The Ensign Group, Inc. (ENSG)

November 20, 2020 |Current Price: $69.90 | Price Target: $86.83

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Recommendation Summary

The Ensign Group, Inc. (ENSG), a holding company with subsidiaries that provide skilled nursing and rehabilitative services, is poised for substantive value appreciation as the below theses materialize and the market re-rates ENSG as a pure SNF play.

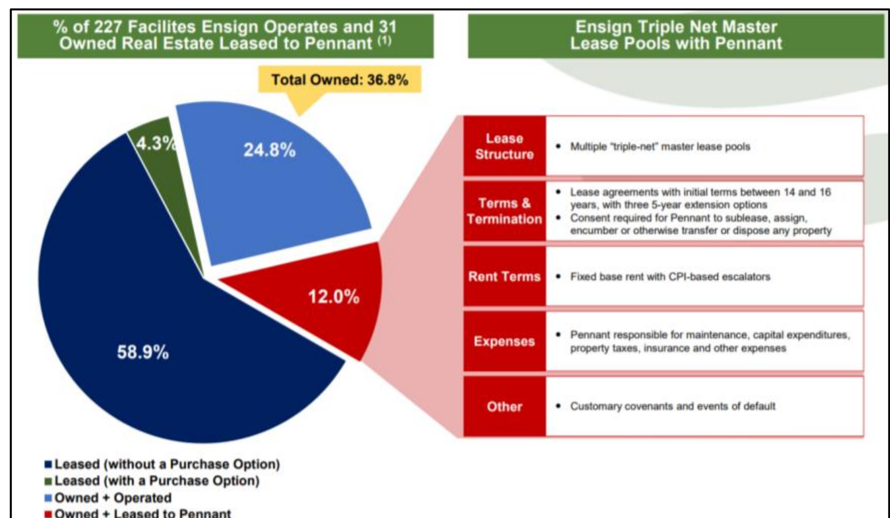
- COVID has decreased skilled nursing occupancy rates, resulting in a distressed market landscape and several discounted acquisition opportunities for Ensign's capital-rich, proven operating team.
- The spin-off of The Pennant Group creates a pure-play skilled nursing facility operator, allowing management to focus on its core competencies in one service niche and reportable segment, Transitional and Skilled Services.
- ACA repeal risk has reduced almost entirely, diminishing the primary threat to Ensign's top line.
- Ensign's reputation for clinical quality and effective virus containment will be a big selling point going forward, especially as the industry shifts to a value-based care reimbursement model.
- With extreme market fragmentation across the SNF space and expected Genesis Healthcare bankruptcy, Ensign is poised to realize significant consolidation opportunities and emerge as the top public SNF provider.
- The company is trading at a significant discount to peers due to its limited coverage and mispricing as a diversified provider.

As of November 20, 2020, Ensign trades at $69.90 per share with a market capitalization of roughly $3.79bn. The company is currently trading at an EV/EBITDA discount of 28.3% to peers, despite being near the top of its 52-week range as the comp group consists primarily of SNF exposed—rather than senior living—operators. Management has guided 2020 projections positively, expecting +18.6 YoY revenue growth despite COVID's disruption. Coupled with our thesis and rationale below, we have placed an $86.83 (+24.2%) price target on the company.

Business Overview

With approximately 227 assisted-living facilities across the United States, Ensign's portfolio consists of skilled nursing, senior living, rehabilitative care as well as limited speech, occupational and physical therapy services. It provides these services on both a short and long-term basis for the elderly and patients with a variety of healthcare issues including chronic conditions and prolonged illnesses. These residents are commonly high-acuity individuals who are recovering from strokes, cardiovascular/respiratory/neurological conditions or other related muscular and skeletal disorders. The company's dedication to delivering high-quality healthcare services is carried out by their combined mix of experienced medical professionals.

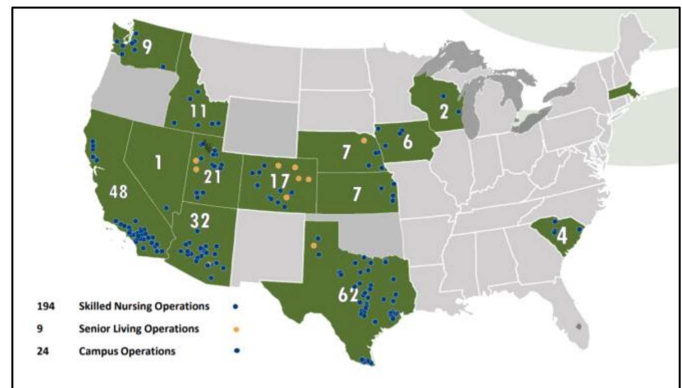
As of 3Q20, 163 of the 227 facilities operated by Ensign are under long-term leased agreements with 11 of those 163 facilities possessing options to purchase in the future. The company owns 93 real estate properties, including 63 facilities operated and managed by themselves as well as 31 senior living operations leased to the Pennant Group as part of the recent spin-off (Thesis Point 2).



Ensign's main operating segment is Transitional and Skilled Services (TSS) which generates approximately 95% of the company's revenue. The company previously had two other operating segments: Home and Health Hospice and Senior Living, both of which were spun off into separate entities. The Transitional Skilled Services segment comprises of facilities that provide the listed services above and are equipped to provide specialty care such as on-site dialysis, ventilator care, and pulmonary management. In addition, due to the company's commitment to ensuring the highest quality care, all facilities offer room and board, special nutritional programs, social services as well as

recreational activities. The revenue from this segment derives from Medicaid, Medicare, managed care, commercial insurance and private pay. Approximately 70% of TSS revenue is from government sponsored insurance programs. Revenue from this segment since 2016 has consistently grown at a rapid pace of 15%.

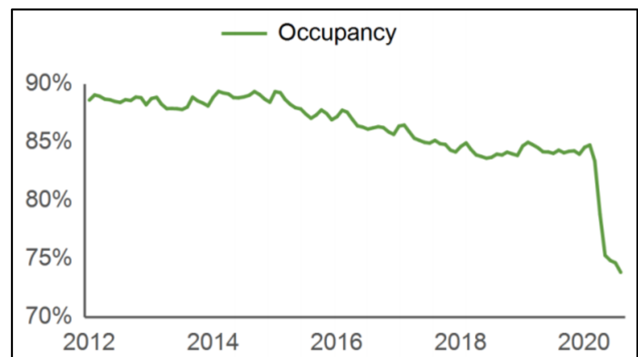
The remaining 5% of revenue is generated from a variety of sources such as senior living operations, real estate properties, mobile diagnostics and other ancillary services. As of December 31, 2019, Ensign held 2,154 senior living units at 33 different operations all of which offer standard residential accommodations and assistance to daily living, however not to the extent of nursing care provided at skilled nursing operations. Before 2019, the senior living segment played a more prominent role in revenue generation; yet, after The Pennant Group spin-off a substantial number of facilities were leased or sold away. Real estate revenue is directly generated from the leasing of 31 properties to The Pennant Group on a triple net basis. Lastly, ancillary service revenue is created by Ensign's interest in exploring new business lines that are complementary to their existing operations such as mobile digital x-ray, ultrasound, electro diagram and laboratory services. Due to the company's strategy shift from a combined effort of skilled and senior nursing services to a concentration in skilled nursing services, revenue from senior facilities has fell. However, with the increased demand from mobile diagnostics as well as passive income from real estate properties, revenue from this segment has grown at a rate of 16%, reaching $102 million in the year ended 2019.



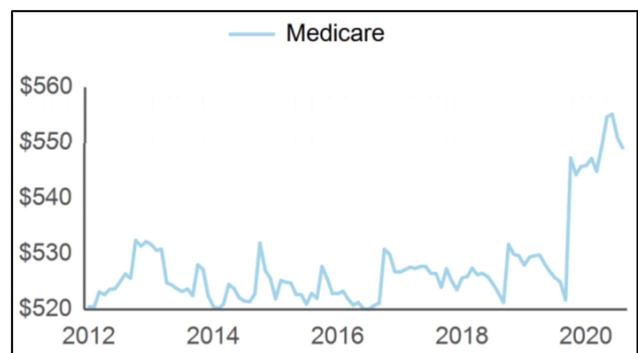
The company serves patients in fifteen states clustered in the Western and Mid-Western United States, with California and Texas being the company's largest markets. Although its prominence is concentrated across the western United States, management has not mentioned plans of expansion towards the East Coast. Nonetheless, with 227 facilities in fifteen states the company is well positioned to continue their success as evidenced by management's increase in both 2020 and 2021 earnings guidance from $3.04 - $3.12 and $3.44 - $3.56 respectively.

Macro Environment and Industry Analysis

With COVID as the most pressing and immediate macro headwind, players within the Providers & Services sector have seen declining occupancy rates given heightened virus concerns in enclosed hospitality settings. According to the National Investment Center for Seniors Housing & Care (NIC), as of August, the national skilled nursing occupancy rate is 73.8%, representing a 10.9%-point drop since February (84.7%). In addition to occupancy rate, revenue per patient day (RPPD) is a critical KPI for determining SNF success.



National average Medicare revenue per patient day sits at $549 and has trended upwards during the pandemic as skilled nursing properties received additional COVID related reimbursements to support positive patient isolation. Contrastingly, Managed Medicare ($447) decreased significantly during the pandemic's depth but has shown recent signs of stabilization. This recovery can be attributed to reimbursement stability from rebounding insurance agencies.

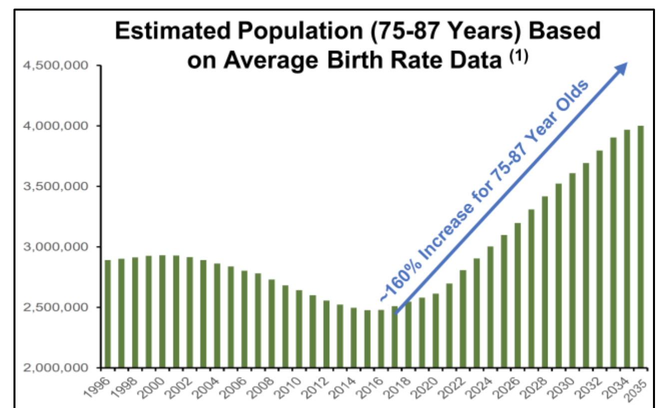


Clearly, COVID has complicated the Providers & Services vertical. Providers that can effectively contain the virus while rebuilding occupancy will thrive in a post-pandemic environment. We believe there is an end in sight to the chaos and Ensign is currently positioned to capitalize on headwinds (Thesis Point 1), especially considering Management's experience providing services throughout many different business and political cycles.

The occupancy–and consequently SNF–outlook looks promising as Operation Warp Speed has facilitated Pfizer and Moderna's vaccine discovery efforts. Both drugs have completed Stage Three development and are seeking regulatory approval in the coming weeks. Although COVID will not disappear once a vaccine enters distribution, the Healthcare sector will likely see a positive turnaround in KPIs as cases stabilize and decrease in volume. Regardless, Ensign's CEO, Barry Port, believes the SNF model is resilient through the pandemic as "lower occupancies will be offset by a higher skilled mix" and higher-acuity facilities measure constant performance even in a fluctuating landscape. In fact, as cases rose over the summer across the Sunbelt, Ensign's declining occupancy was partially offset by increased skilled nursing demand.

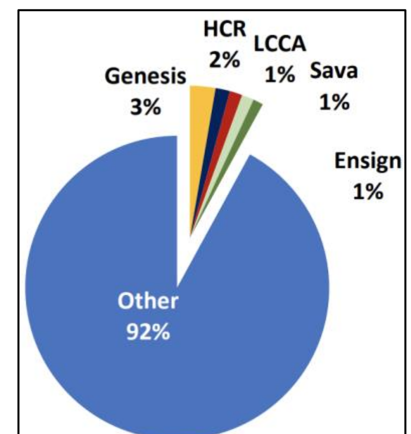
Aside from COVID headwinds, the healthcare regulatory environment can be extremely volatile. Leading up until the election, many political pundits believed that Amy Coney Barrett and the conservative Supreme Court were likely to strike down the Affordable Care Act due to the Individual Mandate. On Nov. 10th, five justices–including two conservatives Kavanaugh and Roberts–indicated that they could sever the individual mandate provision while keeping the rest of the law in place. In other words, ACA repeal risk has reduced significantly, diminishing the primary threat to providers in the health care services space and stabilizing uncertainty in public health plan revenues (Thesis Point 3). The Biden/Harris election results have also created tailwinds poised to impact the healthcare sector going forward. By keeping control of the House of Representatives, gaining the Presidency, and considering recent judicial conversations, we are reasonably confident that the Affordable Care Act will remain. Additionally, if Democrats manage to win both senate seats in the run-off elections in Georgia, then they will have a largely unobstructed ability to expand the Affordable Care Act.

Lastly, we will acknowledge three favorable end market fundamentals for healthcare services: (1) the aging population, (2) a shift to value-based care, and (3) the reimbursement environment. The US's 75yr+ population segment is projected to nearly double by 2050 (US Census), increasing demand for senior living facilities, in-house therapy and skilled nursing services. As described later, value-based care primarily benefits SNFs as they operate under lower cost, higher quality settings. Providers with high clinical quality are expected to increase market share as patients have increased leverage paying for value, rather than standard treatment. Lastly, CMS (Centers for Medicare and Medicaid Services) reimbursement rates in the SNF industry have increased steadily at 1.0% to 2.5% over the past 10 years, driving top line growth for facilities as a primary KPI.



Competitive Landscape

According to the US Nursing Home Market Summary by IQVIA, the skilled nursing vertical is quite fragmented. The top SNF operators competitive to Ensign include Genesis Healthcare (NYSE: GEN), HCR ManorCare, Life Care Centers of America (LCCA), and SavaSeniorCare. Out of this group, Genesis is the only publicly traded corporation.



Genesis operates in similar business segments to Ensign (Rehabilitation Therapy, Senior Living, Long-Term Care), consequently facing the same macro headwinds and industry trends. It is the largest skilled nursing player, managing about 100 more facilities across 11 more states than Ensign, posing as the current market leader in terms of operational presence. Despite this, GEN is terribly positioned, and bankruptcy looms on the horizon. GEN's long-term debt of $1.36bn, and net working capital of -$100mn puts its total debt around $1.45bn which is highly concerning given its equity value of ~$80mn. In fact, Genesis's management has released a going concern notice, acknowledging it is likely to breach its financial covenants soon: "it is unlikely that we will be able to generate sufficient cash flows to meet our required financial obligations … The existence of these conditions raises substantial doubt about our ability to continue as a going concern for the twelve-month period following the date the financial statements are issued (3Q20 10-Q). We believe the fall of Genesis and extreme market fragmentation across the skilled nursing vertical creates significant consolidation opportunities and will solidify Ensign's position as a market leader, both clinically and strategically.

Understanding Growth Strategy

Ensign's target growth strategy features four main highlights: (1) Growing their Talent Base and Developing Future Leaders, (2) Increasing the Mix of High Acuity Patients, (3) Improving Internal Operating Efficiencies, as well as (4) Adding Facilities and Expanding Existing Facilities.

By growing their talent base the company seeks to create strong local leadership who can continue the success of each operation (Thesis Point 1). Additionally, since Ensign's revenue is derived from occupancy rates, the company continues to attract patients to its operations by enhancing its reputation for quality care and fostering a community focused approach. Another critical factor in the company's expansion strategy is the acquisition of underperforming assisted living facilities. Once acquired, the company implements its proven operating model in order to increase efficiency, cash flow and eventually profit; thus, allowing these facilities to either maintain or increase occupancy rates.

Although the company has utilized its unique operating model to counter the COVID-19 pandemic, acquisitions have slowed during the year. Through the first three quarters of 2020 the company has made a total of 5 acquisitions including three Skilled Nursing Operations at an aggregate purchase price of $23mn. However, in 2019 the company completed 26 acquisitions with an aggregate purchase price of $149mn. Some of the most prominent acquisitions the company has made that has helped grow their two most important key performance indicators, occupancy rates and beds/units, have been outlined below:

a) 2020: Acquisition of both the real estate and operations of *The Healthcare Center at Patriot Heights,* a healthcare campus with 59 skilled nursing beds and 158 independent living units located in San Antonio. The acquisition is expected to strengthen its presence in Texas and more specifically the San Antonio market.
b) 2020: Acquisition of *Ridgeview Post-Acute* and *Irondale Post-Acute*, both of which are SNFs with a combined 188 nursing beds.
c) 2019: Acquisition of the real estate and operations of *Mission Palms Post-Acute*, a SNF with 160 skilled beds in Mesa, Arizona.

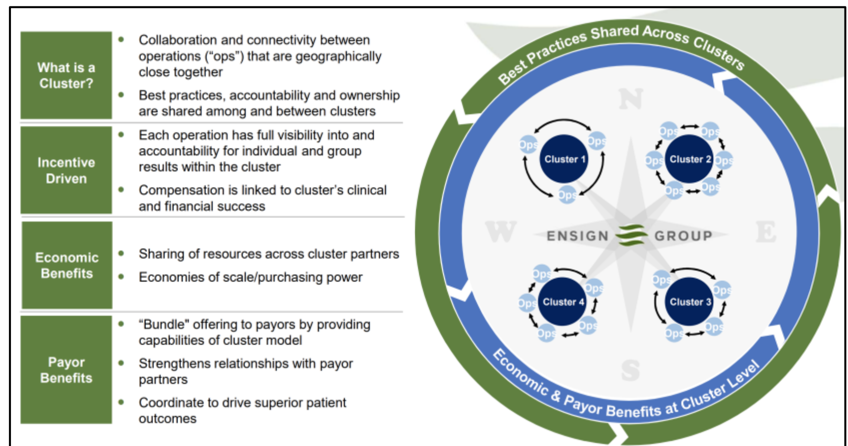
With operational skilled nursing beds playing a key role in the company's ability to increase occupancy rates, the company has made a consistent effort to target underperforming facilities with an adequate number of beds. Over the years the company has consistently increased their cumulative number of operational skilled nursing beds reaching 22,625 at the year ended 2019, marking a 15% increase from 2018 and a 174% increase since the start of the decade. Despite the company's inherent slow acquisition growth in the 2020 year, it is still poised for consistent expansion. As operating expenses have increased approximately 5-8% a quarter due to labor costs, and the demand for PPE and other infection prevention equipment grows, the company has expressed discipline and conservation in spending their cash. However, as discussed later, the company's liquidity remains strong with $175.4mn of cash on hand and another $342.4mn of available capacity under its line-of-credit facility. The company also received over $100 million from various government relief packages, most of which has been repaid. Although the company has made less acquisitions from previous years, it is also evident it has plenty of liquidity to initialize their growth strategy once the pandemic is over. More importantly, due to the widespread inefficiency of numerous nursing facilities, Ensign's liquidity has placed them in prime position to make several acquisitions at discounted prices (Thesis Point 1).

Thesis Point 1: Distressed Opportunities

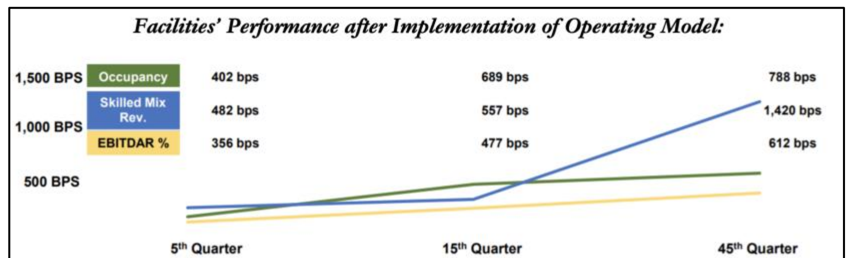
With COVID decreasing occupancy rates across facilities in the Providers & Services vertical, the marketplace is flush with discounted opportunities for management to identify, acquire and improve. We are excited about Ensign's proven clinical and strategic operating models and management's competence in targeting attractive opportunities (i.e., distressed assets, new ventures, or disciplined acquisitions), especially in today's distressed environment.

Ensign has a proven track record of successfully incubating new ventures through its unprecedented *Local Leadership* and *Cluster Model* organizational structure. Local leaders are regional healthcare experts; they navigate regulation, determine growth opportunities and identify localized acquisition targets. The company's *Cluster Model* facilitates collaboration between operations and local leaders that are geographically close. Compensation is linked to the cluster's clinical and financial success. Consequently, the cluster is incentivized to share best practices with all facilities—especially new acquisitions—to exceed targets. In fact, Ensign's buy-and-improve model averages around 14.4% growth in EBITDAR in just 5 quarters with continual improvement until plateau around the 45th quarter. As 23% of Ensign's SNFs have been operating for less than 3 years, we expect continual underlying improvement as facilities age in its portfolio.

In addition to Management's buy-and-improve competence, it also has the means and proper positioning for market exploitation. Ensign currently has $324.4mn capacity under its line-of-credit with Truist and $174.4mn cash on hand as of 3Q20. The company has signaled initial signs of utilizing its capital through its recent (Nov 2nd) SNF acquisition of *The Medical Lodge in Amarillo*. Although we do not know multiples, the property was 45% occupied at the time of acquisition, indicating Ensign purchased the facility at a severe discount and management will promptly implement necessary operational improvements.



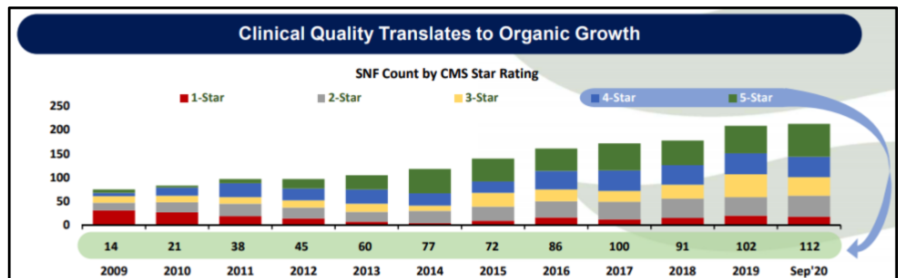
The company's Total Debt/EBITDA is 3.0x versus the comparable average of 4.5x. As referenced in the comparable company discussion, Ensign is uniquely discounted to peers which we think is a market inefficiency due to its debt capacity and ability to acquire cheap market opportunities.



Additionally, COVID has delayed transformation efforts of the company's newly acquired operations, which management believes presents "enormous upside" in all of its recent acquisitions. Coupled with distressed acquisitions on the horizon, Ensign is positioned to gain additional market share as it continues to improve occupancies and strengthen relationships with acute providers and healthcare partners.

In tandem with inorganic tailwinds, the company's reputation for clinical quality and response to the pandemic will materialize superior organic growth going forward, in our opinion. As Ensign sees a direct correlation between quality care and financial results, it has emphasized clinical quality across subsidiaries as a top priority. The company has done a phenomenal job containing the spread of COVID across most of its facilities: 297 confirmed COVID cases across 217 skilled nursing facilities and 161 facilities with no confirmed cases. Ensign's effectiveness in containing COVID puts its clinical operating model towards the top of the pack, which will be a big selling point for care going forward.

In summary, with COVID decreasing occupancy rates of mismanaged facilities, several discounted acquisition opportunities may arise for Ensign which is promising as the company has over $300mn in available capital to deploy, substantive liquidity, a proven clinical and strategic operating model and a track record of successfully exploiting a distressed landscape.

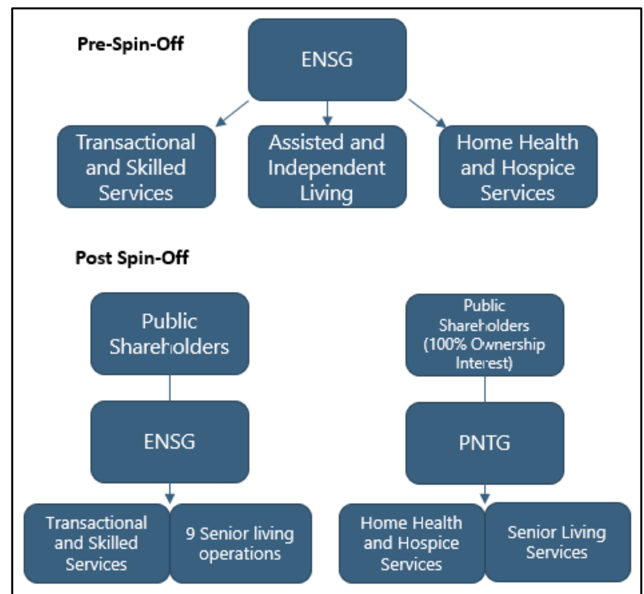


Thesis Point 2: Pennant Group Spin-Off

In October 2019, Ensign became a pure-play SNF provider after spinning off its home health, hospice care operations and nearly all its senior living operations into The Pennant Group. We believe this is a strong catalyst for earnings growth as management can focus on refining its core competencies in its Transitional and Skilled Services segment.

Executives have speculated that non-skilled care is subject to general market skittishness regarding post-acute and long-term care. As discussed later, this is clearly reflected in our comparable company analysis as our skilled nursing-based peer group records much higher multiples than its senior living peers. We believe Ensign has yet to re-rate as a pure SNF play.

Nonetheless, post spin-off, Ensign will be able to properly prioritize and execute SNF operations as complexity of services (and consequently daily revenue rates) continues to increase. By creating two "smaller but stronger" organizations, the management team can adapt to changing market conditions and focus on growing the individual segments. In addition, the spin-off has identified a closer link between Ensign's original business. Management has found that home health and senior living operate more synergistically than home health and skilled nursing. By splitting these segments up, the companies have allowed themselves the resources and time to master their respective segments.



In addition, the company have a track record of effective spin offs. It divested the majority of real estate operations into the CareTrust REIT back in 2014 and has almost entirely reduced its non-skilled nursing facility exposure today. Ultimately, these spin-offs will enhance the value of Ensign's non-SNF senior housing and care businesses as management focuses on perfecting its skilled nursing approach.

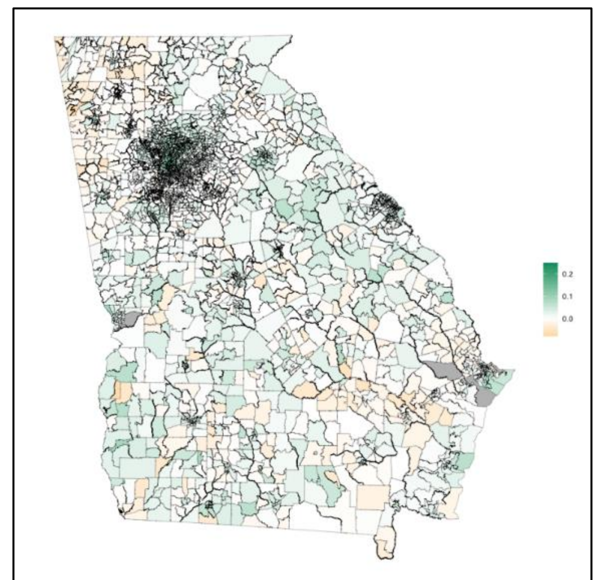
Thesis Point 3: Political Landscape

Democratic election results, reduced ACA repeal risk, and the general political landscape almost entirely eliminate the primary threat to Ensign's top-line, decreasing revenue stream uncertainty and solidifying management expectations.

The US's political climate has recently been a great source of uncertainty regarding the future of the healthcare. Trump's conservative administration and the recent confirmation of Amy Coney Barret jeopardized the future of the Affordable Care Act as it looked very likely that the Supreme Court would rule the Individual Mandate unconstitutional and strike down the entire Act. This was a major concern for Ensign as ~70% of revenues derive from government sponsored insurance.

However, to the dismay of conservatives, Chief Justice John Roberts and Associate Justice Brett Kavanaugh suggested that they would be in favor of keeping the Affordable Care Act intact even without the Individual Mandate. From a regulatory risk perspective, the most significant headwind facing the healthcare sector has largely been mitigated.

Uncertainty regarding other political headwinds on the healthcare sector are very much still intact. While Democrats have won control of the House of Representatives and the Presidency, control of the Senate is very much an uphill battle. On January 5th of 2021, both Senate seats in the State of Georgia will hold a run-off election. If Democrats manage to win both races, the Senate will be split 50-50 with Vice President-Elect Kamala Harris holding the tiebreaking vote. If the Democrats have complete control over the Legislative Branch and Executive Branch, the Affordable Care Act would almost certainly see expansion in its usage. The introduction of a public option for the Affordable Care Act would be a significant driver for companies across the healthcare sector, including Ensign. This, coupled with the millions of Americans who have lost their insurance since the beginning of the pandemic, presents a very enticing and significant tailwind for the healthcare sector overall.



Flipping both seats in Georgia is no easy task. While the state did vote Blue in the most recent Presidential Election, we see it as very unlikely that the Democrats manage to pick off both seats. The GOP is quite literally fighting for the party's political life and is not sparing any expenses to ensure that they hold the two crucial seats. Conservative political action committees such as the Senate Leadership Fund and American Crossroads are set to spend over $80 million on the two races. In addition, both Democratic candidates received significantly less votes on a statewide level during the General Election compared to President-Elect Joe Biden. Furthermore, the Democrats flipped Georgia for Joe Biden this November on

unprecedented turnout in Urban and Suburban communities. It is very unlikely that they will be successful in drumming up the enthusiasm to help push both of their candidates over the hump to victory.

In the likely event that it is a split Congress, the outlook on the healthcare sector will continue to remain strong. While rapid and widespread expansion of the Affordable Care Act will be extremely difficult with Senate Majority Leader Mitch McConnell in power, small and gradual expansions are more likely which will in turn benefit the healthcare sector. In addition, Joe Biden and Mitch McConnell have a history of stepping across the aisle to allow progress to occur during Joe Biden's tenure as Vice President.

In addition, the re-election of Joe Biden alone is a strong catalyst for future earnings for Ensign. The incoming administration has discussed policy that reduces the age of Medicare down to 60 from 65 and a tax plan that helps the solvency of these government-sponsored programs. All of these initiatives would further stabilize revenue and demand for Ensign's services (Medicaid ~46% of total revenue; Medicare ~25%). If Donald Trump was reelected, significant risks would have been presented to reducing spending for these programs.

Due to the likelihood of a split congress, we believe that Ensign will benefit greatly from this semi-split political environment. The company will be able to benefit from a growing number of recipients of the Affordable Care Act without being stretched thin due to rapid expansion. The unique political environment that Ensign finds itself in is volatile. This volatility, however, has led to a future that will allow Ensign to continue to grow.

Thesis Risks

One of the largest issues to the operational profitability of the company is the increased costs and staffing requirements directly related to CDC guidelines. While their facilities require more nurses, the threat of the virus has resulted in high turnover rates and departures of nurses as well as other skilled personnel. According to the International Journal of Mental Health, Nursing Certified Nurse Assistants, Social Workers, Therapists, have all experienced anxiety due to the immense threat the virus poses, and thus has created two interconnected issues. The first is the widespread shortages in adequately trained healthcare professionals due to the psychological anxiety and stress of COVID-19 patient care, and the second is the high turnover rate of these professionals. With a decreasing supply in high-quality personnel and the inability to also retain any trained specialists the company faces a serious risk of operational inefficiency. In addition, due to the high-risk nature of Ensign Group's patients, their susceptibility to COVID-19 virus can result in fatal outbreaks in facilities that eventually could lead to class-action lawsuits.

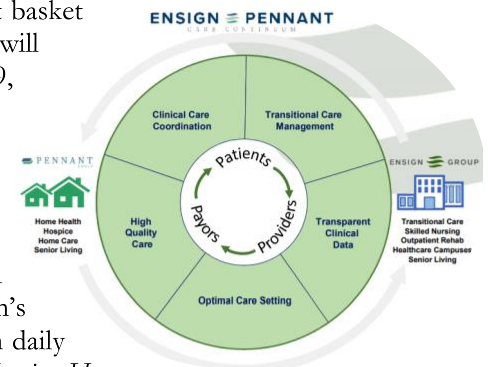
At the same time, the pandemic has pressured operating expenses, which have increased between five and eight percent due to the volume, cost, and type of PPE required to provide regulation level testing, cleaning and sanitization. Additionally, Ensign reports that they expect to experience increase in labor costs on a per patient basis, and thus in response they have reduced spending on non-essential supplies, travel costs, non-essential capital expenditure projects and multiple other discretionary items.

Valuation

Our Transitional and Skilled revenue projections derive primarily from expectations related to payor type (Medicare, Medicaid, Managed Care, Private / Other Payors, Other Skilled) and the segmentation is calculated as the product of three main metrics: Skilled Nursing Average Daily Revenue Rates, Actual Patient Days, and Percentage of Skilled Nursing Days. This buildup methodology allowed us to confidently forecast each metric based on industry expectations and management guidance.

Historically, average daily revenue rates have steadily increased due to providers taking in more complex patients. Ensign's management has been particularly effective in allocating towards higher paying patients, as illustrated by the average daily revenue rates and respective composition below. Additionally, Ensign's reputation for clinical quality (Thesis Point 1) will attract higher acuity patients (increased medically complexity) above and beyond its peers. This will result in higher reimbursement rates on a go forward basis. In fact, management has had a history of buying-and-improving distressed facilities by shifting convalescent SNFs to a higher-acuity model. In 2018, Medicare accounted for 3.6% of the country's GDP, which is expected to grow to 4.7% by 2027 under current policies. 70% of this growth is due to increases in per capita spending (Congressional Budget Office) that is driven by growth in payment rates rather than service use. Consequently, our team moderately projected available patient days, and primarily focused on average daily revenue rates.

Date	2017A	2018A	2019A	1Q20A	2Q20A	3Q20A	4Q20P	2020P	2021P	2022P	2023P	2024P
End date	12/31/17	12/31/18	12/31/19	3/31/19	3/31/20	9/30/20	12/31/19	12/31/20	12/31/21	12/31/22	12/31/23	12/31/24
Skilled Nursing Average Daily Revenue Rates ($) - BASE												
Medicare	569.77	580.96	607.24	657.78	661.05	656.43	656.43	657.92	677.66	691.21	698.13	705.11
Managed Care	440.55	447.34	458.26	472.74	493.1	493.78	493.78	488.35	498.12	503.10	508.13	513.21
Other skilled	451.16	475.34	490.93	514.81	530.57	535.22	535.22	528.96	544.82	555.72	561.28	566.89
Private and other payors	208.24	218.3	226.43	229.89	234.02	245.54	245.54	238.75	247.10	253.28	255.81	258.37
Medicaid	209.72	218.42	223.97	231.05	229.76	231.77	231.77	231.09	236.86	240.42	242.82	245.25
WA Daily Revenue Rate	**297.29**	**304.14**	**311.66**	**326.57**	**335.54**	**348.76**	**339.51**	**346.98**	**360.75**	**366.90**	**370.57**	**374.27**
Skilled Nursing Average Daily Revenue Rates (YoY % change) - BASE												
Medicare	NA	1.96%	4.52%					3.00%	3.00%	2.00%	1.00%	1.00%
Managed Care	NA	1.54%	2.44%					2.00%	2.00%	1.00%	1.00%	1.00%
Other skilled	NA	5.36%	3.28%					3.00%	3.00%	2.00%	1.00%	1.00%
Private and other payors	NA	4.83%	3.72%					3.50%	3.50%	2.50%	1.00%	1.00%
Medicaid	NA	4.15%	2.54%					2.50%	2.50%	1.50%	1.00%	1.00%
WA Daily Revenue Rate Growth	NA	**2.31%**	**2.47%**					**11.34%**	**3.97%**	**1.70%**	**1.00%**	**1.00%**
Occupancy - BASE												
Operational beds at end of period	18,870	19,615	22,625	22,883	22,907	22,991	23,073	25,299	27,739	30,415	33,349	36,566
Growth %	*NA*	*3.95%*	*15.35%*					*9.65%*	*9.65%*	*9.65%*	*9.65%*	*9.65%*
Available patient days	6,699,025	6,984,685	7,560,687	2,070,732	2,084,261	2,113,808	2,900,000	9,168,801	9,742,348	10,229,466	10,638,644	10,957,804
Growth %	*NA*	*4.26%*	*8.25%*					*21.27%*	*6.26%*	*5.00%*	*4.00%*	*3.00%*
Actual patient days	5,050,140	5,405,952	5,987,027	1,643,390	1,530,286	1,495,285	2,233,000	6,901,961	7,533,099	8,100,334	8,530,733	8,896,233
Growth %	*NA*	*7.05%*	*10.75%*					*15.28%*	*9.14%*	*7.53%*	*5.31%*	*4.28%*
Occupancy percentage	75.39%	77.40%	79.19%	79.36%	73.42%	70.74%	77.00%	75.28%	77.32%	79.19%	80.19%	81.19%
Percentage of Skilled Nursing Days - BASE												
Medicare	13.40%	12.60%	12.00%	12.40%	15.10%	16.90%	14.80%	16.90%	17.90%	17.90%	17.90%	17.90%
Managed Care	12.20%	12.00%	12.20%	12.40%	10.00%	10.90%	11.10%	10.90%	10.90%	10.90%	10.90%	10.90%
Other skilled	4.70%	4.90%	4.80%	4.50%	4.60%	5.00%	4.70%	5.00%	5.00%	5.00%	5.00%	5.00%
Private and other payors	12.50%	12.20%	12.10%	11.50%	11.30%	10.80%	11.20%	10.80%	10.80%	10.80%	10.80%	10.80%
Medicaid	57.20%	58.30%	58.90%	59.20%	59.00%	56.40%	58.20%	56.40%	55.40%	55.40%	55.40%	55.40%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**



While the increases in daily revenue rates is also partially attributable to YoY market basket increases, we believe the introduction of the Patient Driven Payment Model (PDPM) will serve as an additional tailwind for growth. After its implementation on October 1, 2019, PDPM has worked to combat the conflict of interest between volume of services and financial incentives. As previously mentioned, Ensign is strategically positioned to embrace value-based care at the local level. Management has implemented the Ensign Pennant Care Continuum (EPCC), a structure that empowers local leaders to collaborate across facilities in order to maximize clinical quality. This positioning and aforementioned rate trend justify our assumption that daily average revenue rates will continually increase around 3.8%. In fact, it is slightly conservative given Ensign's regional exposure. The Pacific region recently saw the highest percentage increase in daily revenue rates of around 10.3% (Marcum Accountants and Advisors: *A Five-Year Nursing Home Statistical Analysis*) and 23.95% of Ensign's operational beds (either skilled nursing or senior living) are out of California and Washington.

Although we are confident ACA repeal risk has reduced significantly and the current political environment will serve as a tailwind for Ensign, we projected a draconian scenario accounting for a full repeal of Obamacare. Low- and moderate-income citizens eligible for Medicaid would be primarily affected. According to a March 2019 analysis by the Urban Institute, full repeal of the ACA would cause enrollment in Medicaid to fall by 22.4%. In other words, 23.3mn people stand to lose coverage, which is a 7.72% decline across the board, considering that 92% of the population is currently covered. In this scenario, our discounted cash flow projections and trading comps imply a blended intrinsic value of $54.51 per share (-22.0% downside).

Fortunately, we are reasonably confident that recent Supreme Court conversations and the current political landscape increases Ensign's margin of safety, if not serving as a tailwind. Coupled with our theses that management will exploit the distressed acquisition landscape and refine its operational strategy as a pure play, our revenue projections are slightly above street with profitability (EBITDA margins) in line.

Multiple Approach					
	Terminal Value EBITDA Multiple				
WACC	10.7x	11.7x	12.7x	13.7x	14.7x
8.05%	73.41	78.82	84.23	89.65	95.06
7.80%	74.06	79.53	84.99	90.46	95.92
7.55%	74.72	80.24	85.76	91.27	96.79
7.30%	75.39	80.96	86.53	92.10	97.67
7.05%	76.07	81.69	87.32	92.94	98.56

Perpetuity Approach					
	LT Growth Rate				
WACC	0.50%	0.75%	1.00%	1.25%	1.50%
8.05%	66.40	68.28	70.30	72.46	74.79
7.80%	68.75	70.78	72.96	75.31	77.84
7.55%	71.27	73.47	75.83	78.38	81.14
7.30%	73.98	76.36	78.93	81.71	84.72
7.05%	76.89	79.48	82.28	85.32	88.63

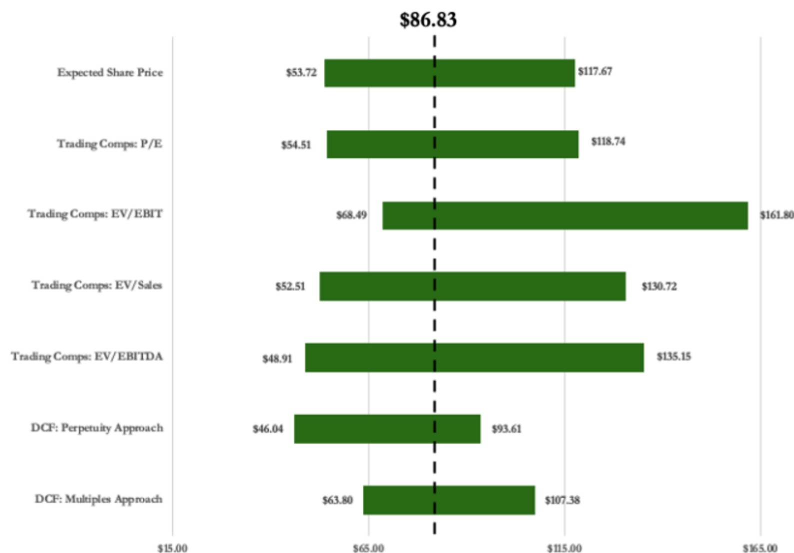
Based on our assumptions detailed above, we valued the company using discounted cash flows and trading comps. We believe the company's fastest growth will occur in 2021 as the democratic administration settles into office, COVID vaccine distribution increases occupancy rates, and management fosters both inorganic (i.e., distressed landscape) and organic (i.e., clinical quality) expansion. We used Ensign's TTM EV/EBITDA of 12.7x and a long-term growth rate of 1.00% in our multiple and perpetuity DCF analyses. Ensign is trading at a 28.3% discount to peers (17.8x) on an EV/EBITDA basis, increasing trading comp valuation expectations and our multiple approach if using the comparable multiple.

Multiple Approach

		Terminal Value EBITDA Multiple				
		15.8x	16.8x	17.8x	18.8x	19.8x
WACC	8.05%	100.66	106.07	111.48	116.89	122.31
	7.80%	101.57	107.03	112.50	117.96	123.43
	7.55%	102.49	108.01	113.53	119.05	124.56
	7.30%	103.43	109.00	114.57	120.14	125.71
	7.05%	104.38	110.00	115.63	121.25	126.87

The inflated comparable multiple is primarily due to the market's mispricing and delayed re-rating of Ensign after the Pennant Group spin-off. Currently, the market has priced Ensign as a diversified player with both senior living and SNF revenue streams. Given the low cost, high quality settings of SNFs, they usually trade at higher multiples compared to senior living peers. As Ensign is now a pure SNF play, we expect the market to re-rate as coverage picks up and our thesis plays out.

Company	Stock Price 11/20/20	Market Value of Equity	Enterprise Value	Enterprise Value / LTM Sales	EBITDA	Gross	LTM Margins EBITDA	EBIT	Total Debt / EBITDA	P/E	EV/EBIT
Select Medical Holdings (SEM)	$24.86	$3,350,200	$7,902,600	1.5x	9.2x	14.9%	17.5%	8.7%	5.6x	20.5x	9.2x
Brookdale Senior Living (BKD)	$3.99	$731,700	$5,761,000	1.6x	23.2x	41.1%	8.8%	-1.1%	12.1x	21.1x	-
National Healthcare (NHC)	$64.60	$992,200	$758,800	0.8x	6.9x	-	13.1%	5.2%	1.8x	16.6x	18.8x
Encompass Health (EHC)	$78.84	$7,839,300	$11,650,600	2.5x	13.4x	-	21.3%	15.0%	4.3x	27.1x	19.0x
Pennant Group (PNTG)	$47.20	$1,330,500	$1,634,700	4.4x	28.9x	13.2%	13.1%	1.7%	5.6x	89.0x	121.7x
Amedisys (AMED)	$241.10	$7,910,600	$8,203,500	4.0x	35.1x	41.2%	11.9%	9.1%	1.7x	46.6x	41.3x
HCA Healthcare (HCA)	$147.34	$49,856,100	$78,140,100	1.5x	8.1x	-	19.9%	14.1%	3.4x	13.7x	11.4x
US Physical Therapy (USPH)	$106.72	$1,371,400	$1,581,600	3.7x	17.4x	-	22.4%	14.0%	1.0x	41.2x	30.1x
Ensign Group (ENSG)	**$69.90**	**$3,791,500**	**$4,715,900**	**2.0x**	**12.7x**	**20.4%**	**15.0%**	**6.3%**	**3.0x**	**25.0x**	**15.4x**
Mean				2.5x	17.8x	27.6%	16.0%	8.3%	4.5x	34.5x	19.0x
ENSG vs. Mean				-19.0%	-28.3%	-26.0%	-6.3%	-23.9%	-33.4%	-27.4%	-18.7%
Top Quartile				3.8x	24.6x	41.1%	20.2%	14.0%	5.6x	42.5x	35.7x
Bottom Quartile				1.5x	8.9x	14.5%	12.8%	4.3%	1.8x	19.5x	15.1x



Combining our DCF and trading comp methodologies, we arrived at a $86.83 target price, implying 24.23% upside. Our weighted average expected share price was influenced by the following: DCF Multiples Approach (25%), DCF Perpetuity Approach (25%), EV/EBITDA Trading Comps (25%), EV/Sales Trading Comps (15%), EV/EBIT Trading Comps (5%), and P/E Trading Comps (5%). We deemed it appropriate to weight the DCF methodologies and EV/EBITDA the highest given our thesis inclusion in the DCF and industry acceptance of EV/EBITDA.

Conclusion

In addition to our aforementioned thesis points, it is important to note that Wall Street has given Ensign little attention and coverage. Four small/medium investment banks issue ratings on the stock, but none have released an initiation report or any type of long form research. In fact, only one analyst was on the Q3 earnings call. The street's lack of engagement with ENSG is surprising given its size (~$3.79bn) and positioning for growth. We believe that once hedge funds discover ENSG, and banks initiate coverage, the stock, at the very least, should reach a valuation in line with its peer group. During our due diligence, we started to see this conjecture unfold. Wasatch's small cap growth fund—which has significantly and consistently outperformed its benchmark (Russell 2000 Growth Index) every year of existence (founded in 2011)—added 14% to its ENSG position on November 10th, increasing its exposure to $71.4mn (~2.3% outstanding). Additionally, Stephens & Co. released a price target of $79 on November 11th. These coverage-related headlines are promising in addition to our fundamental theses for value appreciation:

(1) Ensign's proven operating model is poised to exploit the discounted facility landscape and emerge post-pandemic with a heightened reputation for clinical quality, a huge organic growth driver as the industry shifts to value-based care.
(2) Management will refine its core competencies in TSS after its spin-off of The Pennant Group.
(3) The political landscape and reduced ACA repeal risk has diminished the primary threat to Ensign's top line.

With the above catalysts for growth and recent positive development regarding vaccines and judicial conversations, our team expects a mid to near-term materialization of our $86.83 (+24.2%) price target.