Siena Market Line
3rd week of October 2016

LHC Group, Inc.

NASDAQ:LHCG

Analyst: Eric Crown
Sector: Healthcare

BUY

Price Target: $42.40

Key Statistics as of 10/21/2016

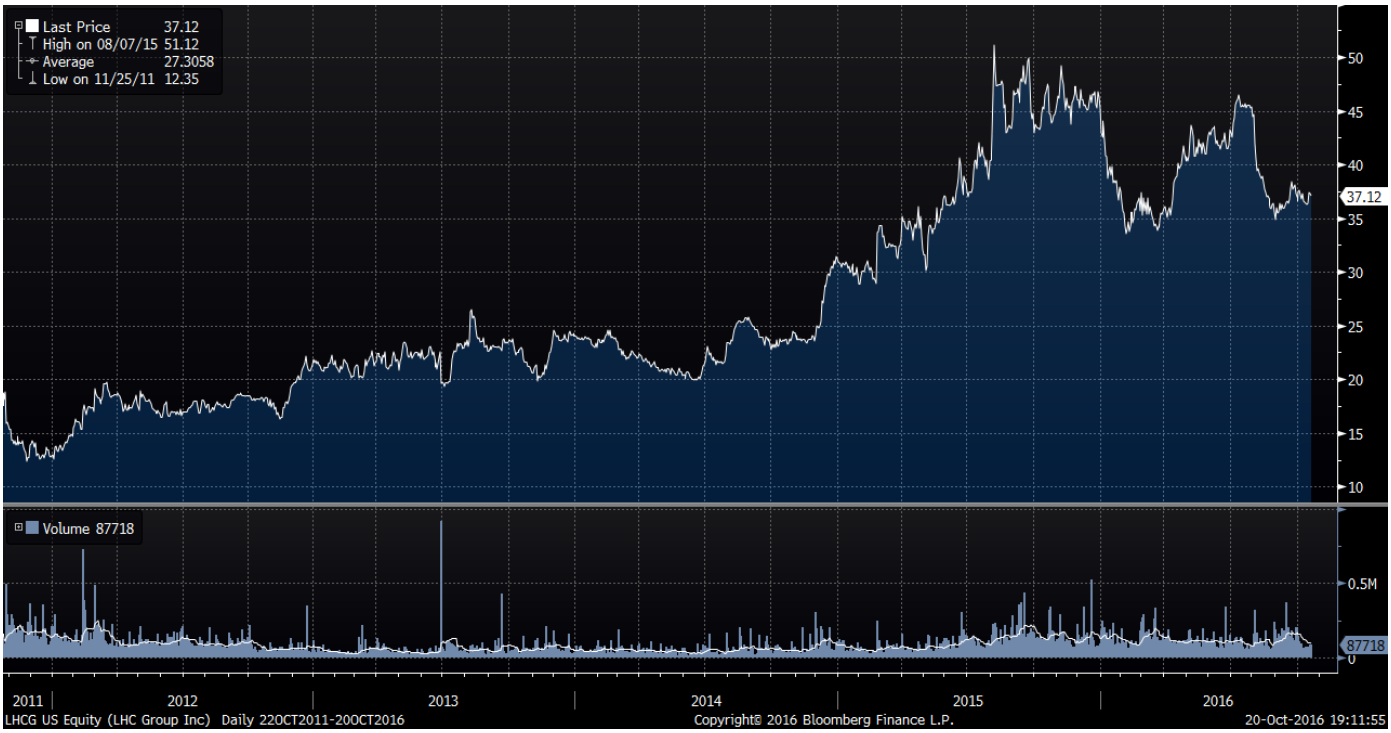
Market Price:	$36.37
Industry:	Healthcare Providers and Services
Market Cap:	$673.85M
52-Week Range:	$32.77-49.34
Beta:	0.51

Catalysts:

- Short Run: Q3 Earnings
- "Mid" Run: Managing Operating Cost
- Long Run: Industry Outlook

Company Description:

Louisiana Health Care Group (LHCG) provides post-acute health care services to patients. They operate in four primary segments home health services, hospice services, community-based services, and facility-based services. With the home health service segment being the largest. LHCG focuses on providing care in rural areas of the United States because these area lack acute medical facilities. As of June 30, 2016, LHC Group operated 283 home health services locations, 62 hospice locations, 11 community-based service locations and six Long-Term Acute Care Hospitals with eight locations.

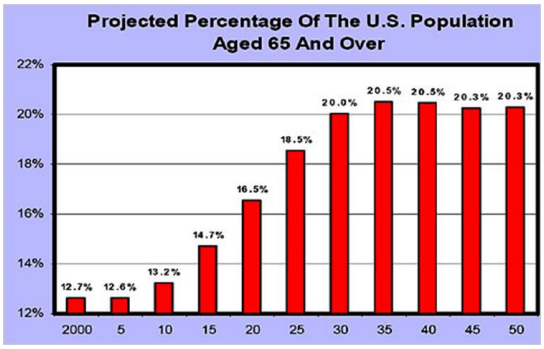


Thesis

LHCG is the best in class in its industry in both quality of service provided and financial ratio comparison with competitions. That being said LHCG has room to grow in this rapidly growing industry with large amounts of future demand. Within this industry one of the keys to success is managing operating cost. LHCG is positioning itself to lower operating cost and increase the bottom line. With a Q3 earnings call on the horizon and the stock trading near 52 week lows this could be an ideal time to purchase shares.

Industry Outlook

LHC group operates in the healthcare providers and services industry, with an emphasis in "at home health care services". At home health care is an effective and less expensive alternative to standard long term care facilities. A wide range of medical conditions can be treated in the comfort of the patients own home. An upwards of 70% of revenues are from patients who are beneficiaries of the federal government Medicare program. Medicare reimburses LHCG based on the setting which the service is provided, length of time service is required, and the specific medical condition of the patient. This fixed payment system is the standard for the healthcare services industry. This means that it is extremely important for companies in this industry to be able to manage operating cost, to help increase profitability margins. However it is important for companies to still maintain quality care for the patients. The common age for Medicare beneficiaries is 65 and up.



As can be seen in the graph above, the U.S. has an aging population because of the baby boomers reaching their elderly years. This leads to an interesting long term prospect for the industry. There is a quickly growing long term demand for the services, specifically at home care, provided by LHC group. In the long run this could be a factor that leads to an increase of the value of LHC Group's stock price.

Financials

LHCG recorded a net income of 33.73 million off a revenue of 854 million. This resulted in an operating margin of 8%. Which when compared to the industry average of around 4% shows LHCG is effectively managing their cost. These numbers are brought down significantly from the operating cost. Specifically SG&A which took up 30% of the revenue.

Best in Class

LHCG is amongst the top of its peers both qualitatively and quantitatively. The Center for Medicare and Medicaid (CMS) gives a star rating for quality of care to every home health service company. In 2015 LHCG was rewarded with the highest ranking in the industry. They were 20 basis points above the nearest public competitor and 85 basis points above the national average. This shows that LHCG offers a quality service which is a huge selling point to customers in this industry. Financially LHCG also outperformed its competitors. LHCG recorded a ROIC/WACC ratio of 1.02 compared to the healthcare industry average of .79. LHCG had a higher return on invested capital then its peers and a lower WACC then said peers. The debt to equity of LHCG is .14 compared to the .42 of the competitors. This shows LHCG dos not need as much debt to sustain growth compared to other companies in the industry. Finally, LHCG outperformed competitors in terms of EBITA margin. Recording 8.2% in comparison to competitors 7.3%. All these factors show that even though LHCG is not the biggest company in the industry, it is out

preforming its peers making it best in class. If it can sustain these margins as its grows it could be a very profitable company to invest in.

Segments

LHCG provides acute health services to patients in four main segments: at home nursing care, hospice, community-based services, and long-term acute care hospitals. At home care is the largest segment which focuses on providing patients with routine checkups, administration of medications and technically trained staff. The hospice segment is generally administered at home and helps provide patients and family with spiritual, medical, and pain relief support. The community based service segment is for patients with long term medical conditions that need assistance with daily activities. Finally the Long term acute care segment is for patients whom conditions are too severe for home treatment.

Type of Segment	2015	2014	2013
Home Health Services:	75.1%	77.0%	79.5%
Hospice Services:	10.5%	9.2%	8.5%
Community-based services:	5.1%	3.8%	0.5%
Facility-based services:	9.3%	10.0%	11.5%
	100.0%	100.0%	100.0%

As can be seen in the table above Home health service makes up a majority of the business. It is important to note the growth in the hospice segment. This segment is slightly more profitable with an operating margin of 9% compared to 8% of at home services. As well the CMS plans to boost hospice rates by 2% by the end of 2016. This would mean that LHCG is growing one of its more profitable segments which could potentially lead to lots of value creation. Based on management discussions the two segments mostly represented in the pipeline are the hospice and at home care segments. This shows me that LHC Group wants to make a cash cow out of the hospice segment and continue to grow the at home care segment to accommodate the growing elderly U.S. population.

Porters Five Forces

Bargaining Power of Suppliers: 50
LHCG scored a neutral score for bargaining power of suppliers. This is because the medical equipment and medication is from a limited suppliers. However most of their cost are associated with SG&A.

Bargaining Power of Customers: 79
LHCG scored fairly highly on bargaining power of customers. This is mostly due to the fact that their customers are usually paying through Medicare and have no desire to negotiate pricing. Also considering the service being provided the price is usually not discussed upfront as much as other goods or services.

Intensity of Existing Rivalry: 50
LHCG scored moderately for existing rivalry. This is because there are a lot of other competitors providing similar services. However this industries demand is large and growing, leaving market space for LHCG.

Threat of Substitution: 83
LHCG scored very high for threat of substitution. This is because the service they are providing is a universal one and there is no realistic substitute for it.

Threat of New Competition: 67
LHCG had a good score in threat of new competition because there is a large capital cost to entering the industry as well as government loop holes to jump through.

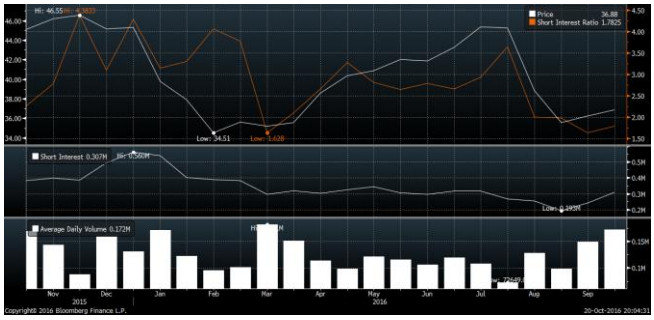
Ownership

Top Ownership Type (%)

54) Ownership Type	10/16/16	Curr	Change
41) Investment Advisor	71.31	71.32	+0.01
42) Hedge Fund Manager	12.03	12.04	+0.01
43) Family Office/Trust	6.24	6.24	0.00
44) Individual	5.29	5.30	+0.01
45) Government	1.62	1.62	0.00
46) Insurance Company	1.54	1.54	0.00
47) Pension Fund	1.48	1.48	0.00
48) Unclassified	0.17	0.17	0.00
49) Brokerage	0.12	0.12	0.00

Q3 – Earnings Call

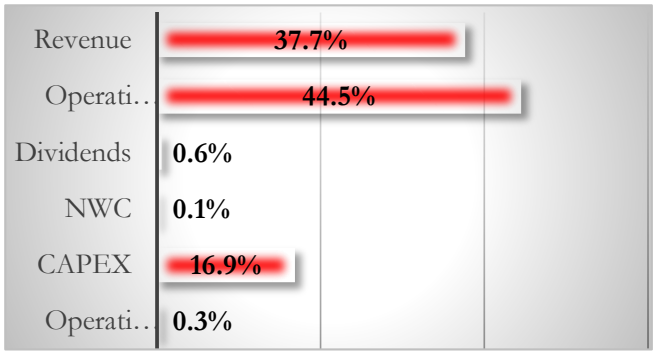
LHCG Quarter 3 earnings will be released on Thursday, November 3rd 2016. I believe this will be a major catalyst in the price short term. Management expects general and administrative expense as a percent of revenues to be in the range of 29% to 30%. This range is 1% lower than previously reported and could help benefit profit margins. Now would be a good time to purchase shares because the stock is trading near 52 week lows. This creates more upside potential on good results and less downside on lack luster results. Another indicator of good earnings is the lack of short interest in the stock two weeks before earnings.



This shows that analyst believe that the stock is not overly valued and that analyst are not expecting bad earnings results.

Managing Operating Cost

As stated before operating cost is a major factor in the profitability of companies in this industry. As can be seen in the pro-forma's sensitivity analysis:



This makes controlling these cost more important than ever. One of the biggest of these cost is the SG&A expense. Considering the nature of the service provided this comes as no surprise.

However when comparing LHCG to its competitors it appears there is room for improvement. LHCG has an SG&A margin of 31% compared to competitors of 14%. This shows there is huge room for improvement in general and administrative cost. LHCG would be very desirable if they could come close to the industry average on this front paired with their above average industry margins. Management has been taking steps to help lower these SG&A expenses. Some of these steps are joint venture strategies and steady growth through tactical acquisitions.

Growth

Management has expressed their goals for growth and how they intend to reach said goals. They intend to grow in existing markets by increasing the number of health care providers from whom they receive referrals. Their strategy to achieve this goal is to continue their high level of quality work and educate health providers of the benefits of working with LHCG. Management intends to expand into new markets by acquiring existing Medicare and/or Medicaid certified agencies in attractive markets throughout the United States. As well management wishes to continue joint ventures/ partnerships with hospitals because it provides a good stream of revenue without the high G&A expenses.

Valuation

A majority of the continuing value inputs were set to industry averages. The selected peers for comparison all had very similar business models, making them effective for forecasting.

Summary

I recommend a **BUY** on LHCG. They are a top tier company in terms of quality of service provided, which is the most important selling point to customers in this industry. The company is steadily growing while maintaining some of the best industry margins. In the short run there is

potential for gains with a earnings report in two weeks. If management continues to take steps to lower operating profit the company will increase net income. The industry is rapidly growing and will continue to grow for years to come. As well the stock is trading near a 52 week low of $36.37 with the analyst median price target being $46. Overall I believe this is a quality company at a low price in a very attractive industry.

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3rd week of October 2016

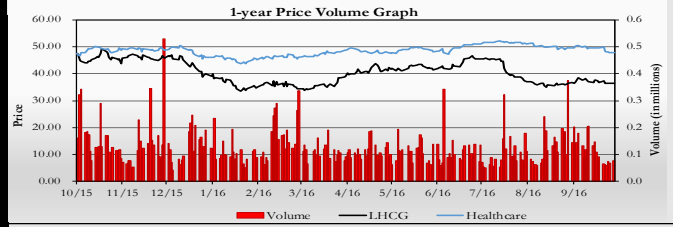
LHC Group, Inc. (LHCG) — CENTER FOR GLOBAL FINANCIAL STUDIES — NEUTRAL

Analysis by Eric Crown
10/21/2016

Current Price: $37.12
Divident Yield: 0.1%

Intrinsic Value: $36.29
Target Price: $42.40

Target 1 year Return: 14.28%
Probability of Price Increase: 74.8%



Description

LHC Group, Inc., together with its subsidiaries, provides post-acute continuum of care primarily for Medicare beneficiaries in the United States.

General Information

Sector	Healthcare
Industry	Healthcare Providers and Services
Last Guidance	November 3, 2015
Next earnings date	November 2, 2016
Estimated Country Risk Premium	6.25%
Effective Tax rate	40%
Effective Operating Tax rate	38%

Market Data

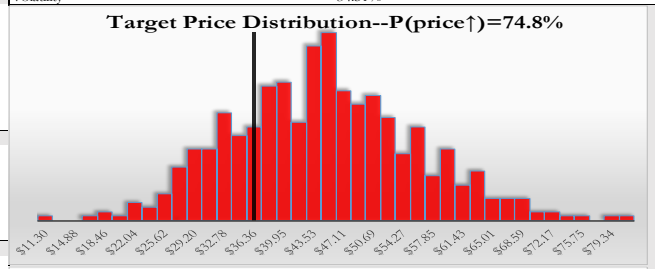
Market Capitalization	$677.48
Daily volume (mil)	0.09
Shares outstanding (mil)	18.15
Diluted shares outstanding (mil)	17.61
% shares held by institutions	79%
% shares held by investments Managers	66%
% shares held by hedge funds	13%
% shares held by insiders	11.62%
Short interest	1.69%
Days to cover short interest	2.63
52 week high	$49.34
52-week low	$32.77
Levered Beta	0.82
Volatility	34.51%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
6/30/2015	-2.56%	17.83%
9/30/2015	-1.82%	4.98%
12/31/2015	-0.87%	-0.16%
3/31/2016	0.86%	5.88%
6/30/2016	-1.49%	-16.71%
Mean	-1.17%	2.36%
Standard error	0.6%	5.6%

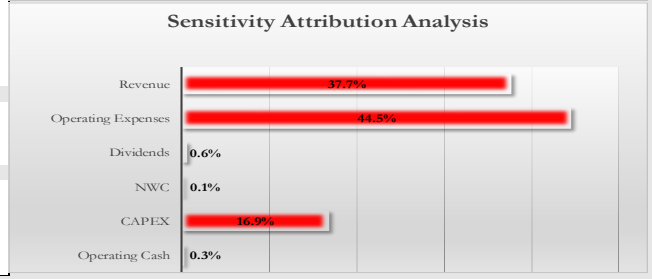
Peers

Amedisys Inc.
BioScrip, Inc.
Almost Family Inc.
Providence Service Corp.
Civitas Solutions, Inc.
Chemed Corp.
National HealthCare Corporation
Healthways, Inc.

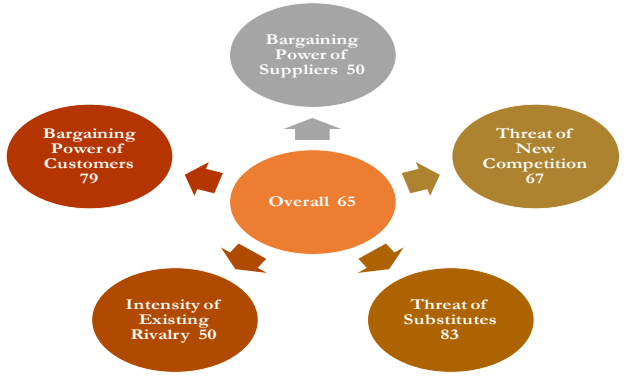


Management	Position	Total compensations growth	Total return to shareholders
Myers, Keith	Co-Founder, Chairman and Chi	18.08% per annum over 5y	-12.82% per annum over 5y
Stelly, Donald	President and Chief Operatin	10.25% per annum over 5y	-12.82% per annum over 5y
Proffitt, Joshua	Chief Financial Officer, Exe	50.28% per annum over 2y	37.26% per annum over 2y
Indest, John	Consultant, Director and Cha	40.03% per annum over 4y	17.73% per annum over 4y
Thompson, John	Chief Information Officer an	N/M	N/M
Macip, Marcus	Chief Administrative Officer	N/M	N/M

Profitability	LHCG (LTM)	LHCG (5 years historical average)	Industry (LTM)
ROIC	14.6%	14.64%	10.01%
NOPAT Margin	8%	9.95%	5.1%
Revenue/Invested Capital	1.74	1.47	1.98
ROE	28.3%	23.02%	12.71%
Adjusted net margin	8%	9.39%	4.2%
Revenue/Adjusted Book Value	3.67	2.45	3.00
Invested Funds	**LHCG (LTM)**	**LHCG (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	2.1%	1.3%	20%
Estimated Operating Cash/Total Capital	0.8%	0.7%	N/A
Non-cash working Capital/Total Capital	6.8%	8.3%	1%
Invested Capital/Total Capital	57.4%	58.8%	75%
Capital Structure	**LHCG (LTM)**	**LHCG (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.32	0.32	0.37
Cost of Existing Debt	4.12%	5.16%	4.37%
Estimated Cost of new Borrowing	4.79%	4.99%	4.37%
CGFS Risk Rating	CC	CC	C
Unlevered Beta (LTM)	0.70	0.90	0.68
WACC	7.65%	8.46%	7.87%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	12.9%	8.4%	1.91
6/30/2017	6.3%	7.1%	1.60
6/30/2018	5.9%	7.1%	1.60
6/30/2019	5.7%	6.9%	1.51
6/30/2020	5.5%	6.8%	1.51
6/30/2021	5.3%	6.7%	1.46
6/30/2022	5.1%	6.6%	1.44
6/30/2023	4.9%	6.5%	1.42
6/30/2024	4.7%	6.5%	1.40
6/30/2025	4.5%	6.4%	1.39
6/30/2026	4.3%	6.3%	1.38
Continuing Period	4.1%	6.3%	1.22

Period	Invested Capital	Net Claims	Price per share
Base Year	$366.06	$255.78	$35.65
6/30/2017	$363.55	$193.82	$41.28
6/30/2018	$386.68	$139.49	$47.15
6/30/2019	$434.17	$67.64	$53.07
6/30/2020	$489.54	$9.35	$59.05
6/30/2021	$529.09	-$55.16	$65.11
6/30/2022	$563.57	-$121.08	$71.21
6/30/2023	$611.35	-$188.33	$77.35
6/30/2024	$640.00	-$256.85	$83.51
6/30/2025	$684.55	-$326.55	$89.67
6/30/2026	$723.15	-$397.34	$95.82
Continuing Period			