

FINAL TRANSCRIPT

Medical Facilities Corporation

2018 Second Quarter Results Conference Call

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PRESENTATION

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation 2018 Second Quarter Results Conference Call.

Before turning the call over to management, listeners are reminded that certain statements made in today's call, including responses to questions, may contain forward-looking statements within the meaning of the safe harbor provisions of Canadian provincial security law. Forward-looking statements involve risks and uncertainties, and undue reliance should not be placed on such statements.

Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied in such statements. For additional information about factors that may cause actual results to differ materially from expectations, about material factors or assumptions applied in making forward-looking statements, please consult the MD&A for this quarter, the Risk Factor section of the Annual Information Form, and Medical Facilities and other filings within Canadian security regulators.

Medical Facilities does not undertake to update any forward-looking statements. Such statements speak only as of the date made.

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Listeners are also reminded that today's call is also being recorded for the benefit of individual shareholders, the media, and other interested parties who may want to review the call at a later time.

I would now like to turn the meeting over to Mr. Rob Horrar, President and CEO of Medical Facilities.

Sir, you may begin.

Rob Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Thank you, Operator, and good morning, everyone. Joining me on the call today is Tyler Murphy, our Chief Financial Officer; and Jim Rolfe, Chief Development Officer.

Earlier this morning, we released our second quarter financial results. Our news release, financial statements, and MD&A may be accessed through our corporate website at www.medicalfacilitiescorp.ca and were also filed on SEDAR today.

Before I turn the call over to Tyler to review our financial results, I would like to discuss the importance of our acquisition of the seven ambulatory surgery centres in February this year through our partnership with NueHealth, which we refer to as MFC Nueterra.

As many of you already know, in addition to organic growth, a key part of our growth strategy is to increase and diversify our revenue base through strategic acquisitions of physician-aligned ambulatory surgery centres and surgical hospitals. Our Q2 results underline the importance of the increase in diversified revenue base.

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The MFC Nueterra ASCs provide medical procedures, including orthopaedic surgery, neurosurgery, and pain management. The addition of these ASCs significantly expanded our capacity and footprint, adding 18 operating rooms and 8 procedure rooms, more than doubling the number of facilities in our portfolio, and more than doubling the number of states in which we operate from 5 to 11.

In the second quarter, the ASCs added 3,614 outpatient cases to our case volume and contributed revenue of \$9.6 million, accounting for most of our revenue growth in Q2.

I'll discuss the benefits of our partnership with NueHealth in more detail when I discuss our outlook later in the call. But for now, I'd like to turn the call over to Tyler to discuss our second quarter financial results.

Tyler?

Tyler Murphy — Chief Financial Officer, Medical Facilities Corporation

Thanks, Rob. As per usual, I'd like to note that all the dollar amounts expressed in today's call are in US dollars, unless otherwise stated.

Our revenue for the quarter increased 10.8 percent to \$106.5 million compared to \$96 million in Q2 of last year. As Rob mentioned, most of this increase came from the Nueterra ASCs.

Total certifications were up 39.5 percent, with a 60.9 percent increase in outpatient cases being partially offset by a 5 percent reduction in inpatient procedures. Excluding MFC Nueterra, same-

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facility case volume was flat. We did see notable volume increases at Unity Hospital in Black Hills, but they were offset by decreases in ASH and Sioux Falls Surgical Hospital.

Our case volume for the quarter was negatively impacted by unusually high rate of physician absences, due both to vacations and illnesses.

Looking at our payor mix for the quarter, including MFC Nueterra, surgical case volume from commercial insurance was up 111 percent and case volume from Medicare was up 63 percent.

While I mentioned Unity case volume was up in the quarter, revenue was down. But this was mainly due to fluctuations in contractual reserves last year. If you look at the six months year to date for Unity, income from operations is actually up 1.2 million versus prior year.

We had EBITDA of 23.9 million for the quarter, representing an increase of 3.4 percent over the second quarter of last year. However, EBITDA as a percentage of revenue fell to 22.5 percent from 24.1 percent a year ago, as the incremental contribution from MFC Nueterra of 2.3 million and increases at Black Hills and Oklahoma Spine were offset by decreases at other facilities.

Also, the divestiture of IMD sharpens our focus on growing our core businesses and partnering with physicians to own and operate high-quality health care facilities.

Cash available for distribution in Q2 was 11.7 million, which is down 2.9 percent from this time last year. On a per common share basis, cash available for distribution of C\$0.38 was \$0.01, or 2.6 percent lower than the same quarter last year. Distributions remained constant at C\$0.28,

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resulting in a payout ratio of 74.3 percent in Q2, and up slightly from 72.4 percent in the same period last year.

At June 30, 2018, the Corporation has consolidated net working capital of negative \$9.1 million compared to 33.8 million at December 31, 2017. The change was mainly due to the acquisition of MFC Nueterra ASCs in the first quarter of 2018.

At the end of the quarter, we had cash and cash equivalents of \$37.2 million and about \$12.2 million available on our credit facility.

For additional detail on our financial results, including specific results for each centre, please refer to our MD&A.

I would now like to return the call to Rob to provide a few comments on our outlook before we open the call for questions.

Rob?

Rob Horrar

Thanks, Tyler. Looking ahead to the balance of the year and beyond, we will continue to focus on enhancing and adding services at our existing facilities, including the recruitment of new physicians and the addition of ancillary services, such as urgent care clinics to further diversify our service offering.

As you know, hospital systems face a tough reimbursement and expense environment and are looking for ways to lower the cost of care. With a strong and growing portfolio of facilities, our

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scale enables us to leverage operational efficiencies. As our growth continues, we will focus additional time and attention on assisting facility partners, improve efficiencies with value-add services like group purchasing, and the sharing of best practices.

With MFC Nueterra, our seven ASCs are included in NueHealth's corporate procurement program, which leverages their 50-plus facilities under management to achieve cost savings. We would expect to achieve further synergies from any future ASCs we may acquire or develop with this new platform.

We remain focused on building scale and further diversifying our portfolio through accretive acquisitions. And while our pipeline of acquisition opportunities remains strong, I would add that the ASC acquisition market in particular is characterized by a highly competitive buyer landscape, as ASC management companies are under pressure to grow through acquisitions in order to meet their investor expectations.

Finally, with our track record of superior care with our facilities being the hospital of choice in their respective communities, we are well positioned to benefit from the increased demand for surgical services due to the increasing average age of life expectancy of the United States population.

With that, we would now like to open the line for questions.

Operator?

Q&A

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**Operator**

Ladies and gentlemen, to ask a question, please press *, 1, on your telephone keypad. We'll pause for a moment as questions come into queue.

Your first question comes from Neil Linsdell with Industrial Alliance. Your line is open.

Neil Linsdell — Industrial Alliance

Hey. Good morning, guys.

Rob Horrar

Morning.

Tyler Murphy

Morning, Neil.

Neil Linsdell

Hey. Okay. Just to start off with the ASCs and the NueHealth partnership, you talked about the landscape for acquisitions. Are you getting more aggressive buyers looking at the ASCs out there that you're also looking at? Is that right?

Rob Horrar

That's correct. I think that feeds off of itself, Neil, more activities sort of begetting some more opportunity. And it was very helpful for us doing the partnership to really bolster our pipeline. So there's just a lot more activity I think is the comment.

Neil Linsdell

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Okay. And so with the NueHealth partnership that you have, they manage, I think, it's 50 different facilities, and there's ones in that network that might be particularly attractive for you to add to your—the JV, I guess?

Rob Horrar

Yes. That's a part of it, correct.

Neil Linsdell

Okay. And has there been any kind of progress on those types of discussions since—

Rob Horrar

Yeah. I think I would tell you—and Jim Rolfe is here; I'll turn it over to him—and I'll tell you that the pipeline really it continues to be strong, so.

Jim Rolfe — Chief Development Officer, Medical Facilities Corporation

Yeah. Neil, it is. The pipeline is very strong. As Rob said, we maintain a strong pipeline. We're in advanced discussions with several in-market tuck-in acquisitions, but also new market acquisitions as well.

The thing about it is, there's been some consolidation in the ASC market. And so the onesies and twosies as far as ASCs has been a little bit less competitive than the platform acquisitions. And so yeah, we remain strong on that. But we also are ... been heavily involved in organic growth initiatives in several of our centres as well.

Neil Linsdell

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Okay. All right. And last quarter we were talking about the synergies from the NueHealth, their purchasing capacities, and I think Vanderbilt as well. And you were talking about \$0.5 million in initial savings, and then there were more that could come on after that. Can you give us an update on how that's been progressing?

Rob Horrar

Yeah. So I'll just note that on two fronts the Vanderbilt initiative for us, it was fully implemented and we continue to see benefits from that. And I would tell you that we see that number growing as we find additional opportunities. It's not just a one-shot deal. We'll continue to add opportunities to save even on implants and other initiatives through the purchasing cooperative.

And on the NueHealth side, that again the ASCs could benefit from the NueHealth GPO program, and that was also fully implemented in mid Q2. So we'll start to see the benefit of the savings on that as well.

Neil Linsdell

So can you quantify—

Rob Horrar

So all—

Neil Linsdell

Can you quantify your expectations?

Rob Horrar

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Yeah. I think, again, I think we said around 0.5 million. We'll see that continue to go up and improve. To get—we're not fully baked in all of that in terms—it's all fully implemented, but there are more and more programs that we can add to it as we work with each of our partner facilities.

So I really don't have any guidance on that particular number, but it'll continue to increase. We haven't topped off I think is the comment.

Neil Linsdell

Okay. Fair enough. And I'll just kind of leave it a kind of a broad open question. If we look at the competitive environment and the regulatory environment, there's things like the ... we talked last quarter about the knee opportunity, taking that inpatient, and the competitive environment, say, in South Dakota, or in other places where you have competitors that are not new competitors, but they're trying to improve their offering. Any kind of update on what you've seen? Any kind of reaction from the doctors or other partners that you have?

Rob Horrar

No, not on the competitive front. I'll tell you that the total joint is—as we've mentioned before here—total joints, the demand for that is increasing. We continue to see inpatient demand on total joints as well. But the future opportunity, clearly, is on the outpatient side.

So I think, if anything, that will continue to be an opportunity, both for our hospitals and our ASCs. And nothing ... at this point nothing on the competitive front that's impacted any of our hospitals, other than the normal.

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Neil Linsdell

Okay. So no churn in doctors or anything like that as well?

Rob Horrar

No.

Neil Linsdell

Okay. Perfect. Thanks.

Operator

Again, to ask a question, please press *, 1 on your telephone keypad.

Your next question comes from Endri Leno with National Bank. Your line is open.

Endri Leno — National Bank Financial

Hi. Good morning, and thanks for taking my questions. I was wondering if you can comment a little bit on UMASH's revenue and operating income decrease? What was the contractual change that happened there?

Tyler Murphy

Yeah. I mean, the change is just—it'll even out over the year. It was just a different ... looking at different reserves. We had, obviously, a new financial ... a new CFO come in, and we're just making sure that we're looking at everything on a full potential.

We had a little bit some changes in reimbursement up there with Blue Cross and some other things. And so it's ... really looking at UMASH, I think you need to look at it on a broad basis. Again,

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for the first six months, again, it's actually doing quite well compared to last year, and over the year I think we'll be fine.

Endri Leno

Okay. I mean, is it possible to quantify what the operational income would have been without the contractual services changes? Or no?

Tyler Murphy

No. We don't—I mean, we don't really ... we haven't really broken it out. Again, if you look at the ... if you look at it over the six months, I mean, they're actually up over \$1 million from last year. So we feel good about our prospects there. We have a lot of in-market activity, and we're creating new positions and really working on that market.

It's a big concentration of ours, and so we feel good about prospects as we go forward.

Operator

And there are no further questions queued up at this time. I turn the call back over to Mr.

Rob Horrar.

Rob Horrar

Thank you for participating on today's call, and for your continued interest in MFC. We look forward to reporting on our progress next quarter.

Thank you.

Operator

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This concludes today's conference call. You may now disconnect.

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