Medical Facilities Corporation

2018 Fourth Quarter Results Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Neil Linsdell
Industrial Alliance — Analyst

Bob Gibson
PI Financial — Analyst

Stephen Kwai
National Bank Financial — Analyst

Lennox Gibbs
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PRESENTATION

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation 2018 Fourth 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 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 Factor 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 Mr. Rob Horrar, President and CEO of Medical Facilities.

Please go ahead, Mr. Horrar.

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, our Chief Development Officer.

This morning, we released our 2018 fourth quarter and year-end 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.

2018 was a year of significant expansion for MFC. At the beginning of 2018, we acquired seven ambulatory surgery centres in a partnership with NueHealth LLC. These additional seven ASCs were the largest contributor to our growth for the year, resulting in record revenue of $431.6 million. The addition of these facilities also significantly changed the size and composition of our growing national footprint.

More specifically, our total facility count has grown from 6 to 13, so we now have 8 ASCs and 5 specialty surgical hospitals. Geographically, we have increased our presence from 5 states to 11 in 2018. The acquisition added 18 operating rooms and 7 procedure rooms to our portfolio.

We also expanded our footprint through organic growth. Following the opening of our urgent care centre in Sioux Falls, South Dakota in the fourth quarter of 2017, we opened two new urgent care centres in 2018: one at Little Rock, Arkansas in January and one in Gillette, Wyoming in December.

The strategy behind our urgent care centres is to expand our existing facilities' outreach in the surrounding communities. For example, the urgent care centre at Little Rock expands the reach for Arkansas Surgical Hospital, and Gillette, Wyoming is located in a secondary market for Black Hills Surgical Hospital.

Overall, our growing national presence strengthens our competitive positioning and reduces risk that may arise in a particular geography, including changes in payer mix. Increased diversity of our business, including the number and types of facilities, and our expanded service offering helps ensure dependable cash flow going forward.

One of the keys to our continued success is the commitment to providing the highest quality of care to our patients that is shared by physicians, nurses, and other medical professionals at each of our facilities.

In fact, our facilities continue to rank high in surveys and studies of patient satisfaction, and have a reputation for superior customer service, exemplified by the most recent awarding of five-star ratings by CMS at Sioux Falls Surgical Hospital and Arkansas Surgical Hospital.

With that, I would now like to turn the call over to Tyler.

Tyler Murphy — Chief Financial Officer, Medical Facilities Corporation

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

As Rob mentioned earlier, we had record revenue in 2018 of 431.6 million, which represented growth of 12 percent compared to the 385.3 million in revenue in 2017.

The MFC Nueterra ASCs generated 34.1 million of incremental revenue, with the remainder of the growth coming from the same facility operations.

For the fourth quarter, which is typically our strongest quarter and was again this year, we had revenue of 123.3 million, which was up 10.8 percent from Q4 of 2017. The MFC Nueterra ASCs contributed 9.9 million of the 12 million increase. The remainder was higher case volumes from same facility operations, partly offset by a decline from case and payer mix combined and the discontinuation of revenue from IMD.

EBITDA for the year was 99 million, up 14.8 percent from the 86.2 million in the prior year. As a percentage of revenue, our EBITDA margin was 22.9 percent compared to 22.4 percent in 2017.

For the quarter, our EBITDA increased 36.8 percent to 32.4 million from 23.7 million in Q4 of 2017. EBITDA margins grew to 26.3 percent, increasing from 21.3 percent in the fourth quarter of the prior year. The increase was primarily due to prior-year goodwill impairment charges and incremental contribution from MFC Nueterra's ASCs.

For 2018, we had 48.8 million Canadian in cash available for distribution compared to 51.7 million Canadian in 2017. Cash available for distribution in Q4 was 18.9 million Canadian, up from 16.7 million Canadian in Q4 2017.

On a per common share basis, cash available for distribution for 2018 was C$1.58 compared to C$1.67 for the prior year. For the quarter, cash available for distribution—per common share was C$0.61 versus C$0.54 in the fourth quarter of last year. Distributions remained constant at C$0.28 quarterly and 1.13 Canadian annually.

The payout ratio for the year was 71.4 percent compared to the previous year at 67.5 percent. Payout ratio for Q4 of this year was 46.2 percent compared with 52.3 percent in the same period last year. The higher payout ratio for the year was due to lower cash available for distribution, particularly in Q1 and Q3, including adjustments made for taxes.

At December 31, 2018, we had consolidated net working capital of 33.2 million compared to 33.8 million in 2017. At the end of the year, we had cash and cash equivalents of 36.7 million and about 81.2 million available on our credit facility.

As a reminder, in August 2018, we renewed and increased our corporate credit facility, and in doing so, we have reclassified the credit facility to noncurrent.

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

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

Rob?

Rob Horrar

Thanks, Tyler. This is an exciting time for MFC, and we firmly believe that the progress we made in 2018 better positions us for 2019 and beyond.

One of the biggest drivers of medical spending in the United States over the next decade or so will be the care provided to adults aged 65 and older. This demographic is expected to grow from around 53 million today to over 71 million by 2030. In addition, as technology advances, an increasing number of procedures are being done on an outpatient basis, and we expect the amount of ASCs to increase significantly over the next 10 years in response.

Add to that the fact that the ASC market is a very fragmented one, we expect to see a lot of opportunity for consolidation in this space.

Our mission is to capitalize on these drivers by continuing to execute on our growth strategy, which includes organic growth and acquisitions.

As far as organic growth goes, we continue to focus on enhancing and adding services at our existing facilities, recruiting new physicians, and sharing and implementing best practices and cost-reduction strategies.

We will also continue to evaluate opportunities to add more urgent care centres to our portfolio where we think it makes sense.

We see the growing popularity of urgent care centres as an opportunity for our surgical hospitals to expand their networks in order to achieve and enhance brand recognition in new and existing markets.

Our acquisition pipeline remains strong, and our MFC Nueterra partnership positions us well for potential opportunities in the ASC space.

As we have stated in prior calls, this is a highly competitive market, and we will be diligent in evaluating new opportunities that are accretive to our portfolio.

I'd like to close my remarks by thanking all of our physician partners, facility leaders, nurses, caregivers, and all those who contribute to the outstanding level of care that is provided to our patients day in and day out.

And while we are proud of our accomplishments in 2018, we fully believe MFC's best days remain ahead of us.

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

Operator?

Q&A

Operator

If you'd like to ask a question at this time, please press *, then the number 1 on your telephone keypad. If you'd like to withdraw your question, press the # key. We will pause for just a moment to compile the Q&A roster.

First question comes from the line of Neil Linsdell with Industrial Alliance. Your line is open.

Neil Linsdell — Industrial Alliance

Hey. Good morning, guys.

Rob Horrar

Morning.

Tyler Murphy

Morning.

Neil Linsdell

Good finish to the year. So looking into next year, if we look at you mentioned the ASC opportunities; dramatic growth over the next few years. Right now, you've got the partnership with NueHealth. Would you expect with NueHealth's portfolio of companies—or ASCs that they currently deal with that would be your main source of opportunities to add to your own joint venture with them? Or do you see more separately—organically or separately acquiring facilities there?

Rob Horrar

Yeah. Neil, I think it would be the latter. While MFC Nueterra does present us a lot of good opportunities and pipeline opportunities, we also see there's additional and significant opportunities across the US, whether it's de novo or acquiring existing ASCs.

So my answer to that would be both.

Neil Linsdell

Okay. And sticking with the Nueterra facilities, have you seen any kind of significant benefits—you've been with them over a year now—any significant benefits that have translated into your other operations? Or significant improvements since you guys have partnered up?

Rob Horrar

Well, I'd just tell you that we're pleased with the integration process that we went through with the platform. And I think that it has given us some leverage in evaluating pipeline and having conversations and acquisition opportunities; having that credibility and operating platform has given us an advantage.

Neil Linsdell

Okay. And you also made a point of talking about the urgent care centres that you've developed. Do you have anything kind of quantifiable that you can talk about as far as benefits that you've seen since you've opened up these facilities as far as number of cases, new patients, transfers into the surgical hospitals as a result?

Rob Horrar

No. I think these are really one-off strategies. We evaluate these as an individual business unit as well and an expansion of our, as we said, our brand and our ability to provide care in secondary markets in the case of Gillette, so. And they continue to ramp up as well, and we've targeted to open these in typically high-volume months in the season. So we'll continue to evaluate new opportunities, but we're pleased with the opportunities we've opened here recently.

Neil Linsdell

Do you have a target number in the next year or two or three?

Rob Horrar

No, we don't. We haven't set a target number for that, but I think, again, it's part of a bigger strategy on our part.

Operator

Next question comes from Bob Gibson with PI Financial. Your line is open.

Bob Gibson — PI Financial

Good morning. I just want to continue more on this M&A side and what your thinking is as far as how you might finance these and what sort of metrics sort of debt-to-EBITDA ratios you would think might be your sort of maxed-out limit?

Tyler Murphy

Yeah. As I said earlier, we have cash on the balance sheet. We have another $80 million-plus on our credit line, so a lot of it would come down to just what the size of ultimately an acquisition would be. Those would be our first two sources.

In our credit agreement, I mean, we kind of have a governor of 3 times leverage. We have the ability to go above that if we showed a path on a larger acquisition to go back down below 3 after 12 months, so those would be our first two primary ones.

But we don't see just up and doing one transaction and doubling our leverage or anything like that. I mean, we're looking at some smaller pieces here and there.

Bob Gibson

Okay. Great. And what are you seeing as far as recruiting more doctors to the system? Has it become more competitive? And what sort of, let's call it, carrots are you using to attract them?

Rob Horrar

Well, we have an advantage in that area. Since when we typically recruit physicians into whether it's the practices that we're partnered with or even individually, the opportunity to buy in to the facilities is a big advantage that we have. So it's … that's the carrot right there. Coming into a high-quality, high-functioning, and efficient centre, as well as having a piece of ownership gives us the advantage. Where maybe an acute care facility might have to pay up to get a physician, we've got that opportunity for ownership.

And I'll just tell you that we've had success. We've seen in Arkansas and in Black Hills particularly recent recruitment additions over the year, and we're very pleased with that.

Bob Gibson

Great. Thank you very much.

Rob Horrar

Welcome.

Operator

Once again, if you would like to ask a question, please press *, 1 on your telephone keypad.

Next question comes from Stephen Kwai with National Bank Financial. Your line is open.

Stephen Kwai, your line is open.

Stephen Kwai — National Bank Financial

Hey, guys. I'm just calling on behalf of Endri. I just have a few questions for you guys just at the hospital level, really. Just in regards to Black Hills, the revenue was down a bit year over year. Could you just expand on the lower case volume that was seen? And kind of how you see it developing going forward?

Rob Horrar

Go ahead. (phon)

Tyler Murphy

Yeah. I mean, there was a couple different things going on in Black Hills. We did open our new Gillette urgent care, which is also a clinic. That's where we recruited one of the new surgeons, so that's bigger than your average urgent care because it also has a clinic and a new physician that will be doing cases in our hospital. So we had some cost there.

We had a little bit of a case mix shift and a little bit higher cost in spine implants, although they still do a good job up there in managing those costs.

Rob Horrar

Yeah. I'll just say that overall for the year, Black Hills in terms of volume was up. The quarter was a little bit missing. We did have a key doctor that was out for a period of time for personal reasons, so those things happen. For the whole year, their volumes same store year over year were up.

And we, like we've said, we've got a good strategy there, a great team, and they've had some good success recently recruiting physicians, and we expect to ramp up nicely in 2019.

Stephen Kwai

Okay. Great. And just a couple more again at the hospital level. I'm going to assume is it kind of a similar story with Sioux Falls? Or is maybe the new competition kind of getting involved? Or could you also just elaborate on that one as well?

Tyler Murphy

Yeah. No, there was a number of kind of one-off items that happened in Sioux Falls in the quarter. There's a self-funded health plan up there that we got a number of cases from that actually went bankrupt earlier in the year, so we thought we might still be able to get some money out of that bankruptcy. It was determined in the fourth quarter that we probably wouldn't, so that was a hit.

We did have a little bit increase in Medicare patients, so obviously those are a little bit lower reimbursed than the commercial volumes from the year before.

And then finally, we had additional cost in both the new urgent care centre in Sioux Falls, but also that facility just went under a huge remodel, so some of the ORs were closed at different times as the thing was being remodelled. Now everything is back open; they actually have more OR capacity. And some of the costs that hit the fourth quarter were staffing up the new ORs ahead of bringing in patients.

So those kind of things all kind of hit in the fourth quarter.

Stephen Kwai

Okay. Great. And yeah, just on ASH there, there's strong growth there. Could you also just expand a little bit on what was driving that growth?

Rob Horrar

Well, we were fortunate enough to have good, strong surgery volumes particularly in the fourth quarter and also that we did add a pain physician that brought cases back. The prior year we lost a pain physician; we added one late third quarter that's ramped up very nicely. So overall, volumes were up and they had a good quarter.

Stephen Kwai

Cool. Okay. Perfect. And just my last one here, just on the MFC Nueterra. So revenue seems to be in line with what was guided to, but just at the operating income level it wasn't really exactly what we expected.

Rob Horrar

Correct.

Stephen Kwai

Is it more of a cost thing? Or is it kind of a case mix? Or is it both? Just a little bit of insight on that one as well, please.

Rob Horrar

Sure. Well, overall we're very pleased. This was a platform acquisition for us, as we've talked about, in the pipeline. And yes, we did experience some higher costs. We integrated those ASCs around things like insurance and IT—those were a little bit higher than we anticipated—bringing that in line with where we expect operations to be.

I'll also add that our growth initiatives that we have in place when we did the acquisition we didn't have those in the time frame we expected, but overall we remain optimistic on the platform and we continue … as we continue to evaluate new opportunities and execute on our growth plans into 2019.

I'll just add one point there is in the fourth quarter our partner, Nueterra, did buy up the 10 percent from 4.75, so we all believe in where we're heading with this and executing on our growth.

Operator

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

And we have a question from Lennox Gibbs with TD Securities. Your line is open.

Lennox Gibbs — TD Securities

Good morning. Thanks. Sorry about that. I tried to withdraw. My questions have been asked.

Tyler Murphy

Okay.

Rob Horrar

All right. Thanks, Lennox.

Operator

And once again, if you'd like to ask a question, please press *, 1.

And we do not have any questions over the phone line at this time. I will turn the call over to the presenters.

Rob Horrar

Thank you. Thank you for participating on today's call and for your continued interest in MFC. We look forward to reporting on our progress throughout the remainder of 2019.

Thanks, and have a good day.

Operator

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