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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the LHC Group Q4 2019 Earnings Conference Call. (Operator Instructions) Please be advised that today's call is being recorded. (Operator Instructions)

I would now like to hand the conference over to your host, Mr. Eric Elliott, Senior Vice President of Finance. Thank you. You may begin.

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

Thank you, Blue. I'd like to welcome everyone to LHC Group's earnings conference call for the fourth quarter and year ended December 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 full year 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-K 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 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; and Josh Proffitt, Chief Financial 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 2020 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, President & CEO*

Thank you, Eric, and thank you, everyone, for dialing in and participating in this morning's call. I would like to begin by thanking our growing family of health care professionals for their unwavering dedication and commitment to delivering the highest standards of clinical quality, outcomes and patient satisfaction, the growing number of patients, families and communities we are privileged to serve. It's an honor and privilege for me to be part of your team.

2019 was another record year for LHC Group. In addition to surpassing a major milestone of an average daily census of 100,000 patients we recognized last quarter, we also formed new partnerships with Norton Healthcare, Geisinger Home Health and Hospice and AtlantiCare Home Health and Hospice. We successfully expanded our joint venture partnerships with leading health care partners, such as LifePoint, Ochsner Health System, THR and Methodist, Capital Region Medical Center and others. We experienced a strong year of organic growth in the face of industry and company-specific headwinds that Josh will elaborate further on in his prepared remarks, and we achieved a record number of LHC agencies achieving 5-star ratings from CMS, the highest possible rating.

As I mentioned last month to approximately 32,000 team members throughout the country. I believe our most significant accomplishment was the teamwork demonstrated throughout the organization, and in a very professional, disciplined manner, strategically positioning LHC Group for success in the new environment created by PDGM. We've received hundreds of calls and e-mails of appreciation from our team members, highlighting the level of attention and planning placed on testing, training and educating them on our clinical care models and proprietary IT system. I want to thank the entire team for their contributions to the innovative thinking that went into our clinical care models. With their help, we have been able to fulfill our obligation to our patients, partners and stakeholders to remain healthy, viable and flexible without compromising our primary focus on clinical quality and patient satisfaction. We are poised to do great things and are already seeing excellent outcomes in each of our 6 pillars of excellence.

Now I want to talk about what these PDGM preparations mean for us in 2020 and beyond. Let's focus first on the clinical aspects, the short-term disruption caused by this work ahead of PDGM in Q4 and early 2020, and the growth opportunities this new reimbursement model is creating. As many of you know, our clinical leadership team began preparations to transition to PDGM more than a year ago. We are very proud and appreciative of their tireless efforts over the past year, and how, through their efforts, we have made significant improvements to our clinically-driven evidence-based operating model, which focuses on comorbidities, functional scores and diagnosis.

Throughout the second half of 2019, we piloted the cross walking of the previous 153 resource groups to the new 432 different PDGM resource groups to ensure we could maintain our industry-leading patient outcomes and satisfaction, while at the same time, improving efficiencies and care delivery and better managing the care of our patients. We also tested increasing the use of telephonic teaching and training visits, leveraging our call center and remote patient monitoring. Our assessment of the first 2 months under PDGM shows that everything is going as planned with our clinical care model, the use of other methods such as telephone, teaching and training visits to increase the number of patients encounters and the early benefits of a streamlined operational structure in home health. For example, in the month of January, we saw the percentage of our Medicare patients receiving telephone, teaching and training visits increase to 19% from 16% throughout the fourth quarter. That's an increase of over 2,000 patients received in [remote channels] in 1 month's time.

Another example of the innovation in our care model is spending more quality in home time with patients. From August 2019 to February 2020, we were able to average 5 more minutes of home time with patients. That translates to 5 million more minutes of care delivered in February compared with August, or the equivalent of 125,000 more 40-minute visits per month. To be able to make the statement that everything is going as planned and we're not seeing any surprises takes a lot of work ahead of time. You heard those same words from us with the integration of Almost Family as we went through a very methodical approach to position us for success postintegration. We took a similar approach in 2019 to set us up for 2020 and beyond.

Consistent with the outlook we provided throughout the second half of 2019, all of the training, policing and preparations for PDGM had an impact on our performance in the fourth quarter. It's also reflected in the ramp-up of our earnings and EBITDA in 2020 that Josh will discuss in a moment. In addition to the PDGM specific preparations, we aligned our home health and HCBS segments for growth in 2020. The Homecare Homebase implementation across all of Almost Family locations was completed by year-end, while at the same time, we were completing a system conversion in HCBS to one system. We also realigned the sales and operational leadership at several of our home health divisions during the quarter.

As we've seen in the combined organic growth numbers that we're accelerating through 2019 and so far this year, this approach to get us ready for more growth in 2020 and beyond was the right one. Despite these disruptions, we did not see any negative impact on our admissions or organic growth or clinical quality. We remain supportive of PDGM and CMS's core goals. There's still a lot of room to improve on this model in the coming years, but it does play to our strengths. It reinforces the critical role in home health care plays as the most appropriate and most efficient setting to delivering high-quality care in the privacy and comfort of the home, our primary place of residence, and we are appreciative that Congress, in creating PDGM and CMS and implement it -- implementing it recognizes so strongly the growing value of quality in-home services.

As a result of this transition, in Q4 and the first 2 months of 2020, we have seen an increase in the number of inbound calls from smaller agencies looking to add to the business. Some of these opportunities could be good acquisition candidates and others, we can naturally roll into our organic growth through market share gains as we earn more of the business in our existing locations instead of acquiring that volume. Our pipeline of potential joint venture partners is increasing as well with our value proposition resonating as strongly as ever. After completing $114.3 million in acquisitions in 2019 and to date in 2020, we believe the current environment positions us to exceed this amount in 2020 and 2021. We have described the consolidation opportunity driven by PDGM and the elimination of the RAP payments as historic and so far, it is playing out for the smaller and more rural providers as we had expected. It's still too early to say whether the projected 30% closures among smaller home health agencies is the right number, but it is -- it is our and the industry's expectation that consolidation will accelerate in 2020 and continue over the next several years. Change is nothing new to our team. We have successfully managed through numerous reimbursement changes over the past 3 decades, each time appropriately adapting to change in a timely manner and emerging a stronger and better organization, and as a result, greatly benefiting from the resulting industry consolidation opportunities.

As we look ahead to 2020 and beyond, there are a number of priorities that our team is focused on: executing on PDGM transition; continuing to lead the industry in quality; patient satisfaction scores as well as key areas around employee recruitment and retention; organic growth; increased M&A activity in home health, hospice and hospital joint ventures; capturing incremental growth and market share from incremental contribution from Almost Family; recent joint ventures and other acquisitions; maintaining our disciplined approach to capital allocation; and continuing and enhancing our good relations with congressional leadership and CMS to position home health for even greater opportunities in the future.

Now here is Josh to provide some color on our financial results and 2020 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'll begin my prepared remarks by saying how much I appreciate all of our clinical professionals across the country and what they do each and every day. It is truly a privilege to serve you as you give so much of yourself serving others.

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 fourth quarter financial results, here are the big takeaways. We had another quarter of strong growth at our legacy LHC locations and continued sequential improvement in our Almost Family home health locations that I will describe in more detail shortly.

Home health revenue was slightly below our expectation due to a decline in case mix in the fourth quarter as we focused on piloting and preparing for a company-wide rollout of our PDGM model. Our adjusted earnings per share was $1.15 for the fourth quarter, including approximately $0.09 related to a lower tax rate in the quarter. Q4 EBITDA was a little shy of what we had originally anticipated due to disruptions from operational realignment and PDGM preparations, but by making these changes and accelerating our preparedness into the fourth quarter, we are so much more well prepared for a strong and successful 2020 and beyond.

As Keith mentioned before, everything we did in 2019 was to prepare us for the future. Our system conversions, our home health operational and sales realignment, our heavy focus on improvement of Almost Family quality scores and our PDGM preparations have now all been completed, and we are set up very well for success this year and into the future.

Now to the fourth quarter and full year highlights. Incremental margin improvement has continued across all segments on a year-over-year basis. Home health adjusted EBITDA improved from 10.5% in 2018 to 11.2% in 2019. Hospice adjusted EBITDA improved from 8.1% last year to 11.5% in

2019. HCBS adjusted EBITDA improved from 3.1% to 5.4%. Facility-based adjusted EBITDA improved from 3.3% in '18 to 4% in '19. And HCI adjusted EBITDA improved from 2.2% in 2018 to 7.6% in 2019.

Organic growth was a bright spot for us again this quarter, with legacy LHC locations delivering 10.3% growth in home health admissions. We are also very pleased with the fact that we experienced a 5.5% increase in home health admissions on a combined basis across all LHC locations, including the former AFAM locations. It's evident that as we now turn the page to 2020 when we will be reporting organic growth on a combined basis, that we are starting 2020 from a more solid launching off point than previously anticipated, as the Almost Family assets continued their dramatic improvement throughout the year last year. While this is the last quarter we will be excluding the former AFAM location from our organic growth, one way to look at the impact of this improvement we've made at the Almost Family locations is to look back at the organic home health admissions on a combined basis by quarter. I'll refer you to Page 6 of the supplemental deck for this comparison. You will see that in Q2, combined growth for the entire company for home health was 1.7%. In Q3, it rose to 3.3%, and as I said a moment ago, we were up to 5.5% combined organic growth in Q4. Maybe the more impressive number is the current projected pace of growth for Q1 2020. We're currently pacing at a growth rate of 8% to 10% for combined home health organic admissions for Q1. Compared with our long-standing target of 5% to 7% growth for home health, I think you can see the benefit of bringing all of our acquired locations up to the operational and clinical standards that we are known for at LHC Group and possibly early indications on of the effect of PDGM market share gains.

Turning to Page 9 of the supplemental deck. I would note that our adjusted consolidated gross margin of 37% in Q4 was a 10 basis point improvement year-over-year and a 70 basis point improvement for the full year 2019 versus 2018. Consolidated adjusted G&A expense as a percent of revenue was 27.1% for the full year 2019, which was a 50 basis point improvement, down from 27.6% in 2018. Our adjusted consolidated EBITDA was 10% for the fourth quarter and 10.2% for the full year, which is a year-over-year 130 basis point improvement for the full year of 2019, up from 8.9% in 2018.

Pages 12 through 18 of the supplemental deck highlight the results, and Page 7 notes the key stats by segment. In addition to the improvement in organic growth in our home health segment, we have maintained our gains in the hospice and HCBS segments. With regard to hospice, for the full year 2019, we delivered an 11.5% EBITDA margin, which is attributable to lower G&A expense, solid volume growth and improved cash collections on our hospice receivables. In regards to our HCBS segment, we achieved a 5.4% EBITDA margin for the full year up 230 basis points from 3.1% in 2018. These gains were made in both gross margin and G&A expense.

Turning to Page 22 of the supplemental deck, we've updated all of our debt and liquidity metrics for the year. You will note that adjusted free cash flow net of taxes paid was $115.4 million for the 12 months ended December 31, 2019. Driving growth and free cash flow will continue to be a priority for us in 2020, but I will call out that it will be heavily influenced on a quarterly basis by the timing of how we progress through the new PDGM model during the year.

DSOs were 49 days in the fourth quarter compared to 46 days in the same period a year ago due mainly to a buildup of unbilled receivables in HCBS caused by our conversion of the AFAM locations to ContinuLink. This should work itself out over the next 6 months as the locations work through those claims. DSOs under the PDGM model have not been an issue up to this point, as CMS is paying claims relatively quickly, but we still expect there could be a bit higher as the year progresses and settles out.

During 2019 and to date in 2020, we acquired annualized revenue of $114.3 million through joint ventures, both new and extensions of existing partnerships as well as through strategic acquisitions and tuck-in acquisitions. We cannot be happier with how closely we are working with these partners and the better performance we are getting postintegration. Our joint venture partners are only a fraction of the 1/3 of hospitals that have home health agencies. We have more room to grow in that space for sure. Maybe even the much larger opportunity is among the remaining 2/3 of hospitals who don't yet have home health agencies but are starting to recognize the strategic value that in-home health care provides to their health system. With our seat at the table with our ACO business, leading quality measures and extensive partnership experience, we are a contractual partner that they can depend on.

The home health industry remains highly fragmented. The impact of PDGM and the elimination of the RAP payments should accelerate the consolidation into the largest providers such as LHC Group over the next several years. We expect to increase our volumes through inorganic growth and also earning the business with leading quality and patient satisfaction scores to drive incremental organic growth. We've already seen what can happen in the acquired former Almost Family locations after taking a very patient approach to build out solid operations and higher scores before we began an aggressive sales and marketing effort. That same approach can and will be replicated in this new environment.

We are certainly known for home health, but another growth engine for us is in hospice. We are making a very intensive push on adding hospice to markets where we already have an established home health presence. Our goal is over the next 5 years to have at least 75% of our locations where we have home health colocated with hospice. With a solid balance sheet and over $450 million of liquidity, we are well positioned to fund all of this growth activity. Net leverage at year-end was 1.04x adjusted EBITDA for 2019. We have $220 million available on our credit facility and an accordion feature that can provide an additional $200 million of capacity.

Now moving to 2020 and introducing our guidance for the full year. Guidance for 2020 net service revenue is in a range of $2.13 billion to $2.18 billion; EPS in a range of $4.60 to $4.80; and EBITDA less noncontrolling interest in a range of $230 million to $240 million. We are assuming an effective tax rate of 27% for the year and fully diluted shares of 31.6 million, but the main assumptions to factor in for the full year are the timing associated with offsetting the PDGM behavioral assumption revenue cut and sequential increased cost efficiencies that will ramp throughout the year. We have consistently noted throughout 2019 that we thought we would see some disruption in Q1, lesser disruption in Q2, and then more normalized results in the second half of the year when we believe we will mitigate the entire cut from a revenue standpoint while having upside on EBITDA with our cost reduction and extend our visit optimization initiatives. Our guidance reflects that progression and has more details on pages 19 and 20 of the supplemental deck.

To help understand how that progression will work, we have issued guidance for the first quarter. We are expecting net service revenue to be in the range of $500 million to $510 million; EPS in the range of $0.70 to $0.80; and EBITDA less noncontrolling interest in the range of $33 million to $40 million. The first quarter will see a home health Medicare rate impact of approximately 3% to 4% or $7.5 million to $10 million due to the impact of the PDGM behavioral adjustment. This will incrementally improve and should be offset by midyear. Our cost efficiencies and extender optimization will also take a similar track and improve sequentially throughout the year. The first quarter will also be impacted by $4 million to $5 million in higher payroll taxes compared to Q4 of 2019, but will benefit from an approximate $2.5 million reduction in income tax expense due to the impact of an excess tax benefit on restricted stock vestings.

We believe the flow of 2020 will have a sequential improvement quarter-over-quarter. We are proud of the strong execution and commitment by our teams all across the country during 2019, particularly in our preparations for PDGM. We have the plan in place and the care model to thrive in 2020 and beyond. We have a historic consolidation opportunity ahead of us, with multiple levers to pull to deliver growth on all fronts and clear differentiators that provide competitive advantages. We look forward to reporting our progress to you throughout 2020.

That concludes my prepared remarks. Blue, we are ready to open the floor for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Brian Tanquilut from Jefferies.

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

I guess my first question is for you, Josh. So as I think about Q4, you obviously put up some really good growth, as I think about 5.5% on the volume side. But obviously, you missed some of the top line and -- which flowed through the EBITDA line. So as I think about what happened there, I get the PDGM mitigation and the case of exchange. But is that all part of PDGM prep? And then if that's the case, why is Q1 revenue also weak if you've already adjusted the case mix and your volumes are very strong quarter to date?

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

Yes. Brian, great question. And you're spot on. So for Q4, the top line effect, although, as you mentioned, we had such good, strong admissions growth, you had a depression in our pricing of about $20 per episode on Medicare, which resulted in $2 million to $2.5 million of top line that fell straight to the bottom line on case mix and pricing in Q4. That does have a piece of the roll forward into our Q1. So if you're trying to bridge from Q4, let's just stick with top line for a minute of around $530 million in revenue to our guidance range of -- even at the top end of $510 million in revenue.

I'll give you a few pieces that may help you bridge that. One is call it, $7.5 million to $10 million of the behavioral adjustments effect of Q1. That will be further mitigated in Q2 and then as we've been saying, by July, should be fully offset. But that is about $10 million of the bridge. You've got another call it, $3 million to $5 million for continued lower case mix for the crossover episodes from 2019. So that same drag down that affected Q4 is also flowing through in those crossover episodes. So that is factored into this guide. And then not as impactful, but we do have lower billable hours in our HCBS segments that's rolling starting into Q1 due to the disruption from the ContinuLink conversion that we finalized in Q4. So I think those 3 pieces should help bridge you on the top line to get you to our Q1 guide, Brian. And then the only other thing I would add for bridging the Q4 to Q1 on the bottom line would be that roughly $5 million in increased payroll taxes that is different from Q4.

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

Yes. I appreciate that. And then I guess I'll pass it on to Keith. As I think about growth, AFAM looks like it's bouncing back or we're starting to see that inflection there. How do you feel about your ability to, number one, get it back up to LHC growth averages, and then the ability to sustain that growth for the combined entity going forward? I know you've talked about JVs in the past. They've historically been challenged in Florida. So if I put all those together, how should I be thinking about post-2020 growth?

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

Yes, that's a great question. So I referenced the restructuring of our entire sales effort in the last 2 quarters, most of that happening in the fourth quarter -- beginning in the fourth quarter, and we're already seeing very strong results in that. I want to be -- go a little deeper into that. Prior to midpoint of 2019, historically, we operated a model where all sales funneled up through operations. And we began to look at that strongly in the second quarter of last year and thinking about opportunities for improvement, as we always do in all aspects of the business. But actually, one of our board members, Brent Turner, came in and helped us with this and helped to assess our structure. And we -- where we landed is separating sales out from operations and having a dedicated sales leadership all the way up to the C-suite and focused 100% on sales in every market. After about 90 days of beginning to roll that out, we started to see early signs of improvement. And it really took off in Q4. And so that's where these results are coming from. It's not an accident and it's not as though we don't know why it's happening. We know why it's happening and it's replicable. So we're highly confident that this growth trend we see in all aspects of our business, both sides, legacy LHC and legacy AFAM, is going to continue to ramp on this trajectory.

One last thing. Just to be really clear on this, every state is a unique market. I think we all know that, but I have to remind you of that. So Florida does not have the market share potential for us per agency that a state like Maryland would have, where you have only a handful of providers. So -- but on a -- in that Florida market, I think we'll be a leading growth company within our competitors within the Florida market in every state, if that makes sense?

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

Yes, Keith. Brian, this is Josh. I want to tag on to where Keith just ended. I'm glad you ended with Florida because that was a specific point of Brian's question. And in connection with the operational and sales realignment, one thing we also did in the fourth quarter around Florida was to add a higher-level executive over the sales efforts just for that state. So as you know, Brian, we've got division-level executives that run as partners to our operational folks across the company, and we really put an intense focus with one leader in the state of Florida. And I've got to tell you, not only are we pleased with the combined growth for the combined company in Q4, Florida itself was about 2% positive in the fourth quarter, the first positive organic growth quarter that I can remember for the state of Florida, even long before our acquisition of Almost Family, and it is pacing to around 8% positive in Q1. So when we give you that 8% to 10% for the full company, since Florida was asked about, I want to give you, Florida is also right there in that same mark, which has us all really pleased here at the home office.

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

Got it. And then I guess my last question related to all that is 1 feedback or question you got from investors is just, with Don leaving, how do you guys think about the bench and ability to execute at a time when there's so many balls up in the air?

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

Yes. So that's a good question. First of all, with regard to Don, I just want to be clear, Don's still working with the company on a consulting basis. And here in the room with me is Angie Begnaud, Chief Clinical Officer. Angie's been here since -- I mean, since early days, and Dr. Ben Doga is our senior medical adviser. Don still works with them on quality initiatives and things like that. So for those of you that don't know, we have a strong team of seasoned, tenured divisional presidents who are all clinical -- clinicians themselves, all nurses that have been in home health for 20 years or more, every one of them. And that's where the day-to-day operational leadership is. So I could go on further about bench. But I guess, the takeaway is there's a lot of clinical leadership structure that's been here a long time that's operating the business and Don's still here. Don hasn't -- we haven't lost that benefit.

Operator

Your next question comes from the line of Joanna Gajuk of Bank of America.

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

So just to clarify, so the commentary around the disruption you've experienced in Q4 because of the (inaudible) for PDGM and also realignment of the visit -- divisions. So how much you expecting to see in Q1 from these, I guess, disruptions that you experienced in Q4?

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

Yes, Joanna, this is Josh. Great question. I'm glad you asked it. So I'll specifically address your question and maybe even go to another category that's related. As it relates to the operational realignment, PDGM preparedness, we accelerated and pushed all that into the fourth quarter.

So there's no continued cost, or no continued disruption from that regard that we expect. There will be no adjustments around that in Q1 that we expect. We just had the headwinds of the rate cut and continue to roll out the model, but we really were intentional in getting all of that into Q4 and not kicking the can and spreading it out over a period of time. Likewise, an operational realignment that's done. So any severances and any other aspects of the cost side there are fully behind us, and you won't see any of that replicate. And then lastly, the other category, Joanna, that I will highlight, that we've had throughout the course of this year on the adjustments around the Almost Family transaction and all of the integration costs and the conversion to Homecare Homebase, I am pleased to report that, that is now also all behind us and we will not be having those kinds of adjustments going forward either.

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

Okay. Good. Because yes, that was my question that in terms of any I guess, implementation costs or any other costs excluded from the guidance for 2020 adjusted EBITDA. It sounds like you don't expect any of that either included in the adjusted EBITDA or excluded, correct?

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

That's correct, Joanna.

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

Okay. Good. And then talking about how, I guess, the PDGM impact will flow through the year. So can you kind of remind us and also give us an update where you are in these different pieces in terms of rolling out different actions. We talked about in the past, with the reduction number of visits per episode and since changes to the -- to your staffing model. So can you give us an update where you stand and kind of how the pacing is going? So we can see how that compares versus how we were talking about this last time.

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

Sure, sure. I can start and maybe if I leave anything out, Keith can jump in as well. As far as how it's going to ramp and pace throughout the year, as evidenced by our Q1 guide, we expect not only the revenue pressure in Q1. There will be continued revenue pressure, but not quite to the same extent in Q2, and that will be gone from July forward. On the cost side, the receptivity of the model is extremely strong. And I know Keith alluded to that in his prepared remarks, but we are getting such great feedback of our evidence-based clinical care model that's out there. And really, the increased number of patient touches or patient encounters. I know Keith mentioned over 2,000 additional patients receiving telephonic visits over the run rate of Q4. That was telephonic visits that have been incorporated as part of the care delivery model in the field. We also have a centralized call center, here at the home office, that has increased its number of interventional health check-related calls from the run rate in Q4 up to where we're running in January and February, and we're seeing a lot of that. So as that continues to progress and as extender utilization continues to mature throughout the year, you're going to see that ramp of margin improvement quarter-over-quarter. I know we've highlighted this one, and this is totally unrelated to PDGM, but I want to highlight it for you again. On the extended utilization side, now that we have Almost Family completely converted to our instance of Homecare Homebase and completely deployed on our care delivery models, we at LHC have historically, depending on if you're talking nursing or therapy, been anywhere from a 50-50 to a 60-40 extender mix, with 60% being the extenders, the lower cost of care delivery; and 40 being the RNs, PT level. At Almost Family, that is still around a 35-65, depending on the discipline and in certain areas, 40-60. So there is now a lot of room for kind of that final level of care model deployment once we've got them converted, which is going to be a big contributor to our EBITDA improvement throughout the year. So I would -- to put a bow on this, Joanna, I would tell you that Q2 will definitely be much stronger than Q1. Q3, even though typically it might not be, will be stronger than Q2. And then Q4 will be slightly stronger than Q3. So that's how I would kind of model it out to ramp.

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

Okay. Great. Yes, that's what I was getting at with the seasonality, it's going to be much different than in the past than we're used to because of all these dynamics. And then, I guess, the other piece of the discussion. You mentioned briefly, and I guess we talked about this in the past in terms of cash flow and how Q1, seasonally weak but also because of the RAP elimination. So can you give us a current view in terms of quantifying the annual number for cash flow for the year? Operating cash flow and like also with CapEx. Because in the past, you would talk about the home office expansion. So I don't know whether this is still in the works. Because it seems like the '19 CapEx may be a little bit low. So were things pushed to 2020? So just kind of can you talk about the operating cash flow and the CapEx for 2020?

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

Yes. Thanks, Joanna. So on the cash flow and the impact from the RAP reduction, I guess we'll call it, in 2020, the full RAP elimination is in 2021, but the RAP reduction going from either 60% or 50%, depending on a start or a recert versus now the 20%, the quantification of that, our best estimate, as I sit here today, is roughly $35 million to $40 million of less cash collections in Q1. Now as we've described, that's a onetime cash collections phenomenon that will happen in the first quarter, level off, and then for Q2 throughout, we would expect our cash collections to be on a similar run rate than what we've historically had. So that's a onetime kind of event on cash. The DSO impact that we've described, and we still feel confident of for a company-wide DSOs throughout the year, will be about a 5- to 10-day uptick and then kind of set to a new norm. So we still feel confident about the guidance that we've given in that. As it relates to CapEx and then free cash flow, we had free cash flow of about $115 million for 2019. I would tell you, our free cash flow for 2020 would be somewhere in the $130 million range. And then the CapEx component of that, we expect to be somewhere around $50 million for this year. And you highlighted the big one, Joanna, which is the continued expansion of our home office efforts. Some of those costs were felt from a CapEx standpoint in the last year, and the remainder will -- the brunt of it will be here in 2020, with possibly just a little rolling over into 2021 at the beginning. But we should have that wrapped up in Q1 of 2021.

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

Great. And if might squeeze a last quick one. Can you remind us in terms of the fastest rate update for fiscal '20? What do you expect for LHC, given the rebasing?

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

About 1.5% to 2%.

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

Still a positive update. Okay. Great. I'll go back to the queue.

Operator

Your next question comes from the line of Scott Fidel from Stephens.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

Interested if you can give us an update around the topic of the recertifications and what you saw in the 4Q. I know that had been sort of a topic throughout the back half of the year. I didn't really hear that mentioned specifically as well, but just interested in terms of the impact of that add between the admissions growth that you reported relative to the net revenues and Medicare build episodes? And then also as we flip forward to 2020, what you're expecting on the recertifications as well.

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

Yes, Scott. This is Josh. Good questions. For Q4, we experienced pretty much our typical run rate for research, 30%, 35%. And so far into Q1, we're not seeing any change. We're not seeing anything different from a recertification or a length of stay perspective. And through our care planning models and everything that the clinical team have been working on, we don't see any reason why that would change. So for modeling purposes, I would just continue to model the same recertification on length of stays that we have historically had.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

Got it, Josh. So bottom line on the research pieces at this point, that's pretty much stable in terms of the impact.

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

That's right. That's right, yes. Yes.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

Okay. And then also just wanted to follow back up on the hospice segment and just get some thoughts or framing in terms of what you're expecting on either revs or volume growth in terms of how you want to frame that. And then on the margin outlook for 2020 after you did see a pickup in the hospice margins last year.

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

Yes. So as we've been saying on the past few calls, very, very proud of our hospice leadership team. We made some realignment in that area well before we did on the home health and HCBS side, and we're starting to see the fruits of that. From a top line perspective, I would expect 6% to 8% admissions growth this year. We had a slightly lower admissions quarter in Q3 that kind of rolled over and affected our top line a little bit for Q4 in hospice. But we expect that to sequentially, quarter-over-quarter, improve. We were up to about 5% in Q4. Q1, maybe in the 3% to 5% range and then continue to progress throughout the year there. And then from a length of stay and ADC perspective, again, I would say that that's pretty stable as was the discussion around home health.

And then I guess, lastly, your question on margin expectations. For about 3 years, we were really striving to get to those double-digit EBITDA margins for hospice and obviously, in Q1, they'll be depressed with payroll taxes and other. But for the year, last year, we were 11.5%. We've been saying, if we can be in that 10% to 12% fully loaded EBITDA margin percentage. That was our goal. So if we could be at that 11.5% to 12%, maybe a little bit better than that as we get to the back half of the year, that would be really good for our hospice segment.

Scott J. Fidel - *Stephens Inc., Research Division - MD & Analyst*

Got it. That's helpful. And then just last quick 1 for me. In terms of just the 2020, the differential between the adjusted EBITDA growth at the midpoint of around 11%. And the EPS growth a little bit lighter at 5%. Is that pretty much just all the normalization of the tax rate that drives that? Or just anything else that you wanted to call out there?

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

No. That's it. You got it, Scott.

Operator

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

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

I wanted to go back to the operational realignment. Other than just the separation of the direct report line between marketing and operations. Is there anything specifically that you could share with us on what they're doing different? Because this is really some amazingly fast improvement that you're starting to see. So any specific color on what is different other than just the separation of the org chart?

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

Sure, frank. This is Keith. I'll take that. So in simple terms, you had -- we have had a Senior Vice President of Operations that reported to Don in the past. And so -- and all of the divisional sales and operations people went to that Senior Vice President of Operations for support. And what we've done now is split that into -- we have 2, we have a Senior Vice President of Operations that -- that supports only -- or focuses his full attention on supporting the operational leaders; and another Senior Vice President of Sales that focuses solely on supporting sales leaders.

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

Got you.

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

Also a group of analysts that have separated. There are sales-specific analysts that work for that sales -- Senior Vice President support that -- and everybody is just focused 100% on sales. So sales is getting probably 3x the focus that they got in the past because it was really -- we were such an operations company. And Brent helped us realize that, that we were such an operations company that we focused on sales when we had nothing to focus on in operations.

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

In terms of anything specifically they've done within this group, the new Senior VP of Sales and all the analysts, I mean is there anything they specifically implemented so far that you could share with us?

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

Yes. Josh, you want to throw some nuggets out? I mean -- I mean -- I mean that -- so there are specific goals and then sales programs and then the daily monitoring of how each individual is tracking to their individual goals. Reported back to them every day. That's something that we do in operations and have always done, but we haven't done it in sales with the intensity that we do it in operations.

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

Yes, Keith, that's what I was going to say. I mean there are several elements to this. But Frank, I mean, I think you definitely know us well enough, and a lot of folks do, about our discipline and rigor in how we concurrently manage the business operationally. We, frankly, have taken that discipline and rigor and concurrent management to a whole another level on the sales side, not just in the metric management, but the data that they get in their handheld every morning. The prescriptive route planning that the support team is now giving them, they've created some new metrics that we didn't even track and monitor prior to the fourth quarter that is really pretty eye-opening, that is now being put forth out there every morning. And to their credit, a lot of times, sales folks can get a bad rep, but I'll tell you, when you give them goals and you give them measures and they have camaraderie and competitiveness among themselves, you really see that take hold.

The last thing I'll say on the kind of realignment side is we also went from 9 divisions in home health down to 7. And in that restructure, you had multiple division presidents up until the fourth quarter that were -- all had locations in the state of Tennessee, for example. And then multiple division presidents that may have locations in the state of Georgia. And that's on both the sales and operations side. So they were bumping into each other, so to speak. And the efficiency that has been gained from realigning not only at the division level, but down through the regional Vice Presidents and Area Vice Presidents in those markets where there was still that overlap between LHC and Almost Family, is really starting to bear fruit. You have a lot more focused leadership.

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

Got you. That makes a lot of sense. Maybe just 1 more and I'll hop off. In terms of 1 of the areas that you called out as an opportunity was for better rate growth coming from the AFAM side of the business with better quality scores. Can you give us kind of any color there on where that initiative stands and really how long do you think it takes to see that start to be reflected in their rates? And then I'll hop off.

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

So we definitely expect to see it in the growth rates. So I want to emphasize that and frankly, Frank, we're seeing the signs a little bit earlier than we expected. As we alluded to, all through last year, we weren't planning to report AFAM growth until Q1. We were pleased to be able to report that trajectory in Q4. And so much of that is just getting the distraction of the conversion out of the way, giving those team members the same tools that Keith and I just described on the sales front in that same level of kind of concurrent rigor and discipline. So I mean, from the growth standpoint, I think we've kind of hit that one. On the quality, feel really good about now that we've got them on our one instance, and we've been saying that all along. But now that they're fully converted, you're going to continue to see that ramp quarter-over-quarter. They're fully deployed into our performance improvement program and all of the efforts that we put to drive our quality scores. So I'm pleased with where they're at, and you're going to see that quarter-over-quarter continue to improve, which will then lead to more growth on the organic side.

Operator

Your next question comes from the line of Justin Bowers from Deutsche Bank.

Justin D. Bowers - *Deutsche Bank AG, Research Division - Research Associate*

So I just wanted to kind of take a step back and give you an opportunity to talk about some of the initiatives that you guys have done in Q4 just to get ready for PDGM and resume growth in AFAM, not to mention all the -- the D.C. and the regulatory issues as well. So just kind of in that context, too, do you feel like you've made the investments that you need to make as we're now in 2020? And then I'll pause until the next one.

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

Not sure if I understand the question. If the question is around the operating model and IT and those type things that we've made the investments, I would say that we've made the investments in 2019, of course, and the investment -- any further investments that we need are built into the budget and the guidance for 2020.

Justin D. Bowers - *Deutsche Bank AG, Research Division - Research Associate*

Okay. Got it. I'll follow up off-line. And then secondly, with respect to the top line guidance, I mean, the 8% to 10% in 1Q, how does that relate to the rest of the year? That's obviously much higher than what your historical target has been. How are we thinking about pacing for that for the rest of the year? And then just at a higher level, how much M&A is in the guide announced versus unannounced? And does the guide include any target market share gains from PDGM? Or would that be incremental?

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

Good questions, Justin. This is Josh. So I guess in reverse order, there are no market share gains baked into our growth expectations or the guide. So maybe you could even call that a little bit conservative. We fully expect that. We just don't know the pace in which that will happen. As I even alluded in my prepared remarks, that could very well be a contributor to the 8% to 10% that we're experiencing quarter-to-date in Q1. For the full year, our guide still includes an assumption of 6% to 8% on total admissions growth for home health, which is below that 8% to 10% for the year. That's not in any way trying to signal that we think it's going to tail off. It's just we typically guide this early in the year to the 6% to 8%. We are guiding that for the full company of all locations, no more with and without Almost Family. But there could be some upside even in that projection if this current run rate sustains itself. And this 8% to 10% we experienced in the first quarter, if that keeps the momentum that it has, and you start seeing some market share gains from PDGM in some of our markets that could really be a big boost throughout the year to give some upside to that top line. And then the question on, are there any acquisitions baked in? No. We have no future acquisitions baked into the guide at all.

Operator

Your next question comes from the line of Matt Larew from William Blair.

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

Just wanted to ask briefly on Almost Family. It had now closed about 50 home health agencies in the last 2 years. In years past, that typically averaged around 14% to 15%, and I understand there's always some ongoing trimming and there may have been some overlap. But just want to get a sense from a modeling perspective, I mean, how should we be thinking about the number of agency closures moving forward, more in line with the last 2 years or more in line with your historical precedent?

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

Matt, this is Josh. That's a great question. And I would say definitely more in line with the historical precedents. Onesie-twosie here and there, as we've always done, but all of the closures and realignment and everything that we've done operationally to be prepared for the growth in 2020 and beyond is behind us. I will continue to point out, though, that even with the closures that we've experienced, that was about a $5-or-so million -- if I can remember the number right, EBITDA drag on the business. So we -- definitely, we're closing the right locations and, in many instances, just consolidating into others within the market. But the specific answer to your question is, you would expect us to be back to that precedent of pre-Almost Family.

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

Thanks, Josh. And then just thinking about some of the offset to the PDGM on the staffing mix side. What are the things that you can do to help effectuate that? Is it incentives or comp changes? Is it more agency-level direction that you're giving out. And then, Keith, maybe just at a higher level, between some of the changes in PDGM and PDPM, where is therapy going to occur? Do you sense that there may be sort of a desert in folks willing to provide therapy in the same way that it's been provided in the past?

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

Could you repeat the last part of that? You said about the therapy...

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

Yes. Yes, just the last part was just between some of the changes that CMS has made with PDGM and also PDPM on the SNF side, where they're sort of disincentivizing therapy, just getting your sense for whether there may be a desert in terms of operators willing and able to provide therapy moving forward?

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

Okay. Yes, that's clear. So providers, I would say not LHC providers. I mean there are opportunities to operate the model more efficiently in the delivery of therapy services, and we're certainly going to harvest those over time as we transition into full implementation of our model and our clinical benchmark. But that's going to take time. But for us, there's no change in patients we're accepting or -- and we're still accepting therapy patients. No difference in that at all.

I would imagine -- I would imagine perhaps some smaller providers maybe going -- you may hear stories of that, of going to models where they try to avoid therapy. But for us, that would be announced or -- remember that much of our business comes from joint ventures with hospitals and health systems. And we white label that. So we fly under their brand, our LHC employees on their brands. So they expect us to take all-comers from the hospital. And so that's what we've done throughout the history of this company. So it wouldn't -- just wouldn't fit our model.

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

Yes. And maybe the only thing I would add, Matt, is on the how some of that efficiency occurs throughout the year. I hate beating the same drum over and over again, but I'll hit it one more time with all of Almost Family not only converted to our instance of Homecare Homebase, but us deploying some of our other proprietary tools out to them, there is much more visibility into the care pathways that would lend itself to this visit is more appropriate to be made by an LPN versus an RN practice at the top of your license type of a thing. So that extender utilization is also a big key component to the upside there.

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

And then just the last 1 would be on HCI? I know when the acquisition was announced, that was something you were particularly excited about, and I think you sold the component of that business here, and it was less in 2019 than it was in 2018 in terms of contribution. But could you just give us an update on what's going on there? And have you seen benefits to the rest of the business in terms of knowledge you've gained from HCI as well?

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

Yes, great questions, Matt. And this is 1 of those topics that we always like to speak about and just doesn't always get the airtime. So the contribution to the bottom line of the company was actually much stronger in 2019 versus 2018 from the HCI segment. About $2.3 million of EBITDA contribution that we got out of that segment, mostly from just better core operations in each of the underlying businesses. You've got Imperium, which is the ACO management business. You've got LTS, which is the long-term insurance assessment business. And then you've got our nurse practitioners business as well. So each of those incrementally throughout the year were improving their operations. So we're very pleased with that, and expect them to continue to contribute even more so in 2020. As far as the learnings go and the other ancillary benefits to the company, as you think about even volume growth and upside there, not only do we have relationships with almost 40 unique independent ACOs throughout the country as preferred providers, but we have a management company, Imperium, that manages ACOs across the country. And in markets where we have a leading 4.5, 5-star home health agency, there is market share gains to receive from that as well. So I would tell you that the learnings and the benefits are very much on target with what we expected.

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

This is Keith. Let me just add a couple of things to that. So let's go back to the nurse practitioner business for a minute, maybe to just help share our thinking around HCI. So there were approximately 100 nurse practitioners there in that business. And when Almost Family acquired that business, it was -- the model was just to do home visits and bill Part B and maybe have some benefit of home health referrals. But what we're doing with that business is using it as a launching point to develop a palliative care model that we intend to deploy throughout the organization. And so that maybe will paint the bigger vision we have for that particular asset. The same could be said for the -- for Imperium, the ACO business, and I'll ask Bruce to chime in here in a minute. But the -- being the second largest ACO in the country, we were able to learn from that model and take that knowledge base and utilize it as we look to grow our value-based models and -- with managed care payers and others. Bruce, do you want to comment on it?

Bruce D. Greenstein - *LHC Group, Inc. - Executive VP and Chief Strategy & Innovation Officer*

Yes. Yes, so to add on to what -- to what Josh said in terms of our learnings, both within the ACOs that we manage today under Imperium and those that we work together with, whether it's through a preferred provider arrangement or we're just a provider. We're moving along with the ACO market as it matures. In the early days, the ACO is focused almost entirely on managing hospital cost and physician costs, but as ACOs mature and look for total cost of care across all their provider types, it finally fits right in our sweet spot. Because as we continue to offer highest quality overall lowest total cost of care. As we look at our 180-day total cost, all of a sudden, our offering in home health becomes even more attractive. So we continue to educate the ACO market to make strategic decisions on their home health providers to improve their health outcomes and total cost of care. And as ACOs learn that home health is a strategic lever to pull, we end up doing better and better. We expect a lot of education happened in 2020 and, therefore, more referrals coming our way.

Operator

Your next question comes from the line of Whit Mayo from UBS.

Bryan William Ross - *UBS Investment Bank, Research Division - Equity Research Associate of Managed Care*

This is Bryan Ross on for Whit. Just 1 on PDGM. I know you've talked about the mitigation on the top line and potential for EBITDA upside over the course of the full year for 2020. But just looking at the 1Q and the 2020 EBITDA ranges. It'd be helpful if you could clarify exactly what level of PDGM offsets. Or the net PDGM impact is embedded in the low and the high end of those ranges, either in a percentage or a dollar basis?

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

Yes, Bryan. This is Josh. I'll take a shot at it. I would go back to what I've -- how I answered the question of Brian Tanquilut at the start of the call and bridging you to the Q1 effect from PDGM, and the headwinds that we'll be feeling there. As far as the sequential ramp, now obviously, we're not giving quarterly guidance broken out quarter-over-quarter. So we've given Q1, and we've kind of bridged and walked you through how and why that makes sense. As I said earlier, I would bake in definite, not only top line, but margin growth over Q1 and Q2 and so forth in Q3 and then again in Q4. To Joanna's point earlier, it's not kind of the typical seasonality trend that we've experienced. But I wouldn't be quantifying as percentages or anything right now, PDGM effect. I just think it's going to take throughout the year to mitigate on the top line side and then put these initiatives in place on the cost side.

Operator

With no more questions, I would like to turn it back over to Mr. Keith Myers for closing remarks.

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

Okay. Thank you, everyone, for dialing in. As always, if you have any questions, if you'd like to contact either Josh or myself, please contact Eric Elliott and he will arrange that. Thanks for dialing in, and we look forward to talking to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may all disconnect.
