. No, Brian, that's good question. I would say it's very much in line and have some good momentum going into Q2 that we just bridged that their Q1 performance last week at the MORs that Keith and Don just talked about. We bridged where they were in March and kind of the trajectory for April for the quarter. So I feel real good about kind of where they ended their quarter and the momentum we got going into Q2.

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

Appreciate it. I think, Keith, last question for me. As I read the press release last night and then listened to your comments this morning. Clearly, you are sending a message on M&A. Where do you stand in that leg in terms of your timing and your interest level? And then you called out the JVs as part of that comment as well. If you don't mind giving us more color to remind us how should we be thinking about the ramp of the JVs, when you bring them on board and what that brings you in terms of long-term organic growth?

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

Yes, sure. So I did emphasize that quite a bit because I just don't want to -- anyone to think that at any point in time, over the last 6 months, that we ever cease to work that pipeline. That's a big part of why we wanted to bring BRG in to help run that -- head up the transition team. So last year, we were at $114 million, a little over $114 million in acquired revenue and the majority of that was joint venture. We fully expect to exceed that this year. And when the pipeline, I guess the way I would say it, we -- I just tallied this up. We're in discussions right now with 24 different hospitals and health systems across 14 states. And all of those move on varying time lines, of course, but these aren't people that we're making -- just making pitches to. These are people that we're in active discussions and negotiations with. So 85% of that pipeline is hospital and health system joint ventures at this time. Hopefully, that will give you some color. Very little freestanding activity.

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

And then I guess, just on that point on how should we be thinking about the JVs once they roll into your business? And what kind of organic growth do you normally see once they're tied into LHC?

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

Yes. Well, it's kind of hard to answer because of the recent ones of LifePoint, Baptist and CHRISTUS by far have bigger hurdle rates on the organic side than we would even like on Erlanger. Here's how I would say, it usually -- it still takes us about 6 months. They're all -- many of them are losing money and once we get that, they usually can hit the upper-single digit, double-digit growth, which then facilitates our portfolio at 5% to 7%. And I guess, stated differently, Brian, if we wouldn't see double-digit growth in the second and third year of that, it would be a surprise only because of where they're starting from.

Operator

Our next question comes from Kevin Ellich with Craig-Hallum.

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

I guess, following up on some of Brian's questions. I guess, Don, starting off. You commented about the sales and growth side for Almost Family and cost of sales as a percent of revenue is much higher than LHC Group's. So just wondering, what does that mean for gross margin in Q2 and going forward? How should we be thinking about that? I don't know if Josh can chime in with some help there, too.

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

In fact, we'll take it in reverse. I'll throw it to Josh to get to the end of the movie, and I'll tell you how.

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

Yes, Kevin. I mean I wouldn't bake in any incremental improvement that fast out of the gate on the gross margins for Almost Family. But I mean, I would think over time as we continue to get their growth trajectory up at a higher rate as ours has experienced over the past few years, then as a percent of revenue, the cost of sales will go down, but I definitely don't want you to think that we got -- where I don't need anybody listening to the call to think that we're going to be out there, cutting sales force or doing anything to get the percentage down at this time, but I think you're going to see an improved quarter-over-quarter.

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

Yes, as a matter of fact, we're not cutting anything. What we're going to do is we're going to go grow it a little bit differently, because their bell curve of production has a little less shift, meaning that they have more as a total percentage of sales executives that weren't hit in their production numbers, and we think that when we overlay our CRM product and a couple of route planning things that are proprietary to us, it's going to really enhance that. But at the same time, they are hiring in capacity. We've got to plan that accordingly. So I echo, Josh, what you said, and I wouldn't plan on any of that coming to fruition until the late back half of this year.

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

Got you. That's helpful, guys. And then, Keith, going back to your M&A pipeline comments and the JV activity, since it's May already, is it safe to assume that some of the deals you had in the pipeline are very sizable? And then on top of that, have you seen increased activity or interest from hospital and health system partners since you announced and even closed the Almost Family transaction?

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

So it's really a good question. So the answer is yes to both. So we have -- some of these are larger systems where we're targeting specific hospitals that assuming those are successful that could lead to a larger pipeline within an existing system. And that's not unusual, that's happened to us in the past, in fact that's how normally -- the relationship normally begins. But with Almost Family, what's unique about Almost Family is that we picked up -- we nearly doubled our geographic footprint in some very important states, state of Florida, for example. So with Almost Family, we add to our organization a larger number of freestanding locations that are end markets with target hospitals that do not have home health agencies. So there are opportunities to align with some of those systems and put our freestanding agency together with the market-leading health system in a market, and we see that as a very interesting part of our long-term strategy.

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

Sure, that's very helpful. Going back to Josh, just wondering if you could give us any -- and maybe a little help in terms of your outlook for cash flow and capital expenditures for the year?

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

Yes. No. Kevin, great question. And as you saw, we had a real strong quarter for free cash flows, a little over $28 million. We feel good about that. Our cash collections continue to run just right out 100%, just a notch above 100%, all in for the company. Our DSOs continue to be running at a healthy clip and a lot of the bottleneck, if you will, of cash collections some of last year from some of the larger joint ventures we did, now that more of the channels have been processed, we're seeing that come through. So when you look at our free cash flow, and you look at how much we're able to pay down debt in the first quarter, hopefully, that gives you some confidence in how less it's going to look for the rest of the year, but I feel really good about it.

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

I mean, with Almost Family coming in, presumably, we can't just annualize Q1 and it's going to be greater than that, right? I mean, I think in your presentation, you guys had stated $110 million of free cash flow. Is that still kind of the target?

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

Yes, that's right.

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

Okay. Great. And then thinking about the big deals you did last year and now with Almost Family, are you expecting any -- I don't want to say issues or integration issues with billing and collections? Will it take a little bit of time?

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

No. We actually feel really good about that. There's -- I'll take Almost Family since it's the most current and pressing and the largest. They have a, as you would imagine being a public company, they had a very robust and sophisticated billing and collections back office support system up in Louisville and although over time, we'll be able to kind of take the best of both worlds and make some enhancements, that is still running like clockwork like it was it before April 1, so don't really envision any hiccups there at all.

Operator

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

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

So if I may, a follow-up on some of the commentary around the hospice, particularly because it did improve and you mentioned that it was sort of in line with what you were thinking about for the year, the 5% to 7% growth. So with the AFAM deal closed, how should we think about these rates for the major segments, hospice and home health, in terms of organic growth for the year previously talked about 5% to 7%?

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

Well, good question, Joanna, thanks. I wouldn't change that at all because they, again, with their number of hospice locations, we've already brought that into the LHC Group structure, and we think we can bring those along at the same clips. I still think the 5% to 7% annual number is a good number, obviously, with Q3 coming up and seasonality and things of that sort, that's always probably one that we'll see the dip, but then we'll pick that up in the fourth quarter. So I still feel very good about the 5% to 7% number for the whole thing.

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

And what about the home health in terms of organic growth there?

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

We guided to the same exact thing, 5% to 7%. I'll tell you now, we really are happy where we sit so far Q2 to date. But again, we got the summer months and if we were close out right now, we'd be at the top of that 5% to 7% for Q2, but I would not bake in any higher number than that 7% for an annual number on home health.

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

And on the front, sorry, go ahead.

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

Yes, Joanna, this is Josh. I just wanted to kind of piggyback on Don. So in addition to just the growth that he spoke to, I want to really applaud the team on the hospice side for the incremental month-over-month improvement we've been seeing on the margin side. I know we talked about that in the past few quarters and Don mentioned in his prepared remarks, but just 2 weeks ago, when we were really digging into hospice, and you start trimming it back to call it August, September of last year and see the momentum and the trajectory, I really think we're going to have a lot of upside opportunity in the hospice margins for the back half of the year as well.

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

And I guess, on the front, how should we think about the margins for the year? I mean, definitely a very nice improvement for hospice. So can you talk about hospice? And then maybe also on the home health, I guess, too flat, the margin being compressed because of the Medicare rate cut there. So how should we think ballpark number in terms of the hospice and home health margins for the year?

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

Yes, I would say that you're just going to continue to see -- really on both service lines. On the home health, you're going to continue to see incremental margin improvement throughout the year in large part due to the continued improvement on those acquisitions. CHRISTUS especially, the last one that came in the fold and there are some real upside there on the margin front. And then hospice as well, I think you're just going to see gradual climb throughout the year.

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

Great. If I may just follow up after one more last question here for me, on the integration issues. I appreciate the color in terms of you haven't seen many surprises and I guess the fact that are both companies using a feed that's going to help too? But on the employee side, so I guess, it's good to hear that you have the regional management kind of in one room, working together. But have you seen or have you got a sense that there is any increased employee turnover? I know [Eric Elliott] is only 1 month in, but any kind of color you might give there would be helpful.

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

Yes, Keith? I would just say in short, absolutely not and transaction aside, we don't see that as a problem whatsoever. Obviously, you always have some turnover, but because of the transition itself, it's not bearing any weight on that. As a matter of fact, we think we can actually help that with some of the things that have come through with our benefit conversions and some of the other employee side on PTO and some of those other things that are going to take effect with our benefit playing here in October.

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

Yes, I would just echo Don's comment. We haven't seen any of that, but also I just want to point out the experienced team that Almost Family had in all of these new geographies we picked up. So it's not just the license service area and agencies. I mean, that would be great, but this is an organization that's been around a long time and a leader in the home health industry. And so we, in states like Florida, we don't just pick up the geography, we picked up a very experienced team in place. So if we approach hospitals and health systems, you don't get a second chance to do things exactly right within it. And we feel really good about the experienced team that is on board now. So when you have that kind of talent, and they're engaged in working in harmony with our existing team, we're really very bullish on our growth opportunities.

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

And Joanna, this is Josh. Keith, the one thing I would also add is that, it's not only having the regional leaders that were here for a few days last week, but Keith and William have literally been on roadshows going around to the local level. I know Don and I have each been on the ground at some of the local markets, and just the energy is palpable. You can feel it. So I really do think that there's a lot of positive energy and momentum out in the field not just at the regional level, and you wouldn't expect to really see any incremental turnover from the transaction.

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'll start out with a couple of just higher level questions. With regards to your development pipeline, it looks like it's clearly joint venture related. So I'm just curious, how do those valuations compare when you're able to do transactions inside of joint ventures versus just one or freestanding portfolio acquisitions? Certainly valuations looks like in home healthcare and especially hospice have been on the climb here to say the least with a couple of big transactions, but that would be my first question is, how does that compare to freestanding larger acquisitions?

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

Yes, so freestanding -- our large acquisitions that have strong earnings will be more -- will be higher priced. So with hospitals and health systems, we have to use fair market valuation in all of those trades. So as Don mentioned earlier, most hospitals and health systems we approach have existing home health agencies that are performing below the mean of freestanding organization. That's safe to say it in many cases, they're actually losing money. So we have to -- in those cases, go to a revenue multiple that's suggested for the region and largely based on provider density if it's a Certificate of Need state or non-CON state. So they are less expensive to enter. And if you -- then we have the ability, of course, to have that lower value entry point and bring our operational experience to the table, turn it around in terms of quality and efficiency. And then a year into the joint venture, begin to aggressively seek more business once you have the quality scores and the efficiencies all in place.

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

And on the non-JV backlog, is that primarily -- is that focused in one area? Is it home health? Or is it hospice or a blend of both?

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

Yes. So it's primarily hospice on the freestanding side. When you said -- did you say backlog?

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

Yes, in terms of just deal opportunities, you said that the bulk of it was JV. So for the non-JV backlog of opportunities, is it more hospice or is it home health or a mix of the 2?

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

Yes, it's a mix of the 2, but more hospice on that. And I would say that -- so this is a good point to bring up. So some of the freestanding opportunities that we're acquiring, we're acquiring with a greater goal of attaching them to some hospital or health systems in a market, so long term. So it's just a market that we don't have yet and there may be hospitals or health systems in those market that don't have home health or hospice service lines.

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

Got you. In terms of, obviously, a new facility here you put in place. But I guess, in terms of long-term funding and long-term balance sheet strategy related to acquisitions, what is sort of your limit in terms of leverage in the near term? And then where do you want to be in the long term given all these opportunities that seem like that are out there?

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

Yes, Frank, this is Josh. It's a great question. As you can see from the new credit facility, before we entered in the new credit facility, our available amount under our old deal was starting to get below $100 million. With the new credit facility, even consolidating all the debt, we've got over $200 million currently available and with the cash flows that we talked about earlier, we'll be paying that down and freeing up more capacity. From a leverage standpoint, I mean, you know us and you know how conservative we've tended to been over the years, but for the right opportunities, I mean I'd look at Keith, I could easily see us getting to 3 -- north of 3x levered with a strategy to pay that down over time. You're not going to see us up in the 4x or 5x range, but I could see us getting north of 3x for the right opportunities.

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

Got you. And then just one more at the high-level on acquisitions. You did call out the G&A extra costs in -- deal-related costs in your SG&A because of the AFAM deal, but I'm just curious, with these deals and sounds like maybe more to come, how much scale do you think you can get off of your G&A, SG&A infrastructure? Can we expect to see some positive leverage as you layer in these incremental layers of growth? Or do you think you'll have to step up and build up more G&A at an equal rate?

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

Great question. Frank, in addition to the operations in sales MORs that we've all spoken about, in 2 weeks, I'll be hosting our home office kind of support infrastructure MOR, if you will, and the biggest topic of conversation is the one you just mentioned. We are very bullish on our ability to lever our back office infrastructure and feel like incrementally, if we're, call it 8% to 9%, the incremental add for depending on the size of the acquisition is anywhere from 2% to 3%, no higher than 4%. So I think you could really see some leverage over these next few years as we move out into the future and continue to grow.

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

Okay. I'm going to ask 2 nitpickers and then I'll hop off. One, it just seems like the hospice pricing growth, I don't know that I've ever seen anything that high. Was there anything unusual in there that would have caused that, I want to say it was like almost close to 7% year-over-year? So just call it there. And then number two, as re-cert rates continue to decline, do you really think you can get enough the sustainability of the organic admission growth? Can that really help ultimately drive episodic growth? I'll hop off.

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

Frank, no. This is Josh. I'll take the first question and kick it to Don for the second. So on the revenue per patient day growth on hospice, it's really 2 factors. One is just the rate increase that we experienced year-over-year of probably 1%, 1.2%. But we also had an increase from 28.5% of the 33.7% of what's called Tier 1 days in the hospice reimbursement model and that's due to the growth in the new admissions. So as you continue to see our new admissions grow, the Tier 1 days' percentage goes up, which helps your per patient day revenue.

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

And on the second question, that's a really good observation. As re-certs go down, and you're looking at the backfill of that 5% to 7%, the other factor is pricing because just as a point to make on our first episodes, we're running a case mix of 1.23 to 1.25 whereas you get a subsequent episode at about 0.8 to 0.9. So yes, you certainly decrease that census number with that same 5% to 7%, but your pricing and your per diems are going to offset that. And we've seen that really quarter-over-quarter as the landscape changes on the shorter length of stay.

Operator

(Operator Instructions) Our next question comes from Matt Larew with William Blair.

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

I appreciate the color on the margin progression at the joint ventures. I was hoping you could give us some detail on top line contribution relative to your expectations and if there are any service lines in particular at this joint ventures that are doing better or worse than you're expecting?

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

Yes. I mean, I'll start. Matt, this is Josh, and Don can jump in with any specifics. From a top line perspective, across all of the joint ventures from last year, LifePoint, Baptist, CHRISTUS and Erlanger were right in line. Now there are some ups and downs at different markets and different service lines, but we feel really good about kind of how we pro forma modeled out the top line growth for each of those, and they're coming in really well. Don?

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

And on the question about are any of them doing worse than we thought, the answer is, both home health and CHRISTUS, our LTCHs, are doing worse. But let me qualify that. There were some drag locations and drag operations that early on, in our JV board meetings, we knew that we would drop in a disco. But because there are some issues in the community, we've had to kick those closure times down a couple of months. So that drag is flushing through just a little bit longer than what we thought. And so in and of itself eliminating that and what you'll probably -- I'm getting ahead of myself, see that in the second quarter drop a couple of them into disco, that'll accrete right off the bat and get us back to where we thought we'd be to start with.

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

Okay. I appreciate that. And then just a higher-level question on the recent announcements from CMS that Medicare grants plans can pay for, non-skilled care, just wanted your high-level thoughts on the opportunity particularly with the broader geographic reach with Almost Family in the fold and whether you started to have any initial conversations with payers or how you think that market might develop?

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

Yes, that -- what a great observation. I earlier said in my prepared comments that we were excited with the trilevel of care approach and that Almost Family bringing their personal care platform. I mean, we went from the low teens in the number of locations now to the 90s. And inside of the nonfunded business, this is a huge opportunity for us. So I'll be brief in saying absolutely, it's an opportunity and Steve and the gang right now are literally talking to payers of how we can coordinate the skilled and the nonskilled to make it all kind of one trilevel bundle, if you would, in these markets. So it's a great opportunity. The footprint with Almost Family's personal care could not have come at a better time and it's just a tremendous tailwind with the recent news that you alluded to.

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

Yes, I'll add -- I'd like to add, just echo what Don said. Many of you on the phone know Steve, and Steve Guenthner. And that's where Steve is spending a lot of his time now. There's no one with more experience or more capable than Steve to do that for our organization. So he's not only driving the strategy to build out the personal care platform, but having -- personally having those discussions with managed care companies as we speak.

Operator

Our next question comes from Dana Hambly with Stephens.

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

Just it hasn't been asked so I must ask. On the HHGM, what's the time line of events that we should be looking for? When do you expect we'll hear more on this? And based on your current discussions and understanding, is there anything happening that have you kind of rethinking anything about the way you're delivering home health services?

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

No. The short answer is no. I mean, there really isn't, so. But as you know, we're very involved with -- in the industry, and with the Partnership for Quality Home Health and Alliance for Home Health Quality and Innovation. So we're in the process right now of developing our legislative and policy strategy for the remainder of the year and in fact, we have a group meeting on Friday to finalize that. So I mean we're -- but no -- again, no surprises. I mean, we would hope to get something in legislation at the end of this year attached to something that would give us some clarifications and some regulatory relief in certain areas, and feel pretty good about our opportunities to do that. So -- but those would all be wins, if we get them done.

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

Okay. All right. And then on the synergies for this year, the $8 million to $12 million. I guess, I was -- my original thinking was that you would get very little synergy this year and it will be mostly next year. Had I misunderstood that? Or is there something as you get closer to close that you found some lower-hanging fruit?

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

No. Dana, it's a great question, and it's what you just said. So we still feel very good about the $25 million all in, but as we were getting closer and when we came out with our guidance, we felt real confident that we would get more in that $8 million to $12 million range this year as opposed to maybe the $5 million to $10 million range we were earlier thinking. So feel good about that.

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

Okay. And then lastly, I think you gave it, but I missed it. The margins on your -- the gross margin on the acquired revenue?

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

Yes. It's 30.5% for the quarter, up from 28-and-change in the fourth quarter. So incrementally, it's up 150-or-so basis points.

Operator

And our final question comes from Brian Tanquilut with Jefferies.

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

Yes, just as a follow-up to Dana's question on the regulatory front. Keith, as we think about the CMS having to bring you and the rest of the industry as part of the -- they're just rediscussing and replanning payment reform. I mean, how should we be thinking about the direction that, that's taking? And then, I guess just wanted to hear your views too on the budget-neutrality provision that they put in the budget bill. What your interpretation of that is? Is your -- is it a lock? Or is that as firm as we think it is?

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

I'm looking at Richard MacMillan here, who's -- Richard, we're going to -- I'm going to let you chime in.

Richard A. MacMillan - *LHC Group, Inc. - Senior VP and Senior Counsel for Legislative & Regulatory Affairs*

Sure. Pardon me. Yes, the budget neutrality, the -- all of us in the industry are interpreting that, that it would be truly budget neutral, any payment change that CMS would come up with in this proposed rule this year.

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

Got it. And then, Keith, just in terms of the discussions with CMS, I mean, what is the industry looking to propose? Or where does the industry want to take payment reform?

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

Well, so I think generally, we -- at the partnership level, we support directionally the move towards value-based payment. We think we understand, at times, that we -- that the national association, sometimes there's concern over smaller agencies. They have concerns about the pace at which we move in that direction. But we try to stay on the same page, and we work collaboratively so the industry goes in unified to CMS. But there is discussion about that. At the partnership level, we -- those organizations -- the large organizations would prefer to see that accelerated. So anytime payment reform comes up as an alternative to just having to negotiate against cuts, we like to put value-based first thing on the table as an offset for them. So I don't know if that's answered your question, but that's where we are.

Operator

Ladies and gentlemen, that does conclude our question-and-answer session for today's call. I would now like to turn the call back to Mr. Keith Myers for any closing remarks.

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

Okay, thank you, operator. Thanks, everyone, for joining our call. As always, if you have any questions, please reach out to Eric Elliott and if you need to speak to any member of the management team, we'll make ourself available for you. Thanks, again.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, you may all disconnect and have a wonderful day.