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Medical Facilities Corp. (DR.CA)

Q3 2022 Earnings Call

CORPORATE PARTICIPANTS

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

OTHER PARTICIPANTS

Endri Leno
Analyst, National Bank Financial, Inc.

Paul Stewardson
Analyst, iA Private Wealth

Sahil Dhingra
Analyst, RBC Capital Markets

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone. Welcome to Medical Facilities Corporation's 2022 Third Quarter Earnings Call. After management's remarks, this call will include a question-and-answer session, whereby qualified equity analysts will be permitted to ask questions.

Before turning the call over to management, listeners are reminded that today's call may contain forward-looking statements within the meaning of the Safe Harbor provisions of Canadian provincial security laws. 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, 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.

I would now like to turn the meeting over to Mr. Jason Redman, President and CEO of Medical Facilities. Please go ahead, Mr. Redman.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

Thank you, operator. Good morning, everyone. And welcome to our third quarter earnings call. Joining me today is our Chief Financial Officer, David Watson.

We reported our third quarter results earlier this morning. Our news release, financial statements and MD&A may be accessed through our website at medicalfacilitiescorp.ca and have also been filed with SEDAR.

During the quarter, our surgical case volumes were up 3% as they continued to recover towards prepandemic levels. The higher volumes contributed to a 6% increase in facility service revenue for the quarter. Our facilities did not receive any additional government stimulus income in the quarter, whereas they received $2.7 million in Q3 of last year. While we were pleased to see the continuous strengthening of case volumes, inflationary pressures also continued to impact our operating expenses.

Like others in our industry, we remain focused on attracting and retaining talent, and we are subject to market wage pressures, including those resulting from the overall shortage of nurses. Those pressures and planned annual salary increases led to a $2.4 million rise in clinical and nonclinical wages for the quarter. Our case mix and higher surgical case volume contributed to a 12.9% increase in the cost of drugs and supplies for the quarter.

We also had a 30.5% increase in our general and administrative expenses. The combined impact of higher operating expenses and a decrease in government stimulus income exceeded the increase in facility service revenue. Regardless, our balance sheet remains strong, and with our strong cash flow, we are well-positioned to drive financial performance and unlock additional shareholder value.

During the quarter, we purchased 426,800 shares for just under CAD 4.1 million under a normal course issuer bid. Since the start of last December, through our NCIB and the recently completed substantial issuer bid, we purchased approximately 4.8 million shares at a cost of approximately CAD 50 million.

In other news, I'm pleased to share with you that three of our hospitals, Arkansas Surgical Hospital, Black Hills Surgical Hospital, and Sioux Falls Specialty Hospital recently received Specialty Excellence Awards from Healthgrades. These awards recognize hospitals that deliver superior quality care and superior patient outcomes.

Healthgrades is a leading online database platform in the US, dedicated to helping people make more confident healthcare choices, whether choosing the right doctor, hospital or treatment. These are just the latest accolades for our award-winning facilities, which have a long track record of placing high-end surveys and studies of patient satisfaction.

With that, I'd like to turn the call over to David to review our financial results for the quarter. David?

David N. T. Watson

Chief Financial Officer, Medical Facilities Corp.

Thank you, Jason. Good morning, everyone. I would like to start by reminding everyone that all dollar amounts I'm about to discuss are in US dollars unless stated otherwise.

Total revenue and other income for the quarter increased 3.2% to $102.2 million as facility service revenue increased by $5.8 million to 6% primarily on higher surgical case volumes. Facility service revenue also benefited from changes in case and payer mix and from ASH moving its anesthesia service and related billing in-house in the current year. However, total revenue and other income for the quarter did not include any government stimulus income, whereas the same quarter of last year included government stimulus income of $2.7 million.

As Jason said earlier, total surgical cases were up 3% compared to Q3 of last year. Our outpatient cases increased 3.5% and observation cases increased by close to 32%. Inpatient cases were down 12.4% for the quarter.

Looking at the expense side, operating expenses for the quarter were up by $9.3 million or 11.2% to $91.7 million. As a percentage of total revenue and other income, operating expenses increased to 89.8% from 83.3% in Q3 of last year. Consolidated salaries and benefits increased by $2.4 million or 8%, mostly due to increases in both clinical and nonclinical wages and salaries as a result of annual increases in market [indiscernible] (00:05:49) due to the industry-wide shortage of nurses and other staff.

Consolidated drugs and supplies costs increased by $4 million or 12.9%, largely attributable to case mix volume and pricing, as well as a gain of $2.0 million recorded in the prior year on the exchange of implant inventory as part of a new vendor agreement at Black Hills.

Our general and administrative expenses were up by $4.5 million or 30.5%. $1.4 million of the increase was attributable to the impact of Arkansas Surgical Hospital moving its anesthesia service and related billing in-house in the current year. Another $0.8 million was related to the reclassification of Sioux Falls Specialty Hospital's accountable care organization costs to G&A expenses. We also had increases in administrative and facility-related expenses, billing and contracted services, and various other G&A costs.

Our income from operations for the quarter was $10.4 million, which was down $6.1 million or 37% from the same quarter of last year. The difference includes the $2.7 million in government stimulus income in Q3 of last year and the $2 million gain on inventory.

EBITDA for the quarter was $15.6 million or 15.3% of revenue and other income, down from $23.3 million or 23.6% of revenue and other income in Q3 of last year. The loan receivable from Unity Medical and Surgical Hospital was fully written off this quarter with a further $9.4 million impairment loss on top of the $4 million earlier in the year. In addition, we wrote off $300,000 of other receivables from Unity that were reflected in G&A expenses.

In the third quarter, we generated cash available for distribution totaling CAD 3.8 million, resulting in a payout ratio of 61.5%. At the end of September, we had consolidated net working capital of $56.1 million, including $44.3 million of cash and equivalents. This compares to working capital of $67.4 million, including cash and equivalents of $61 million at the end of 2021. Total cash includes about $900,000 in Medicare advances, which will be recouped by year-end.

During the quarter, we also extended the maturity of our existing corporate credit facility by two years to August 31, 2025, while amending the limit down to $75 million from the previous $150 million. At the end of the quarter, we had $21 million outstanding on our corporate credit facility. Inclusive of lease liabilities, our net debt-to-equity stands at 0.52, which remains well below that of our US-listed peers.

This concludes our prepared remarks. At this time, we'd like to turn it back over to the operator to open up the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from Endri Leno with National Bank.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Hey. Good morning. Thanks for taking my questions. The first one I have is more for Jason. And if you can share us a little bit, I mean, since you started, like kind of your vision for Medical Facilities? And what – to the extent that you can share, obviously, what steps can you take to drive financial performance?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Thank you, Endri. Appreciate the question. So at this point, I mean, there's not much more that I can add apart from the press release that we had issued roughly in mid-September. I mean, obviously, our focus is going to be on looking at the noncore assets of the business that we have, looking at all possible ways to maximize shareholder value, and looking at the overall cost structure of the business and making sure that the costs are in line with the business going forward.

So at this point, I'm focused on making sure that we look at every opportunity to maximize shareholder value and return capital to the shareholders.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Okay. Fair enough. And in terms of the divesting the noncore assets, I mean, is there any insights you can share from how does the market look for them out there? Or which ones those noncore assets could be? Is it only the fees or could it involve any of the hospitals and anything like that?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

No. So there's – obviously, we can't speak to any specific transaction. I'm going through – I mean, we're going through as a team reviewing all the assets that we have and look where it makes sense to, if it's a noncore asset, I mean, I can't speak to any certain facility, obviously, but if there's opportunities out there to realize value in these assets, we'll look at them. If a transaction makes sense, we'll pursue it.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Right. Okay. Makes sense. All right. Next question, is a bit more kind of operational in nature. And if you can share us any insights in terms of how are you seeing case volumes in Q4? I mean, it's a seasonally strong one anyways, but how are you seeing the trends? And more importantly, expenses, have they stabilized in Q4? Are they increasing/decreasing? Any color there? Thank you.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Yeah. Hey, Endri. It's David. As you said, Q4 is typically the strongest quarter, and we don't see any reason for that to be different this year. With respect to expenses, we, like most in our industry, continue to experience the impact of inflationary pressure, whether its wages and benefits or supplies costs. So we are – we'll continue to be subject to the same inflation that everyone else is.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Right. Okay. Thank you. And the last one for me. Have the CMS rates, the final ones been published yet? And if you can share how do you expect them for 2023?

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

They published the outpatient rates. I think the across-the-board increase is roughly 3.8%. I don't recall what the – I haven't seen the inpatient rates impact yet.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Okay. Okay. Thank you. That's it for me.

Operator: And next, we will hear from Paul Stewardson with iA Capital Markets.

Paul Stewardson
Analyst, iA Private Wealth

Q

Good morning, gentlemen. Thanks for taking our questions. Just calling in for Chelsea. First question, just in terms of the new vision as well, can you talk about kind of what your targets might be in terms of where you could take the dividend, where you could take leverage ratio and what you're comfortable with, especially on the leverage side?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

In terms of dividend, we haven't made any decision with respect to increasing the dividend yet. I mean, it's something obviously that we're looking at all different ways of returning capital. I mean, we've used the NCIB in the past. We've used the SIB. And to the extent that there is additional free cash flow in the business then we'll look at opportunities for returning that cash flow. But nothing specific right now to announce.

Paul Stewardson
Analyst, iA Private Wealth

Q

Okay. And just on the leverage side, do you have any targets? Now that you've returned some of the capital, how can we look at leverage going forward?

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Yeah. Hey, Paul. Our leverage continues to be very manageable. And I think the expectation is we want to keep it manageable. And I would say that somewhere below three turns.

Paul Stewardson
Analyst, iA Private Wealth

Q

Okay. Thanks. That's all for us.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Yeah. Thank you, Paul.

Operator: [Operator Instructions] We will now go to Sahil Dhingra with RBC.

Sahil Dhingra
Analyst, RBC Capital Markets

Q

Hi. Good morning. This is Sahil for Doug Miehm. And thank you for taking the questions. My first question is, were there any onetime costs that impacted adjusted EBITDA in this quarter? And the second one is on the inflationary pressures. Are you still seeing those pressures or – because I recall at the last call you said – do you expect [ph] a migration (00:15:10) going into the second half of the year? If you could please elaborate on that a bit? Thank you.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Yeah. Paul – Sahil, no, there were no onetime costs that we'd call out in the quarter, other than the impairment charge on Unity, which ran through finance cost of the $300,000 that ran through G&A.

With respect to inflationary pressure, we continue to manage that as best as possible. We're having to remain competitive in our markets on the salaries and wages perspective, to retain our staff, which we've done a – our facilities have done a very good job of. And we've got a group purchasing organization that we work with on pursuing other supplies. So we continue to make every effort to control those costs. But we'll continue to be subject to the inflationary pressure.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

[indiscernible] (00:16:28) does that answer your question?

Sahil Dhingra
Analyst, RBC Capital Markets

Q

Yes, it does. I have one follow-up. Are you seeing more cost pressures on the nurse side or is it on the doctor side?

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Well, as you may recall, we don't typically employ physicians. We're partnered with them. So most of our labor costs are on the nursing, other clinical staff and nonclinical staff.

Sahil Dhingra
Analyst, RBC Capital Markets

Q

Okay. Thank you. That is very helpful.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Sure.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Thank you.

Operator: And with no further questions in the queue, I'd like to turn the call back over to Mr. Redman for any additional or closing remarks.

Jason Redman

Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

Thank you, operator. And thank you everyone for joining our call this morning. We look forward to updating you again next quarter. Take care.

Operator: And once again, that does conclude our call for today. Thank you for your participation. You may now disconnect.