Medical Facilities Corporation

Fourth Quarter 2019 Results Conference Call

Event Date/Time: March 12, 2020 — 8:30 a.m. E.T.

Length: 20 minutes

CORPORATE PARTICIPANTS

Robert Horrar
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David Watson
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James Rolfe
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CONFERENCE CALL PARTICIPANTS

Neil Linsdell
Industrial Alliance Securities — Analyst

Endri Leno
National Bank Financial — Analyst

PRESENTATION

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation 2019 Fourth Quarter Results Conference 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 certain statements made in today's call, including responses to questions, may contain forward-looking statements within the meaning of the Safe Harbour 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 to 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 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.

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Thank you, Operator, and hello, everyone. With me this morning is David Watson, our Chief Financial Officer, Jim Rolfe, our Chief Development Officer, and we are welcoming John Schario, our Chief Operating Officer, to his first call.

This morning we released our fourth quarter and year-end results. Our news release, financial statements, and MD&A may be accessed through our website at www.medicalfacilitiescorp.ca, and have also been filed with SEDAR today.

Over the past several months, we have been focused on realigning our portfolio and improving our financial flexibility. I'd like to highlight our progress in this regard before discussing our fourth quarter financial results.

As we said on our last call, one of our top priorities has been addressing the issues at Unity. We spent considerable time and effort evaluating strategic alternatives for Unity, and we are pleased with the outcome. As we announced, on February 26, we were able to partner with three of the premier physician groups in the South Bend area. We believe that bringing in new partners and capital will significantly improve facility utilization and financial performance of Unity.

February 26, we also announced an agreement for the sale of the real estate assets underlying Unity, consisting of land and buildings, for approximately $25 million. The real estate transaction, which is subject to due diligence, closing costs, and customary closing conditions, is expected to close in the second quarter.

Also in the second half of December, we sold our interest in Central Arkansas Surgical Centre. This facility was part of a group of seven ASCs acquired through our MFC Nueterra partnership in early 2018. In short, this facility was part of a platform acquisition. Due to the relatively small market size and limited growth opportunities, we felt our capital would be better deployed in a larger market. While it’s not a material transaction, it was consistent with our objectives of improving profitability and strengthening our balance sheet.

On the topic of improving our financial flexibility, at the end of 2019, we retired our 5.9 percent convertible debentures, repaying all outstanding principal and interest. We used a combination of cash on hand and $16 million from our credit facility to retire this financial obligation.

Turning briefly to our fourth quarter results; on a consolidated continuing operations basis, which excludes Unity’s results, our revenue, operating income, and EBITDA were up compared to a strong fourth quarter the year before, and our improvement from earlier in 2019. While I’ll leave most of the line item discussions to David, I did want to call out the strong contributions during the quarter from two South Dakota hospitals.

Revenue from Black Hills was up 9.5 percent, due largely to an increase in surgical cases and more favourable case mix. The hospital also benefited from an increase in imaging revenue and urgent care revenue, including our Gillette clinic that opened in December of 2018. Black Hills income from operations was up 13.3 percent for the quarter.

Sioux Falls specialty hospital saw revenue increase 7 percent due to an improved payer mix and better case mix. As neurosurgery cases increased, income from operations was up 9.6 percent in Sioux Falls for the quarter.

I would like to turn the call over to David to discuss the financial results for the quarter and the year. David?

David Watson — Chief Financial Officer, Medical Facilities Corporation

Thanks, Rob, and good morning everyone.

A few reminders before I get started; first, our 2019 financial results include the impact of IFRS 16, a substantial change to lease accounting standards. MFC adopted IFRS 16 using the modified retrospective approach, and our financial results prior to 2019 were not restated. As a result, when comparing our 2019 EBITDA to periods prior to January 1, 2019, the impact of IFRS 16 should be considered. Second, all dollar amounts expressed in today's call are in U.S. dollars, unless otherwise stated. Third, because negotiations to sell the majority of our interest in Unity, and the sale of the underlying real estate began prior to year-end, they have been classified as assets held for sale on a consolidated balance sheet as of December 31, 2019. As such, the financial results of Unity Medical will no longer be consolidated into our results. Instead, we will begin accounting for our interest in Unity under the equity method of accounting, beginning in the first quarter of 2020.

The following comments are for continuing operations and exclude the results of the Unity discontinued operations.

Looking at our financial results beginning with revenue; for the year, we had revenue of $398.1 million, an increase of $7.3 million or 1.9 percent compared to 2018. The increase results from several factors, including: higher surgical case volume at most facilities; growth in primary care, pain clinic, and imaging revenue; the addition of the Gillette urgent care clinic, which opened at the end of 2018; an extra month of contributions from the MFC Nueterra ASCs which were acquired in February of 2018; and positive variances in both case and payer mix. Revenue growth for the year was partly offset by the discontinuation of revenue from IMD, after the disposition of its assets in June of 2018, and the impact of the sale of the ENT clinic at Black Hills.

For the fourth quarter, revenue increased $2 million or 1.8 percent to just under $114 million. The growth was primarily attributable to higher inpatient case volumes from increased spine and other high acuity cases, which generated higher average revenue per case. We also had higher revenue from urgent care, primary care, pain management, and imaging. However, these gains were partly offset by changes in the payer mix, and total surgical cases were down 2.6 percent for the quarter.

Excluding the $22 million non-cash goodwill impairment charge for the MFC Nueterra AFCs in the third quarter, Adjusted EBITDA for the year was $96.2 million, which was up 3.1 percent from $93.4 million in 2018. As a percentage of revenue, Adjusted EBITDA in 2019 improved to 24.2 percent compared to 23.9 percent in 2018.

For the quarter, we had EBITDA of $32.7 million, an increase of 8.5 percent from $30.1 million in Q4 the prior year. Our EBITDA margin for the quarter improved to 28.7 percent of revenue from 26.9 percent of revenue in the fourth quarter 2018. The increase was mainly due to higher revenue, combined with lower general and administrative expenses, stemming from the impact of adopting IFRS 16.

Looking at distributable cash and our payout ratio for the period, I'll remind everyone that the revision to our dividend took place partway through the fourth quarter. For the year, cash available for distribution totalled CAD$27.5 million, resulting in a payout ratio of 111.1 percent. For the quarter, we had cash available for distribution of CAD$11.8 million, resulting in a payout ratio of 37 percent. On a pro forma basis, utilizing the new dividend rate, the payout ratio would have been approximately 32 percent for the year, and about 18 percent for the quarter.

As Rob mentioned, we've been working to strengthen the balance sheet and improve our financial flexibility. At the end of the year, we retired the 5.9 percent convertible debentures, repaying the outstanding principal and interest of $32.1 million with a combination of cash on hand and $16 million drawn from the corporate credit facility. Following the repayment, we had corporate debt outstanding of $84.8 million compared to $99.4 million at the end of 2018. This leaves about $65 million available on our $150 million credit facility.

On a consolidated basis, total long-term debt, excluding lease liabilities, decreased $19.6 million to $151.4 million as of year-end, and cash and cash equivalents were just under $32 million.

At year-end, consolidated net working capital improved to $71.5 million compared to $33.2 million the year before. The change was due mainly to the redemption of the convertible debentures, which was partially funded by the draw on the corporate credit facility, as well as the impact of classifying Unity and the underlying real estate as assets held for sale. This was partly offset by the impact of IFRS 16, which recognizes the current and long-term portions of lease liabilities.

This concludes my financial review for the year and the quarter. For additional detail on our financial results, including specific results for each facility, please refer to our MD&A.

I would now like to turn the call back to Rob to provide a few comments on our outlook, before we open the call for questions. Rob?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Thanks, David.

Despite a challenging 2019, we firmly believe that MFC has a solid foundation from which to build upon, and we will continue to focus on reinforcing and building upon what we do best: investing in, and partnering with, high quality facilities to combine the best patient experience and quality of care. Our shared commitment to care is reflected in high patient quality and satisfaction scores.

Most recently, at the end of the January, the U.S. Department of Health and Human Services released its latest Hospital Consumer Assessment of Healthcare Providers and Systems, or HCAHPS, survey results. Based on 10 important hospital quality topics, this year’s survey revealed that 89 percent of MFC patients would definitely recommend our hospitals, compared with 72 percent for the national average. In fact, three of our hospitals received a five-star rating, which is very rare and difficult to attain.

Looking ahead, while we remain focused on operational improvements and strengthening our balance sheet, our overarching goal is to ensure that MFC is ready to take advantage of opportunities for sustainable growth. We'll continue to enhance and add services at our existing facilities, including the recruitment of new physicians.

We continue to leverage our partnership with NueHealth as we build out our ASC platform. More and more cases are being done on an outpatient basis. We believe our platform is well-positioned to take advantage of the shift to outpatients, and while relatively small, it will benefit from scale.

In addition to potential acquisitions of ASCs, our pipeline included de novo opportunities, such as the development of the St. Luke's ASC, which remains on track to open in the second quarter.

Before opening the call to questions, I want to thank our investors for their support during a challenging year for MFC. We look forward to updating you on our progress towards building a strong and sustainable long-term future. We'd also like to take this opportunity to thank all of our physician partners and associates who deliver outstanding care to patients each and every day.

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 star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. We'll pause for just a moment to compile the Q&A roster.

The first question comes from Neil Linsdell with Industrial Alliance.

Neil Linsdell — Analyst, Industrial Alliance Securities

Hey, good morning, guys.

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Good morning.

Neil Linsdell — Analyst, Industrial Alliance Securities

Well, congratulations on some of the restructuring efforts that we're seeing going into… As we start looking forward, obviously you're looking at—as we look at 2020, is there additional restructuring now that you've got Unity basically out of the way, that you feel you need to focus on? Or is it really going to be more of a focus on acquisitions and more growth opportunities?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Well, for now, I don't think we have anything planned exactly. We are looking and evaluating strategic options for one of the ASCs that we called out to improve its performance, but overall, we're going to be focused on continuing to grow same-store and acquisition development.

Neil Linsdell — Analyst, Industrial Alliance Securities

Okay. Any physician retirements or major impacts that we should know about, especially as we're starting to look at Q1 which is almost complete here, that might impact the results there?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Not that we're going to call out today. I think we finished the year pretty much even in terms of our physician complement, with the exception of just the divestiture of the Central Arkansas ASC, so we were pretty flat on the physician complement through 2019.

Neil Linsdell — Analyst, Industrial Alliance Securities

Okay. Could I get Jim to comment on any major recruitment pushes or drives, or feedback that he's been getting from groups?

James Rolfe — Chief Development Officer, Medical Facilities Corporation

Neil, say that again? I'm sorry.

Neil Linsdell — Analyst, Industrial Alliance Securities

I'm just wondering, as you're always on the road talking to different physician groups trying to recruit them into your network and such, I'm just wondering if there's—that you can provide any kind of colour on recent conversations, willingness to move, speed of growth here and that type of thing?

James Rolfe — Chief Development Officer, Medical Facilities Corporation

Yes, no, the pipeline remains strong. We're having a lot of activity with our de novo strategy, and as far as the organic growth, we're seeing some good movement in that as far as moving into our existing centres and our hospitals.

Neil Linsdell — Analyst, Industrial Alliance Securities

Okay. Then maybe just one last side question; in the urgent care centres, not in your main surgical hospitals, are you seeing any major shifts with any questions about the COVID-19—of course that had to come up as a question here. Anything you're preparing for within the urgent care side more?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Yes, I appreciate the question, and you're taking that on for the group as well. To-date, I'll just tell you that we, like everyone else, we can't project what's going to happen or what the impact on the business would be. We have not seen any impact to-date in the hospitals, or really in the urgent care so far, but we are clearly taking precautionary steps to every extent available. That includes working with all the state and local health departments. We've got all the necessary resources, including infectious disease resources, advising us and sharing best practices.

We are preparing as best as everyone can, but to-date, no impact.

Neil Linsdell — Analyst, Industrial Alliance Securities

Okay, thanks. That's it for me.

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Thank you.

Operator

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

We have a question from Endri Leno with National Bank.

Endri Leno — Analyst, National Bank Financial

Hi, good morning, thanks for taking my questions. Just a couple from me; first, I just wanted to clarify, the sale of Unity, do we still then expect it to close in Q2?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

The real estate, yes, correct.

Endri Leno — Analyst, National Bank Financial

Okay, and for the hospital, or the interest that you sold; is that done already, or is that Q2 or further out?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Yes, that's done. That was done on February 26. The sale of the interest is closed. What's not closed was—agreed to but not closed, is the real estate, which we expect to close in second quarter.

Endri Leno — Analyst, National Bank Financial

Okay, great, thank you. Central Arkansas surgical, that was not excluded in Q4 results, right? That was there as well?

David Watson — Chief Financial Officer, Medical Facilities Corporation

No, we…

Endri Leno — Analyst, National Bank Financial

For sale?

David Watson — Chief Financial Officer, Medical Facilities Corporation

It's in continuing operations, but it's immaterial. It's immaterial, Endri.

Endri Leno — Analyst, National Bank Financial

Okay. Okay, great, thank you. The last one, or actually one more before—I mean, you called out, in Q4 or in Q3 rather when you were talking, that you had some investment ongoing, I believe, in a couple of the hospitals in South Dakota, as well as in Arkansas. Did you see any lift—this improvement that you saw in Q4, did those investments have anything to do with that?

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Well, I think overall, we had a good quarter. We called the Sioux Falls and Black Hills. Our South Dakota hospitals were up; the revenue at Sioux Falls was up 7 percent and up even more than that at Black Hills. Again, they're both in competitive markets, they continue to grow their markets, and we had a good shift in case mix with stronger inpatient growth out of the mix. That helped to drive our results, Endri.

Endri Leno — Analyst, National Bank Financial

Okay, great. Then the last one for me, I mean, and we see there was some—or I guess, after adjustment, to get more or less in line, at least from a numbers, year-over-year. But can you help me reconcile, or at least comment a little bit on why distributable cash was down year-over-year, even if we have, in terms of operating results, in line or even an improvement? That's it for me, thank you.

David Watson — Chief Financial Officer, Medical Facilities Corporation

Yes, from a cash perspective, Endri, it still includes the impact of UMASH, or Unity, which, with negative EBITDA, was a drain.

Endri Leno — Analyst, National Bank Financial

Okay. Great, thank you. That's it for me. Appreciate it.

Operator

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

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

Robert Horrar — President and Chief Executive Officer, Medical Facilities Corporation

Thank you for joining us on today's call and for your continued interest in MFC. As always, we look forward to reporting on our progress again next quarter. Thank you.

Operator

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