FINAL TRANSCRIPT

Medical Facilities Corporation

2015 Third Quarter Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Medical Facilities Corporation 2015 Third Quarter Results Conference Call.

Before turning the call over to management, listeners are cautioned that today's presentation and 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 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 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 would now like to turn the meeting over to Dr. Donald Schellpfeffer, Chief Executive Officer of Medical Facilities. Please go ahead, Dr. Schellpfeffer.

Donald Schellpfeffer — Chief Executive Officer, Medical Facilities Corporation

Thank you, Operator and good morning, ladies and gentlemen. Thank you for joining us for today's conference call. With me today is Michael Salter, the Chief Financial Officer of Medical Facilities Corporation.

First. Let me note that the financial results do not include revenue from discontinued operations, which I will discuss further in a moment.

Prior to market open today, we reported our third quarter 2015 financial results. Our news release, financial statements and MD&A may be accessed through our corporate website at www.medicalfacilitiescorp.ca and we'll also file that on SEDAR today.

In the third quarter, consolidated revenue from continuing operations decreased slightly by 1.5 percent to 73.1 million compared to 74.2 million for the same period last year. Overall, we experienced growth of our surgical and pain management cases during the quarter. However, the unfavourable shifts in case mix, primarily at Sioux Falls and Arkansas facilities, ended up offsetting the overall increases in case value.

Consolidated income from operations, on a continuing operations basis for the quarter was 14.7 million, down 11.1 percent from the 16.6 million in the third quarter last year. This represents 20.1 percent of revenue compared to 22.3 percent for the same quarter in the previous year.

Our net income from continuing operations declined by 14.4 million, mainly due to an unfavourable impact of the changes in the value of exchangeable interest. Cash available for distribution decreased to 9.8 million Canadian compared to the same period last year. In US dollar terms, we saw a decrease of 2.3 million to cash available for distribution, to 7.5 million.

This decrease in cash available for distribution in both cases was primarily due to higher foreign currency losses on foreign exchange forward contracts which matured in the respective periods. As a result, our cash available for distribution resulted in a payout ratio of 89.8 percent, compared to 82.4 percent for the same quarter in the previous year.

With 139 consecutive dividends paid to our shareholders, we remain comfortable with our payout ratio. However, I would like to note that if the foreign exchange losses were excluded our payout ratio would have improved to 77.2 percent, at the average exchange rate over the quarter.

As we have previously communicated, our year-over-year revenue and income from operations can fluctuate from quarter to quarter and center by center. This is a result of shifts in case and payor mix, as well as changes in case counts, which are the main drivers of our results.

Michael will now provide more detailed insight into our financial performance for the third quarter of 2015, then I will conclude with our views on how the larger economic environment is impacting the healthcare market and our business. We will then open up the call to any questions you may have.

With that, let me turn the call over to Michael to discuss our financial results. Michael?

Michael Salter — Chief Financial Officer, Medical Facilities Corporation

Thanks, Don, and good morning, ladies and gentlemen. Please note that all dollar amounts expressed in today's call are in US dollars unless we note otherwise.

For the third quarter. We recorded revenue of 73.1 million, down 1.5 percent compared with 74.2 million in the same quarter last year. As Don mentioned earlier, despite an increased case count, we did experience an unfavourable shift in case mix.

Overall, we have seen a 2 percent increase in surgical cases, with a large portion of them being outpatient cases. In addition, the number of pain management procedures increased by a respectable 8 percentage points.

Our South Dakota centers continue to experience a positive impact on case volumes from the Patient Choice legislation passed last November by South Dakota voters. This legislation allows doctors, clinics, and surgical hospitals to join previously restricted insurance networks. Additionally, our centers are seeing previously uninsured patients who are now covered under the healthcare exchanges established as a result of the Patient Protection and Affordable Care Act.

Most of our centers, with the exception of Oklahoma Spine, recorded growth in their revenues, with the largest growth attributable to Sioux Falls. Sioux Falls' increase in revenue stream stems from a favourable shift in payor mix, growth in surgical cases and pain management procedures, as well as ancillary services, imaging, and primary care. This increase would have been higher had it not been partially offset by an unfavourable shift in case mix and the receipt of electronic health records incentive payment in September 2014, a year ago.

Black Hills reported a marginal increase in revenue, as more favourable payor mix was offset by a decrease in case volumes and a shift in case mix related to smaller cases that generated less revenue per case.

Turning to Arkansas. Arkansas Surgical Hospital revenue was also marginally higher. Those increases in surgical case volume was partially offset by negative changes in our case mix. On the other hand, case mix favourably impacted revenue at the surgery center of Newport Coast, despite a lower surgical case count and some unfavourable changes in payor mix.

As a result of an unfavourable shift in payor mix and lower case volumes, our Oklahoma Spine unit recorded lower revenue during the quarter, which was partially offset by an increase in pain management cases.

For the third quarter of 2015, income from operations on a consolidated basis decreased by 1.8 million to 14.7 million from the 16.6 million recorded in the same period last year. And that basically reflected the decline in revenues which we have just talked about and an increase in certain operating expenses.

During the third quarter, we recorded net income from continuing operations of 10.6 million, compared with 25 million for the same quarter last year. The decrease was primarily attributable to the impact of the change in value of the exchangeable interest liability, which is driven by the changes in the number of common shares to be issued for that exchangeable interest, the changes in the market price of the corporation's common shares, and fluctuations in the value of the Canadian dollar against the US dollar.

Cash available for distribution, including realized losses on foreign exchange forward contracts, was 9.8 million Canadian, a decrease from 10.7 million generated in the third quarter of last year. Our declared distributions were 8.8 million, consistent with the same period last year, resulting in a payout ratio of 89.8 compared to 82.4. And as Don noted earlier, it improves further when foreign exchange losses are excluded from the calculation.

As at September 30, 2015, we had outstanding foreign exchange forward contracts for future delivery of US 9 million, in exchange for 9.8 million Canadian. Our cash, cash equivalents, and short-term and long-term investments were a healthy 69.9 million.

All in all, the third quarter experienced improvements in revenue at most of our facilities and we are pleased at the progressive increase in revenue contributions from our ancillary services. We remain committed to utilizing our strong financial position to invest in quality opportunities, whether internal or external, that maximize return while improving patient outcomes.

Let me now call on Don for his closing comments. Don?

Donald Schellpfeffer

Thanks, Mike. MFC's outlook can be affected by many interrelated factors, which include the economy, healthcare reform, and management strategies. Per a Federal Reserve September press release, US economic activity has continued to expand at a moderate pace with household spending and business fixed investment increasing, along with the improvements in the housing sector. The labor markets also continue to improve with solid job gains and declining unemployment.

We remain confident that we'll continue to benefit from the fact that most of our revenues are generated in South Dakota, Oklahoma and Arkansas, states that for the most part continue to exhibit favourable economic trends as compared to the national averages.

In terms of healthcare reform. While it remains difficult to assess the full long-term impact of the Patient Protection and Affordability Care Act, we believe its implementation will cause the healthcare industry to experience a number of opportunities and challenges. We anticipate that the increase in the number of patients under coverage will result in an increased number of surgical cases with reduction in uncompensated care.

Healthcare entities may also be offered reimbursement incentives rewarding those who meet quality of care and operational criteria. However, the ongoing pressures on reimbursement rates will remain a challenge for most healthcare providers.

Noting the aforementioned, we have started to see significant mergers and acquisitions in the insurer sector, bankruptcies and failures of the insurance cooperatives which were heavily subsidized under the Patient Protection and Affordability Care Act. Further extension of coverage, which while significant, falls significantly short of covering the number of uninsured that the plan was designed to cover.

Also, price increases for health coverage, including that offered under the exchanges, are starting to hit double digits. This has the potential to increase the subsidies under the Patient Protection and Affordability Care Act and may lead to Congressional impasses over cost control.

The Republicans in the US House of Representatives are taking action to repeal the Patient Protection and Affordability Care Act through the new 2016 budget. Given the special budget rule known as reconciliation, this creates a greater chance of passing the Senate with a 51 percent vote count, as opposed to the 60 percent vote in the previous attempts to repeal the Patient Protection and Affordability Care Act.

As to our management strategies. With our healthy balance sheet, we continue to assess and identify accretive acquisition opportunities while applying best practices and cost reduction initiatives to achieve the Company's business and strategic objectives. We intend to continue capitalizing on our unique business model, which includes a physician-centric focus complemented by physician ownership and an active role in center management.

We will continue to support our centers with their physician recruitment efforts as increases in the number of physicians holding medical staff privileges and/or ownership interest in our centers are key drivers, positively impacting our results. Our strong results in delivering high-quality care and patient satisfaction are demonstrated by our performance measured by a nation-wide survey that HCAHPS, or hospital consumer assessment of healthcare providers and systems, which are ranked all of our specialty hospitals at five-star rating.

The combination of the increasing average age and life expectancy of the US population, overall population growth, and increased proportion of the population with access to health insurance, and advances in science and technology will continue to drive an increased demand for the services we provide at our centers.

Management remains confident in our ability to generate cash available for distribution that is more than adequate to satisfy our current annual dividend of CAD $1.125 per common share.

Before the lines are open for the question-and-answer portion of the call, I would like to thank you, our investors. As you probably know, I'm retiring as the CEO of Medical Facilities at the end of the year and want to express my gratitude for your unwavering dedication and support over the past 11-plus years. It is with confidence that I'm able to retire knowing that MFC will be left in the very capable hands of management and the Board. Truly it's been a great honour to be part of this company, and I look forward to MFC's continued prosperity for many decades to come.

With that, I would now like to open the line for any questions that you may have. Operator, please?

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from Neil Maruoka from Canaccord Genuity. Your line is open.

Neil Maruoka — Canaccord Genuity

Hi. Good morning, guys.

Donald Schellpfeffer

Good morning, Neil.

Neil Maruoka

Mike, 16 percent—16.4 percent of your revenue—G&A expenses represented 16.4 percent of your revenue this quarter, having creeped from 14.4 last year and was kind of settling in the 15.5 percent range earlier this year, and most are due to increased spending on related transaction, including specifically at Sioux Falls. Are you getting the requisite benefits and efficiencies and opportunities as a result of this growing expense line?

Michael Salter

I believe so, Neil. I think it's early days and if you—in reading our material you'll see that after the Sioux Falls Surgical Hospital, there is what's called an accountable care organization and it has, inherent as part of it, there's a service line management agreement. And service line management agreements are not unusual in the American healthcare landscape, and it principally involves where the doctors involved in that particular service line will basically manage it on behalf of the hospital facility.

Now, it is in this case tied in with an accountable care organization which our facility, Sioux Falls Surgical Hospital, has established. And accountable care organizations are designed to try and get all the providers that are involved in them, and the participants in this particular one include a group of doctors. There's primary care doctors involved and there's facilities involved, and ours is one of them.

And one of the goals, of course, with the federal government with accountable care organizations is to try and drive down—bend the cost curve, I think, was what our President once said when they were proposing the health reform act a few years back. And you will see it over time, though, are benefits that will come.

Again, it helps to create the patient contingent that will end up being serviced by our facility, by our doctor participants in the ACO. So I think over time you will see that happen, but you are correct in your observation, and I believe our MD&A spells it out, where there have been some expenses incurred on that side.

Neil Maruoka

And so do you think that G&A will reset at a slightly higher level here then going forward?

Michael Salter

I would suggest to you—you know, obviously there's a bit of a—there has been a bit of a pickup but then again if you're asking in terms of percentages and then the impact that has on operating margins, I think you'll see a bit of an abatement from perhaps what you saw going up, like you referred to the 16 percent. So it's a fluid situation because as you get the benefits come in it comes on the revenue side and, of course, when you're looking at the margin against it.

Neil Maruoka

Okay. And just moving to management changes, the identification of a new CEO seems to be taking a little bit longer than expected. What criteria are you looking for? And what kind of challenges are you seeing in your search?

Donald Schellpfeffer

Well, basically the criteria is we recruit a leader who's going to drive us forward in both the growth in mid- and long-term and also to ensure that—bring on somebody who's got a track record of success in our sector, basically, and who's going to bring knowledge to the Company to continue to make MFC grow in the future.

Neil Maruoka

And any challenges, hurdles that you've encountered thus far in that search?

Michael Salter

Well, currently they reviewed a number of candidates and are continuing in doing that, but needless to say, they want—we're going to be very discreet in who this individual would be.

Neil Maruoka

Okay. Okay...

Michael Salter

About the expectation.

Donald Schellpfeffer

I think suffice it to say, Neil, we have, I believe, what is a very robust process in place and the goal is to get the best individual possible.

Neil Maruoka

Okay. And clearly there's a lot of opportunities that you're looking at, both in the specialty surgical hospitals and ASCs, and you're sitting on a lot of capital. How do you approach these opportunities, given the current management uncertainty?

Michael Salter

Well, I think, Neil, I'd go back to what we've always said. There's two areas—well really three areas of interest to us—but two areas involve the acquisition of the space where surgeries are performed. That's the nature of MFC; that's what we do. We provide the facilities where surgeries are performed.

With respect to the specialty hospital side, you're all aware of the restrictions on further physician ownership of those type of facilities. There is a good stock of them out there, somewhere, depending whose numbers you believe, between 250 and maybe as high as 300. We obviously own four of them, and you know the other players that also have holdings of surgical hospitals. We see them from time to time, but I think as we've continually reiterated, these are a little bit like the family farms, being sold on occasion, so they don't come along with the steady—it's not a steady process of them coming to market—it is more sporadic.

There have been a few sales now over the last couple of years. Of course we bought Arkansas at the end of 2011 and there have been a couple of other reported sales within the last 12 months where two of the other aggregators have picked up—I think in one case, one hospital, and the other one there was maybe three but they weren't necessarily specialty hospitals. They were physician-owned, but they were full acute care facilities is my understanding. So I think we see—we continue to see those opportunities—and it's a pretty small market, and we know who's who in the pile.

In terms of looking at the ambulatory surgery space, it's a little bit different. There's a lot more of them out there. There are transactions taking place and you've recently seen one of the larger aggregators go public—that being Surgery Partners—which happened within the last, I believe, month, month and a half.

We do see those. I think as we've continually expressed, in that business, where our surgical hospital space—the operations are much more fully contained units. With ASCs you need more of a management platform, and we continue to explore opportunities in that field.

And then finally, we continue to look at opportunities in the healthcare field that may not be the provision of surgical space but any type of venture that will enable us to enhance the value proposition for our physician partners in the surgical facilities. And again, I refer back to things even as simple as primary care, urgent care, and you're all aware of our initiatives in that. We've now—our third hospital is into the urgent care—early stages again.

But I think, as I indicated, we've been quite satisfied with what we have seen on our first two ventures into the urgent primary care, in terms of it accomplishing the goal and that goal being to, as I said, enhance the value proposition for our physician partners and also for our facilities, and I believe it's doing that. We are seeing progress.

Neil Maruoka

Okay. Great. Thanks a lot, and just one last word. Congratulations, Don, on your retirement.

Donald Schellpfeffer

Thank you.

Operator

Once again, if you'd like to ask a question, please press *, then the number 1 on your telephone keypad.

Your next question comes from Joel Hurren from RBC Capital Markets. Your line is open.

Joel Hurren — RBC Capital Markets

Hi there, guys. Joel on for Doug. Just a quick question. Wondering if you could...

Donald Schellpfeffer

Good morning.

Michael Salter

Morning.

Joel Hurren

Good morning. Just wondering if you could comment on surgical volumes in Oklahoma and how you kind of view them going forward? Do you expect them to increase again? Just kind of a one-off quarter with the decline?

Donald Schellpfeffer

Well, currently I think it's basically a one-off quarter. The third quarter, as you know, traditionally in all the facilities is our weakest quarter, and we're looking forward to the fourth quarter being better at their facility and all the other sites also, which traditionally is what normally happens.

Joel Hurren

Okay. Perfect. And then just overall M&A time line. I know you just touched base on what you're looking at, but in terms of time lines that you think you could get something done—any further comments on that?

Michael Salter

Again, I'd go back to the commentary I made. On the specialty side, they are sporadic. They really are. In terms of other things, obviously, as Neil pointed out, we are sitting on a fair bit of cash and have very good access to capital with our credit facilities, et cetera, in place. Again, it's hard to really talk to a specific, in terms of a time line on it, but certainly within the next foreseeable future, and I would put that being anywhere from one to three years.

Joel Hurren

Okay. Perfect. Thanks very much, and congratulations on your retirement.

Donald Schellpfeffer

Thank you.

Operator

Once again, if you'd like to ask a question, please press *, then the number 1 on your telephone keypad.

We do not have any questions at this time. I turn the call over to the presenters.

Seymour Temkin — Chairman of the Board, Medical Facilities Corporation

Hello. Good morning. It's Seymour Temkin. I'm the Chair of Medical Facilities. And before we end today's call, on behalf of the Board, I'd like to thank Dr. Don Schellpfeffer for his dedication, passion, hard work during his tenure at Medical Facilities. Over the past 11 years, Don has contributed significantly to the growth and the success of Medical Facilities, with the highest level of integrity and commitment. His efforts have not gone unnoticed and we wish him the very best in his retirement.

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

Operator

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

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