The Ensign Group, Inc.

NasdaqGS:ENSG

Analyst: Coralie Cornern
Sector: Healthcare

BUY

Price Target: $54.26

Key Statistics as of 11/13/2015

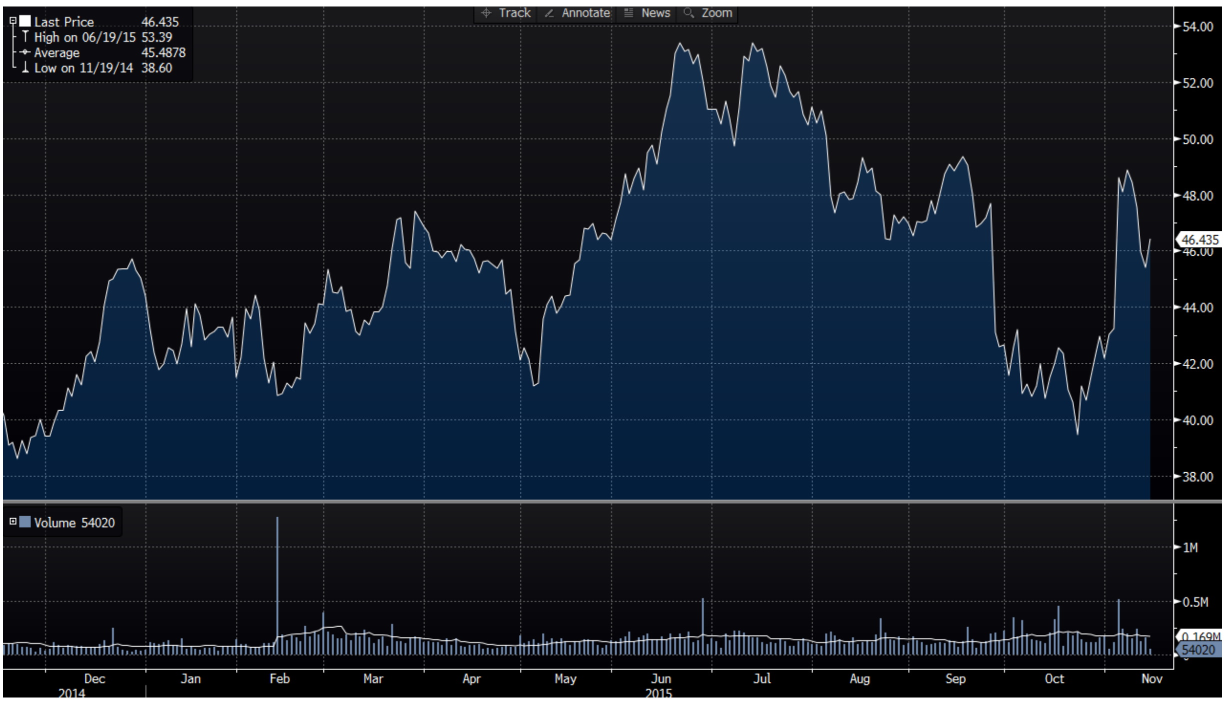
Market Price:	$46.46
Industry:	Long –Term Care Facilities
Market Cap:	$52.60 M
52-Week Range:	$28.24-$54.08
Beta:	0.78

Thesis Points:

- Macro data forecast to increase demand for Long Term Care Facilities
- Continuous organic and inorganic growth
- Leading operator in each of the local community it is serving

Company Description:

The Ensign Group Inc., through its subsidiaries, provides skilled nursing and rehabilitative care services in the United States that provide a range of medical, nursing, rehabilitative, and pharmacy services, as well as routine services comprising daily dietary, social, and recreational services to Medicaid, private pay, managed care, and Medicare payers; and assisted and independent living facilities offer residential accommodations, activities, meals, security, housekeeping, and assistance in the activities of daily living to seniors who are independent or who require some support. The company's home health care services include nursing, speech, occupational and physical therapists, medical social workers, and certified home health aide services; and hospice care services, such as physical, spiritual, and psychosocial needs, including palliative and clinical care, education, and counseling for terminally ill individuals and their families. Its urgent care centers provide daily access to healthcare for minor injuries and illnesses, including X-ray and lab services; and mobile diagnostic services, including digital X-ray, ultrasound, electrocardiograms, ankle-brachial index, and phlebotomy services to people in their homes or at long-term care facilities. As of November 2, 2015, the company had 182 healthcare facilities, 14 hospice agencies, 15 home health agencies, 3 home care businesses, and 17 urgent care clinics all in the United States. The company was founded in 1999 and is based in Mission Viejo, California and went public in 2007.



Thesis

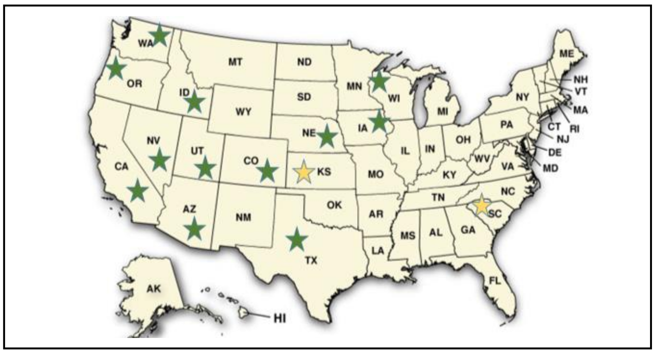
The Ensign Group Inc., has been showing continuous growth since it went public in 2007. The company is actively acquiring operating subsidiaries each quarters. The business is showing that it is creating shareholders value by raising its dividends continuously since its IPO, with a dividend growth rate of 8.45%. Operating subsidiaries are proven to be leaders in each of the area in which they are present. Executive management is committed to empower its local leaders and workforce by providing training but also by incentivizing them with bonuses. The Ensign Group's workforce is a catalyst for organic growth. The growing elderly population characterized by the aging of the baby boomers will support the Ensign Group revenue growth in the future.

The latest ROIC/WACC ratio was 1.81x which again shows that Ensign is creating value.

A buy of The Ensign Group, Inc. is therefore recommended with a one-year target price of $54.26. Currently trading at $46.46, it has an upside potential of 17.46%.

Product Portfolio/ mix

Ensign provides transitional, skilled and assisted living services as well as home health and hospice service. Those segment include skilled nursing and rehabilitative care services through the operation of 136 facilities, twelve home health and eleven hospice operations, one home care business, one transitional care management company, fourteen urgent care centers and a mobile x-ray and diagnostic company. Ensign operates in the United States only, as per shown in the below exhibit. The stars show the states where Ensign currently have operating subsidiaries.



The company announced during the first week of November 2015 that they were going into two new States: South Carolina and Kansas. It is important to note that the Ensign group is a company with no direct operating assets, employees or revenues. The Ensign group has wholly owned subsidiaries, which are operated by separate, independent entities, each of which has its own management. Ensign's portfolio includes 231 independent healthcare operations across 14 states. About 90% of the Ensign Group's facilities are leased, with an additional 2% of leases with a buy option. The remaining 8% of the facilities are owned by the group.

Growth initiatives and Strategy

The Ensign group's strategy is to rely heavily on local management. Executive management believes that local leaders, operating in each states are the only one able to put their facilities first in customer's mind and make it the best choice for patients. Each of the operating subsidiary of the firm has very skilled, dedicated and experienced employees. Christopher Christensen, co-founder and CEO of the group highlighted several times in the latest earnings call the importance of the leadership teams and their commitment to clinical excellence to pursue organic growth. The company capacity to empower and retain business and clinical leaders and to allow them the freedom to take decisions is key to their success in the healthcare facilities industry. Employees have incentive programs that are unique in the industry. Operational leaders and key employees get performance bonuses and stock options based on target clinical quality achievement and financial benchmark. Furthermore, the group set up the Ensign University aiming at continually training its staff. Training opportunities are offered on a monthly basis and include updates on Medicaid and Medicare billing requirements, leadership development, but also trainings purely for the clinical staff to increase their knowledge and expertise. The Ensign group corporate culture focuses on community. Each local leader needs to make sure that patients and their family members will receive individualized attention. This all contributes to the superior quality of the care provided to patients and resident and therefore to the reputation of the group. Within each community that the Ensign group serves, it achieved to build a certain brand awareness of high quality and cost effective care facilities. All these strengths combined allow each operating subsidiary to be the operation of choice in its area but also to attract patients who require more intensive and complex care resulting in higher reimbursement than lower acuity patients.

The Ensign group build its competitive strengths around its strategy of continually acquiring, and improving existing facilities. As of December 2014, through long term leases and purchases the group acquired 136 facilities. The latest update concerning acquisitions stated that as of November 4, the group had 64 operations in its recently acquired group. In the third quarter of 2015 only, the group acquired 11 skilled nursing operations, 20 assisted living operations, one home health business and one hospice agency. The recent acquisitions made Ensign's subsidiary in Arizona one of the largest providers of post-acute healthcare service in the state.

The firm still has $93 Million of availability on its $150 million revolving line of credit and is planning on additional acquisitions in 2016. The CEO highlighted a week ago that the Ensign group was committed to keep its cash flow strong and their debt relatively low in the future. The constant inorganic growth of the Ensign group is closely linked to the organic growth as management is committed to a disciplined approach to growth that permits the group to acquire an operation only when they believed that they will have qualified leadership for that operation. Despite the high volume of acquisition, the company executive vice president Chad Keetch stated that he and the executive management were "picky buyers" remaining true to their "locally driven approach".

Porter's Five Forces

The bargaining power of suppliers can be classified as relatively low. The raw material used by the Ensign Group would be essential products such as needles or sterile gauze compresses. It is in this case very easy to switch suppliers.

The bargaining power of customers is medium low. Customer have quite a large choice when selecting a long term care provider or assisting living services. Still the bargaining power of customer is still rather low as patients are not really sensitive to prices. The services offered by the Ensign Group's subsidiaries are mostly supported by Medicaid and Medicare. The demand for acute care or skilled nursing is inelastic. Moreover, there are a large number of customers that will be growing in the following years due to the aging population.

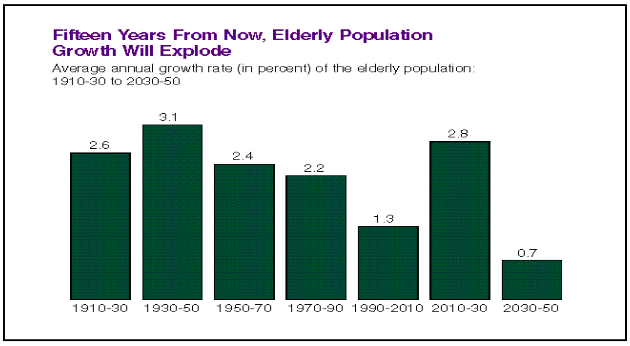
The intensity of existing rivalry is high. The industry is characterized by a large number of local and regional healthcare providers. The Ensign group is also competing with inpatient rehabilitation facilities and long term acute care hospitals. But the long-term care industry and especially the skilled nursing segment is large and will grow in the future which allows multiple firms to prosper.

The threat of substitutes is low as customers cannot easily find other products that would meet their need. People who need to enter assisted living facilities or who need assistance have no other solution.

The threat of new competitors is low. The barriers to entry are high. First, a new entrant in the long –term care facilities industry would need an intense capital to acquire facilities and develop the business. Moreover, many American states require healthcare providers to obtain certificate of need before being able to create or acquire facilities. In addition to this, competitors would need to get Medicaid certification. In addition, there is already a large number of long-term care facilities in the US, existing competitors are already flooding the market. The Ensign Group's subsidiaries are leaders where they are implemented and it would be hard for other healthcare provider to compete.

Macro Environment

According to the US Census Bureau, one in five Americans could be elderly (65 years old or over). Most of this growth is occurring now as the baby boom generation is aging. The below graph shows that the number of elderly will grow by an average of 2.8% annually.



Additionally, and luckily for Ensign, California has the largest number of elderly and other states such as Nebraska, or Idaho where the company is currently operating have 14% or more elderly population. Furthermore, according to alz.com, the number of people age 65 and older with Alzheimer's disease is estimated to reach 7.1 million by 2025 and might again double by 2050. This should benefit Ensign as the primary market demographic for skilled nursing services is people age 75 or older, two third of them with Alzheimer's disease.

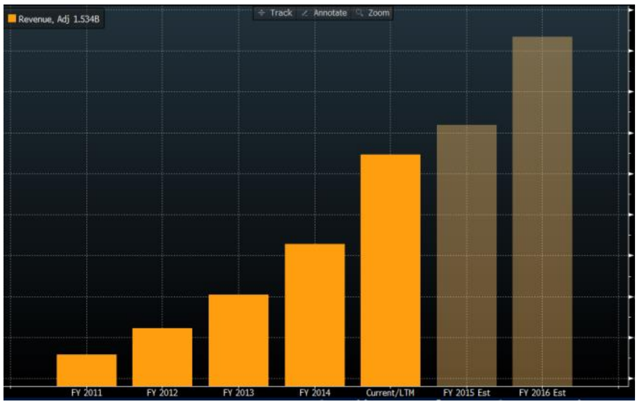
This predicted growth of the elderly population will probably raise faster than the government funds available for healthcare programs. The Federal and state governments will therefore be likely to encourage more cost effective solutions for those in need of assistance. Patients will therefore naturally chose skilled nursing facilities rather than acute care hospitals, inpatient rehabilitation facilities and other post-acute care settings as it is a significantly cheaper option. Moreover, Medicare currently covers all skilled nursing care provided in a skilled nursing facility. These macro data and the potential healthcare coverage improvement in the US will lead Ensign to raise its facilities' occupancy rates from 79% at the end of 2014 to potentially 100% in a near future. Ensign will also be able to eventually grow its revenue as the mix of high acuity (or medically more complex) patients will increase generating higher reimbursement rates.

Financials

FY 2014

2014 was one of the most important year for the group so far as it was one of the most active acquisitions year and as the group completed a significant spin off of Care Trust REIT. In June, the real estate business was separated into an independent publicly traded company through the distribution of the outstanding shares of CareTrust to Ensign Stockholder on a pro rata basis. The major impact of the Spin-off is in the fact that former properties own by the group are now leased by CareTrust to Ensign. Ensign leased back property associated with 94 affiliated skilled nursing facilities on a triple net basis. The separation resulted in "two very healthy platforms for growth" as mentioned by Mr. Christensen.

The Ensign Group has been growing constantly since its debut with revenue reaching $1.03 Billion in 2014, a 13.2% increase year on year. The below graph shows the group historic revenue growth and forecast for the end of the year and next year.

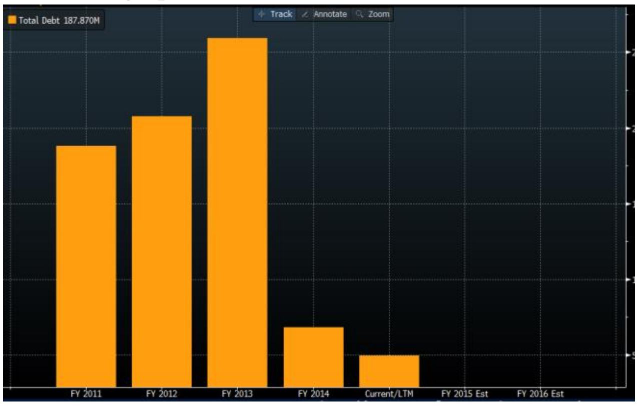


LTM revenues already are at $1.25 billion. The main catalysts for the revenue growth are both acquisition and strong employee performance throughout the year.

In the same period, Ensign group managed to increase its Net income by 30% even with the 59% jump in Selling General and Administrative due to costs related to the Spin off. This has been made possible thanks to the $9 million that Ensign received from CareTrust. The overall increase in operating cost by 48% year on year led to a slightly decreasing EBITDA margin in 2014 from 10.16% to 9.67%.

The company free cash flow in 2014 was $31.2 million, which highlights the group's ability to generate profits. Their free cash flow added to the $93 million available in their line of credit shows the ability of the company to create value for shareholder, and more particularly to continue its acquisition activities and dividend payments. Suzanne Snapper, Ensign Group's CFO declared that she will remain "committed to keeping our cash flow strong".

The LTM Debt to Equity ratio is about 42%. The total LTM debt for Ensign is $49.5 million. Looking in the future, the company wants the debt to remain relatively low. The group managed to decrease the amount of debt since 2011 quite significantly as per the below graph.



Debt was high in 2013 due Ensign's decision to extend the maturity date on its $75 million term loan. This shows how healthy the balance sheet is, as the company managed to decrease their total debt while pursuing its strategy of inorganic growth.

The NOPLAT margin is forecasted to attain 5.4% at the end of the year, but it likely to slightly decrease to 5.3% in 2016 due to an increase in depreciation that goes with acquisitions. The Net margin of 5.11% is above peer, sub industry and industry average 2 to 3 percentage points.

Valuation

The valuation of The Ensign Group is based on a proforma that values the company with a discounted cash flow model and focus on the company's return on Equity. A summary of the outputs of the valuation is attached to this report and can be found on the last page. When valuing the Ensign Group, a slow decay growth rate has been utilized to determine the speed of reversion toward long term stability. A constant Debt-to-Equity ratio has been chosen for future assumption as the industry is pretty stable. The intrinsic value of the firm is quite sensitive to the risk premium. A 2% premium has been added to the United States' risk premium of 5.5%. The risk in the Health care facilities' industry is linked to political pressure and potential health care reform. There is also a high risk of medical malpractice in the industry that can lead to costly lawsuits.

The revenue growth rates for FY 2015 and FY 2016 are analysts' median estimates of 6.3% and 18.1% respectively. In the following years revenue growth has been set to decline year-over-year to reach a revenue growth for the long-term of 3% which is assuming revenue growth to follow long-term GDP growth.

The following financial metrics are used to attain a valuation of the company converging to sub-industry averages through the continuing period. A conservative approach has been utilized in valuing the Ensign Group.

The LTM operating cost to Revenue ratio is 91%, and it is unlikely that by following its acquisition activity the company will manage to decrease operating costs. Therefore, the assumption of stable operating costs of 91% in the long term has been used. The rent to revenue ratio of 3.9% has also been set to stay the same in the continuing period.

According to the proforma, Ensign is currently creating value as per their latest ROIC/WACC ratio of 1.81.

Furthermore, Ensign group's P/E ratio has decreased over year and is now 32.5% lower than the sub industry average, which implies the undervaluation of the stock. Additionally, Ensign's CFO announced during the last earnings call on November 4th a share repurchase program. Details were not given concerning the amount of shares to be bought back but Suzanne Snapper stated that the group's "strong balance sheet, cash flow and existing credit facility provides the flexibility to repurchase Ensign shares while continuing to acquire well performing and struggling operations."

All assumptions utilized in the valuation are very conservative. Nevertheless, an upside potential of 17.46% with a one year target of $54.26 are expected.

Summary

Management is very confident in the firm's ability to further grow organically and inorganically and is committed to value creation. Ensign's strategy of excellence makes it a leader in each of the community it is serving. It proves to be a good investment opportunity since the company has a healthy balance sheet and capital available in order to pursue its strategy. Lastly, the announcement of a share repurchase program confirms the current undervaluation of the stock.

Sources:
- Ensign Group , 10-K
- Capital IQ
- Bloomberg
- www.census.gov
- www.medicare.gov

www.alz.org

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		Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield		
The Ensign Group, Inc.	ENSG	Coralie Cornern	$46.46	$52.56	$54.26	1%	1-y Return: 17.46%	NEUTRAL

General Info	
Sector	Healthcare
Industry	Healthcare Providers and Services
Last Guidance	November 4, 2015
Next earnings date	February 9, 2016

Market Data	
Enterprise value	$1,215.68
Market Capitalization	$1,191.83
Daily volume	0.20
Shares outstanding	25.65
Diluted shares outstanding	25.29
% shares held by institutions	82.75%
% shares held by insiders	6.34%
Short interest	3.61%
Days to cover short interest	5.60
52 week high	$54.08
52-week low	$38.25
5y Beta	0.78
6-month volatility	33.60%

Peers	Market Cap.
Amedisys Inc.	$1,348.31
IPC Healthcare, Inc.	$1,396.76
HEALTHSOUTH Corp.	$3,065.00
Kindred Healthcare Inc.	$996.35
AmSurg Corp.	$3,920.20
National Healthcare Corp.	$969.34
Acadia Healthcare Company, Inc.	$4,851.87
Brookdale Senior Living Inc.	$4,236.51
Diversicare Healthcare Services Inc.	$56.77

Current Capital Structure	
Total debt/Common Equity (LTM)	0.42
Cost of Borrowing (LTM)	6.88%
Estimated Cost of new Borrowing	5.22%
Altman's Z	5.19
Estimated Debt Rating	BBB
Current levered Beta	0.63
LTM WACC	6.36%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Christensen, Roy	Co-Founder and Chairman	$101,236	$101,236	$102,472
Christensen, Christopher	Co-Founder, Chief Executive Officer, Preside	$1,417,939	$897,602	$3,627,811
Snapper, Suzanne	Chief Financial Officer	$910,569	$747,243	$3,067,982
Wittekind, Beverly	General Counsel and Vice President	$486,024	$533,829	$747,443
Keetch, Chad	Executive Vice President and Secretary	$0	$0	$2,075,111
Port, Barry	Chief Operating Officer of Ensign Services, In	$1,326,303	$1,920,808	$2,231,012

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	5.52%	-0.84%	0.00%	2.00%
Last Quarter-1	-1.84%	2.82%	5.26%	2.08%
Last Quarter -2	4.49%	12.42%	8.47%	2.29%
Last Quarter -3	2.15%	6.02%	0.00%	1.76%
Last Quarter -4	1.93%	-10.38%	-6.38%	3.63%
Standard error	1.3%	3.8%	2.5%	1.47%
Standard Error of Revenues prediction	1.3%			
Imputed Standard Error of Op. Cost prediction	3.6%			
Imputed Standard Error of Non Op. Cost predictio	NM			

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (100th Percentile), Bargaining Power of Customers (43th Percentile), Intensity of Existing Rivalry (33th Percentile), Threat of Substitutes (100th Percentile), Threat of New Competition (67th Percentile), and Overall (85th Percentile).

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years

General Assumptions	
Money market rate (as of today)	0.39%
Risk-Free rate (long term estimate)	3.09%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	37.5%
Country Risk Premium	7.5%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$1,245.54
FY2015	6.3%	$1,323.67
FY2016	18.1%	$1,563.91
FY2017	4.0%	$1,625.97
FY2018	3.8%	$1,688.52
FY2019	3.7%	$1,751.43
FY2020	3.6%	$1,814.57
FY2021	3.5%	$1,877.79
FY2022	3.4%	$1,940.94
FY2023	3.2%	$2,003.87
FY2024	3.1%	$2,066.41
Continuing Period	3.0%	$2,128.40

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year
Operating Cash/Rev.	0.00%	0.00%	0.0%
NWV/Rev.	5.16%	8.58%	0.3%
NPPE/Rev.	20.65%	34.29%	1.4%
Dpr/NPPE	8.58%	14.43%	0.6%
NET MARGIN	5.11%	3.81%	-0.1%
Op. Exp./Rev.	91.08%	91.08%	0.0%
SBC/Rev.	0.51%	0.54%	0.0%
Rent Exp./Rev.	3.93%	3.93%	0.0%
R&D/Rev.	0.00%	0.39%	0.0%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	5.48%	11.03%	0.6%
ROE	31%	24.84%	-0.63%
P/E	17.11x	15.69x	-0.14x
P/BV	3.54x	3.90x	0.04x
Debt/Equity	42%	42%	0.0%
Unlevered beta	0.50	0.50	0.00
Dividends/REV	1%	1%	0.0%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years
100% of all E&P expenses are capitalized and amortized 'straightline' over 10 years
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (7.275%, 7.5%, 7.725%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value $\sigma(\varepsilon)$	$0.24
1-year target price $\sigma(\varepsilon)$	$0.25

Valuation

Forecast Year	ROE	Ke	Common Equity	Implied Equity Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	31.1%	7.8%	$307.95	$1,635.39	$7.91	25.65	$52.37
FY2015	36.9%	7.9%	$327.02	$1,669.85	$8.46	25.65	$53.94
FY2016	22.6%	8.0%	$384.01	$1,786.22	$10.05	25.65	$56.55
FY2017	19.1%	8.1%	$439.30	$1,912.84	$10.52	25.65	$59.42
FY2018	16.6%	8.1%	$493.39	$2,048.98	$10.99	25.65	$62.49
FY2019	14.7%	8.1%	$546.07	$2,195.92	$11.47	25.65	$65.80
FY2020	13.1%	8.2%	$597.02	$2,354.98	$11.96	25.65	$69.38
FY2021	11.7%	8.2%	$645.52	$2,527.55	$12.45	25.65	$73.27
FY2022	10.5%	8.3%	$690.88	$2,715.39	$12.95	25.65	$77.52
FY2023	9.3%	8.4%	$732.40	$2,920.37	$0.00	25.65	$82.16
FY2024	8.3%	8.5%	$769.24	$3,144.57	$0.00	25.65	$87.31
Continuing Period	24.8%	8.6%	$786.91				

Monte Carlo Simulation Results

The $3\sigma(\varepsilon)$-adjusted intrinsic value is $52.56; the $3\sigma(\varepsilon)$-adjusted target price is $54.26; and the analysts' median target price is $56.8

Sensitivity Analysis

Revenue growth variations account for 95.9% of total variance
Risk premium's variations account for 2.5% of total variance
Operating expenses' variations account for 1.4% of total variance
Continuing period growth variations account for 0.2% of total variance