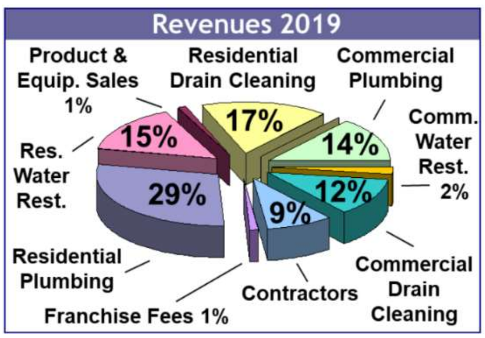
Chemed Corporation (CHE)	**Price: $455.00 Yield: 0.28% Mkt Cap: $7,222.0M**
Sector: Health Care	Industry: Health Care Services
Analyst: David Wagner, CFA	Earnings Report: 7/23/2020

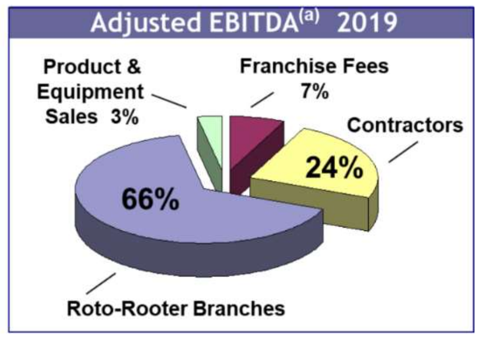
Business Overview

Chemed (CHE) operates in two distinct business - one of the largest hospice operators (Vitas) and the largest provider of plumbing and drain cleaning services in the U.S. (Roto-Rooter). VITAS derives roughly two-thirds of Chemed's total sales, and Roto-Rooter the remaining one-third. We believe the management's bets have proved to be brilliant. Both subsidiaries, although appearing "boring," have good business economics in our view. In particular, we see them as having leading market positions, scale advantages, strong cash flow, capital-light operations, and superior ROIC should yield the stock an above-average multiple.

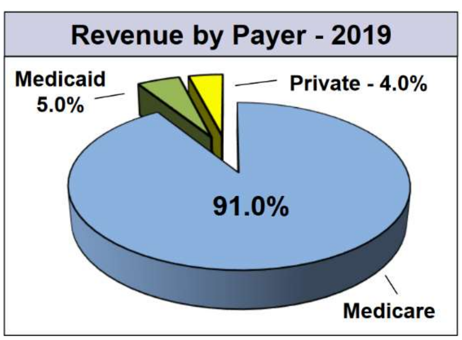
	Pct. of Revenue	Pct. Of Net Income
Roto-Rooter	33.9%	39.6%
VITAS	66.1%	60.4%

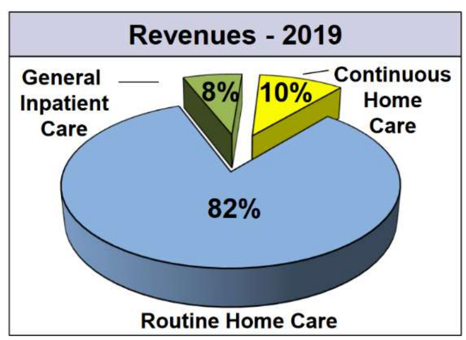
1. *Roto-Rooter (34% of Revenues):* The largest provider of plumbing and drain cleaning services in North America with services to ~90% of the U.S. and 40% of the Canadian population. This is a fragmented market where Roto-Rooter maintains an estimated 15% of drain cleaning market share and only 2%-3% of same-day service plumbing market. The breakout for Residential versus Commercial is 61%/28% (product sales is the difference).





2. *VITAS Healthcare (66% 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.





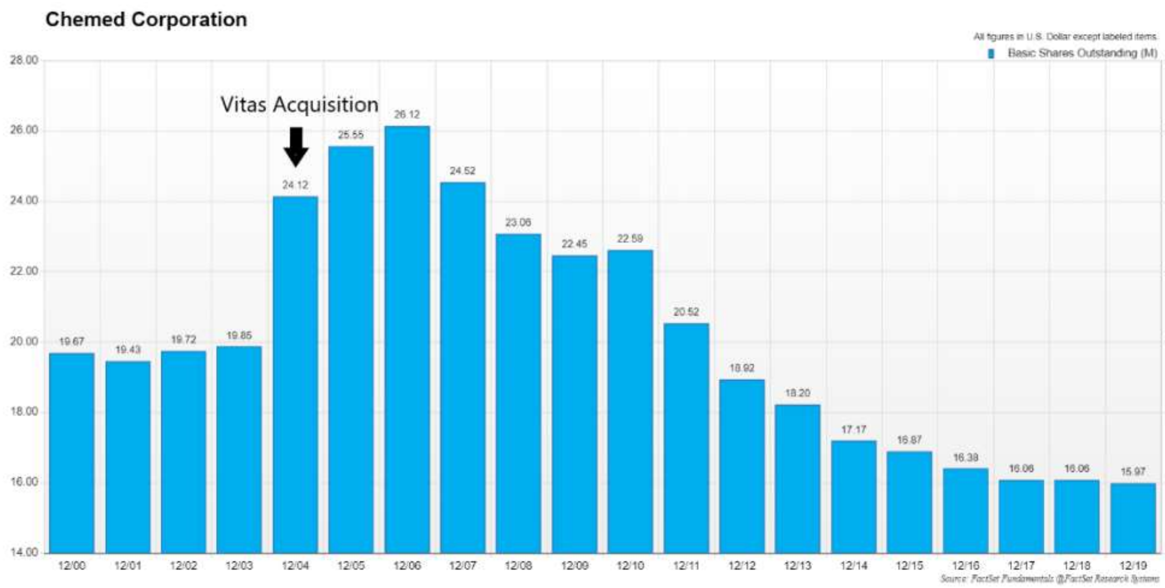
Analysis: We believe that CHE is a *very* strong operator with tailwinds on both sides of its business. On the Roto-Rooter segment, given its above peer margins, its asset-light model, the reduced exposure to economic cycles (due to its growing exposure to water restoration), and limited online competition, 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), analyst's 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.

From our view, CHE has been 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.

Capital Allocation

Given its solid cash flow generation, Chemed has spent excess cash flow on share repurchases and dividends over the last several years. CHE has been steadily buying back its stock, spending about $100m annually on buybacks since 2010. Since then, it has reduced its share count by 27%, from 23 million to about 15 million as of June 2020. Going forward, we assume CHE will spend about $100m per year on buybacks, essentially buying back 2% of its shares annually. Overall, we estimate the company can generate FCF of about $280m annually, which we expect to be used as follows: $20m of dividends and $100m of share buyback, with the rest used for debt paydown or building on the balance sheet.

1. Repurchasing Stock: Since 2006, CHE has decreased their share count by almost 40%! Since the program was restarted in 2007, CHE has repurchased 13.7M shares, aggregating over $1.0B at an average cost of ~$79.00.



Source: Factset

2. M&A: For the most part, CHE's acquisition activity is limited to buying up Roto-Rooter franchises and occasionally a hospice practice. Acquisition activity in the hospice industry is limited by regulations that prevent the transfer of referral networks. With a high rate of patient turnover, this makes acquisitions risky. With this, CHE hospice acquisitions have been very modest. The Company has made only three minor acquisitions of smaller hospice operators in 12 years. In the past, Chemed expressed skepticism of acquiring hospice assets given very high valuations. If it was to spend $30m on hospice assets at its targeted multiples in the 5- 6x range, we estimate it could be 2% accretive to annual EPS. However, hospice deal multiples are currently in the 10-15x range given the interest from private equity and strategic buyers.

   Within Roto-Rooter is where inorganic growth will flourish. Historically, CHE has been able to re-purchase Roto-Rooter franchisees. Historically, CHE has paid around 5x – 6x EBITDA, but have recently seen prices increase to 6x – 8x EBITDA → which is still very accretive due to their 16x current multiple valuation. There is ample opportunity to keep the momentum of acquisitions here as CHE, the parent company is the ideal purchaser for mom and pop plumbing shops, along with retiring Roto-Rooter franchise operators. For example, A Japanese private equity team purchased Roto-Rooter locations in California. Within three year, The PE shop sold the locations back to the company, as they could not figure out the model to efficiently run the locations.

3. Dividend Increases: They continue to grow the dividend by double digits, which is great, but the DPR is so low that they can afford to pay a higher dividend – wish that they would. But we think you still can't argue with consistent double-digit dividend growth.

D + G

0.28% + <u>10.58%</u> = **<u>10.86%</u>**

Sales Growth Rate + Roto-Rooter Inorganic Growth + Margin Expansion + Share Repurchases = Growth Rates

6.33% + 1.50% + 0.75% + 2.00% = 10.58%

Weighted Average Sales Growth Rate:

	Growth Rate	Sales Exposure
VITAS	7%	66.10%
Roto-Rooter	6%	33.90%
		6.33%

		(1) One Year	(2) CAGR Three Year	(3) Sixteen Year
	Chemed			
(1)	**Service revenues and sales**	**8.7%**	**7.1%**	**13.4%**
(2)	**Adj. net income**	**15.0%**	**23.8%**	**23.5%**
(3)	**Adj. diluted EPS from continuing operations**	**16.9%**	**24.4%**	**24.9%**
	Roto-Rooter			
(4)	**Service revenues and sales**	**12.4%**	**13.2%**	**5.9%**
(5)	**Adj. net income**	**11.1%**	**27.7%**	**14.2%**
	VITAS			
(6)	**Service revenues and sales**	**7.0%**	**4.5%**	**6.9%**
(7)	**Adj. net income**	**17.8%**	**22.0%**	**14.1%**

Source: CHEMED Corp. Company Presentation

Growth	
5YR Sales CAGR	5.9%
10YR Sales CAGR	5.0%
5YR EBIT CAGR	9.7%
5YR EPS CAGR	18.1%
10YR EPS CAGR	14.0%
5YR Div. CAGR	8.1%
10YR Div. CAGR	13.2%
EPS Growth (Next 5)	9.8%

Source: Factset

Income Statement (M)

	Dec '18	Dec '19	Mar '20 Q1	Jun '20E Q2	Sep '20E Q3	Dec '20E Q4	Dec '20E	Mar '21E Q1	Jun '21E Q2	Sep '21E Q3	Dec '21E Q4	Dec '21E	Dec '22E
Sales	1,783	1,939	516	523	521	549	2,110	548	560	570	585	2,267	-
Cost of Sales	1,229	1,321	352	347	351	362	1,412	374	377	385	390	1,514	-
Gross Income	554	-	-	-	-	-	-	-	-	-	-	-	-
EBITDA	305	351	93	95	103	114	408	98	105	106	117	437	-
Operating Income	255	301	91	78	89	99	353	82	94	94	105	364	-
Pretax Income	240	264	75	77	84	96	334	86	95	96	107	370	-
Tax Expense	34	63	20	19	21	24	84	22	24	24	27	95	-
Net Income	206	220	56	59	65	73	251	62	71	72	80	278	-

Source: Factset

Valuation

Ticker	Median	Average	Chemed Corporation CHE	Amedisys, Inc. AMED	LHC Group, Inc. LHCG
P/E (LTM)	39.8	38.7	30.9	45.4	39.8
P/E (NTM)	36.0	35.0	27.8	41.1	36.0
EV/EBITDA (LTM)	26.8	26.2	21.2	30.6	26.8
EV/EBITDA (NTM)	23.9	22.2	17.8	24.9	23.9
P/Book	9.4	7.9	10.5	9.4	3.7
Dividend Yield	0.0%	0.1%	0.3%	0.0%	0.0%
FCF Yield	3.4%	2.7%	3.5%	3.4%	1.3%
ROE	21.2%	21.6%	36.35%	21.23%	7.16%
ROIC	12.8%	15.3%	27.39%	12.77%	5.77%
Short Interest	3.1%	2.8%	1.7%	3.7%	3.1%
LT EPS Growth	12.6%	12.2%	9.8%	14.2%	12.6%
Market Cap	$ 6,398.12	$ 6,312.89	$ 7,217.22	$ 6,398.12	$ 5,323.32
Debt-to-Capital	18.5%	22.2%	18.5%	29.8%	18.3%
BV Growth	13.1%	17.3%	12.1%	13.1%	26.6%

Source: Factset

SOTP		
	% of Revenue	Peer EBITDA Multiple
VITAS	66.0%	24.5
Roto-Rooter	34.0%	15.0
	SOTP Multiple	21.3
	Current Multiple	17.8
	Upside / (Downside)	19.49%

There are no direct comps for either the hospice business or the Roto-Rooter business. We would look at home health companies, such as AMED and LHCG, as the closest comps for VITAS. These companies operate hospice along their much bigger home health operations, and their exposure to hospice is much smaller than VITAS. Currently, this group is trading at an average multiple of 22.2x 2021E EBITDA. AMED, which has the biggest exposure to hospice (25% of revs vs 11% for LHCG), is trading at 25x.

There has been interest in hospice by both private equity (PE) and strategic players. In early 2019, all publicly traded home health companies indicated they are interested in growing their hospice businesses given the favorable outlook for that industry. The companies talked about multiples in the 10-14x range for large hospice assets. In March 2018, Encompass (EHC) announced plans to acquire Camelia Healthcare for $135m, which we believe implies a multiple towards the higher end of that range. Meanwhile, the other strategic players stepped away from pursuing hospice deals given the high multiples. At the same time, Humana in partnership with PE firms, formed the biggest hospice operator by merging Kindred at Home's hospice with Curo, a privately held hospice operator. We estimate the multiple in the Curo deal was about 13x EBITDA.

In our view, Vitas deserves a premium multiple vs home health players. Not only that, but Roto-Rooter deserves a premium vs peers given its high margins (21- 24%), reduced exposure to economic cycles (grew water restoration), and limited exposure to trade tensions and on-line competition. Roto-Rooter creates a buffer in case there is a Medicare rate pressure for hospice. During a recession, hospice provides offsets to Roto-Rooter vulnerability, as we saw commercial weakness during COVID (30% of Roto-Rooter Revenue, equating to a small hit to CHE's overall revenue).

Meanwhile, given the size of the Vitas platform (scarcity value), the positive outlook for the hospice industry, the minimal leverage at the corporate level, the growing dividend, and the solid track record, we argue for a multiple for Vitas above the peer average and above the recent hospice transactions. Hospice has a similar outlook to home health (volume tailwinds, stable reimbursement, high ROIC), but CHE has a lower leverage and pays a dividend (which is growing), justifying a premium to the home health average multiple. Nonetheless, we believe that CHE yields a conglomerate multiple, a business structure that was rewarded in the 1960's, but is now looked as a method to cap shareholder value. We do not believe that this is true, and CHE should be trading closer to the 27x-28x EBITDA multiple, allowing for the potential of substantial upside.

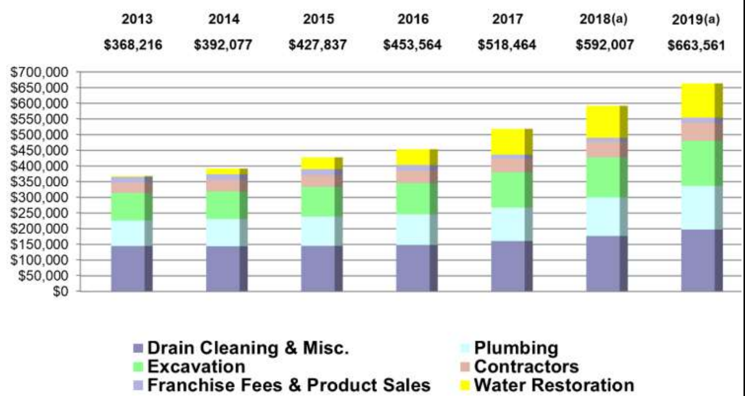
Yield & Growth

Income Stmt	12/2010	12/2011	12/2012	12/2013	12/2014	12/2015	12/2016	12/2017	12/2018	12/2019	LTM	FY20 (e)	FY21 (e)
Revenue	1,280.5	1,356.0	1,430.0	1,413.3	1,456.3	1,543.4	1,576.9	1,666.7	1,782.6	1,938.6	1,992.3	2,109.6	2,267.1
EBITDA	175.8	186.8	191.2	201.0	207.2	223.3	220.8	252.0	284.6	316.6	343.8	408.3	437.5
EBIT	146.7	157.3	160.7	168.6	174.1	189.8	186.1	216.4	245.7	271.3	295.0	353.0	364.5
EPS (GAAP)	3.55	4.10	4.62	4.16	5.57	6.33	6.48	5.86	12.23	13.31	13.99	15.97	16.48
EPS (non GAAP)	4.17	4.78	5.29	5.62	6.07	6.98	7.24	8.43	11.93	13.95	#N/A	16.13	17.53
Gross Margin	27.0%	26.3%	25.6%	26.3%	26.7%	27.4%	27.1%	28.8%	28.9%	29.5%	29.7%	#N/A	#N/A
EBITDA Margin	13.7%	13.8%	13.4%	14.2%	14.2%	14.5%	14.0%	15.1%	16.0%	16.3%	17.3%	19.4%	19.3%
EBIT Margin	11.5%	11.6%	11.2%	11.9%	12.0%	12.3%	11.8%	13.0%	13.8%	14.0%	14.8%	16.7%	16.1%
Net Margin	6.4%	6.3%	6.2%	5.5%	6.8%	7.1%	6.9%	5.9%	11.5%	11.3%	11.6%	11.9%	12.3%
Balance Sheet											MRQ	CAGR 10	CAGR 5
Cash & Equiv.	49.9	38.1	69.5	84.4	14.1	14.7	15.3	11.1	4.8	6.2	29.0	-25.2%	-15.3%
Total Assets	830.2	795.9	859.6	893.7	859.9	852.3	880.1	920.0	1,016.3	1,346.5	1,277.6	5.1%	9.4%
Intangibles	514.8	518.9	523.0	523.4	522.7	527.4	527.4	531.8	578.8	703.7	701.5	3.3%	6.1%
Total Liabilities	368.1	382.2	406.3	444.8	408.6	339.1	356.0	379.7	425.0	619.8	594.0	6.1%	8.7%
Total Debt	170.3	177.1	174.9	183.6	147.5	91.3	108.8	101.2	89.2	225.7	284.5	3.3%	8.9%
Total Equity	462.0	413.7	453.3	448.9	451.4	513.3	524.1	540.4	591.3	726.6	683.6	4.3%	10.0%
BVPS	21.71	21.71	24.46	25.53	26.72	30.55	32.38	33.69	37.25	45.57	43.28	8.0%	11.3%
Tang. BVPS	(2.48)	(5.52)	(3.76)	(4.24)	(4.23)	(0.84)	(0.21)	0.54	0.79	1.43	(1.13)	#N/A	#N/A
Shares O/S	23.03	20.95	19.34	18.59	17.84	17.42	16.79	16.74	16.80	16.53	16.52	-3.1%	-1.5%
Net Cash/Share	(5.23)	(6.64)	(5.45)	(5.33)	(7.48)	(4.39)	(5.57)	(5.38)	(5.02)	(13.29)	(15.47)	(6.38)	(5.41)

Source: Factset

The company continues to grow EPS off strong revenue growth, margin improvement, and tax reform. Over the last year, Vitas increased revenue by 7.0% and Roto-Rooter grew at a 12.3% clip. The strongest unit in Roto-Rooter, Water Restoration has propelled growth in this segment significantly continues to post double digit YoY growth rates.

Although the company increased its top line by a mid-single-digit CAGR for the past decade, it managed to deliver a mid-teens annual growth rate in EPS mainly due to margin expansion and some share repurchases.



Source: CHEMED Corp. Company Presentation

Roto-Rooter: Roto-Rooter EBITDA margins are in the 21-24% range, much higher than Vitas' margins in the 14-15% range as the business is all private-pay, unlike VITAS which almost entirely is reimbursed by the government. In addition, Roto-Rooter performance is driven by demand-supply forces with the shortage of skilled labor force driving pricing power for the services. Roto-Rooter top line is driven by price increases in the 2.5-5.0% range with job growth (volume) ranging from -1.5% to +1.5%. Of note, the margin growth over the last five years has been driven by business mix as the company increased water restoration penetration. CHE has been growing referrals from its existing customers which allowed it to leverage the existing fixed cost structure. As a result, Roto revenues grew at a 9% CAGR, with EBITDA growing at a 13% CAGR over the last few years. In addition to total volume, the adjusted net margin almost doubled from less than 8% in 2004 to nearly 17% last year.

VITAS: The adjusted net margin at VITAS improved from 6.2% in 2004 to 11.7% in 2018 and has stayed above 8% every year for the past decade, compared with the average operating margin of 4%-8% in industry. Also, it is estimated that 50% of hospices are suffering from negative margins. In this regard, size and scale matter again, as a large hospice group can afford to lose money on some units/patients. This segment continues to clip a healthy and steady growth rate, but has been most effected by stronger-than-expected Medicare reimbursement rates in 2019.

Both the VITAS and Roto-Rooter segments are well positioned to perform during the COVID-19 pandemic and during a broader recession. On the VITAS side, CHE saw admissions from hospital referrals (50% of total admits) increase +7.9% in 1Q20 as hospitals freed up bed capacity in anticipation of COVID-19. While hospital referrals could drop in the short term as hospitals treat less terminal patients and more COVID-19 patients, the increase in vols highlights VITAS' exposure to high acuity cases and the necessity of their hospice business. Meanwhile, on the Roto-Rooter side, they continue to operate at full capacity, with commercial operations lower as restaurants/businesses remain closed but residential opportunities up as people spend more time at home. We are lowering revs and raising EBITDA for the beat on margins, and reiterate our Buy rating on the defensiveness of VITAS in the backdrop of COVID-19/ a recession.

Source: Raymond James

Quality

Quality												Avg	Median
ROE	17.4%	19.6%	20.6%	17.1%	22.1%	22.9%	21.0%	18.4%	36.3%	33.4%	35.1%	22.9%	20.8%
ROIC	13.1%	14.3%	14.8%	14.3%	19.1%	18.5%	17.8%	15.6%	31.3%	27.8%	27.4%	18.7%	16.7%
Debt / Capital	26.9%	30.0%	27.8%	29.0%	24.6%	15.1%	17.2%	15.8%	13.1%	23.7%	29.4%	22.3%	23.7%
EBITDA / Interest	14.7	13.5	13.0	33.7	43.2	61.3	59.4	59.0	57.0	69.8	78.4	42.5	50.1

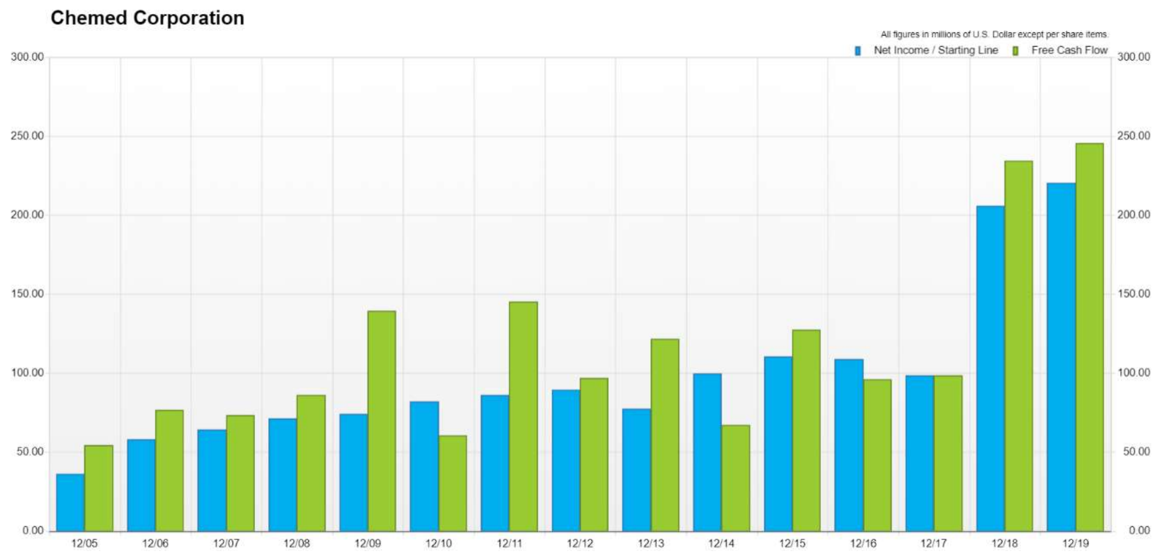
Cash Flow Stmt											LTM	CAGR 10	CAGR 5
Gross CFO	134.3	147.7	140.5	131.3	164.1	179.6	167.3	175.6	269.3	292.3	308.9	7.9%	12.2%
Chg in W/C	(48.2)	26.7	(8.7)	19.5	(53.9)	(8.1)	(31.9)	(13.1)	17.9	5.9	5.1	-13.3%	#N/A
Net CFO	86.0	174.3	131.8	150.8	110.3	171.5	135.4	162.5	287.1	298.1	314.0	6.4%	22.0%
Cap Ex.	25.6	29.6	35.3	29.3	43.6	44.1	39.8	64.3	52.9	53.0	59.1	9.4%	4.0%
Free Cash Flow	60.4	144.8	96.5	121.5	66.7	127.4	95.6	98.2	234.3	245.1	255.0	5.8%	29.7%

Source: Factset

We view CHE as a high quality name with very low leverage, solid FCF, and a strong track record of returning capital to shareholders via the growing dividend and share repo, with EPS growing in the double digits (beat EPS for the past six quarters). We see value in the combination of health care services and industrial services: 1) both businesses generate solid cash flows with very limited capex requirements (particularly for Vitas). 2) Roto-Rooter creates a buffer to cash flows in case hospice Medicare reimbursement is under pressure. 3) During a recession, hospice provides an offset as it is less sensitive to the economy than Roto-Rooter

The company has always had a bit of debt on a revolving credit (LIBOR + 100). They currently have net debt of 0.37x, which their covenants allow them up to 3.5x debt-to-EBITDA. Management has cited its concentration of risk surrounding government reimbursement rate as a main reason for being "under-levered".

The company has strong FCF to service debt – look at the consistency of FCF conversion from net income.



Source: Factset

Uses of Free Cash Flow - Since leverage is already very low (0.4x debt/EBITDA), we expect CHE to use the excess cash flow for accretive purposes such as acquisitions/consolidation of Roto-Rooter franchisees and higher dividends.

Since 2004, there has only been one year where the company experience a YoY sales decrease (i.e., -1.2% in 2013), thanks to the recession-proof-ness of its two businesses.

Just look at the resiliency of Roto-Rooter – technicians are paid almost entirely on commission, so if revenue doesn't happen, labor pressure doesn't happen. Downturns typically manifest themselves in the commercial business, as restaurant volumes slow, which is magnified during the current pandemic with almost all retail businesses being shut down. Management has stated that they have maintained their technician and customer bases and can therefor quickly reaccelerate business as restaurant occupancy increases. The company also states that they believe that they will increase their market share as some mom and pop shops may not survive the slowdown in business.

Downside Protection

Quarter	R2KV	CHE
4Q08	-24.9%	-3.0%
1Q09	-19.6%	-2.0%
2Q10	-10.6%	0.7%
3Q11	-21.5%	-15.9%
3Q15	-10.7%	2.0%
4Q18	-18.7%	-11.3%
1Q20	-30.6%	-1.3%

Source: Factset

Momentum

EPS Surprises and Estimates

EPS History				EPS Trends				
Quarters	EPS Act.	EPS Est.	Surp. %			Cur. Est.	90 Days	90 % Chg
03/2020	3.68	3.65	0.7%	Qtr	06/2020	3.75	4.06	-7.5%
12/2019	4.22	4.09	3.2%	Qtr	09/2020	4.09	4.07	0.5%
09/2019	3.46	3.31	4.5%	Qtr	12/2020	4.61	4.52	1.9%
06/2019	3.36	3.12	7.9%	Qtr	03/2021	3.93	3.93	-0.1%
03/2019	2.92	2.96	-1.4%	Year	12/2020	16.13	16.34	-1.3%
12/2018	3.35	3.26	2.8%	Year	12/2021	17.53	17.71	-1.0%

Source: Factset

The company continues to outperform Wall Street's expectations, and this is apparent going back for years, as the company continually increases its annual expectations throughout the year. Nonetheless, the company continues to expect strong YoY EPS growth going into 2021. Look at the 10-YR annual EPS growth for CHE:

Income Stmt	12/2010	12/2011	12/2012	12/2013	12/2014	12/2015	12/2016	12/2017	12/2018	12/2019	LTM	FY20 (e)	FY21 (e)
Revenue	1,280.5	1,356.0	1,430.0	1,413.3	1,456.3	1,543.4	1,576.9	1,666.7	1,782.6	1,938.6	1,992.3	2,109.6	2,267.1
EBITDA	175.8	186.8	191.2	201.0	207.2	223.3	220.8	252.0	284.6	316.6	343.8	408.3	437.5
EBIT	146.7	157.3	160.7	168.6	174.1	189.8	186.1	216.4	245.7	271.3	295.0	353.0	364.5
EPS (GAAP)	3.55	4.10	4.62	4.16	5.57	6.33	6.48	5.86	12.23	13.31	13.99	15.97	16.48
EPS (non GAAP)	4.17	4.78	5.29	5.62	6.07	6.98	7.24	8.43	11.93	13.95	#N/A	16.13	17.53

Source: Factset

The market loves consistency in growth and consistency in meeting expectations. These two characteristics, tend to yield companies higher-than-average multiples.

Technical Analysis

Same as any other good trending stock from before, it consolidated around its 400 SMA for most for most of 2016, and started on a solid 1.5 year up-trend until mid-2018 when it consolidated and tested its 400 again back in Q4 '18 (like everything else that dropped) and finally broke to new highs again mid-2019. It found support again near its 400 SMA when the world was falling apart in March this year and is now just consolidating / hanging out near its 200 SMA, testing higher but not making new highs. If the stock is able to break out of this trend, you should see some strong volume supporting an uptrend.

Source: Bloomberg

Bull Case

- ***Two Boring Cash Cows Make a Great Company -*** VITAS derives roughly two-thirds of Chemed's total sales, with Roto-Rooter being the remaining one-third. We feel that management's bets have proved to be brilliant. Both subsidiaries, in our view, although appearing "boring", have strong business economics. In particular, we see them as having their leading market positions, scale advantages, strong cash flow, capital-light operations, and superior ROIC make their parent company an appealing candidate for stock investment.
- ***Roll-Up Strategy → Continue to Consolidate Plumbing Franchises*** – Roto-Rooter continues to increase efficiency at the branch level, while looking to acquire franchisees in certain territories at reasonable valuations. They look to purchase at 6x-8x EBITDA range and given their stock price, these branch acquisitions are immediately accretive. Per management, there continues to be a long runway of opportunities to consolidate their Roto-Rooter franchise business.
- ***Inelasticity of the Two Businesses*** - Since 2004, there has only been one year where the company experience a YoY sales decrease (i.e., -1.2% in 2013), thanks to the recession-proof-ness of its two businesses.

Kevin J. McNamara
President, Chief Executive Officer & Director, Chemed Corp.

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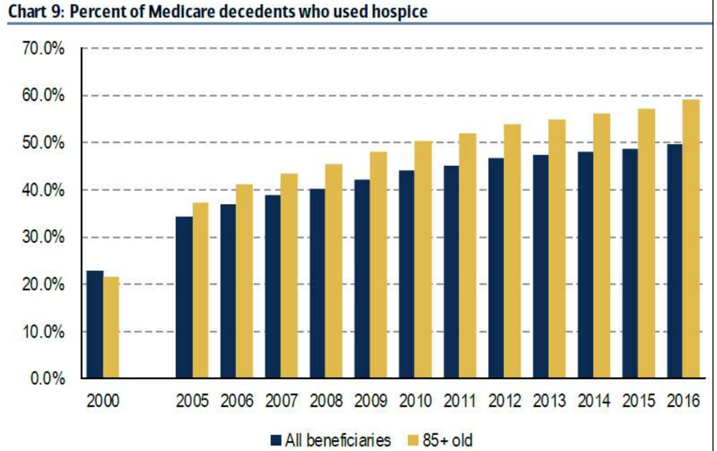
Well, one thing that's very clear is both plumbing, the Roto-Rooter business and VITAS are recession [ph] resistant (15:20). I mean that's kind of been proven in the past and it's unusual, because normally we say – VITAS clearly has I mean that's a government program really not tied to the recession whatsoever. To the extent we talk about Roto-Rooter, you go back to 2008 to 2010. Still very strong Roto-Rooter business. The thing that's unusual is not only we would say, well, it's recession resistant but we expect the commercial to suffer. Well, in this situation, we expect even with the recession, our commercial to improve because it's going from a base – a base of zero, let's say with commercial establishment so we – what we characterize is commercial is broader than that what I'm just saying. So yes, if the economy goes into recession, some of the Roto-Rooter business won't be as robust as we previously were enjoying, but it'll be a profound improvement from the current situation which is still overall for Roto-Rooter pretty good.

Source: CHEMED Corp. Company Q1 2020 Earnings Transcript / Factset

- ***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.
- ***Growth in Ancillary Roto-Rooter Services → Growth in Water Restoration*** – CHE expanded its water restoration offering as a way to drive incremental revenue growth at Roto-Rooter while taking advantage of fixed overhead costs, significantly leveraging company margins, which were stellar this past quarter. This segment is supposed to grow 18.9%, which 90% of the revenue comes from residential. No to mention, the large opportunity to drive growth from the commercial side of this business.
- ***Increased Awareness and Acceptance of Hospice*** - The use of hospice among Medicare beneficiaries increased slowly for the first 10 years after Medicare hospice benefit was established in 1983. Early in the benefit history, most beneficiaries who elected hospice had terminal diagnoses of cancer. From 2000 to 2010, utilization increased more dramatically. In 2000, 23% of the Medicare beneficiaries who died that year used hospice, which almost doubled to 44% in 2010, after CMS clarified for physicians the rules for recommending hospice. This suggested that many more beneficiaries have access to hospice than was the case at the outset of the benefit. Since then, penetration has continued to climb, albeit at a slower rate. In 2016, 49.7% of the Medicare-decedent population had elected hospice, up 110bps year over year. Hospice use is more common among older beneficiaries, with use rates ranging from 30% among Medicare decedents under age 65 to 59% among Medicare decedents age 85 or older. We note that the penetration of the 85+ population is growing faster than average with a 200bps y/y increase in 2016 to 59.1%.

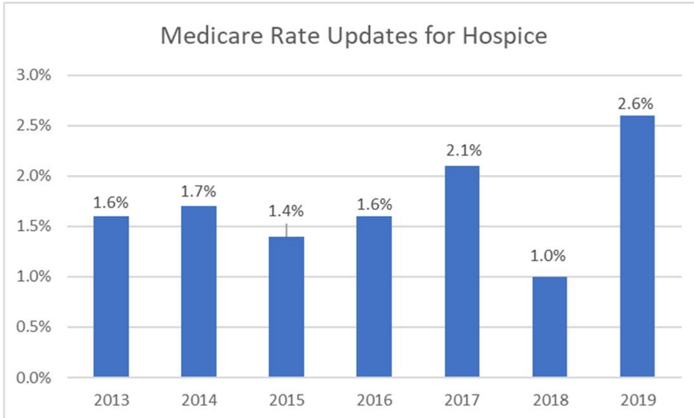
Chart 9: Percent of Medicare decedents who used hospice



Source: BaML

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.



Source: CHEMED Corp. Company 2019 10-K

- ***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 the for-profit providers.
- ***Hospice Relies on Medicare*** - Medicare accounts for 90% of hospice revenues, making the industry the most reliant on this payor (home health is second with 80% of revs coming from Medicare). 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.
- ***Increased Competition*** - The hospice market is highly fragmented, and there has been an increased interest in the space from traditional healthcare providers such as hospitals and home health operators. With demand for hospice service relatively predictable, an increase in competition would adversely impact results. Additionally, there has been an industry wide shortage of skilled nursing, which could lead to *further wage inflation*.