CHEMED CORPORATION

Company Overview

Chemed (CHE) is a conglomerate that operates in two distinct businesses:

1. *VITAS Healthcare (55% of Revenues)*: Largest provider of Hospice Services for patients with severe, life-limiting illnesses with approximately 7% of the U.S. market share. Operates a comprehensive range of hospice services through 45 operating programs in 15 states and the District of Columbia.
2. *Roto-Rooter (45% of Revenues)*: The largest provider of plumbing and drain cleaning services in North America with services to ~90% of the U.S. and 40% of the Canadian population. This is a fragmented market where Roto-Rooter maintains an estimated 15% of drain cleaning market share and only 2%-3% of same-day service plumbing market.

Name	Ticker	Yield	Growth	D + G
Chemed Corporation	CHE	0.28%	9.50%	9.78%

Company Highlights:

We remain buyers of CHE shares following a solid earnings report and an improved outlook for Roto-Rooter. We believe concerns over potential Medicare cap limitations are overblown with the company proactively managing with shorter-stay hospital admissions in select markets.

We are pleased to see continued organic census growth at VITAS, which we believe reflects solid execution on favorable demographic and reimbursement dynamics, as well as strong pull-through of the company's post-COVID community access strategy. We believe the weakness could reflect some concern over Medicare cap limitations in certain markets, particularly in Florida. We believe management's efforts to target hospital discharges in select markets represents a prudent cap management strategy, consistent with strategies employed in the past. As management confirmed to us, the selective shift in focus to shorter length of stay patients is a strategic measure to address stronger-than-expected rate growth in certain markets. As such, we view the need to more actively manage cap limitations as a "high class problem" for hospice providers. Following an accelerated period of strong census growth on traction with community access efforts, the selected focus on hospital admissions is consistent in our view with the company's long-term growth trajectory.

As for Roto-Rooter, we are pleased to see early traction with new pricing strategies. We believe management's withholding of guidance revision at this point in the year is prudent, especially as the company continues to refine commercial rates in its markets.

Bull Case:

- ***Two Boring Cash Cows Make a Great Company –*** VITAS derives more than 50% of Chemed's total sales, with Roto-Rooter being the remaining. In our opinion, management's bets have proved to work really well. Both subsidiaries, in our view, although appearing "boring", have strong business economics with pricing inelasticity. We believe their leading market positions, scale advantages, strong cash flow, capital-light operations, and superior ROIC make CHE an appealing candidate for stock investment.
- ***Long Runway of Growth for VITAS –*** Vitas' volumes are growing 4x faster than the average hospital peer. We see several industry tailwinds: 1) Aging demographics; 2) Increased awareness and acceptance of hospice benefit; 3) Increased use by non-cancer patients; 4) Hospice is a low cost alternative for end of life care; 5) Medicare Advantage could carve in hospice. These tailwinds should drive better volumes growth compared to most of the other subsectors in Health Care where we see particular pressures for institutional settings.
- ***Inelasticity of the Two Businesses –*** Since 2004, there has only been one year where CHE experienced a year-over-year sales decrease (i.e., -1.2% in 2013), thanks to the recession-proof-ness of its two businesses. Just think about the two businesses, emergency plumbing services and end-of-life care.

Bear Case:

- ***Subject to Government Reimbursement Structure –*** Given VITAS' reliance on Medicare (92% of VITAS revenues), if there is a change to reimbursement or rates are significantly lagging cost inflation, there are limited options to directly offset the pressure. However, we view Roto-Rooter as a potential offsetting factor as that business would not be affected by reimbursement changes.
- ***Government Scrutiny –*** There has been scrutiny over long stay hospice patients and live discharges (patients who move to hospice but then drop off because the patient improves and the doctor now believes the patient will live longer than six months). In addition, there has been a growing concern that the industry has grown too fast, particularly in terms of the rapid growth in the number of for-profit providers.
- ***Hospice Relies on Medicare –*** Medicare accounts for 90% of hospice revenues, making the industry the most reliant on this payor. Though, historically, the hospice industry has not been brought up in discussions around budgetary cost cuts given its relatively small spending ($17bn) and relatively low Medicare margins**.**

Overall Thesis:

We believe that CHE is a very strong operator with tailwinds on both sides of its business. On the Roto-Rooter segment, given its above peer margins, its asset-light model, the reduced exposure to economic cycles (due to its growing exposure to water restoration), and limited online competition, we believe that this line of business deserves an above-average premium relative to peers. Meanwhile, given the size of the VITAS platform (scarcity value), the positive outlook for the hospice industry, and the positive near- and medium-term outlook for Medicare reimbursement rates, we believe that VITAS also deserve an above-average premium relative to peers. CHE has demonstrated to be a very strong operator, with minimal leverage at the corporate level, a growing dividend, and accretive share repurchases. With this, we believe that the company is very undervalued relative to peers and should be an all-weather holding in a portfolio given its downside protection along with its outperformance in normalized market scenarios.

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