Encompass Health Corp
Form 10-Q
May 01, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2019
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 001-10315

Encompass Health Corporation
(Exact name of Registrant as specified in its Charter)

Delaware	63-0860407
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
9001 Liberty Parkway Birmingham, Alabama	35242
(Address of Principal Executive Offices)	(Zip Code)

(205) 967-7116
(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer o Non-Accelerated filer o
Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).
Yes o No ý

The registrant had 98,852,589 shares of common stock outstanding, net of treasury shares, as of April 23, 2019.

TABLE OF CONTENTS

NOTE TO READERS

As used in this report, the terms “Encompass Health,” “we,” “us,” “our,” and the “Company” refer to Encompass Health Corporation and its consolidated subsidiaries, unless otherwise stated or indicated by context. This drafting style is suggested by the Securities and Exchange Commission and is not meant to imply that Encompass Health Corporation, the publicly traded parent company, owns or operates any specific asset, business, or property. The hospitals, operations, and businesses described in this filing are primarily owned and operated by subsidiaries of the parent company. In addition, we use the term “Encompass Health Corporation” to refer to Encompass Health Corporation alone wherever a distinction between Encompass Health Corporation and its subsidiaries is required or aids in the understanding of this filing.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains historical information, as well as forward-looking statements that involve known and unknown risks and relate to, among other things, future events, changes to Medicare reimbursement and other healthcare laws and regulations from time to time, our business strategy, our dividend and stock repurchase strategies, our financial plans, our growth plans, our future financial performance, our projected business results, or our projected capital expenditures. In some cases, the reader can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “targets,” “potential,” or “conti negative of these terms or other comparable terminology. Such forward-looking statements are necessarily estimates based upon current information and involve a number of risks and uncertainties, many of which are beyond our control. Any forward-looking statement is based on information current as of the date of this report and speaks only as of the date on which such statement is made. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. While it is impossible to identify all such factors, factors that could cause actual results to differ, such as decreases in revenues or increases in costs or charges, materially from those estimated by us include, but are not limited to, the following:

- each of the factors discussed in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2018, as well as uncertainties and factors, if any, discussed elsewhere in this Form 10-Q, including in the “Executive Overview—Key Challenges” section of Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, in our other filings from time to time with the SEC, or in materials incorporated therein by reference;
- changes in the rules and regulations of the healthcare industry at either or both of the federal and state levels, including those contemplated now and in the future as part of national healthcare reform and deficit reduction (such as the re-basing of payment systems, the introduction of site neutral payments or case-mix weightings across post-acute settings, the Patient-Driven Groupings Model for home health, the CARE Tool for inpatient rehabilitation, and other payment system reforms), which may decrease revenues and increase the costs of complying with such changes;
- reductions or delays in, or suspension of, reimbursement for our services by governmental or private payors, including our ability to obtain and retain favorable arrangements with third-party payors;
- restrictive interpretations of the regulations governing the claims that are reimbursable by Medicare;
- our ability to comply with extensive and changing healthcare regulations as well as the increased costs of regulatory compliance and compliance monitoring in the healthcare industry, including the costs of investigating and defending asserted claims, whether meritorious or not;
- any adverse outcome of various lawsuits, claims, and legal or regulatory proceedings, including disclosed and undisclosed qui tam suits;
- our ability to finalize a settlement of the United States Department of Justice’s investigation which has been pending six years and is discussed further in Note 11, Contingencies and Other Commitments;
- the use by governmental agencies and contractors of statistical sampling and extrapolation to expand claims of overpayment or noncompliance;
- delays in the administrative appeals process associated with denied Medicare reimbursement claims, including from various Medicare audit programs, and our exposure to the related delay or reduction in the receipt of the reimbursement amounts for services previously provided, including through recoupment of ongoing claims reimbursement by CMS;
- the ongoing evolution of the healthcare delivery system, including alternative payment models and value-based purchasing initiatives, which may decrease our reimbursement rate or increase costs associated with our operations;
- our ability to attract and retain nurses, therapists, and other healthcare professionals in a highly competitive environment with often severe staffing shortages and the impact on our labor expenses from potential union activity and staffing recruitment and retention;
- competitive pressures in the healthcare industry, including from other providers that may be participating in integrated delivery payment arrangements in which we do not participate, and our response to those pressures;

- changes in our payor mix or the acuity of our patients affecting reimbursement rates;
- our ability to successfully complete and integrate de novo developments, acquisitions, investments, and joint ventures consistent with our growth strategy, including realization of anticipated revenues, cost savings, productivity improvements arising from the related operations and avoidance of unanticipated difficulties, costs or liabilities that could arise from acquisitions or integrations;
- increased costs of defending and insuring against alleged professional liability and other claims and the ability to predict the costs related to claims;
- potential incidents affecting the proper operation, availability, or security of our information systems, including the patient information stored there;
- new or changing quality reporting requirements impacting operational costs or our Medicare reimbursement;
- the price of our common stock as it affects our willingness and ability to repurchase shares and the financial and accounting effects of any repurchases;
- our ability and willingness to continue to declare and pay dividends on our common stock;
- our ability to maintain proper local, state and federal licensing, including compliance with the Medicare conditions of participation, which is required to participate in the Medicare program;
- our ability to attract and retain key management personnel; and
- general conditions in the economy and capital markets, including any instability or uncertainty related to armed conflict or an act of terrorism, governmental impasse over approval of the United States federal budget, an increase to the debt ceiling, or an international sovereign debt crisis.

The cautionary statements referred to in this section also should be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. We undertake no duty to update these forward-looking statements, even though our situation may change in the future. Furthermore, we cannot guarantee future results, events, levels of activity, performance, or achievements.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
Encompass Health Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
	(In Millions, Except Per Share Data)	
Net operating revenues	$1,124.0	$1,046.0
Operating expenses:		
Salaries and benefits	620.8	570.2
Other operating expenses	150.1	141.2
Occupancy costs	19.6	18.6
Supplies	40.1	39.9
General and administrative expenses	53.4	61.1
Depreciation and amortization	52.5	45.9
Total operating expenses	936.5	876.9
Interest expense and amortization of debt discounts and fees	37.2	35.6
Other (income) loss	(3.7)	0.1
Equity in net income of nonconsolidated affiliates	(2.5)	(2.3)
Income from continuing operations before income tax expense	156.5	135.7
Provision for income tax expense	30.8	30.0
Income from continuing operations	125.7	105.7
Loss from discontinued operations, net of tax	(0.5)	(0.5)
Net and comprehensive income	125.2	105.2
Less: Net and comprehensive income attributable to noncontrolling interests	(22.9)	(21.4)
Net and comprehensive income attributable to Encompass Health	$102.3	$83.8
Weighted average common shares outstanding:		
Basic	98.4	97.8
Diluted	99.7	99.4
Earnings per common share:		
Basic earnings per share attributable to Encompass Health common shareholders:		
Continuing operations	$1.05	$0.86
Discontinued operations	(0.01)	(0.01)
Net income	$1.04	$0.85
Diluted earnings per share attributable to Encompass Health common shareholders:		
Continuing operations	$1.04	$0.85
Discontinued operations	(0.01)	(0.01)
Net income	$1.03	$0.84
Amounts attributable to Encompass Health common shareholders:		
Income from continuing operations	$102.8	$84.3
Loss from discontinued operations, net of tax	(0.5)	(0.5)
Net income attributable to Encompass Health	$102.3	$83.8

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.
1

Encompass Health Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2019	December 31, 2018
	(In Millions)	
Assets		
Current assets:		
Cash and cash equivalents	$56.1	$ 69.2
Restricted cash	59.0	59.0
Accounts receivable	500.6	467.7
Other current assets	67.0	66.2
Total current assets	682.7	662.1
Property and equipment, net	1,736.2	1,634.8
Operating lease right-of-use assets	284.9	—
Goodwill	2,111.6	2,100.8
Intangible assets, net	435.4	443.4
Deferred income tax assets	40.5	42.9
Other long-term assets	292.5	291.0
Total assets[(1)]	$5,583.8	$ 5,175.0
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	$37.3	$ 35.8
Current operating lease liabilities	48.3	—
Accounts payable	94.7	90.0
Accrued expenses and other current liabilities	587.9	546.7
Total current liabilities	768.2	672.5
Long-term debt, net of current portion	2,521.8	2,478.6
Long-term operating lease liabilities	245.0	—
Other long-term liabilities	159.3	205.2
	3,694.3	3,356.3
Commitments and contingencies		
Redeemable noncontrolling interests	273.0	261.7
Shareholders' equity:		
Encompass Health shareholders' equity	1,314.3	1,276.7
Noncontrolling interests	302.2	280.3
Total shareholders' equity	1,616.5	1,557.0
Total liabilities[(1)] and shareholders' equity	$5,583.8	$ 5,175.0

(1) Our consolidated assets as of March 31, 2019 and December 31, 2018 include total assets of variable interest entities of $216.2 million and $197.5 million, respectively, which cannot be used by us to settle the obligations of other entities. Our consolidated liabilities as of March 31, 2019 and December 31, 2018 include total liabilities of the variable interest entities of $62.2 million and $50.8 million, respectively. See Note 3, Variable Interest Entities.

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

2

Encompass Health Corporation and Subsidiaries
Condensed Consolidated Statements of Shareholders' Equity
(Unaudited)

Three Months Ended March 31, 2019
(In Millions)

	Encompass Health Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total
Balance at beginning of period	98.9	$ 1.1	$ 2,588.7	$ (885.2)	$ —	$ (427.9)	$ 280.3	$ 1,557.0
Net income	—	—	—	102.3	—	—	18.9	121.2
Receipt of treasury stock	(0.3)	—	—	—	—	(15.9)	—	(15.9)
Dividends declared ($0.27 per share)	—	—	(26.9)	—	—	—	—	(26.9)
Stock-based compensation	—	—	7.0	—	—	—	—	7.0
Distributions declared	—	—	—	—	—	—	(15.3)	(15.3)
Capital contributions from consolidated affiliates	—	—	—	—	—	—	7.1	7.1
Fair value adjustments to redeemable noncontrolling interests	—	—	(20.3)	—	—	—	—	(20.3)
Repurchases of common stock in open market	(0.2)	—	—	—	—	(11.0)	—	(11.0)
Other	0.7	—	2.8	—	—	(0.4)	11.2	13.6
Balance at end of period	99.1	$ 1.1	$ 2,551.3	$ (782.9)	$ —	$ (455.2)	$ 302.2	$ 1,616.5

Three Months Ended March 31, 2018
(In Millions)

	Encompass Health Common Shareholders							
	Number of Common Shares Outstanding	Common Stock	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Noncontrolling Interests	Total
Balance at beginning of period	98.3	$ 1.1	$ 2,747.4	$ (1,176.2)	$ (1.3)	$ (418.5)	$ 242.9	$ 1,395.4
Net income	—	—	—	83.8	—	—	18.6	102.4
Receipt of treasury stock	(0.2)	—	—	—	—	(8.3)	—	(8.3)
Dividends declared ($0.25 per share)	—	—	(24.9)	—	—	—	—	(24.9)
Stock-based compensation	—	—	5.3	—	—	—	—	5.3
Distributions declared	—	—	—	—	—	—	(17.7)	(17.7)
Fair value adjustments to redeemable noncontrolling interests	—	—	(42.2)	—	—	—	—	(42.2)
Other	0.7	—	0.3	(1.3)	1.3	(0.4)	—	(0.1)
Balance at end of period	98.8	$ 1.1	$ 2,685.9	$ (1,093.7)	$ —	$ (427.2)	$ 243.8	$ 1,409.9

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.
3

Encompass Health Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2019	2018
	(In Millions)	
Cash flows from operating activities:		
Net income	$125.2	$105.2
Loss from discontinued operations, net of tax	0.5	0.5
Adjustments to reconcile net income to net cash provided by operating activities—		
Depreciation and amortization	52.5	45.9
Stock-based compensation	19.4	26.1
Deferred tax expense (benefit)	2.6	(3.0)
Other, net	(0.8)	1.6
Change in assets and liabilities, net of acquisitions—		
Accounts receivable	(29.6)	8.3
Other assets	(3.8)	14.2
Accrued payroll	(14.8)	(9.5)
Other liabilities	11.7	27.7
Net cash used in operating activities of discontinued operations	(3.0)	(0.7)
Total adjustments	34.2	110.6
Net cash provided by operating activities	159.9	216.3
Cash flows from investing activities:		
Purchases of property and equipment	(72.3)	(59.9)
Acquisitions of businesses, net of cash acquired	(13.7)	(0.6)
Other, net	(5.5)	(0.1)
Net cash used in investing activities	(91.5)	(60.6)
Cash flows from financing activities:		
Borrowings on revolving credit facility	25.0	95.0
Payments on revolving credit facility	(30.0)	(95.0)
Dividends paid on common stock	(28.3)	(25.4)
Purchase of equity interests in consolidated affiliates	—	(65.1)
Distributions paid to noncontrolling interests of consolidated affiliates	(19.5)	(15.4)
Taxes paid on behalf of employees for shares withheld	(15.9)	(8.3)
Other, net	(13.0)	(2.5)
Net cash used in financing activities	(81.7)	(116.7)
(Decrease) increase in cash, cash equivalents, and restricted cash	(13.3)	39.0
Cash, cash equivalents, and restricted cash at beginning of period	133.5	116.8
Cash, cash equivalents, and restricted cash at end of period	$120.2	$155.8
Reconciliation of Cash, Cash Equivalents, and Restricted Cash		
Cash and cash equivalents at beginning of period	$69.2	$54.4
Restricted cash at beginning of period	59.0	62.4
Restricted cash included in other long-term assets at beginning of period	5.3	—
Cash, cash equivalents, and restricted cash at beginning of period	$133.5	$116.8
Cash and cash equivalents at end of period	$56.1	$86.4

Restricted cash at end of period	59.0	69.4
Restricted cash included in other long-term assets at end of period	5.1	—
Cash, cash equivalents, and restricted cash at end of period	$120.2	$155.8

The accompanying notes to condensed consolidated financial statements are an integral part of these condensed statements.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

Encompass Health Corporation, incorporated in Delaware in 1984, including its subsidiaries, is one of the nation's largest providers of post-acute healthcare services, offering both facility-based and home-based patient services in 37 states and Puerto Rico through its network of inpatient rehabilitation hospitals, home health agencies, and hospice agencies. We manage our operations and disclose financial information using two reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. See also Note 12, Segment Reporting.

The accompanying unaudited condensed consolidated financial statements of Encompass Health Corporation and Subsidiaries should be read in conjunction with the consolidated financial statements and accompanying notes contained in Encompass Health's Annual Report on Form 10-K filed with the United States Securities and Exchange Commission on February 27, 2019 (the "2018 Form 10 K"). The unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the SEC applicable to interim financial information. Certain information and note disclosures included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been omitted in these interim statements, as allowed by such SEC rules and regulations. The condensed consolidated balance sheet as of December 31, 2018 has been derived from audited financial statements, but it does not include all disclosures required by GAAP. However, we believe the disclosures are adequate to make the information presented not misleading.

The unaudited results of operations for the interim periods shown in these financial statements are not necessarily indicative of operating results for the entire year. In our opinion, the accompanying condensed consolidated financial statements recognize all adjustments of a normal recurring nature considered necessary to fairly state the financial position, results of operations, and cash flows for each interim period presented.

Net Operating Revenues—

Our Net operating revenues disaggregated by payor source and segment are as follows (in millions):

	Inpatient Rehabilitation		Home Health and Hospice		Consolidated	
	Three Months Ended March 31,		Three Months Ended March 31,		Three Months Ended March 31,	
	2019	2018	2019	2018	2019	2018
Medicare	$638.9	$624.5	$214.8	$176.9	$853.7	$801.4
Medicare Advantage	85.2	72.5	25.5	20.0	110.7	92.5
Managed care	83.5	85.0	8.4	7.6	91.9	92.6
Medicaid	26.2	24.7	4.3	0.5	30.5	25.2
Other third-party payors	10.0	12.0	—	—	10.0	12.0
Workers' compensation	8.2	7.4	0.2	0.1	8.4	7.5
Patients	6.1	4.4	0.4	0.4	6.5	4.8
Other income	12.0	9.8	0.3	0.2	12.3	10.0
Total	$870.1	$840.3	$253.9	$205.7	$1,124.0	$1,046.0

See Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2018 Form 10-K for our policy related to Net operating revenues.

Leases—

We determine if an arrangement is a lease or contains a lease at inception and perform an analysis to determine whether the lease is an operating lease or a finance lease. We measure right-of-use assets and lease liabilities at the lease commencement date based on the present value of the remaining lease payments. As most of our leases do not provide a readily determinable implicit rate, we estimate an incremental borrowing rate based on the credit quality of the Company and by

5

comparing interest rates available in the market for similar borrowings, and adjusting this amount based on the impact of collateral over the term of each lease. We use this rate to discount the remaining lease payments in measuring the right-of-use asset and lease liability. We use the implicit rate when readily determinable. We recognize lease expense for operating leases on a straight-line basis over the lease term. For our finance leases, we recognize amortization expense from the amortization of the right-of-use asset and interest expense on the related lease liability. Certain of our lease agreements contain annual escalation clauses based on changes in the Consumer Price Index. The changes to the Consumer Price Index, as compared to our initial estimate at the lease commencement date, are treated as variable lease payments and recognized in the period in which the obligation for those payments was incurred. We do not account for lease and nonlease components separately for purposes of establishing right-of-use assets and lease liabilities.

Leases with an initial term of twelve months or less are not recorded on the condensed consolidated balance sheet. We recognize lease expense for these leases on a straight-line basis over the lease term.

Recently Adopted Accounting Pronouncements—

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” and has subsequently issued supplemental and/or clarifying ASUs (collectively “ASC 842”), in order to increase transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. We adopted ASC 842 using the modified retrospective approach and applied the transition provisions with an effective date as of January 1, 2019 for leases that existed on that date. Prior period results continue to be presented under ASC 840 based on the accounting originally in effect for such periods. ASC 842 provides optional practical expedients in transition. We elected the ‘package of practical expedients,’ which permits us to not reassess under ASC 842 our prior conclusions about lease identification, lease classification and initial direct costs, and the practical expedient to not reassess certain land easements. We did not elect the use-of-hindsight practical expedient during the transition to ASC 842. The adoption of ASC 842 resulted in the addition of approximately $349 million in assets and $347 million in liabilities to our condensed consolidated balance sheet as of January 1, 2019, with the remaining $2 million being recorded as an adjustment to Capital in excess of par value. The adoption of ASC 842 also resulted in increased disclosure, including qualitative and quantitative disclosures about the nature, amount, timing and uncertainty of cash flows arising from leases. See the “Leases” section of this note and Note 4, Leases, for additional information about our leases.

Recent Accounting Pronouncements Not Yet Adopted—

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326),” which provides guidance for accounting for credit losses on financial instruments. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments and modifies the impairment model for available-for-sale debt securities. The new guidance is effective for us beginning January 1, 2020, including interim periods within that reporting period. Early adoption is permitted beginning January 1, 2019. We continue to review the requirements of this standard and any potential impact it may have on our condensed consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.” The update helps entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement (hosting arrangement), by providing guidance in determining when the arrangement includes a software license. It requires entities to account for such costs consistent with the guidance on capitalizing costs associated with developing or obtaining internal-use software. The new guidance is effective for us beginning January 1, 2020, including interim periods within that reporting period. Early adoption is permitted. We continue to review the requirements of this standard and any potential impact it may have on our condensed consolidated financial statements.

We do not believe any other recently issued, but not yet effective, accounting standards will have a material effect on our condensed consolidated financial position, results of operations, or cash flows.

6

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Revision of Previously Issued Financial Statements—
During the preparation of our December 31, 2018 financial statements, an error was identified in the accounting for deferred tax assets related to fair value adjustments to redeemable noncontrolling interests. At that time, we assessed the materiality of the errors in deferred tax assets and related balances and concluded they were not material to any previously issued financial statements or disclosures. However, we revised our previously issued annual financial statements in connection with the issuance of our 2018 financial statements to correct for such errors. In addition, we have revised our condensed consolidated statement of shareholders' equity for the three months ended March 31, 2018 presented herein to reflect the correction of these errors, which originated in years prior to 2018, as disclosed in the table below. For additional information on this revision, see Note 1, Summary of Significant Accounting Policies, "Revision of Previously Issued Financial Statements" to the consolidated financial statements accompanying the 2018 Form 10-K.

	As Reported	Adjustment	As Revised
For the Three Months Ended March 31, 2018	(In Millions)		
Fair value adjustments to redeemable noncontrolling interests	$(40.5)	$ (1.7)	$(42.2)
Capital in excess of par value	2,731.6	(45.7)	2,685.9
Accumulated deficit	(1,108.5)	14.8	(1,093.7)
Total shareholders' equity	1,440.8	(30.9)	1,409.9

2. Business Combinations

Home Health and Hospice

Alacare Acquisition

In March 2019, we signed a definitive agreement to purchase substantially all of the assets of privately owned Alacare Home Health & Hospice ("Alacare") for a cash purchase price of approximately $217.5 million. Alacare operates 23 home health locations and 23 hospice locations in Alabama. This transaction, which is subject to customary closing conditions and regulatory approvals, is expected to close in June 2019. We expect to fund the transaction with cash on hand and borrowings under our revolving credit facility.

Other Home Health and Hospice Acquisitions

During the three months ended March 31, 2019, we completed the following home health and hospice acquisitions, none of which were individually material to our financial position, results of operations, or cash flows. Each acquisition was made to enhance our position and ability to provide post-acute healthcare services to patients in the applicable geographic areas. Each acquisition was funded using cash on hand.

- In February 2019, we acquired the assets of Tidewater Home Health, PA in Columbia, South Carolina.
- In March 2019, we acquired the assets and assumed the liabilities of two home health locations from Care Resource Group in East Providence, Rhode Island and Westport, Massachusetts.

We accounted for these transactions under the acquisition method of accounting and reported the results of operations of the acquired locations from their respective dates of acquisition. Assets acquired and liabilities assumed were recorded at their estimated fair values as of the respective acquisition dates. The fair values of identifiable intangible assets were based on valuations using an income approach. The income approach is based on management's estimates of future operating results and cash flows discounted using a weighted-average cost of capital that reflects market participant assumptions. The excess of the fair value of the consideration conveyed over the fair value of the net assets acquired was recorded as goodwill. The goodwill reflects our expectations of our ability to utilize the acquired locations' mobile workforce and established relationships within each community and the benefits of being able to leverage operational efficiencies with favorable growth opportunities based on positive demographic trends in these markets. All goodwill recorded as a result of these transactions is deductible for federal income tax purposes.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

The fair value of the assets acquired and liabilities assumed at the acquisition date were as follows (in millions):

Identifiable intangible assets:	
Noncompete agreements (useful lives of 5 years)	$0.2
Certificates of need (useful lives of 10 years)	2.0
License (useful life of 10 years)	0.8
Goodwill	10.8
Other assets acquired	0.2
Total assets acquired	14.0
Liabilities assumed:	
Accrued payroll	(0.1)
Other current liabilities	(0.1)
Other long-term liabilities	(0.1)
Total liabilities assumed	(0.3)
Net assets acquired	$13.7

Information regarding the net cash paid for the other home health and hospice acquisitions during each period presented is as follows (in millions):

	Three Months Ended March 31, 2019	2018
Fair value of assets acquired	$3.2	$0.1
Goodwill	10.8	0.5
Fair value of liabilities assumed	(0.3)	—
Net cash paid for acquisitions	$13.7	$0.6

Pro Forma Results of Operations

The following table summarizes the results of operations of the above mentioned acquisitions from their respective dates of acquisition included in our consolidated results of operations and the unaudited pro forma results of operations of the combined entity had the date of the acquisitions been January 1, 2018 (in millions):

	Net Operating Revenues	Net Income Attributable to Encompass Health
Acquired entities only: Actual from acquisition date to March 31, 2019		
Home Health and Hospice	$ 1.0	$ (0.1)
Combined entity: Supplemental pro forma from 01/01/2019-03/31/2019	1,126.0	102.5
Combined entity: Supplemental pro forma from 01/01/2018-03/31/2018	1,048.4	84.0

The information presented above is for illustrative purposes only and is not necessarily indicative of results that would have been achieved if the acquisitions had occurred as of the beginning of our 2018 reporting period.

See Note 2, Business Combinations, to the consolidated financial statements accompanying the 2018 Form 10 K for information regarding acquisitions completed in 2018.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

3. Variable Interest Entities

As of March 31, 2019 and December 31, 2018, we consolidated eight limited partnership-like entities that are variable interest entities ("VIEs") and of which we are the primary beneficiary. Our ownership percentages in these entities range from 50.0% to 75.0%. Through partnership and management agreements with or governing each of these entities, we manage all of these entities and handle all day-to-day operating decisions. Accordingly, we have the decision making power over the activities that most significantly impact the economic performance of our VIEs and an obligation to absorb losses or receive benefits from the VIE that could potentially be significant to the VIE. These decisions and significant activities include, but are not limited to, marketing efforts, oversight of patient admissions, medical training, nurse and therapist scheduling, provision of healthcare services, billing, collections, and creation and maintenance of medical records. The terms of the agreements governing each of our VIEs prohibit us from using the assets of each VIE to satisfy the obligations of other entities.

The carrying amounts and classifications of the consolidated VIEs' assets and liabilities, which are included in our consolidated balance sheet, are as follows (in millions):

	March 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	$0.7	$ 0.3
Accounts receivable	31.0	31.0
Other current assets	5.9	4.9
Total current assets	37.6	36.2
Property and equipment, net	121.2	111.5
Operating lease right-of-use assets	7.2	—
Goodwill	15.9	15.9
Intangible assets, net	4.0	4.3
Other long-term assets	30.3	29.6
Total assets	$216.2	$ 197.5
Liabilities		
Current liabilities:		
Current portion of long-term debt	$0.7	$ 0.6
Current operating lease liabilities	1.4	—
Accounts payable	5.6	5.2
Accrued expenses and other current liabilities	37.7	45.0
Total current liabilities	45.4	50.8
Long-term debt, net of current portion	11.1	—
Long-term operating lease liabilities	5.7	—
Total liabilities	$62.2	$ 50.8

4. Leases

We lease real estate, vehicles, and equipment under operating and finance leases with non-canceable terms generally expiring at various dates through 2037. Our operating and finance leases generally have 1- to 25-year terms, with one or more renewal options, primarily relating to our real estate leases, with terms to be negotiated at the time of renewal. The exercise of such lease renewal options is at our sole discretion, and to the extent we are reasonably certain we will exercise a renewal option, the years related to that option are included in our determination of the lease term for purposes of classifying and measuring a given lease. Certain leases also include options to purchase the leased property.

9

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

The components of lease costs are as follows (in millions):

	Three Months Ended March 31, 2019
Operating lease cost	$ 17.5
Finance lease cost:	
Amortization of right-of-use assets	11.9
Interest on lease liabilities	8.1
Total finance lease cost	20.0
Short-term and variable lease cost	0.3
Sublease income	(0.8)
Total lease cost	$ 37.0

Supplemental condensed consolidated balance sheet information related to leases is as follows (in millions):

	Classification	As of March 31, 2019
Assets		
Operating lease	Operating lease right-of-use assets	$284.9
Finance lease [1]	Property and equipment, net	344.0
Total leased assets		$628.9
Liabilities		
Current liabilities:		
Operating lease	Current operating lease liabilities	$48.3
Finance lease	Current portion of long-term debt	18.2
Noncurrent liabilities:		
Operating lease	Long-term operating lease liabilities	245.0
Finance lease	Long-term debt, net of current portion	381.9
Total leased liabilities		$693.4

[1] Finance lease assets are recorded net of accumulated amortization of $95.6 million as of March 31, 2019.

	As of March 31, 2019
Weighted Average Remaining Lease Term	
Operating lease	8.6 years
Finance lease	13.5 years
Weighted Average Discount Rate	
Operating lease	6.3 %
Finance lease	8.2 %

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Maturities of lease liabilities as of March 31, 2019 are as follows (in millions):

	Operating Leases	Finance Leases
April 1 through December 31, 2019	$ 48.1	$ 37.8
2020	58.6	49.9
2021	51.0	48.0
2022	40.8	57.6
2023	35.4	43.7
2024	31.3	58.1
2025 and Thereafter	129.7	391.4
Total lease payments	394.9	686.5
Less: Interest portion	(101.6)	(286.4)
Total lease liabilities	$ 293.3	$ 400.1

Future minimum lease payments at December 31, 2018, for those leases having an initial or remaining noncancelable lease term in excess of one year, are as follows (in millions):

Year Ending December 31,	Operating Leases	Capital Lease Obligations
2019	$ 71.4	$ 36.2
2020	65.8	32.3
2021	54.3	30.3
2022	41.0	28.7
2023	35.3	28.0
2024 and Thereafter	148.2	299.7
	$ 416.0	455.2
Less: Interest portion		(191.4)
Obligations under capital leases		$ 263.8

Supplemental cash flow information related to our leases is as follows (in millions):

	Three Months Ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 17.2
Operating cash flows from finance leases	8.0
Financing cash flows from finance leases	2.8
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 5.5
Finance leases	3.1

5. Investments in and Advances to Nonconsolidated Affiliates

As of March 31, 2019 and December 31, 2018, we had $12.5 million and $12.2 million, respectively, of investments in and advances to nonconsolidated affiliates included in Other long-term assets in our condensed consolidated balance sheets.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Investments in and advances to nonconsolidated affiliates represent our investments in five partially owned subsidiaries, of which four are general or limited partnerships, limited liability companies, or joint ventures in which Encompass Health or one of its subsidiaries is a general or limited partner, managing member, member, or venturer, as applicable. We do not control these affiliates but have the ability to exercise significant influence over the operating and financial policies of certain of these affiliates. Our ownership percentages in these affiliates range from approximately 19% to 60%. We account for these investments using the cost and equity methods of accounting.
The following summarizes the combined results of operations of our equity method affiliates (on a 100% basis, in millions):

	Three Months Ended March 31,	
	2019	2018
Net operating revenues	$11.6	$11.0
Operating expenses	(6.8)	(7.6)
Income from continuing operations, net of tax	4.9	3.4
Net income	4.9	3.4

6. Redeemable Noncontrolling Interests

The following is a summary of the activity related to our Redeemable noncontrolling interests during the three months ended March 31, 2019 and 2018 (in millions):

	Three Months Ended March 31,	
	2019	2018
Balance at beginning of period	$261.7	$220.9
Net income attributable to noncontrolling interests	4.0	2.8
Distributions declared	(1.8)	(2.2)
Reclassification to noncontrolling interests	(11.2)	—
Purchase of redeemable noncontrolling interests	—	(65.1)
Change in fair value	20.3	42.2
Balance at end of period	$273.0	$198.6

The following table reconciles the net income attributable to nonredeemable Noncontrolling interests, as recorded in the shareholders' equity section of the condensed consolidated balance sheets, and the net income attributable to Redeemable noncontrolling interests, as recorded in the mezzanine section of the condensed consolidated balance sheets, to the Net income attributable to noncontrolling interests presented in the condensed consolidated statements of comprehensive income for the three months ended March 31, 2019 and 2018 (in millions):

	Three Months Ended March 31,	
	2019	2018
Net income attributable to nonredeemable noncontrolling interests	$18.9	$18.6
Net income attributable to redeemable noncontrolling interests	4.0	2.8
Net income attributable to noncontrolling interests	$22.9	$21.4

On December 31, 2014, we acquired 83.3% of our home health and hospice business when we purchased EHHI Holdings, Inc. ("EHHI"). In the acquisition, we acquired all of the issued and outstanding equity interests of EHHI, other than equity interests contributed to Encompass Health Home Health Holdings, Inc. ("Holdings"), a subsidiary of Encompass Health and an indirect parent of EHHI, by certain sellers in exchange for shares of common stock of Holdings. Those sellers were

12

members of EHHI management, and they contributed a portion of their shares of common stock of EHHI, valued at approximately $64 million on the acquisition date, in exchange for approximately 16.7% of the outstanding shares of common stock of Holdings. At any time after December 31, 2017, each management investor has the right (but not the obligation) to have his or her shares of Holdings stock repurchased by Encompass Health for a cash purchase price per share equal to the fair value. Specifically, up to one-third of each management investor's shares of Holdings stock may be sold prior to December 31, 2018; two-thirds of each management investor's shares of Holdings stock may be sold prior to December 31, 2019; and all of each management investor's shares of Holdings stock may be sold thereafter. At any time after December 31, 2019, Encompass Health will have the right (but not the obligation) to repurchase all or any portion of the shares of Holdings stock owned by one or more management investors for a cash purchase price per share equal to the fair value. In February 2018, each management investor exercised the right to sell one-third of his or her shares of Holdings stock to Encompass Health, representing approximately 5.6% of the outstanding shares of the common stock of Holdings. On February 21, 2018, Encompass Health settled the acquisition of those shares upon payment of approximately $65 million in cash. As of March 31, 2019, the value of the outstanding shares of Holdings owned by management investors was approximately $245 million. See also Note 7, Fair Value Measurements.

7. Fair Value Measurements

Our financial assets and liabilities that are measured at fair value on a recurring basis are as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
As of March 31, 2019	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique [(1)]
Other long-term assets:					
Restricted marketable securities	$ 63.6	$ 6.7	$ 56.9	$ —	M
Redeemable noncontrolling interests	273.0	—	—	273.0	I
As of December 31, 2018					
Other long-term assets:					
Restricted marketable securities	$ 62.0	$ 6.4	$ 55.6	$ —	M
Redeemable noncontrolling interests	261.7	—	—	261.7	I

(1) The three valuation techniques are: market approach (M), cost approach (C), and income approach (I).

The fair values of our financial assets and liabilities are determined as follows:

- Restricted marketable securities - The fair values of our restricted marketable securities are determined based on quoted market prices in active markets or quoted prices, dealer quotations, or alternative pricing sources supported by observable inputs in markets that are not considered to be active.
- Redeemable noncontrolling interests - The fair value of the Redeemable noncontrolling interests related to our home health segment is determined using the product of a twelve-month adjusted EBITDA measure and a specified median market price multiple based on a basket of public home health companies and transactions, after adding cash and deducting indebtedness that includes the outstanding principal balance under any intercompany notes. To determine the fair value of the Redeemable noncontrolling interests in our joint venture hospitals, we use the applicable hospitals' projected operating results and cash flows discounted using a rate that reflects market participant assumptions for the applicable facilities. The projected operating results use management's best estimates of economic and market conditions over the forecasted periods including assumptions for pricing and volume, operating expenses, and capital expenditures. See also Note 6, Redeemable Noncontrolling Interests.

13

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

In addition to assets and liabilities recorded at fair value on a recurring basis, we are also required to record assets and liabilities at fair value on a nonrecurring basis. Generally, assets are recorded at fair value on a nonrecurring basis as a result of impairment charges or similar adjustments made to the carrying value of the applicable assets. During the three months ended March 31, 2019 and March 31, 2018, we did not record any gains or losses related to our nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis as part of our continuing operations.

As discussed in Note 1, Summary of Significant Accounting Policies, "Fair Value Measurements," to the consolidated financial statements accompanying the 2018 Form 10 K, the carrying value equals fair value for our financial instruments that are not included in the table below and are classified as current in our condensed consolidated balance sheets. The carrying amounts and estimated fair values for all of our other financial instruments are presented in the following table (in millions):

	As of March 31, 2019		As of December 31, 2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Long-term debt:				
Advances under revolving credit facility	$25.0	$ 25.0	$30.0	$ 30.0
Term loan facilities	276.4	277.5	280.1	281.3
5.125% Senior Notes due 2023	296.8	305.3	296.6	298.5
5.75% Senior Notes due 2024	1,194.8	1,221.0	1,194.7	1,200.0
5.75% Senior Notes due 2025	345.2	357.9	345.0	339.5
Other notes payable	20.8	20.8	104.2	104.2
Financial commitments:				
Letters of credit	—	39.1	—	37.4

Fair values for our long-term debt and financial commitments are determined using inputs, including quoted prices in nonactive markets, that are observable either directly or indirectly, or Level 2 inputs within the fair value hierarchy. See Note 1, Summary of Significant Accounting Policies, "Fair Value Measurements," to the consolidated financial statements accompanying the 2018 Form 10 K.

8. Share-Based Payments

In February 2019, we issued a total of 0.4 million restricted stock awards to members of our management team and our board of directors. Approximately 0.1 million of these awards contain only a service condition, while the remainder contain both a service and a performance condition. For the awards that include a performance condition, the number of shares that will ultimately be granted to employees may vary based on the Company's performance during the applicable two-year performance measurement period. Additionally, in February 2019, we granted 0.1 million stock options to members of our management team. The fair value of these awards and options was determined using the policies described in Note 1, Summary of Significant Accounting Policies, and Note 13, Share-Based Payments, to the consolidated financial statements accompanying the 2018 Form 10 K.

In conjunction with the EHHI acquisition discussed in Note 6, Redeemable Noncontrolling Interests, we granted stock appreciation rights ("SARs") based on Holdings common stock to certain members of EHHI management at closing. Half of the SARs vested on December 31, 2018 with the remainder vesting on December 31, 2019. Upon exercise, each SAR must be settled for cash in the amount by which the per share fair value of Holdings' common stock on the exercise date exceeds the per share fair value on the grant date. In February 2019, members of the management team exercised a portion of their vested SARs for approximately $13 million in cash. As of March 31, 2019, the fair value of the SARs is approximately $86 million, all of which is included in Accrued expenses and other current liabilities in the condensed consolidated balance sheet. For additional information, see Note 13, Share-Based Payments, to the consolidated financial statements accompanying the 2018 Form 10 K.

14

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

9. Income Taxes

Our Provision for income tax expense of $30.8 million and $30.0 million for the three months ended March 31, 2019 and 2018, respectively, primarily resulted from the application of our estimated effective blended federal and state income tax rate and share-based windfall tax benefits.

We have state net operating losses (“NOLs”) of $64.5 million that expire in various amounts at varying times through 2031. The $40.5 million of net deferred tax assets included in the accompanying condensed consolidated balance sheet as of March 31, 2019 reflects management’s assessment it is more likely than not we will be able to generate sufficient future taxable income to utilize those deferred tax assets based on our current estimates and assumptions. As of March 31, 2019, we maintained a valuation allowance of $34.5 million due to uncertainties regarding our ability to utilize a portion of our state NOLs and other credits before they expire. The amount of the valuation allowance has been determined for each tax jurisdiction based on the weight of all available evidence including management’s estimates of taxable income for each jurisdiction in which we operate over the periods in which the related deferred tax assets will be recoverable. It is possible we may be required to increase or decrease our valuation allowance at some future time if our forecast of future earnings varies from actual results on a consolidated basis or in the applicable state tax jurisdictions, if the timing of future tax deductions differs from our expectations, or pursuant to changes in state tax laws and rates.

During the third quarter of 2016, we filed a non-automatic tax accounting method change related to billings denied under pre-payment claims reviews conducted by certain of our MACs. In March 2017, the IRS approved our request resulting in additional cash tax benefits of approximately $51.3 million through December 31, 2017. These benefits are expected to reverse as pre-payment claims denials are settled and collected. This change did not have a material impact on our effective tax rate. The 2017 Tax Cuts and Jobs Act (the “Tax Act”) included revisions to Internal Revenue Code §451 that may eliminate this deferral of revenue for tax purposes. We are currently evaluating this provision of the Tax Act and its future impact on the method change we received in March 2017.

Total remaining gross unrecognized tax benefits were $0.9 million as of March 31, 2019 and December 31, 2018, respectively, all of which would affect our effective tax rate if recognized.

Our continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. Interest recorded as part of our income tax provision during the three months ended March 31, 2019 and 2018 was not material. Accrued interest income related to income taxes as of March 31, 2019 and December 31, 2018 was not material.

In December 2016, we signed an agreement with the IRS to participate in their Compliance Assurance Process (“CAP”) for the 2017 tax year. CAP is a program in which we and the IRS endeavor to agree on the treatment of significant tax positions prior to the filing of our federal income tax returns. We renewed this agreement in January 2018 for the 2018 tax year and in December 2018 for the 2019 tax year. As a result of these agreements, the IRS is currently examining the 2017, 2018 and 2019 tax years. In May 2018, the IRS issued a no-change Revenue Agent’s Report effectively closing our 2016 tax year audit. The statute of limitations has expired or we have settled federal income tax examinations with the IRS for all tax years through 2016. Our state income tax returns are also periodically examined by various regulatory taxing authorities. We are currently under audit by one state for tax years ranging from 2013 through 2015.

For the tax years that remain open under the applicable statutes of limitation, amounts related to unrecognized tax benefits have been considered by management in its estimate of our potential net recovery of prior years’ income taxes. Based on discussions with taxing authorities, we anticipate that approximately $0.5 million of our unrecognized tax benefits will be released within the next 12 months.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

10.Earnings per Common Share

The following table sets forth the computation of basic and diluted earnings per common share (in millions, except per share amounts):

	Three Months Ended March 31,	
	2019	2018
Basic:		
Numerator:		
Income from continuing operations	$125.7	$105.7
Less: Net income attributable to noncontrolling interests included in continuing operations	(22.9)	(21.4)
Less: Income allocated to participating securities	(0.4)	(0.3)
Income from continuing operations attributable to Encompass Health common shareholders	102.4	84.0
Loss from discontinued operations, net of tax, attributable to Encompass Health common shareholders	(0.5)	(0.5)
Net income attributable to Encompass Health common shareholders	$101.9	$83.5
Denominator:		
Basic weighted average common shares outstanding	98.4	97.8
Basic earnings per share attributable to Encompass Health common shareholders:		
Continuing operations	$1.05	$0.86
Discontinued operations	(0.01)	(0.01)
Net income	$1.04	$0.85
Diluted:		
Numerator:		
Income from continuing operations	$125.7	$105.7
Less: Net income attributable to noncontrolling interests included in continuing operations	(22.9)	(21.4)
Income from continuing operations attributable to Encompass Health common shareholders	102.8	84.3
Loss from discontinued operations, net of tax, attributable to Encompass Health common shareholders	(0.5)	(0.5)
Net income attributable to Encompass Health common shareholders	$102.3	$83.8
Denominator:		
Diluted weighted average common shares outstanding	99.7	99.4
Diluted earnings per share attributable to Encompass Health common shareholders:		
Continuing operations	$1.04	$0.85
Discontinued operations	(0.01)	(0.01)
Net income	$1.03	$0.84

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

The following table sets forth the reconciliation between basic weighted average common shares outstanding and diluted weighted average common shares outstanding (in millions):

	Three Months Ended March 31,	
	2019	2018
Basic weighted average common shares outstanding	98.4	97.8
Restricted stock awards, dilutive stock options, and restricted stock units	1.3	1.6
Diluted weighted average common shares outstanding	99.7	99.4

In October 2018 and February 2019, our board of directors declared cash dividends of $0.27 per share that were paid in January and April 2019, respectively. As of March 31, 2019 and December 31, 2018, accrued common stock dividends of $27.8 million and $28.4 million, respectively, were included in Accrued expenses and other current liabilities in our condensed consolidated balance sheets. Future dividend payments are subject to declaration by our board of directors.

See Note 16, Earnings per Common Share, to the consolidated financial statements accompanying the 2018 Form 10 K for additional information related to our common stock.

11. Contingencies and Other Commitments

We operate in a highly regulated industry in which healthcare providers are routinely subject to litigation. As a result, various lawsuits, claims, and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. The resolution of any such lawsuits, claims, or legal and regulatory proceedings could materially and adversely affect our financial position, results of operations, and cash flows in a given period.

Nichols Litigation—

We were named as a defendant in a lawsuit filed March 28, 2003 by several individual stockholders in the Circuit Court of Jefferson County, Alabama, captioned Nichols v. HealthSouth Corp. The plaintiffs allege that we, some of our former officers, and our former investment bank engaged in a scheme to overstate and misrepresent our earnings and financial position. The plaintiffs are seeking compensatory and punitive damages. This case was stayed in the circuit court on August 8, 2005. The plaintiffs filed an amended complaint on November 9, 2010 to which we responded with a motion to dismiss filed on December 22, 2010. During a hearing on February 24, 2012, plaintiffs' counsel indicated his intent to dismiss certain claims against us. Instead, on March 9, 2012, the plaintiffs amended their complaint to include additional securities fraud claims against Encompass Health and add several former officers to the lawsuit. On September 12, 2012, the plaintiffs further amended their complaint to request certification as a class action. One of the former officers named as a defendant has repeatedly attempted to remove the case to federal district court, most recently on December 11, 2012. We filed our latest motion to remand the case back to state court on January 10, 2013. On September 27, 2013, the federal court remanded the case back to state court. On November 25, 2014, the plaintiffs filed another amended complaint to assert new allegations relating to the time period of 1997 to 2002. On December 10, 2014, we filed a motion to dismiss on the grounds the plaintiffs lack standing because their claims were derivative in nature, and the claims were time-barred by the statute of limitations. On May 26, 2016, the court granted our motion to dismiss. The plaintiffs appealed the dismissal of the case to the Supreme Court of Alabama on June 28, 2016. On March 23, 2018, the Alabama Supreme Court reversed the trial court's dismissal, holding that the plaintiffs' claims were not derivative or time-barred, and remanded the case for further proceedings. On April 6, 2018, we filed an application for rehearing with the Alabama Supreme Court. On March 22, 2019, the Alabama Supreme Court denied our application for rehearing and remanded the case to the trial court for further proceedings.

We intend to vigorously defend ourselves in this case. Based on the stage of litigation, review of the current facts and circumstances as we understand them, the nature of the underlying claim, the results of the proceedings to date, and the nature and scope of the defense we continue to mount, we do not believe an adverse judgment or settlement is probable in this matter, and it is also not possible to estimate an amount of loss, if any, or range of possible loss that might result from an adverse judgment or settlement of this case.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Other Litigation—

One of our hospital subsidiaries was named as a defendant in a lawsuit filed August 12, 2013 by an individual in the Circuit Court of Etowah County, Alabama, captioned Honts v. HealthSouth Rehabilitation Hospital of Gadsden, LLC. The plaintiff alleged that her mother, who died more than three months after being discharged from our hospital, received an unprescribed opiate medication at the hospital. We deny the patient received any such medication, accounted for all the opiates at the hospital and argued the plaintiff established no causal liability between the actions of our staff and her mother's death. The plaintiff sought recovery for punitive damages. On May 18, 2016, the jury in this case returned a verdict in favor of the plaintiff for $20.0 million. On June 17, 2016, we filed a renewed motion for judgment as a matter of law or, in the alternative, a motion for new trial or, in the further alternative, a motion seeking reduction of the damages awarded (collectively, the "post-judgment motions"). The trial court denied the post-judgment motions. We appealed the verdict as well as the rulings on the post-judgment motions to the Supreme Court of Alabama on October 12, 2016. On September 28, 2018, the Alabama Supreme Court reversed the trial court's judgment and remanded the case for a new trial. On October 12, 2018, the plaintiff filed an application for rehearing with the Alabama Supreme Court, and we filed a brief in opposition to the rehearing application on October 25, 2018. As a result of the Alabama Supreme Court's reversal, we reduced the associated liability below our insurance retention level of $6.0 million, and no longer maintained an insurance receivable in our condensed consolidated balance sheet because we believed the liability did not exceed that retention level. As of December 31, 2018, we maintained a liability included in Accrued expenses and other current liabilities in our consolidated balance sheet in connection with this matter. On February 27, 2019, we entered into a settlement with the plaintiff for an amount less than the remaining liability reserved and not material to us.

Governmental Inquiries and Investigations—

On March 4, 2013, we received document subpoenas from an office of the United States Department of Health and Human Services Office of Inspector General (the "HHS-OIG") addressed to four of our hospitals. Those subpoenas also requested complete copies of medical records for 100 patients treated at each of those hospitals between September 2008 and June 2012. The investigation is being conducted by the United States Department of Justice (the "DOJ"). On April 24, 2014, we received document subpoenas relating to an additional seven of our hospitals. The new subpoenas reference substantially similar investigation subject matter as the original subpoenas and request materials from the period January 2008 through December 2013. Two of the four hospitals addressed in the original set of subpoenas have received supplemental subpoenas to cover this new time period. The most recent subpoenas do not include requests for specific patient files. However, in February 2015, the DOJ requested the voluntary production of the medical records of an additional 70 patients, some of whom were treated in hospitals not subject to the subpoenas, and we provided these records. We have not received any subsequent requests for medical records from the DOJ.

All of the subpoenas are in connection with an investigation of alleged improper or fraudulent claims submitted to Medicare and Medicaid and request documents and materials relating to practices, procedures, protocols and policies, of certain pre- and post-admissions activities at these hospitals including, among other things, marketing functions, pre-admission screening, post-admission physician evaluations, patient assessment instruments, individualized patient plans of care, and compliance with the Medicare 60% rule. Under the Medicare rule commonly referred to as the "60% rule," an inpatient rehabilitation hospital must treat 60% or more of its patients from at least one of a specified list of medical conditions in order to be reimbursed at the inpatient rehabilitation hospital payment rates, rather than at the lower acute care hospital payment rates.

We have been cooperating fully with DOJ in connection with this investigation. Based on recent discussions with the government as well as the burdens and distractions associated with continuing the investigation and the likely costs of future litigation, we now estimate a settlement value of $48 million and have accrued a loss contingency in that amount which is included in Accrued expenses and other current liabilities in our condensed consolidated balance sheet. Discussions are ongoing, and until they are concluded, there can be no certainty about the nature, timing or likelihood of a settlement.

Other Matters—

The False Claims Act allows private citizens, called “relators,” to institute civil proceedings on behalf of the United States alleging violations of the False Claims Act. These lawsuits, also known as “whistleblower” or “qui tam” actions, can involve significant monetary damages, fines, attorneys' fees and the award of bounties to the relators who successfully prosecute or bring these suits to the government. Qui tam cases are sealed at the time of filing, which means knowledge of the information contained in the complaint typically is limited to the relator, the federal government, and the presiding court. The defendant in a qui tam action may remain unaware of the existence of a sealed complaint for years. While the complaint is under seal, the government reviews the merits of the case and may conduct a broad investigation and seek discovery from the defendant and other parties before deciding whether to intervene in the case and take the lead on litigating the claims. The court lifts the seal when the government makes its decision on whether to intervene. If the government decides not to intervene, the relator may elect to continue to pursue the lawsuit individually on behalf of the government. It is possible that qui tam lawsuits have been filed against us, which suits remain under seal, or that we are unaware of such filings or precluded by existing law or court order from discussing or disclosing the filing of such suits. We may be subject to liability under one or more undisclosed qui tam cases brought pursuant to the False Claims Act.

It is our obligation as a participant in Medicare and other federal healthcare programs to routinely conduct audits and reviews of the accuracy of our billing systems and other regulatory compliance matters. As a result of these reviews, we have made, and will continue to make, disclosures to the HHS-OIG and CMS relating to amounts we suspect represent over-payments from these programs, whether due to inaccurate billing or otherwise. Some of these disclosures have resulted in, or may result in, Encompass Health refunding amounts to Medicare or other federal healthcare programs.

12. Segment Reporting

Our internal financial reporting and management structure is focused on the major types of services provided by Encompass Health. We manage our operations using two operating segments which are also our reportable segments: (1) inpatient rehabilitation and (2) home health and hospice. These reportable operating segments are consistent with information used by our chief executive officer, who is our chief operating decision maker, to assess performance and allocate resources. The following is a brief description of our reportable segments:

- Inpatient Rehabilitation - Our national network of inpatient rehabilitation hospitals stretches across 32 states and Puerto Rico, with a concentration of hospitals in the eastern half of the United States and Texas. As of March 31, 2019, we operate 130 inpatient rehabilitation hospitals, including one hospital that operates as a joint venture which we account for using the equity method of accounting. We are the sole owner of 85 of these hospitals. We retain 50.0% to 97.5% ownership in the remaining 45 jointly owned hospitals. In addition, we manage five inpatient rehabilitation units through management contracts. We provide specialized rehabilitative treatment on both an inpatient and outpatient basis. Our inpatient rehabilitation hospitals provide a higher level of rehabilitative care to patients who are recovering from conditions such as stroke and other neurological disorders, cardiac and pulmonary conditions, brain and spinal cord injuries, complex orthopedic conditions, and amputations.
- Home Health and Hospice - As of March 31, 2019, we provide home health services in 221 locations and hospice services in 59 locations across 31 states with concentrations in the Southeast and Texas. In addition, two of these agencies operate as joint ventures which we account for using the equity method of accounting. We are the sole owner of 272 of these locations. We retain 50.0% to 81.0% ownership in the remaining eight jointly owned locations. Our home health services include a comprehensive range of Medicare-certified home nursing services to adult patients in need of care. These services include, among others, skilled nursing, physical, occupational, and speech therapy, medical social work, and home health aide services. Our hospice services include in-home services to terminally ill patients and their families to address patients' physical needs, including pain control and symptom management, and to provide emotional and spiritual support.

The accounting policies of our reportable segments are the same as those described in Note 1, Basis of Presentation, "Leases" to these condensed consolidated financial statements and Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements accompanying the 2018 Form 10 K. All revenues for our services are generated through external customers. See Note 1, Basis of Presentation, "Net Operating Revenues," for the disaggregation of our revenues. No corporate overhead is allocated to either of our reportable segments. Our chief operating decision maker evaluates the performance of our segments and allocates resources to them based on adjusted earnings before interest, taxes, depreciation, and amortization (“Segment Adjusted EBITDA”).

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Selected financial information for our reportable segments is as follows (in millions):

	Inpatient Rehabilitation Three Months Ended March 31,		Home Health and Hospice Three Months Ended March 31,	
	2019	2018	2019	2018
Net operating revenues	$870.1	$840.3	$253.9	$205.7
Operating expenses:				
Inpatient rehabilitation:				
Salaries and benefits	445.0	424.2	—	—
Other operating expenses	127.6	122.9	—	—
Supplies	35.6	35.9	—	—
Occupancy costs	15.8	15.5	—	—
Home health and hospice:				
Cost of services sold (excluding depreciation and amortization)	—	—	116.5	98.6
Support and overhead costs	—	—	88.8	72.0
	624.0	598.5	205.3	170.6
Other income	(2.8)	(0.5)	—	—
Equity in net income of nonconsolidated affiliates	(2.1)	(2.0)	(0.4)	(0.3)
Noncontrolling interests	21.0	20.5	2.7	1.9
Segment Adjusted EBITDA	$230.0	$223.8	$46.3	$33.5
Capital expenditures	$70.4	$62.2	$4.5	$1.7

	Inpatient Rehabilitation	Home Health and Hospice	Encompass Health Consolidated
As of March 31, 2019			
Total assets	$ 4,250.5	$1,366.8	$ 5,583.8
Investments in and advances to nonconsolidated affiliates	9.4	3.1	12.5
As of December 31, 2018			
Total assets	$ 3,900.9	$1,314.6	$ 5,175.0
Investments in and advances to nonconsolidated affiliates	9.5	2.7	12.2

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

Segment reconciliations (in millions):

	Three Months Ended March 31,	
	2019	2018
Total segment Adjusted EBITDA	$276.3	$257.3
General and administrative expenses	(53.4)	(61.1)
Depreciation and amortization	(52.5)	(45.9)
Loss on disposal of assets	(1.1)	(0.8)
Interest expense and amortization of debt discounts and fees	(37.2)	(35.6)
Net income attributable to noncontrolling interests	22.9	21.4
SARs mark-to-market impact on noncontrolling interests	0.8	1.0
Change in fair market value of equity securities	0.9	(0.6)
Payroll taxes on SARs exercise	(0.2)	—
Income from continuing operations before income tax expense	$156.5	$135.7

	March 31, 2019	December 31, 2018
Total assets for reportable segments	$5,617.3	$ 5,215.5
Reclassification of deferred income tax liabilities to net deferred income tax assets	(33.5)	(40.5)
Total consolidated assets	$5,583.8	$ 5,175.0

Additional detail regarding the revenues of our operating segments by service line follows (in millions):

	Three Months Ended March 31,	
	2019	2018
Inpatient rehabilitation:		
Inpatient	$847.6	$817.1
Outpatient and other	22.5	23.2
Total inpatient rehabilitation	870.1	840.3
Home health and hospice:		
Home health	219.5	185.3
Hospice	34.4	20.4
Total home health and hospice	253.9	205.7
Total net operating revenues	$1,124.0	$1,046.0

13. Condensed Consolidating Financial Information

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X, Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered." Each of the subsidiary guarantors is 100% owned by Encompass Health, and all guarantees are full and unconditional and joint and several, subject to certain customary conditions for release. Encompass Health's investments in its consolidated subsidiaries, as well as guarantor subsidiaries' investments in nonguarantor subsidiaries and nonguarantor subsidiaries' investments in guarantor subsidiaries, are presented under the equity method of accounting with the related investment presented within the line items Intercompany receivable and investments in consolidated affiliates and Intercompany payable in the accompanying condensed consolidating balance sheets.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements

The terms of our credit agreement allow us to declare and pay cash dividends on our common stock so long as: (1) we are not in default under our credit agreement and (2) our senior secured leverage ratio (as defined in our credit agreement) remains less than or equal to 2x. The terms of our senior note indenture allow us to declare and pay cash dividends on our common stock so long as (1) we are not in default, (2) the consolidated coverage ratio (as defined in the indenture) exceeds 2x or we are otherwise allowed under the indenture to incur debt, and (3) we have capacity under the indenture's restricted payments covenant to declare and pay dividends. See Note 9, Long-term Debt, to the consolidated financial statements accompanying the 2018 Form 10 K.
Periodically, certain wholly owned subsidiaries of Encompass Health make dividends or distributions of available cash and/or intercompany receivable balances to their parents. In addition, Encompass Health makes contributions to certain wholly owned subsidiaries. When made, these dividends, distributions, and contributions impact the Intercompany receivable and investments in consolidated affiliates, Intercompany payable, and Encompass Health shareholders' equity line items in the accompanying condensed consolidating balance sheet but have no impact on the consolidated financial statements of Encompass Health Corporation.

Encompass Health Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
Condensed Consolidating Statement of Comprehensive Income

	Three Months Ended March 31, 2019						
	Encompass Health Corporation	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminating Entries		Encompass Health Consolidated
	(In Millions)					
Net operating revenues	$5.1	$ 606.5	$ 546.0	$ (33.6	)	$ 1,124.0
Operating expenses:						
Salaries and benefits	15.9	288.9	321.1	(5.1	)	620.8
Other operating expenses	10.3	84.7	67.6	(12.5	)	150.1
Occupancy costs	0.5	24.9	10.2	(16.0	)	19.6
Supplies	—	24.0				