FINAL TRANSCRIPT

Medical Facilities Corporation

2019 First Quarter Results Conference Call

Event Date/Time: May 9, 2019 — 8:30 a.m. E.T.

Length: 21 minutes

CORPORATE PARTICIPANTS

Robert Horrar
Medical Facilities Corporation — President and Chief Executive Officer

Tyler Murphy
Medical Facilities Corporation — Chief Financial Officer

Jim Rolfe
Medical Facilities Corporation — Chief Development Officer

CONFERENCE CALL PARTICIPANTS

Lennox Gibbs
TD Securities — Analyst

Neil Linsdell
Industrial Alliance — Analyst

Stephen Kwai
National Bank Financial — Analyst

PRESENTATION

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation 2019 First 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 securities laws. Forward-looking statements involve risks and uncertainties, and undue reliance should not be placed on such statements. Certain material factors or assumptions are implied 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 and about material factors or assumptions applied in making forward-looking statements, please consult the MD&A for this quarter, the Risk Factors section of the Annual Information Form and Medical Facilities' other filings with Canadian securities regulators.

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

Listeners are also reminded that today's call is 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'd now like to turn the meeting over to Mr. Rob Horrar, President and CEO of Medical Facilities. Please go ahead, Mr. Horrar.

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

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

Earlier this morning, we released our first quarter 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.

Our case volume was up significantly for the quarter as we added 1,387 surgical cases compared to the first quarter a year ago. That represents an increase of 12.4 percent comprised of same facility volume increases in a full quarter of contributions from MFC Nueterra ASCs we acquired in February of last year, which obviously only contributed partial results to the first quarter of 2018.

While our case volume was up, the composition of case mix and payor mix was different. In fact, this past quarter shows the impact that changes in our payor and case mix can have on our financial results.

Changes in payor and case mix impacted our revenue growth for the quarter and our operating results. This highlights the importance of our strategy to diversify our assets through the acquisition and development of physician-aligned ambulatory surgical centres and surgical hospitals and to drive same-facility growth.

We made good progress against this strategy in 2018 with the substantial expansion of our geographic footprint as a result of acquiring the seven MFC Nueterra ASCs and the diversification of our service offering, such as opening two urgent care centres. Clearly, the progress we made in 2018 has better positioned us for continued growth.

We have a broad and robust pipeline of acquisition opportunities comprised of ASCs and surgical hospitals. Our pipeline, with respect to ASCs, is bolstered by our MFC Nueterra partnership. And as always, we are diligent in evaluating new opportunities that are accretive to our portfolio. Whether through acquisition or opening new urgent care clinics, growing and diversifying our national presence reduces our risk that may arise in a particular geography including changes in payor mix.

We also continue to grow organically at our existing facilities, recruiting more physicians as well as adding new operating and procedure rooms.

Our growing presence also better positions us to capitalize on one of the biggest drivers of medical spending in the United States over the next decade or so, and that is the growth of 65-and-older demographic. This age group is expected to grow from around 53 million today to over 71 million by 2030. And as this group grows and people live longer, we expect there to be a higher need for orthopaedic and other surgical procedures.

I would like to now turn the call over to Tyler to discuss our financial results for the quarter.

Tyler Murphy — Chief Financial Officer, Medical Facilities Corporation

Thanks, Rob. As usual, I would like to remind everyone that all of the dollar amounts expressed in today's call are in US dollars unless otherwise stated.

I would also like to point out that effective January 1, 2019, our financial results include the impact of IFRS 16, a substantial change to lease accounting standards.

MSC adopted IFRS 16 using the modified retrospective approach, and our financial results prior to 2019 were not restated. As a result, when comparing our 2019 EBITDA to periods prior to January 1, 2019, the impact of IFRS 16 should be considered.

We had revenue of 99.1 million, which was up 1.5 million, or 1.5 percent, compared to the 97.6 million in the first quarter of last year. In the first quarter of 2019, we had a full quarter of revenue from the MFC Nueterra ASCs versus two months in the first quarter of 2018. That contributed 2.7 million in extra revenue compared to quarter one of 2018.

The higher case volume represented 2 million in revenue but was offset by the changes to our payor mix and case mix, as Rob alluded to earlier. Surgical case volume growth over the same period last year came mostly from Blue Cross/Blue Shield, which was up 34.8 percent, and Medicare cases, which were up 16.4 percent compared to Q1 of last year.

While we experienced a small increase in revenue, income from operations was down 14.1 million in Q1 of 2018 to 10.2 million in Q1 of 2019. Consolidated EBITDA was down 4 percent to 19.3 million for the quarter. As a percentage of revenue, our EBITDA margin was 19.5 percent compared to 20.6 percent for the prior year.

The decrease was due to lower EBITDA from a few facilities, most notably Unity Medical, with these decreases being mostly offset by the IFRS 16 impact for the quarter. The variance at Unity was due primarily to payor mix with a higher proportion of governmental payors as well as an increased proportion of lower-acuity cases.

In Canadian dollars, our cash available for distribution for the first quarter was 5.3 million, down from 9.4 million in the first quarter of last year. Our resulting payout ratio for the quarter was 166.3 percent compared to 92.2 percent for the same period a year ago.

I would like to add here that our financial results do exhibit some seasonal fluctuations with the fourth quarter generally being the strongest quarter for us as we typically see patients using any remaining deductibles of their insurance coverage for the year.

Just as a point of reference, over the past several years, going back as far as 2013, the first quarter has been our weakest quarter. All of this to say that a single quarter can be impacted by seasonal variations that do not necessarily impact our ability to pay dividends over a longer period of time.

Looking briefly at our balance sheet, at the end of the first quarter of 2019, we had cash and cash equivalents of 46.5 million and about 81.2 million available on our credit facility. This is in line with what our cash balances were at the end of 2018.

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

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

Q&A

Operator

At this time, I'd like to remind everyone in order to ask a question, please press *, followed by the number 1 on your telephone keypad. And we'll pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Lennox Gibbs with TD Securities. Go ahead, please. Your line is open.

Lennox Gibbs — TD Securities

Good morning. Thanks. UMASH, is there any demographic or any other sort of structural changes in UMASH's markets that might explain the increase we saw in the government pay on the quarter? That's the first part of the question.

And then secondly, as you look at that payor mix that we saw in the quarter, is that indicative of what we may see in coming quarters?

Robert Horrar

Well, so I'll take that, Lennox. This is Rob. First off here, we made good progress at Unity last year and, overall, we saw, for the quarter, our volume grow there. The issue is that we had a lower-acuity of those surgeries. And what we see from fourth quarter to first quarter, we generally have a higher commercial payor mix in the fourth quarter of the year so that we typically see more governmental payors in the first quarter as a result of just those compressions.

So it's a little bit more I think in this case. But it's evenly split at Unity between payor mix and what we just talked about on the government payors and the case mix, which was the lower-acuity surgeries for the quarter.

Lennox Gibbs

Thank you. Well, then I'll switch the question maybe to case mix—

Robert Horrar

Yeah.

Lennox Gibbs

—and whether or not what we saw in the quarter is indicative of what we might see in additional quarters. Or is this just sort of an anomaly in terms of the lower-acuity cases?

Robert Horrar

Well, we think it's more of an anomaly when we're talking about higher case mix, higher level of acute surgeries, those take a while to source, to preauthorize through insurance and so forth. So we think we're—there's been no trend, no demographic change, nothing that would indicate that it would be a continuing issue.

Lennox Gibbs

Okay. Thanks. And then secondly on Black Hills, can you speak to any changes you may have seen in referral patterns in that market relative to recent quarters? And also, speak specifically to procedural volumes trends at that facility.

Robert Horrar

Sure. So I assume you were referencing the competition that opened at the beginning of the year, and we have not seen any referral pattern changes. If anything, we've seen great success in opening our urgent care in Gillette, Wyoming as well as a clinic there. So I think that's very positive for us.

This facility has also, as we mentioned our last call, recruited four new surgeons. They're ramping up as well. So no issues particularly there.

Lennox Gibbs

Okay. Thanks very much. I'll get back in the queue. Thanks.

Robert Horrar

Thanks, Lennox.

Operator

Your next question comes from the line of Neil Linsdell from Industrial Alliance Securities. Go ahead, please. Your line is open.

Neil Linsdell — Industrial Alliance

Yeah. Good morning, guys.

Robert Horrar

Good morning.

Neil Linsdell

So just from everything you've been talking about, it does sound like Q1, there's really nothing to be read into the activities, the payor mix, the case volume, that would necessarily reflect any kind of changes through the rest of this year or into next year from normal patterns.

Tyler Murphy

Yeah. I would think that's correct. There's nothing—we're not seeing anything in any of our markets that would show a change to just kind of the normal progression. So I think, as Rob alluded to, the first quarter we have a lot more Medicare patients than we do in the fourth quarter, and that trend every year in US health care continues to kind of keep going that way.

Neil Linsdell

Okay. Just every now and again we hear a story about a surgeon that was out on leave and case volumes got deferred as a result of that. Any kind of issues or any kind of changes that we've seen in the surgeons on staff for availability or that type of thing?

Tyler Murphy

Well, we have had some of those. And that was predominantly the issue for us at Black Hills, given all the good growth strategies they've implemented. We did have a couple of physicians who weren't available in the first quarter, but as we've seen, that evens out over the course of the year. But it was an impact again.

Neil Linsdell

Okay. I don't know if Jim's there to talk about it. How's the recruiting or the acquisition strategy coming along? Any—well, you can't tell us if there's anything imminent, I'm sure. But have you seen any changes in attitude as far as being more receptive with the environment?

Jim Rolfe — Chief Development Officer, Medical Facilities Corporation

Yeah. You know, Neil, we remain very focused on acquisitions of ASCs and surg hospitals. We also are focused on the development of new partnership ASCs around our current market. And it seems like over the last six or eight months I've been on a plane about every week continuing current discussions with advanced discussions, but also looking at a lot of new deals.

And again, we're very, very protective of things that are adjacent to our current assets, and so there are a lot of deals that I'll look at that don't fit our criteria. So I just have on them. But, yeah. I've been on a plane about every week trying to advance discussions and expand our pipeline.

Neil Linsdell

Okay. And have you had any additional support or extra activity lately from some of your partners on both the potential to acquire more ASCs or put them in your network? And also, on the other partners you have as far as recognizing more cost synergies in your businesses?

Jim Rolfe

The answer on that is yes and yes.

Robert Horrar

So yeah. NueHealth, I'll give you a little bit colour. Our partnership with NueHealth's been very important to that. It adds to not only the operating credibility, but it's given us a good platform to go have those discussions in partnership on the ASC side.

We've had good cost synergies through our GPO initiative we've called out before, a lot of good participation there. NueHealth has its own GPO initiatives that we could take advantage of as well.

So on the cost side, we've had a very significant win strategy with our GPO affiliation with Vanderbilt Health.

Neil Linsdell

Okay. And just lastly, anything on the macro side that we should make sure we pay attention to, as far as I think we saw some surgeries, there was much more of a push to doing them as day surgeries. Anything else on the health care industry coming up?

Robert Horrar

Well, for the most part, we see—I think this year the market basket's going to be more favourable than it was last year for CMS, which will pay in '19, '20. That's a very favourable part of that rule. CMS will pay hospital departments the same as ASCs, which I think gives everybody a level playing field. And I see that as more of an opportunity for us on the acquisition and joint venture opportunities with health systems. So that's it.

We continue to see a migration to outpatient surgery as technology and benefits afford that. So all that's a very good trend and why we're focused on growing that pipeline.

Neil Linsdell

All right. Well, tell Jim to get on a flight somewhere. Thanks a lot, guys.

Jim Rolfe

Thanks, a lot.

Robert Horrar

Thank you.

Operator

Your next question comes from the line of Stephen Kwai from National Bank Financial. Go ahead, please. Your line is open.

Stephen Kwai — National Bank Financial

Hey, guys. Thanks for taking my questions. I'm just calling on behalf of Endri Leno. Just a couple questions from me. Could you just tell us the IFRS 16 benefit to EBITDA for the quarter?

Tyler Murphy

It's 2.8 million—

Stephen Kwai

Okay. Great. Thank you.

Tyler Murphy

— versus against the prior year.

Stephen Kwai

And just on the hospital level a little bit, and could you talk a little bit about Unity and actually the MFC Nueterra? What drove the lower year-over-year results on operating income? And is this going to change like how you approach future acquisitions?

Tyler Murphy

Well, I think on Unity, as we've talked about in prior quarters, we are—and Jim's spent a lot of time on the plane going up there—in the market, trying to do some other partnerships, bring some new physicians into that market, which is something has been in our plan for a while. Those relationships take a little while to kind of get baked and to try to bring some new volume in. So we still feel good about it, and we think that that's kind of where that's headed.

Do you want to touch on NueHealth?

Robert Horrar

Yeah. I think—look, we've got good opportunity with the portfolio at NueHealth. We've got a nice platform acquisition that we made there. There's nothing systematic or programmatic there. We've got some centres that are up, some that are just challenged for a variety of availability reasons, but we continue to have good discussions on expanding that pipeline, which is important to it. The platform was bought to grow and that's what we're focused on doing.

Stephen Kwai

Okay. Great. Thanks. And just a couple more. So the results at Black Hills, did you see any impact from Regional Health Orthopaedic that opened in January?

Robert Horrar

We've not seen any change in referral patterns in that market related to that. As I've said, for Black Hills, the situation was purely an availability issue of physicians, and it resulted in some case mix impact for the first quarter, then a little bit of cost. But no. There's been no change that we've seen to date from that.

Stephen Kwai

Okay. Perfect. And, sorry. Just a couple more here. Have you seen any changes in competitive behaviour or staffing at Sioux Falls in anticipation for Avera's new ortho hospital in Q4?

Tyler Murphy

No impact there yet. I would just tell you that in the United States, staffing, in general, is, particularly nursing, is always a challenge. It's competitive. There's a large demand for nursing, but we've not seen any—there's been nothing called out in Sioux Falls related to that.

Stephen Kwai

Okay. Great. And just my last one here. The position, could you just maybe if there's going to be any changes on the position of the dividend going forward.

Robert Horrar

We have no plans to change the dividend.

Stephen Kwai

Okay. Great. That's all my questions. Thank you.

Robert Horrar

Thank you.

Operator

And again, as a reminder, if you'd like to ask a question, please press *, followed by the number 1 on your telephone keypad.

And there are no further questions at this time. I'd like to turn the call back over to our presenters.

Robert Horrar

Thank you for joining us today and for your continued interest in MFC. We fully believe MFC's best days remain ahead of us. And we look forward to updating you on our progress again next quarter. Thank you. Have a good day.

Operator

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