Medical Facilities Corporation
Q2 2023 Earnings Call Transcript

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Company Participants

Jason Redman - Interim President, CEO & Director
David Watson - CFO

Conference Call Participants

Andre Bodo - National Bank
Sahil Dhingra - RBC Capital Markets

Operator

Good morning, everyone. Welcome to Medical Facilities Corporation's 2023 Second Quarter Earnings Call.

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 visions 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, 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.

Jason Redman

Thank you, operator. Good morning, and welcome to our second quarter earnings call. With me on the call is our Chief Financial Officer, David Watson. Earlier this morning, we reported our Q2 results. Our news release, financial statements and MD&A may be accessed through our website at medicalfacilitiescorp.ca and have also been filed with SEDAR.

We had a solid second quarter. Our facility service revenue was up 7.2%. Our surgical volumes were up 1% when excluding the MFC Nueterra ASCs and our income from operations and EBITDA were up 8.3% and 9.2%, respectively, when excluding noncontrollable noncash charges at the corporate level related to share-based compensation plans. While the charge in the quarter was nominal, the corresponding expense reversal last year boosted our income from operations and EBITDA by approximately $2 million. These nonoperational charges masked the actual performance of our business. Excluding them provides a more accurate assessment of our ability to generate cash flow and deliver returns to our shareholders.

During the quarter, we used our strong cash flow to pay down debt and returned another $1.9 million to shareholders through share repurchases. We also substantially completed our overhead cost reduction plan, which we first announced along with our change in corporate strategy last September. We benefited from our cost-saving initiatives during the quarter, and we are pleased to say that we have now reduced corporate costs by an annual run rate of approximately $5 million.

Subsequent to quarter end, we completed the divestitures of City Place Surgery Center and Miracle Hills ASC, and sold our non-controlling ownership interest in St. Luke’s. The transactions following quarter end provided aggregate net proceeds of $2.3 million. The buyer of St. Luke’s also assumed debt of $5 million and the lender released MFC from its pro-rata guarantee.

Finally, I want to give a quick shadow to our four surgical hospitals, each of which received 5-star ratings for staff responsiveness based on publicly reported measures from the annual HCAHPS survey data from CMS.

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

David Watson

Thank you, Jason, and good morning, everyone. I would like to start by reminding everyone that all dollar amounts did follow are in U.S. dollars unless stated otherwise.

Facility service revenue for the quarter increased 7.2% to

$109.5 million largely due to case and payor mix, as well as the impact of Sioux Falls moving its anesthesia service and related billing in-house in the current year. Overall surgical case volumes were down 5%. However, as Jason mentioned earlier, when excluding the MFC Nueterra ASCs, volumes were up 1%. Excluding the MFC Nueterra ASCs, observation cases increased by 30.2%, while inpatient cases were down 10.8% and outpatient cases were down 1.4%.

Our operating expenses increased by $7.9 million or 9.1% to $93.9 million. Consolidated salaries and benefits were up by $1.3 million or 4.3% and primarily due to the impact of Sioux Falls moving its anesthesia service and related billing in-house in the current year, higher clinical and nonclinical salaries and wages and separation costs for our former Chief Development Officer.

Clinical and non-clinical salaries and wages were subject to annual increases, full-time equivalent increases, and market wage pressures. The higher salaries and benefits were partly offset by cost-saving initiatives at the corporate level to the tune of $1.2 million, and the forfeiture of stock options relating to the former Chief Development Officer in the current year.

Consolidated drugs and supplies were up $2.9 million or 8.6%, largely due to an increase in spine and higher acuity orthopedic cases partly offset by higher vendor rebates in the closure of clinical operations at Eastwind Surgery Center back in May.

Consolidated G&A increased by $3 million or 19.4%, swing was mainly due to noncontrollable corporate level costs related to share-based compensation plans driven by an increase in our share price in the quarter versus the significant decrease in corresponding $2 million expense reversal in the same period last year. While we also had increases in billing fees, contracted services and facility-related expenses as well as costs pertaining to Sioux Falls as an accountable care organization, these were partly offset by cost savings of $0.5 million at the corporate level.

Income from operations was $15.6 million, representing an increase of 8.3% and when excluding the noncash charges Jason and I highlighted, EBITDA for the quarter was $21.2 million, which was an increase of 9.2% when excluding the same charges. Finance costs for the quarter increased $16.7 million due primarily to the $16.4 million increase in noncash costs related to the change in value of the exchangeable interest liability. Like share-based compensation, the value of the exchangeable interest liability fluctuates based on the share price, which resulted in a $14.4 million reversal of expense in the prior year.

In the quarter, we generated cash available for distribution totaling CAD 6.6 million, resulting in a payout ratio of 30.8%. Looking at our NCIB, during the quarter, we purchased 316,100 of our common shares for a total consideration of $1.9 million. For the first 6 months of the year, we purchased 734,000 shares, returning $4.5 million to our shareholders. We also used our strong operating cash flow and cash balance to repay $9 million on our corporate credit facility during the quarter, bringing the balance down to $27 million. This contributed to a decrease in cash and equivalents at quarter end.

At the end of the quarter, we had consolidated net working capital of $22.3 million, including $27.9 million of cash and equivalents. For comparison, at the end of 2022, we had working capital of $32.5 million including cash and equivalents of $34.9 million. Inclusive of lease liabilities, our net debt-to-equity remains low at 0.87x as compared to 0.94 at December 31, 2022.

This concludes our prepared remarks. We would now like to open up the call for questions. Operator?

Question-and-Answer Session

Operator

Your first question comes from Endri Leno, National Bank.

Andre Bodo

It's Andre Bodo sitting in for Endri. My first question pertains to the remaining ASCs. What's your plan for them given that they're such a small part of the business now?

Jason Redman

Yes. So let me address that. I mean, the last remaining ASC that we have with Nueterra is in the process of being dealt with now. The other ASC, we have Newport, no decision has been made with respect to that yet.

Andre Bodo

Okay. And do you expect beyond ASCs in terms of more asset sales?

Jason Redman

Sorry, can you repeat your question, please?

Andre Bodo

Beyond the ASCs, should we expect more asset sales?

Jason Redman

No decision has been made yet with respect to any disposition of further assets.

Andre Bodo

Proceeds. What is your plan for them?

Jason Redman

The Board has not made any decision with respect to allocation of proceeds yet.

Andre Bodo

And my final question. Do you see the 2024 Medicare budget increasing affecting DR's specific mix at all?

David Watson

Overall, I think the '24 increases are roughly a net increase of about 3%. Now that's overall and not procedure specific. I don't have the detail yet on how it applies to our specific specialties.

Operator

Your next question comes from Sahil Dhingra, RBC.

Sahil Dhingra

This is Sahil filling in for Doug Miehm. My first question is, what was the contribution of the assets that have been disposed of and that were disposed of after the quarter?

David Watson

Yes. Sahil, the contribution was really immaterial. As we've noted we saw a decrease in case volume at the MFC and Nueterra ASCs and the corresponding impact of that on earnings is what you'd expect.

Sahil Dhingra

Okay. Then my second question is, going forward, how are you going to prioritize between debt repayments and dividend increase or share buybacks?

Jason Redman

Yes. So the allocation of capital is something that the Board is constantly looking at. There's various methods that we can use to deploy that capital, but no decision has been made yet.

Sahil Dhingra

Okay. And in terms of inflationary pressures, are you seeing any normalization there, if you have any updated color on those?

David Watson

Yes. Overall, I would say on the labor side, we're seeing less need for special payments, recruiting bonuses, that type of thing. Like much of the industry, that's beginning to normalize. That said, we do continue to see the types of increases that you're seeing across most labor markets. And on the expense side, we -- on the other expenses, drug supply that kind of thing, we do benefit from having a group purchasing plan in place. But we are experiencing the same inflationary pressures that everyone else is.

Sahil Dhingra

Okay. And are you seeing any pressures from new competition that has come up in some of the markets?

Jason Redman

No, not currently, nothing that's been material to our operations.

Sahil Dhingra

And then the final question is, what explains the year-over-year decline in cash available for distribution, even though EBITDA was broadly similar?

David Watson

Yes, if you look at the calculation of cash available for distribution, it includes -- the prior year includes the $2 million reversal of the impact on share-based compensation. So if you were to remove that, it changed the picture a bit.

Operator

There are no further questions at this time, please proceed.

Jason Redman

Thank you, operator. I would like to thank everyone for taking the time this morning. We look forward to speaking with you again in November.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.