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LHCG - Q3 2018 LHC Group Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 01, 2018 / 3:00PM GMT



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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the LHC Group Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

Now I would like to turn the call to Eric Elliott, Senior Vice President of Finance of LHC Group.

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

Thank you, Carmen, and welcome, everyone, to LHC Group's earnings conference call for the third quarter ended September 30, 2018.

Everyone should have received a copy of our earnings release. If not, you may obtain a copy along with other key information about LHC Group and the industry on the Investor Relations page of our website.

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

Before that, I would like to remind everyone that statements included in this conference call and in our press release may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act.

These statements include, but are not limited to, comments regarding our financial results for 2018 and beyond. Actual results could differ materially from those projected in forward-looking statements because of a number of risk factors and uncertainties, which are discussed in our annual and quarterly SEC filings.

LHC Group shall have no obligation to update the information provided on this call to reflect subsequent events.

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



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

Thank you, Eric, and good morning, everyone. Thank you for dialing in and participating in this morning's call.

I want to begin by focusing my comments this morning on our integration activity from the Almost Family acquisition; the growth levers we are pulling both organically and externally for this year as well as 2019 and 2020; and then, wrap up with our take, from an LHC perspective, on the final CMS rule and PDGM that was announced yesterday evening.

But first, I'd like to recognize the dedication and exceptional efforts of our many clinicians and administrative support personnel who consistently exceed expectations in their respective areas of responsibility. I'm extremely grateful to all of you, and I thank you for all that you do, for those we are privileged to care for and serve in communities throughout our country each day. Our LHC Group family is blessed by your personal commitment to go the extra mile to deliver on our promise to be a 24/7, 365 healthcare organization that never sleeps and is always there to meet the needs of those entrusted to our care. Thank you.

Moving on to the Almost Family integration. The #1 question we get in investor meetings and on conference calls is, where are you on integration? Given this is the largest single acquisition we've completed to date, at \$800 million in annual revenues, that's a valid question. Our answer is the same every time, we are right on schedule.

We have the leadership team in place, assisted by the experienced integration resources of BRG, and the synergies are accelerating on a path to exceed at original projections.

To better demonstrate where we are in the process, here are a few data points we are tracking throughout the integration. These are KPIs we gather and monitor on a daily, weekly and monthly basis on our operations and all integrations we've done in the past.

Almost Family admissions have grown 4.5% from the acquisition date of April through September 30 as compared to the same period in 2017. Almost Family home health contribution margin improved 140 basis points from Q2 to Q3, and we will continue to see improvements as we move those providers in line with the LHC operating model.

Almost Family hospice contribution margins have improved from 0.7% of revenue in Q2 to 11.7% in Q3. According to our data analytics vendor, Strategic Health Partners (sic) [Strategic Healthcare Partners], 72% of Almost Family agencies were rated 4 stars or greater for the 3 months ended September 30, 2018, as compared to 68% in the 3 months ended April 30, 2018.

As for what is left to do in the integration, we have begun to convert Almost Family agencies to the LHC Group instance of Homecare Homebase. This conversion will last through the second quarter of 2019. As locations convert, we will be able to more quickly deploy our workflows and processes, which will drive continued margin improvement and quality scores.

Overall, we have moved out of the stabilization phase of the integration plan and to the transformation phase, which has us 6 months ahead of schedule. This allows the organization to start addressing additional operational synergies, growth and strategy, at a much earlier phase of the integration plan.

The smooth integration, in turn, enhances our strong organic growth, adds in new layers of additional growth similar to what we've accomplished with our joint ventures by bringing up the quality to our standards and increasing margins, and enables us to keep our eye on the ball for new growth opportunities through market expansion, extension of our co- and tri-located service offerings, joint ventures and tuck-in acquisitions.

Let's start with the organic growth. For the third quarter, we continued to experience strong growth in home health and hospice admissions. We've regularly stated that a 5% to 7% organic growth rate in these LAC legacy businesses were realistic, which serves as a good baseline to judge how successful we are in raising the quality scores at the previous Almost Family locations to drive organic growth there as well.

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In terms of contributions from past acquisitions, we acquired over \$114 million of revenue in 2017 and over \$816 million year-to-date in 2018, including Almost Family, of course.

As Josh will break down for us in a bit, we've seen our EBITDA margins from the 2017 acquisitions nearly doubled from this time a year ago. Those joint ventures have also led to new growth opportunities such as with LifePoint, where we have acquired 3 additional agencies and are in the process of identifying many more. We anticipate their recent merger with RCCH HealthCare Partners to provide even more growth opportunities.

We've also been asked about our capacity to do acquisitions at a similar pace as prior years during the Almost Family integration. Again, I think some facts here might be helpful to make the point.

In the past 2 years, we have passed on 80 potential acquisitions, representing revenue of approximately \$1.5 billion that either did not measure up to our underwriting standards with regard to IRR threshold or the stringent and disciplined diligence process that must be met prior to consideration by the Corporate Development Committee of our governing board.

We are currently reviewing 15 to 20 transactions at any given time, all of which have been more thoroughly vetted and qualified upfront as being worthy of the investment of internal time and resources of our Corporate Development team.

When you start adding up what we are projecting for 2018, plus the different growth components that Josh will get into later, you end up with some serious incremental growth opportunities in 2019 and 2020.

As we have shared before, we are anticipating 12% to 15% accretion from the Almost Family acquisition in 2018. We believe it is realistic to expect continued accelerated revenue and earnings growth over the next few years in relation to Almost Family and other recent joint ventures.

I'll also note that if we assume acquisitions will be between \$100 million to \$150 million each year going forward, we would still remain under 2x leveraged over the next few years, not a small feat in these days of higher leverage.

I also want to mention that, at a macro level, we are seeing a significant migration of health care services moving to the home. I think most of us know that. Companies like Aspire and Landmark have proven cost savings, and the market has recognized it.

Facility-based admissions are down, and reducing admissions is a major focus across the country, this is well-known. This trend of more care being delivered in the home is expected to accelerate as more care moves to rest. Otherwise, it would be like saying that next year, we think people will be ready to switch back from Netflix to a local Blockbuster store. The trend of care is not going back to institutional settings. With 10,000 Americans turning 65 every day, care is moving more and more to the home.

Moving on to the regulatory landscape. As we all know, the net effect of the 2019 reimbursement change to home health reimbursement is a positive 2.2%.

The Patient-Driven Grouping Models, or PDGM, which will take effect in January 2020, includes improved transparency regarding the focus of CMS in evaluating provider responses to the new model. A lot of ink have been spilled the last few months on the impact of PDGM on the home health industry.

In my role as Chairman of the Partnership for Quality Home Healthcare, we have been very active lobbying CMS and working with members of the U.S. Senate and House on specific legislation to modify CMS' approach to prospective behavioral assumptions.

Even though they have proceeded with this rule against the united front from the industry, the efforts will continue and are important to the industry as a whole, as well as the ability of providers throughout the country to adjust to a new payment model.

The most important fact about PDGM is that it has been required to be budget neutral by the Bipartisan Budget Act of 2018. With our proven adaptability, our efficient operating model and workflow processes, our industry-leading quality and patient satisfaction scores and our



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industry-leading and growing network of hospital and health system joint venture partners, we expect LHC Group, based on our size, scale, capabilities, balance sheet and experience as a leading provider in the industry, will once again thrive in an environment of change and will mitigate any behavioral adjustment without sacrificing the quality of care and level of service we provide to patients, families and communities we are privileged to serve.

We also believe that the changes this new model will bring will open up many consolidation opportunities in the industry. We plan to take full advantage of those opportunities once again. LHC Group's best days are ahead.

Legislation to amend the Bipartisan Budget Act, now being considered by Congress, is unanimously supported by the home health industry at large. There have been 2 separate Senate bills that have been introduced, Republican Senators Kennedy and Cassidy have strong support for S.3458 that they introduced in September and would prohibit CMS from making adjustments based on behavioral assumptions, and instead, requires CMS to base any adjustments on observed evidence.

It would also limit adjustments based on observed elements to a maximum of 2% in any given year. Republican Senator, Collins, introduced S.3545 in October, along with Democrat cosponsors, Senators Nelson and Stabenow that has similar language on the behavioral assumptions, as the Kennedy, Cassidy Senate bill, and also seeks a waiver to the home bound requirements for patients in Medicare Advantage and ACOs.

And in the House, a companion bill to S.3458 was introduced in September by Republican, Abraham, with bipartisan support from Democratic Congressman Sewell, Republican Buchanan, DesJarlais and Graves. We expect more cosponsors will be added on these bills in both chambers to provide more support to win this fight in 2019 before it goes into effect in January 2020. We expect that legislation could potentially be achieved in a year-end package at the earliest this year.

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

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### **Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Thank you, Keith, and good morning, everyone. Thank you all for joining our call. As always, I like to begin my prepared remarks by saying how much I appreciate all of our clinical professionals across the country and what you do each and every day.

I would also like to thank our family members from Almost Family and our home office support teams who have worked tirelessly to ensure a smooth and successful integration. To you all, a very heartfelt thank you for all that you do that makes our LHC Group family so special.

With regard to our third quarter financial results, here are some of the big takeaways. Net service revenue increased to \$507 million and adjusted net income increased 156% compared to the same period of 2017. Net service revenue, prior to implicit price concession, increased 88.4% to \$514.1 million compared to \$272.9 million in the third quarter of last year.

Adjusted net income was \$0.95 per diluted share, which excludes acquisition and other transaction-related costs, expenses related to certain closures and relocations, and the income tax effect of adjustments to income due to certain deal and transaction costs that are not deductible in the aggregate amount of \$8.3 million after tax or \$0.27 per diluted share. That's a 48.4% increase over the prior year.

I'll point you to Page 11 of our earnings release for the reconciliations and breakdown of the \$8.3 million in after-tax adjustments so that we do not have to spend time on the call going through that.

Also, rather than reading what's in the release, I'll focus my usual margin commentary on adjusting for the transaction-related and other costs and expenses, and then we'll wrap up with a few more strategic items.

First, our adjusted consolidated gross margin was 37% in Q3, which is up from an adjusted 36.3% in the second quarter. Adjusting for transaction-related and other costs, our consolidated adjusted G&A expense, as a percent of revenue, was 27.5% in the third quarter, which is down from 28.1% in the third quarter of last year and down sequentially from 27.8% last quarter.



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Our adjusted consolidated EBITDA margin in the third quarter was 9.6% as compared to 8.6% in the third quarter of '17 and 8.8% in the second quarter of '18, for an 80-basis-point improvement in adjusted EBITDA margin quarter-over-quarter.

Looking at our home health business, we are very pleased with our revenue and admissions growth as well as our continued sequential margin improvements for both our legacy LHC locations and our AFAM locations. Same-store revenue for the third quarter increased 9.3%, mainly due to a 9.7% increase in same-store admissions.

Adjusting for the transaction-related and other costs and expenses, our home health gross margin was 38.4% in the third quarter, which is up from an adjusted 38.1% last quarter.

We also continued to see improvement in the Almost Family home health business, with contribution margins increasing 140 basis points quarter-over-quarter.

Adjusted EBITDA margin in the third quarter in the home health segment was up to 10.9% as compared to 9.3% last year and 10.3% in the second quarter.

Now turning to hospice. We could not be more excited about our trajectory of improvement in growth as well as margins in this segment. Adjusting for the transaction-related and other costs and expenses, our hospice gross margin was 35.6% in the third quarter, which is up from an adjusted 34.7% in the second quarter.

Adjusted EBITDA margin in the third quarter was up to 10.5% as compared to 6.4% last quarter for a 390-basis-point improvement quarter-over-quarter. We continue to see improvement in our hospice service line, as expected.

Additionally, as Keith touched on earlier, we are pleased with the 11% quarter-over-quarter improvement in the Almost Family hospice contribution margins.

The LTACH EBITDA margin was negative 4.2% in the quarter as compared to a positive 4.6% in the same period last year. Included in the margin was \$1.6 million in relocation and closure costs. Therefore, adjusted EBITDA margin is a positive 2% for the third quarter.

The lower EBITDA in the quarter is due not only to the relocation and closure costs but also a slightly lower revenue per patient day in the quarter caused by an increase in site-neutral patients. We expect this to return to normal levels in the fourth quarter as the 2 relocated LTACHs we discussed last quarter are now settled in to their new locations.

Adjusted EBITDA margin in the home and community-based segment was 2.6% in the third quarter as compared to an adjusted 7.4% in Q3 of last year and 3.5% in Q2. The decrease in margin in the home and community-based segment is due to the lower acuity patients in the AFAM service line that care for more activities of daily living as opposed to the legacy LHC service line, which has more skilled services. The blending of these margins has caused the decrease, but we are confident that there's upside in the EBITDA margin in this segment, as we will begin to see quarter-over-quarter moving forward.

The margin results for the different segments on a consolidated basis versus LHC stand-alone demonstrate just how much of a runway we have heading into 2019 and beyond as we bring the legacy Almost Family business up to our expectations.

Our focus this year has been on operational stability, but the growth potential is substantial, and we are expecting the next several quarters to show a continued accelerated earnings growth.

As an example of our revenue growth and margin improvement execution associated with acquisitions and joint ventures, from Q4 of last year to this quarter, across LifePoint, CHRISTUS and Baptist, we have grown revenue by over 14% and have more than doubled the contribution margin dollars from these assets while improving their contribution margin as a percent of revenue by 500 basis points.



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For bad debt expense or implicit price concession, we reduced to revenue from implicit price concessions 1.4% in the third quarter of 2018 as compared to 1.2% for the same period last year and down from 1.5% in Q2.

In the third quarter, our Healthcare Innovation segment recorded \$3.7 million in revenue related to the Medicare Shared Savings Program, in which the company participates through multiple accountable care organizations.

The number of ACOs under our management has grown from 16 in 2017 to 30 now. This \$3.7 million payment was \$1.2 million higher than what was received last year of Almost Family. Our ACO management company is the second-largest ACO management organization in the country, covering over 12,000 unique providers, serving now more than 460,000 Medicare attributed lives, which is up from approximately 3,000 providers last year, serving only 140,000 Medicare attributed lives.

With this momentum, we anticipate and are confident in the continued year-over-year growth in the Medicare Shared Savings revenue that we experienced this quarter.

Free cash flow was a \$47.8 million positive in the third quarter. Adjusted free cash flow was \$56 million, excluding the \$8.2 million in after-tax adjustments I discussed earlier. We saw the collection rate on our accounts receivable from Almost Family acquisition increase in the quarter, which drove our DSOs down sequentially from 50 days in the second quarter to 46 days this quarter.

Now let me take a moment and pivot to a couple more strategic topics. There's been a lot of commentary lately on the managed care opportunity in our industry. This is not something new for us. And in the past, we haven't called it out individually. But we think it's worthwhile bringing it into the larger picture of our growth outlook.

That said, I want to provide a few details around our successful managed care strategy improvements that we have already realized in the following 3 areas: rate improvements; margin improvements; and new payer models.

First, on the rate improvement front. In the legacy LHC business, from 2016 to 2018, we have successfully negotiated in the aggregate a 3% increase in our managed care rates. So far in 2018, we have also successfully targeted and negotiated new agreements with 5 payers that cover 28 of our legacy providers across 5 states that have resulted in an incremental rate increase of 7% as we head into 2019.

Assuming no change in volume from the volumes received under the former lower rates, this would result in an increase of revenue of approximately \$1 million next year.

In the Almost Family business, since the acquisition closed in April, we have successfully targeted and negotiated new agreements with 6 payers that cover 49 providers across 16 states, that have resulted in a rate increase of 17% as we head into 2019.

Again, assuming no change in volumes, that would result in an increase of \$2.5 million in revenue for those providers in 2019.

Second, in terms of margin improvement, in the legacy LHC business, we have improved the contribution margin attributable to managed care payers and those volumes by 480 basis points from 2016 to 2018. That comes from a combination of improvement in bad debt, direct cost improvement from operations and leveraging our home office costs attributable to managed care payers.

Third, and more excitingly arguably, we are at different stages of working with several payers on a few different new models. We have executed one risk-based arrangement with upside opportunity and downside risk, with reimbursement that is tied to quality metrics and are already experiencing good results under that agreement.

Specific to our unique joint venture partnerships, we have negotiated and executed one risk-based arrangement with upside opportunity and downside risk, where reimbursement is tied to quality metrics, and we have executed performance-based arrangements covering 5 of our hospital and health systems partnerships that includes upside opportunity.





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Additionally, there are 3 pending new model arrangements being actively discussed with payers at this time. The first new model is a home health bundle arrangement; the second is a home health per member per month arrangement; and the third would be separate arrangements with 4 different payers with upside opportunity and downside risk, with reimbursement tied to quality metrics.

I would also mention that we have established preferred provider agreements with 32 unique ACOs across the country.

In sum, although at various stages in their development, the fact is that we are having more conversations than ever before with payers who are seeing the value of placing more of their members in the home health business as a way to save on the overall cost of care, while at the same time providing high-quality care and outcomes to the patients.

Keith also made a good point earlier and it's worthwhile repeating here, that our balance sheet remains in great shape at 1.5x leverage. And we continue to be one of the lower levered companies in the health care space, with considerable dry powder to execute our various growth plans. We expect to retain that balance sheet flexibility even with an aggressive acquisition pace we anticipate in the coming years.

As noted in our earnings release, we are reaffirming the fiscal year 2018 guidance we issued on May 2, which also included an increase from our original 2018 guidance, with an earnings improvement of 12% to 15% associated with the Almost Family acquisition that we are on track to achieve and deliver.

Consistent with our disclosures last quarter, we realized a higher amount of synergies in Q3. We -- with the continued escalation of synergies in Q4, we are right on track to be in the \$8 million to \$12 million range for 2018 that we originally projected. And based on what we've achieved so far, we fully expect to exceed the original \$25 million by the end of 2019.

As always, 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, location closures, if any, or future legal expenses, if necessary.

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

In summary, and before kicking it over to Don, when factoring in our industry-leading organic growth and our sequential margin improvement with the additional top line and margin growth potential still to come from the Almost Family locations, and the strides we have made and continuing to make in the managed care arena, one can see that there are compelling growth rates over the next several years even before we factor in additional acquisitions or start filling in and connecting the dots with our markets with the full range of our services through a co- and tri-located market strategy. Needless to say, we are more bullish than ever on the future of LHC Group.

That concludes my prepared remarks. Now I'm happy to discuss further any questions during Q&A.

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

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

Thank you, Josh, and good morning, everyone. We certainly are on our way to another great year for our LHC Group family, and I want to thank our 32,000 team members who make that happen each and every day sincerely.

Drilling down into our Q3 results, I want to focus on some of the color behind the results that you've heard already this morning. In the area of growth, legacy LHC same-store total admissions were up 9.7% and Medicare same-store admissions were up 4.6%. Almost Family agency same-store total was 3.5% for the quarter and 4.5% for the 6-month period for April 1 to September 30.

Quality remains our #1 differentiator and a primary driver of our organic and nonorganic admissions growth, and is one of the biggest sources of upside we expect from the Almost Family acquisition.



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In the most recent CMS star ratings for home health quality of care, 98% of our same-store LHC locations have 4 stars or greater. For patient satisfaction, that number is 92%.

On a stand-alone basis, for LHC, the quality rating, we produced an industry-leading score of 4.74, excluding recent acquisitions for the October report, which is an improvement over 4.70 from the July report. This 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 another industry-leading score of 4.20 stars compared to the industry average of 3.48.

As Keith mentioned earlier, 72% of Almost Family's agencies were 4 stars or greater at the end of September as compared to 68% in April.

As we continue to overlay our legacy operating model to Almost Family, we will build upon this early quality improvement, continue to improve patient outcomes and expand market penetration using these difference makers as we go into 2019.

Turning to hospice. We've been talking about the improvements we made beginning late last year that led to the 210-basis-point sequential improvement in EBITDA margins from Q1 to Q2, and another 260-basis-point improvement in EBITDA margins this quarter compared with the last.

The changes continue to take shape and underscored the 5.1% organic growth in this third quarter. All told, and as I said last call, we do expect to hit the 5% organic growth marks for the full year of 2018.

But truthfully, the bigger picture for hospice is how it fits with our longer-term strategy, a strategy that broadens our continuum of care nationally. And I'll briefly explain.

In this segment, we currently have 110 locations in 20 states, with quarterly admissions of 4,500 and a trailing 12-month revenue of \$215 million, including the Almost Family locations.

That places us as one of the largest hospice providers in the country. In addition to growing in a traditional fashion, our intent is to grow our hospice in conjunction with our home health service line by backfilling hospice locations into our existing markets, where we have home health. We currently have 130 markets that fit into this category, and there is a clear, defined strategy for us to grow internally but also externally through disciplined capital allocation.

We continue to take long-term strategic actions with our LTACH service line. And as Josh mentioned earlier, we relocated 2 larger LTACHs late in the second quarter into 2 host hospital facilities which we believe will benefit from the improved mix of ICU patients as well as better collaboration with those host facilities and referral sources.

The late move in the quarter carried over into this quarter, resulting in increased costs as well as temporary disruption in census and acuity which, of course, depressed revenue and margin.

Early results in October are very encouraging, as we've already seen improvement. We expect margins to rebound sequentially through Q4 and into the first quarter of 2019.

These moves were on top of 2 LTACH closures in Texas in the quarter. We'll continue to assess this service line and take the necessary steps to best position it to support the post-acute strategy we are executing within our JV partners.

Next, and consistent with past quarters, I would like to close with where we are on various integration efforts. From a JV standpoint, we're focused on expansion opportunities within LifePoint, CHRISTUS, Baptist and Erlanger, all of our 2017 acquisitions. St. Mary's Health Network, which was completed in May, is fully integrated, and we are ahead of plan on the August joint ventures with Capital Region and the hospice add-on venture with St. Mary's.



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We continue to work on our pipeline of potential adventure -- additional joint ventures, and we will be ready to integrate those as well.

For the Almost Family integration, the transformation phase allows us to start addressing additional operational synergies, growth and strategy at much earlier phases of the integration plan, which we would all agree are not heavy lifts but will certainly result in the greater cost synergies, margin improvements and admission growth.

We have been expecting all this hard work to start showing up in the second half of the year, and we've seen that in the third quarter, with more to come in the fourth and accelerating through 2019 as we see quality scores improve, sequential margin growth and organic revenue growth.

Given that most acquisitions a fraction of the size of Almost Family, transactions take at least a year to start seeing the real benefits to be in a position inside of a year, to be talking about growth on an \$800 million acquisition is quite an achievement.

So thank you again to all of my LHC Group family colleagues, and also thank you for listening in to our call today.

Carmen, we are now ready to open the floor for questions.

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## QUESTIONS AND ANSWERS

### Operator

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

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

Keith, just a question for you, first, on PDGM, and I guess, for Don as well. As you guys have looked at the final rule, it looks like it didn't certainly changed much from the proposal. But as we think about the behavioral adjustments that CMS has contemplated, how are you thinking about operationalizing those and strategically planning for how you would change the business in order to match what CMS expects you to do? Assuming, obviously, the worst case scenario, which is no change to the rule between now and 2020?

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

Yes. Don, you want to take that? You probably...

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

Yes. Brian, it's a great question, of course. In thinking through mitigation, I think it's important the first stage where we are at LHC Group today, in relation to some key components of the rule. So specifically, with CMS classifying 2 admission sources, institutional and community, and, of course, these are determined within the last 14 days prior to the admission, we are a partner of choice for hospitals and health systems around the country. So we see this as an opportunity for these partner locations to truly create the kind of value from these institutional admits that, obviously, CMS is aiming for with the admission split. Next, with the modifications that include these clinical groupings, we also see this as an opportunity, especially considering, as a company, our present and honestly, our historical generalist approach to how we go about providing the services. A little bit more specifically there, the clinical MMTA subgroups, they really do provide a clear path to caring for more complex primary nursing needs, which, again, really reflects on the company's past and where we are today. The next kind of thinking through the functional or the therapy side, the impairment levels of low, medium and high also clearly point to patients that would fit our resource pool of therapists and extenders, the way we use PTAs, COTAs and other adjunctive people. And I guess, lastly, there are some other components of the rule that I won't go into that really will enhance how we modify our care disease management protocols, things like remote patient monitoring, which will eventually lead to some pretty exciting things in the years coming. So I guess with this backdrop, what I'm saying is that mitigation for us is really more about modifying how we



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do what we do versus I think others are going to have to truly step back and have a dramatic need to pivot. And Keith and I were talking that certainly as a clinician and an operator, I've sat in this seat and had these calls with you all for a long time, this isn't the first time that we've had to face this kind of thing and look at it with fresh eyes. And I dare say it's not going to be the last. So we feel pretty good about it honestly.

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**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Brian, this is Josh. And Don, you summed that up very well. The only thing that I would add to that are 2 points that I want to make sure are not missed, and I'm pretty confident that everyone on this call has them. But first and foremost, the intention is budget-neutrality. So everything that Don just described has an intention from the government's perspective of at least being budget-neutral. And depending on where you fall within the provider landscape, some potential upside to that. The other thing I would note is, as was discussed in Keith's opening comments, we are receiving a 2.2% increase in reimbursement in '19, and there's a mandated 1.5% reimbursement in '20. So those reimbursement increases will occur prior to any effect of PDGM and its budget-neutrality.

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

No, I appreciate that. Josh, just a follow -- just a small what have you. If you don't mind giving us sort of your thoughts on how to bridge EBITDA from Q3 to Q4. I mean what are the moving parts there? Because it looks like there's obviously a step up that's assumed in the guidance. So if you don't mind just giving some color on what -- how you're thinking Q3 to Q4 will progress?

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**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes. Great question, Brian. You've got a couple of things in there. One, as Don mentioned, and as we've already talked about, the LTACHs were depressed in this quarter and they're going to be bouncing back. Two, we continue to see improvement in our hospice margins, and that's going to give a little bit more to the EBITDA line. Three, you've got incremental synergies. As I mentioned, we are continuing to pace ahead of schedule. Each quarter, we've been ahead of schedule on synergies. And I do not expect Q4 to be any different than that. So -- and then you've just got the growth that will compound that as well. But those would be the 4 major bridge I'll give you.

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

Got it. And then last question for me, just really quickly. How are you thinking about your ability to drive margins further in 2019?

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

Brian, this is Don. Keith talked about -- I think it was Keith in his prepared comments, about the instance of Homecare Homebase and Almost Family coming to fruition at the end of Q2. Not only do we feel extremely confident, and Josh can color in with math, we really have a path by state, by division President, to get that done. And obviously, the method and the decision to flow that Homecare Homebase conversion is associated. But also, I don't want to lose the opportunity to go back in what Josh alluded to in our recent acquisitions in the legacy side. We're not tapped out there either. So all told, we really do like where we are there. And then I'm going to give you one more caveat is in the home and community-based services. Josh alluded to the blending of the service lines causing the depressed margin. I would offer that, that is at the nadir, that is really at the bottom, because we're also converting the legacy, it's called PCMS system, the documentation system for Almost Family, to our system, which is ContinuLink. And the reason that's important, it's going to allow the legacy Almost Family to expand the greater into skilled service, therefore, pushing up of those margins much more closely to the high single digits like LAC Group was. So Josh, I don't know if you want to add any color. That's the strategy and you can put the math.



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**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes. No, I would add a few things to that, Don. One, Brian, as we've talked a lot, just the rigor and discipline that this management team has now brought, hopefully, in a very support-oriented way to our Almost Family family members, we're now several months in to the MOR process that I know we've talked about on this call a couple of times. And whether it be how we are concurrently managing the business through the MORs, through the day-to-day management of the business with the support we give them and the data analytics, but also, I've noticed in the last month, as we are nearing the end of our budget cycle for 2019, the rigor and discipline that we have brought to the table on budgeting for next year, when you put all those together, the fact that we've already achieved a 140-basis-point improvement in the margin on Almost Family and knowing that there is still more to come on that book of business is pretty exciting when I start thinking about next year.

**Operator**

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

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

So just, I guess, a follow-up question. Thank you for the update on your Medicare Advantage contracting. So where would you say you are now in terms of the average, I guess, MA rate versus the fee-for-service, the traditional Medicare rates on average?

**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Joanna, this is Josh. I would say probably, on average, around 80%. In some of these new models that I've been describing -- that I described earlier, those are much closer to Medicare and, in some instances, an opportunity to even get greater than Medicare. But on average, still today, probably in the 80% to low 80% range.

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

That's great color. And just on a similar front in terms of these new models, I haven't heard you talk about it, but in the value-based purchasing program, are you receiving some bonus payments this year? And what do you expect will be the amount this year?

**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes. Across our value-based purchasing locations, this year, Joanna, we expect to receive around \$1 million of incremental upside revenue, which is double what we had previously expected and received.

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

And obviously, I guess, that's AFAM stars improving, their quality metrics improved. So is the \$1 million include some of the AFAM improvement? Or I guess it's too early, so we should kind of think about those numbers growing exponentially higher with AFAM improvement there, right?

**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes. It's about 70-30, 70% LHC, and about 30% from the Almost Family locations. And that again, gives me a lot of excitement for next year and beyond, because as we continue to improve, those locations will see that million-dollar VPP payment continue to increase.



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

And Joanna, this is Don. Obviously, I just talked about the conversion schedule to Homecare Homebase, Florida is such a driver inside of the legacy Almost Family and they're in the midst of the conversion now. So you add the margin improvement to the value-base improvement that we think we'll see next year, that's pretty exciting for us.

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

That's great. And if I may squeeze another one. In terms of the commentary around the outlook, I guess, we discussed -- you discussed the PDGM, but you mentioned the 2019 rate increase from Medicare will be quite good. I guess it will be the best in more than a decade. So when we think about margins, I guess, outside of synergies there, how should we think about home health margins with the kind of rate? The 2% I guess you haven't seen in very long time. So how should we think about margins for home health segment outside of synergies obviously?

**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes, Joanna. This is Josh. Great question. I definitely expect, and when we get to the point of issuing guidance next year, we will make it more concrete for you, but I expect margins to improve in home health next year. Now, it will be -- you'll offset some of that 2.2% increase with your cost-of-living adjustments, merit increases and some of the SWB that we've had to mitigate against over the past decade. But I still feel the blending of the rate increase and the improvement quarter-over-quarter in Almost Family and still the improvements in CHRISTUS, LifePoint and Baptist, you're going to see margin improvement in home health.

**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 guess I kind of wanted to stay on that line of thought about the sequential improvements. A lot of what you pointed out was more margin related. But we've got some questions of just kind of concerns over just the top line growth. So looking at your guidance and your year-to-date performance, it would imply to the midpoint about 5.5% sequential growth to get to that annual revenue guidance number. So I'm just curious. Is there anything you would like to call out to us to give us confidence that that's -- it looks like it's achievable, based on the past, but anything you may want to specifically point out that would help drive the sequential growth to get to your revenue targets for 2018?

**Joshua L. Proffitt** - LHC Group, Inc. - CFO, General Counsel & Secretary

Yes, great question, Frank, I'm glad you asked it. I'll start and I'll kick it over to Don to color in some of the details as well. I guess, first of all, on the revenue side, I want to make sure in having several conversations over the course of the evening and this morning, it seems like there may be a little bit of disconnect just in some of the models and some inconsistency, not right, wrong or indifferent, but whether it be prior to implicit price concession of \$514 million versus post at \$507 million, some people are modeling those differently. We talked about the LTACH revenue, so that was a kind of onetime blip, if you will, that brought the revenue down in the LTACH segment due to the patient acuity issues and the relocations. And then you've got the closures that we've had in Q2 and Q3. The thing that I would note there, as we've closed those locations, yes it's depressed the revenue slightly, but we closed them for a reason, which was they were dragging on the margin, which is how you're seeing uptick in margin performance. So I guess that's what I would say on the revenue side, Don?



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

And that is absolutely accurate, Josh. But I also want to say that in addition to everything operations is doing with Almost Family, Frank, we're also converting some of the CRM products, PlayMaker is what we use here, and we're also just final with putting the route data in the hands of sales. So their Medicare admissions, if you look sequentially from when we actually did the acquisition in Q2 to Q3, are flat. We're starting to see that move up as well. So when you add what Josh said to this color, we are fully confident that we'll get there.

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

Got you. And just on that subject. Could you tell me what recertification rates were on the Medicare side? Like you've got same-store Medicare was up 4 6, but same-store episodes were only up about 1. So any kind of change or blip you're seeing in recert rates?

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

I'll be very specific. LAC legacy was 41.4%, AFAM 35%, blended 38.7%, which is right in line with what we did consolidated at 37.7% last quarter.

**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, Don, wanted to go back to your commentary on the hospice outlook and nice improvement on the organic admissions growth there. But you mentioned acquisitions and you're going to grow that business organically and through acquisitions. Could you comment about what you're seeing out in the market for evaluations and deal sizes? We all saw a big deal has recently happened. So I was just kind of thinking what you guys are seeing as you look for hospice deals?

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

I'll go with the strategy first, just to color in my prepared comments. What I was trying to say is, I don't want you all to think about this 5% is what we are comfortable with in hospice. That's really when you look at a siloed agency, and we looked at these 110, we're going to focus on growing it that way. But then in these colocated markets, we're either going to go open up through de novos or, if we have to, try to buy the smallest providers to bolt on there. And when you do those things in combination, that's really a self-fulfilling prophecy is what I was trying to say. From a valuation standpoint, I'll throw that to Keith and let him color in that a little bit.

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

Yes, I think the hospice valuations are, probably in the smaller hospices that we would be shopping at, in the 8 to 10 EBITDA multiple range. But again, we're trying to buy something that's high quality and a new market where we already have significant presence and good, strong reputation through our home health service line to grow the hospice. So that's our strategy. And we try to stay away from any hospices that have a significant percentage of their business that are in skilled nursing facilities because that wouldn't fit our model, obviously.

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

Got it. Got it. And then, I guess, to that point, Keith, and maybe Don too, can you talk a little bit more about clinical collaboration efforts between all of your postacute services now that you're integrated with Almost Family?



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

Yes. Honestly, we have a huge opportunity to do that once we model up everything, get into this Homecare Homebase one instance is very important. There are programs we're looking to do that, to do the collaboration. It's almost, to be honest with you, we've got to build it out first. We're doing well in our existing markets, but we, as a portfolio -- as a percentage of our whole company, it's so small. So I guess what I would try to stay there, is that's really Phase II once we do continue to bolt on to these. And there are programs out there, whether it's SHP or Metalogix that are going to help us do that, but we have about 6 months to go before we really start seeing that proliferate.

**Operator**

And our next question comes from Matt Larew with William Blair.

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

Don, I was wondering if you could add maybe a little more color on Almost Family and just if you could maybe parse out some of the organic growth dynamics between agencies that have perhaps converted earlier to Homecare Homebase versus others that still haven't made the transition. And then also, are there additional facility consolidations that we should expect moving forward?

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

On the consolidations, we've done a handful of those already, and that's really not a huge strategy because even in our legacy portfolio, Lexington, for example, Kentucky, and there are different brands, we're a house of brands that we operate under. And the way I look at that operation layer is you can code a G&A of about 300,000, we keep them open. So there's no real push to consolidate, unless we would see that the combined market is more accretive in a 2- to 3-year period than it is being solo. So I wouldn't bake that in. As for the organic growth, I would also kind of caution you. Right now is when we are converting to Homecare Homebase and PlayMaker. The first 6 months, we had to overlay Lawson. We had to do some payroll mapping that really -- I hate to sound so optimistic, to grow as we did was astronomical with the disruptive factors we were putting into that business. So as much as it is Homecare Homebase, it is the disruption that is curtailing, that is going to allow Q4 to be incrementally better than Q3, and I guess, that's the best way I would put it. So I wouldn't just say that it's the conversion in and of itself, there are so many pieces that we have put on these agencies. And just anecdotally, the division Presidents and Vice Presidents of Almost Family have handled this masterfully.

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

Okay, understood. And then, Keith, just thinking about pace of JVs, obviously, the comments you made about 15 to 20 active deals at any given time here. But just wondering now that I guess the latest PDGM update is out there, and as Don alluded to, some of the heavy lifting and disruption on the Almost Family side is in the past, might we see perhaps a bit more JV execution over the next 12 months relative to the past 12?

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

Well, I think the answer is yes, I think you should anticipate acceleration. But I know this might seem odd, but it hasn't been because of any type of pause or delay we've put in those efforts because of the Almost Family integration. It's been more a case of the focus for us now has been more on hospital -- multihospital systems and networks rather than one-offs. And those are a little more complex. And the sales cycle is a little bit longer, but we've had several of those we've been working on for some time. So it may appear that it has some linkage to the Almost Family transaction, but in all honesty, it hasn't.





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

Okay. And then maybe just one more here on some of the new at-risk contracts that you're discussing. Just wondering if you're willing to provide at all what percentage of revenues you think potentially could -- on the home health side, could be either at risk today but could potentially be at risk in 2019 or 2020? And then, just broadly, are any of these both top line enhancing in terms of adding additional capabilities that the customer is asking you to do here? Or are they margin expanding? Understanding it's early, just if you could, I guess, help us a little bit how to think about this contribution in the future?

**Joshua L. Proffitt** - *LHC Group, Inc. - CFO, General Counsel & Secretary*

Yes, Matt. Those are great questions. And it is all of the above. So let me start with the last piece because I think there was some great intuition you had in the question you just asked around are you doing anything different is how I'll paraphrase what you said. And we've got a few different discussions that are going on right now. One that we're very far along with, that would be more of a care management, very specific targeting a new patient population for a particular payer that's really going after some of their healthier commercial population, who normally wouldn't receive home health, but it may be in a post-surgery world or a specific ortho arena. And putting together a nice little bundle with them on that. On the risk-based arrangements we have, those definitely have upside revenue potential. And as those grow, you would see that both in the top line and in the margins. We've got one instance where pretty excited about it up in the Northwest, where we are engaged in negotiating a transaction with a payer where we would come in and have a bundled arrangement for an interim period of time that would then bleed over into a longer-term episodic-type arrangement depending on kind of the outcome of the patient and those conditions. And then we've got one that is targeting more specific diagnosis categories where the payer is getting very aggressive to try and reduced readmissions and their overall cost of care. So that's going to be more diagnosis-specific. But in every instance, they will unequivocally result in increased revenue and better margins. But to sit here and quantify that for you right now going into next year would be probably not fair to where we're at.

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

Yes, Matt. This is Don. I really want to -- that last point Josh made, you all know that we're conservative, but we're also very confident as a management team. We're not going to enter in ink at-risk arrangements when we really think that we would lose revenue on that deal. So Josh, real good point at the end.

**Operator**

Our next question comes from Matthew Gillmor with Baird.

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

I'll just ask one. I wanted to come back to the PDGM, and I guess, with the final rule out, I've assumed the focus would shift to the legislative efforts. And I was hoping Keith could maybe orient us around sort of the next milestone we should be paying attention to on the legislation. Will there be a CVS? Or is there any bill moving through Congress that you think you could attach this to? And if you could also just talk about the level of engagement with lawmakers around the legislation?

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

Yes -- first of all, I would advise you to reach out to Bill Dombi at NAHC or Joanne Cunningham at the partnership, in addition to just me and keep -- get updates on the regulates from them. We've seen broad support for this issue. Obviously, there have been that many other things that they've been focused on on the Hill in the last few months. But we have 14 months ahead of us to work on this. So we have a strong team of assets, both internal and engaged consultants working this on the Hill and Bill supporting the industry. I think the next logical step is going to be a merger of the 2 Senate bills.



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(technical difficulty)

As we love that as a pilot opportunity, but it may have a score and so that may have to be pulled out. I think all those things are going to work itself out. With regard to timing, I think it's possible that this could be attached to something at year-end. But again, we're not counting on that. We have, again, 14 months to work at this. So we're just full speed ahead. And totally laser-focused. Our assets at Washington, D.C. are on working this. And I think you would hear the same from our colleagues at the other large applicers. We're all unified and all pulling the same direction on this one.

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**Operator**

And our last question comes from Dana Hambly with Stephens.

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

Question on the acquisitions. I know excluding AFAM, you had talked about the margins at initial purchase and then 4 quarters later, going from I think like the high-teens to around 30%. As we go into the out years and you're maybe targeting \$100 million to \$150 million, is that a similar type of margin profile you would expect?

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**Joshua L. Proffitt** - *LHC Group, Inc. - CFO, General Counsel & Secretary*

Absolutely, Dana. Absolutely. So the ones that you're referencing, the LifePoint, CHRISTUS and Baptist, that is very typical of what we see when we come in and do these large health system and then hospital partnerships that -- and you're referring to the gross margin line improvement from the 17 up to the low 30s. There's still some -- a little bit more left to get out of those to be quite honest with you. I think Don referred to that earlier, but that is the kind of margin lift that you would expect. I'm also very pleased with the 14% top line growth on those 3 joint ventures that I mentioned earlier. In the aggregate from Q3 -- from Q4 of last year to this quarter, to have the revenue go up by 14% within the first year of those JVs at maturity has been -- tip my hat to Don and the whole sales force and the team that's managing those assets, they're doing a great job.

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

Okay, that's helpful. And then, just on the community -- home and community-based margin, low single-digits this quarter. I think Don, you mentioned it earlier. Is a better way to think about that more of a high single-digit, maybe a 10% type margin?

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

Absolutely. Absolutely.

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**Operator**

And ladies and gentlemen, this concludes our Q&A session. I would like to turn the call back to Keith Myers, Chairman and CEO, for his final remarks.

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

Okay, thanks, everyone. Thanks for dialing in as always. And as always, if you -- at any point, you need to have a conversation with us, please reach out to Eric Elliott, and if you'd like to speak to any other members of the management team, we're always here. We'll make ourselves available to you to answer any questions you may have. Thank you, and we look forward to speaking to you in the next call.



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**Operator**

And with that, ladies and gentlemen, we thank you for participating in today's conference. This concludes the program, and you may all disconnect. Have a wonderful day.

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