# FINAL TRANSCRIPT

## Medical Facilities Corporation

## 2015 Fourth Quarter and Year-End Results Conference Call

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## CORPORATE PARTICIPANTS

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## CONFERENCE CALL PARTICIPANTS

**Matt Bottomley**
*Canaccord Genuity — Analyst*

**Joel Hurren**
*RBC Capital Markets — Analyst*

## PRESENTATION

**Operator**

Good morning, ladies and gentlemen. Welcome to the Medical Facilities Corporation 2015 Fourth Quarter and Year-End Results Conference Call.

Before turning the call over to management, listeners are cautioned that today's presentation and the 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 Seymour Temkin, Interim Chief Executive Officer of Medical Facilities. Please go ahead, Mr. Temkin.

**Seymour Temkin** — Interim Chief Executive Officer, Medical Facilities Corporation

Thank you, Operator, and good morning, ladies and gentlemen. Thank you for joining us on today's conference call.

With me today is Michael Salter, Chief Financial Officer of Medical Facilities Corporation.

Prior to the market opening today, we reported our fourth quarter and year-end 2015 financial results. Our news release, financial statements, MD&A may be accessed through our corporate website, and we also filed on SEDAR this morning.

As we discuss our financial results this morning, I'd like to remind listeners that our financial results do not include income from discontinued operations, which refer to Dakota Plains Surgical Centre transaction that closed earlier this year.

2015 was a year with several changes for many. The instability of the global macro environment, continued pressure on oil prices, the volatility of the equity market—the impacts were all felt across industries and companies.

In spite of all the difficulties and economic conditions, I'm pleased to report that Medical Facilities recorded another year of strong revenue growth, an increase of 4 percent to 309 million compared to the prior year of 297 million.

Our solid operations and financial performance continued throughout 2015 as we recorded a 12 percent increase from income from operations of 75 million compared to the prior year.

Cash available for distributions for the full year 2015 was 46 million Canadian, an increase of CAD 4.5 million compared to the full year of 2014. In US dollar terms, we experienced a slight decrease of 1.6 million to cash available for distribution to 35.9 million.

MFC's cash available distribution, Canadian and US dollars, were impacted by higher foreign exchange losses on foreign exchange forward contracts which have now all matured during the year.

Overall, our cash available distribution resulted in a favourable 2015 payout ratio of 76.7 percent compared to 85.2 percent for the full year ended 2014.

I want take time to reiterate that we strengthen and grow—and now grow our company. We assess opportunities that are in the best of interests of all our stakeholders.

With over a decade of experience with our unique business model, to date, we have distributed 143 consecutive dividends to our shareholders and remain comfortable with our payout ratio levels.

Medical Facilities has a normal course issuer bid program to which we are extremely active, demonstrated by repurchase of over 1 million shares since inception of the buyback program. We intend to continue with our program, given the ability to repurchase shares at favourable prices.

However, I'd like to note that if foreign exchange losses were excluded, our payout ratio would have improved further to 67.8 percent at the average exchange rate of 1.28 for the full year of 2015.

Over the past year, Medical Facilities has continued with its strategies in reinvestment in our business and service offering to further strengthen our presence in our core markets.

The investments made in urgent care, urgent and primary care at our South Dakota facility have begun to positively impact our results. The objectives for the Company and our centres remain focused on recruitment and expansion, along with management of balancing the mix of physicians practicing at our facilities. Recruiting highly skilled physicians and staff demonstrates our commitment to provide our patients with high-quality care.

As common practice for the business, we review a number of opportunities and adjust our sales lines accordingly. Initiatives and expansions are assessed by the centres, management, and the Board of Directors to ensure that opportunities complement our existing offering and are mutually beneficial for the Company and our stakeholders.

As we have previously communicated to the market, our year-over-year revenue and income from operation can fluctuate from quarter to quarter and centre by centre. This is the result of shifts in case, payor mix, as well as change in the case counts which are the main driver of our results.

Michael will now provide more details and insights into our financial performance for the fourth quarter of 2015, and I will conclude our views on how the larger economic environment continues to impact the healthcare market and our business. We'll then open the call for any question you may have.

With that, let me turn the call over to Michael.

**Michael Salter** — Chief Financial Officer, Medical Facilities Corporation

Thank you, Seymour, and good morning, ladies and gentlemen. Please note that all dollar amounts expressed in today's call are in US dollars unless otherwise stated.

As Seymour mentioned earlier, we ended the year with a strong fourth quarter with increases resulting from higher case volumes, favourable shifts in payor mix and increased revenue from our pain management imaging and our urgent and primary care cases.

For the fourth quarter, we recorded revenue of 89.8 million, up 9 percent compared with 82.5 million in the same quarter last year. Our favourable shift in payor mix was attributable to a higher portion of cases that were paid through commercial insurance and self-payments by patients.

Our South Dakota facilities continued to experience a positive impact on case volumes from the Patient Choice legislation passed in November of 2015. The legislation provides patients with the ability to choose a provider of their choice, without incurring any additional out-of-pocket expenses.

For providers, including doctors, clinics and surgical hospitals, it allows them to join previously restricted insurance networks. The legislation has given us an opportunity to further increase our reach to access and treat more patients.

All of our centres recorded growth in their revenues, with the largest increases seen at our Sioux Falls and Arkansas facilities. Sioux Falls' increase in revenue stems from a favourable shift in payor mix, growth in surgical cases and pain management procedures, as well as ancillary services being imaging and primary care.

In spite of that growth in revenue, the facilities results were partially offset by the changes in case mix and lower electronic health records incentive revenue, which is in its final phase.

It is worthy to note that all of our specialty surgical hospitals achieved outstanding HCAHPS scores which reflect our high standards in quality of care.

Arkansas continues its track record of stable revenue generation as the centre continued to see an increase in surgical case volumes, in spite of the changes in case mix during the fourth quarter of 2015.

Black Hills recorded a slight increase in revenue as a result of more favourable payor mix as demonstrated by an increase in commercial insurance payments, along with an increase in surgical case volumes.

Revenue growth was marginal as it was offset by a changing case mix as we saw an increase in EMT cases and a shift in the type of orthopedic cases performed.

Oklahoma experienced increases in both surgical and pain management cases, driving revenues higher on year-over-year basis.

Operating income, while up, was somewhat impacted by a less favourable payor mix and lower per case revenue from pain management.

Our ambulatory surgery centre located in Newport, California saw a significant growth in fourth quarter revenue with a more favourable case mix as a result of increased cases of women's health and complex orthopedic cases. A shift in the way orthopedic implants are reimbursed in that state by certain insurers, combined with a favourable shift in payor mix, drove the 9 percent growth in revenue during the quarter.

On a consolidated basis, we continued to benefit from previously uninsured patients who are now covered under the healthcare exchanges established as a result of the Patient Protection and Affordable Care Act.

I am also pleased to report that on a consolidated basis during the fourth quarter of 2015, MFC has seen a 9 percent increase in surgical cases, with a large portion of them being outpatient, along with a 4 percent growth in the number of pain management procedures.

For the fourth quarter of 2015, income from operations on a consolidated basis increased by 5.7 million or 26 percent to 27.8 million from 22.1 million as compared to the same period last year. This reflects the growth in revenue and decrease in operating expenses.

However, those results are distorted by a decreased G&A expenses of nearly 2.7 million which results from a noncash reversal of an accrued rent liability at our Arkansas facility.

During the fourth quarter, we recorded net income from continuing operations of 25.3 million compared with 6.8 million for the same quarter last year. The significant increase of 18.6 million was primarily attributable to the impact of the decline in value of exchangeable interest liability.

That impact is driven by the changes in the number of common shares that is to be issued for the exchangeable interest, the changes in the market price of the Company's 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 for the fourth quarter of 2015 was 12.6 million Canadian, a slight increase from 12.2 million Canadian generated in the fourth quarter of last year. Our declared distributions were 8.8 million, consistent with the same period a year earlier.

The resulting payout ratio for this quarter was a favourable 69.7 percent compared to 72.1 percent for the same period one year ago. And as Seymour noted earlier, improves further when foreign exchange losses are excluded.

As at December 31, 2015, our cash, cash equivalents, and short and long-term investments were a healthy $17.9 million.

All in all, the fourth quarter experienced strong improvements in revenue, growth at all of our facilities, and we are very pleased with the continued 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 maximizes the returns for our stakeholders which include improving patient outcomes.

Let me now call on Seymour for his closing remarks. Seymour?

**Seymour Temkin**

Thank you, Michael. MFC ended the year with a strong fourth quarter and a full year of strong performance as the result of increased case volumes, favourable shift in payor mix, and along with increased revenue received from our auxiliary services.

Subsequent to December 31, 2015, Medical Facilities announced the acquisition of IMD, which provides MFC with a platform to streamline corporate systems, along with opportunities for future benefits and cost synergies.

At an initial glance, the transaction may seem small in size, but the acquisition of IMD allows us to add new revenue services, in a controlled manner, by investing in the needs of those in the healthcare industry.

As MFC begins to transition to a new management team, with the support of the Board, I'd like to assure our stakeholders that the recruitment process for MFC's next CEO is progressing very well.

MFC underwent an intensive review and assessment of talent professionals for the role of the CEO. Our Board admits that a number of very accomplished candidates have expressed a desire to build on MFC's success.

As an update, I'd like to advise you we are nearing the final stages of the recruitment process and look forward to announcing our new CEO in the near future.

Before I provide an update on the current market environment and future outlook of the Company, I would like to remind listeners that MFC's outlook can be affected by many interrelated factors, which include the economy, healthcare reform, and management strategies.

According to the Federal Reserve press release, despite the slow growth seen in the latter part of 2015, the labour market, the household spending, and overall housing market continue to show moderate improvements.

Medical Facilities remains confident in the operation and financial abilities as our geographic progression in the Midwest continued to exert with the favourable economic trends in comparison to the US national average.

Over 90 percent of our revenues are generated from facilities that are situated in South Dakota, Oklahoma, and Arkansas, and have stood resilient against the challenging economic environment.

In terms of healthcare reform, while it's difficult to assess the full long-term impact of the Patient Protection and Affordable Care Act, we believe its implementation will cause the healthcare industry to experience a number of opportunities and challenges.

We anticipate the increase in the number of patients under coverage will result in an increased number of surgical cases with a reduction in uncompensated care.

Healthcare entities may also be offered incentives rewarding those to meet quality of care and operation criteria, and our facilities are well positioned to be the beneficiaries of such trends. However, the ongoing pressure on reimbursement rates remain a challenge for most of the healthcare providers.

The healthcare sector has experienced a number of significant mergers, acquisitions by the insurance companies, bankruptcies and failures of the insurance cooperatives, which were heavily subsidized under the PPACA.

Further extension of coverage, which was significant, falls significantly short of recovering the number of uninsured that the plan was designed to cover. It would be important to note that the price increases for health coverage, including those offered under the exchange, have begun to hit double-digits which elevates the possibility for increase in the subsidies under the PPACA and may lead to congressional impasse over cost control.

With a healthy balance sheet, MFC will continue to assess the identity of accretive acquisition opportunities while applying best practice and cost-reduction initiatives to achieve the Company's business and strategic objectives.

We remain confident that our continued ability to capitalize on our new unique business model, which includes physician-centric focus, complemented by our physician ownerships and an active role in incentive management.

We continue to support our centres with physician recruitment efforts as an increase in the number of physicians holding medical staff privileges and/or ownership interest in our centres are key drivers positively impacting our results.

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

With growing demographics and the need for healthcare services, Medical Facilities look forward to meeting this demand as we continue to provide all our patients with top-quality care in a comfortable and a hotel-inspired environment.

Our management team remains confident in our ability to generate cash available for distribution that is more than adequate to satisfy our current annual dividend of 1.125 Canadian per common share.

With that, I'd like to open the line for any questions you may have. Operator?

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## Q&A

**Operator**

If you would like to ask a question, please 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 Matt Bottomley from Canaccord Genuity. Your line is open.

**Matt Bottomley** — Canaccord Genuity

Good morning. Thanks for taking my question. I'm just on the line here for Neil Maruoka. Just a quick question for you guys with respect to maybe what your plans are for your foreign exchange going forward. I know a lot of your contracts have rolled off the books now. So with rates at a much more—with US rates at a much more favourable position now, are you potentially planning on locking those in? And if so, how do you think that might impact your payout ratio and the potential to maybe repurchase more common shares in 2016. I see here that you disclosed here that you repurchased 4.5 million. I'm just wondering what the magnitude might be, in your best estimation going forward, considering where your distributable cash will probably land this year.

**Seymour Temkin**

Hi. It's Seymour Temkin. So there are about three questions that you asked, so I'll try and deal with them in reverse order. We are committed to an NCIB program where we feel the opportunity is, that our share price does not reflect value and does not reflect our potential value, and we are committed to that program. And we have demonstrated that over the past year, and we will continue with that. To guess where the exchange rate with the US dollar exchange rate will be, we have told the market that our policy is no longer to hedge. But we reserve the right to look at that from time to time. I mean currencies have never been as volatile as they are today. The Canadian dollar, which was 0.72, everyone is predicting a demise down to $0.50, now bounced back to $0.76. Tomorrow it's $0.75. So our policy is that we will remain unhedged. Unless we think the environment or the currencies changed dramatically there, we'll reserve that right.

**Matt Bottomley**

Okay. Thanks. So I imagine so far, in the current year, sort of almost a quarter in that you'd be seeing some favourable movement to your distributable cash compared to the contracts that you had last year. Is that, sort of from a directional standpoint, is that a fair assessment?

**Seymour Temkin**

Absolutely.

**Matt Bottomley**

Okay. Great. And then just, actually you know what, I'll go back in queue in case someone else has another question. So thank you very much.

**Michael Salter**

Thank you.

**Operator**

Once again, if you would 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. It's Joel on for Doug here. Congratulations on a strong quarter and the year.

**Michael Salter**

Morning, Joel.

**Joel Hurren**

Good morning.

**Michael Salter**

Morning, Joel.

**Joel Hurren**

Two quick questions, one, could you just provide a little bit more detail on the G&A expense and why it was about 2 million artificially lower? And then second question, just any trends in hiring towards the end of the year, hiring of physicians for the hospitals? Thank you.

**Seymour Temkin**

I'll turn the question to Michael.

**Michael Salter**

Yeah. Thanks, Seymour. On the G&A, the item you refer to, Joel, is the—it was a straight line rent adjustment on the building lease under the American accounting rules and similar under the Canadian. You end up with—literally the leases have escalators built into them over time. But you have to record the rent expense on a straight line basis. So in the early years of the lease, you're actually building up an accrued liability. And it's a noncash item. And you'll notice it if you look on—my favourite chart's in the MD&A. You'll see the adjustments for the noncash.

What happened with Arkansas, a group of the doctors who are also our partners in Arkansas, held the hospital building, the real estate. And they entered into a up-REIT transaction with a REIT in the US that saw them sell part of that in return for a part of the REIT, to this third-party REIT. And the accounting treatment for it became that we had to recognize that noncash accrual liability and bring it into G&A. And of course it was a reduction of what the G&A would have been otherwise. And you'll see, again now going forward, you're going to see they, again, will start accruing amounts under that straight line. So it's purely related to that straight line rental adjustment.

**Joel Hurren**

Okay. Thank you.

**Michael Salter**

Okay. Now you asked one other question about hiring doctors coming into the next year. Number 1, we typically in our operation, certainly the surgeons who perform the surgeries at our surgical hospitals, we do not hire those doctors. Those doctors, they may be owners of the centre, and they also will have what are called medical staff privileges. In other words, they've qualified to be able to come in and perform surgeries in our facilities. I won't say that we don't have some doctors on staff. We do. But it's typically in the ancillary areas, such as primary care and urgent care, where we may employ doctors or what they call doctor extenders, being nurse practitioners and physician assistants, and hospitalists in that area. But typically the surgeons are independent practice surgeons.

What is relevant and I think what your question—you may be driving at and I'll, at the risk of putting words into your mouth, is the efforts to add physician—like surgeons to our roster of doctors with medical staff privileges to be able to practice at our facilities.

**Joel Hurren**

Yes. Exactly.

**Michael Salter**

Yeah. That, as Seymour mentioned, is one of our continuing focuses, working with our centres and working with the doctor practices that—where the docs work, like where they practice medicine. And those are our—those independent contractors or independent physicians who come in to perform the surgeries, we very much are focused on working with our hospitals and with those physician practices because that's where you get the addition of new physicians coming into that town, joining those physician practices. And then, because the physicians are practicing with maybe owners and hold medical staff privileges with us, that those new docs will follow along. And that's what we—that's clearly the game plan. That's clearly what we attempt to do. And I think we've seen some good progress in that over the years. And if you look back at most of our facilities, I think it's pretty clear cut that we have increased at all of them in varying degrees. It's very specific to each locale and geography. But we have either held or increased the roster of physicians with medical staff privileges.

**Joel Hurren**

Perfect. Thank you very much.

**Michael Salter**

Okay.

**Operator**

Once again, if you would like to ask a question, 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**

Well, thank you, ladies and gentlemen. And good day.

**Michael Salter**

Bye.

**Seymour Temkin**

Thank you.

**Operator**

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

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