Medical Facilities Corporation

CEO Rob Horrar on Q3 2020 Results - Earnings Call Transcript

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Company Participants

Rob Horrar - President & CEO

David Watson - CFO

Conference Call Participants

Endri Leno - National Bank Financial

Doug Miehm - RBC Capital Markets

Chelsea Stellick - Industrial Alliance Securities

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation's 2020 Third Quarter Earnings 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 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.

Please note, that today's call is being broadcast live over the internet and the webcast will be available for replay beginning approximately one hour following the completion of the call. Details of how to access the webcast replay are available in this morning's news release announcing the company's financial results.

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

Good morning, everyone, and welcome to our third quarter earnings call. Joining me today is David Watson, our Chief Financial Officer. Earlier this morning, we released our third quarter results. Our news release, financial statements and MD&A are available on our website and had been filed with SEDAR.

There have been many challenges to our healthcare system this year. However, all things considered, we were pleased with our third quarter results. Today, we reported total revenue and other income of $98.8 million, which was up 2.4% from Q3 of last year. This figure includes $2.5 million of additional government stimulus income recognized by our surgical hospitals and ambulatory surgery centers during the quarter.

The relief funding had a smaller impact to our revenue and other income this quarter compared to Q2. Nevertheless, the funds were again meaningful and very much appreciated. It is important to highlight that excluding the relief funding, our third quarter adjusted EBITDA was in line with the same quarter last year. While facility service revenue was down $0.2 million compared to quarter three of last year, surgical case volume continued to rebound closer to pre-COVID levels. We also benefited from favorable changes in case and payer mix during the quarter. Contributing to our improved profitability for the quarter, our physician partners continued to manage costs to the extent possible. We also continue to benefit from the successful execution of our strategy over the past year, improving operations at our existing facilities, focusing on markets where we see the most potential for long-term growth and selling down or exiting non-strategic and underperforming assets, while at the same time strengthening our balance sheet.

We're now in what is typically our busiest time of the year, the fourth quarter. The rebound we saw in the third quarter continued through October. However, uncertainty remains around the increased COVID-19 infection rates nationally. We do not know how long the pandemic will last or what the potential material impact COVID-19 may have on our future operations and financial results. But we are certainly in a better position to withstand the impact because of the moves and decisions we made over the past year. We're also better prepared than we were at the start of the pandemic. Our facilities have robust screening and testing capabilities, and currently have access to the supplies and PPE they need to provide safe and outstanding care to patients. Our managing physicians and healthcare professionals have shared lessons learned over the past several months to ensure they're able to continue to provide our services to patients who need them.

Each of our facilities continues to take every precaution to ensure they remain safe places for physicians, staff and patients. Regardless of the challenging environment, we are focused on growing MFC and seeking opportunities to execute our ASC platform growth strategy. In September, we were pleased to announce that the St. Luke's Surgery Center of Chesterfield officially opened and completed its first cases. The new multispecialty ASC is jointly owned by MFC, St Luke's Hospital and local physicians. While the timing was delayed due to the pandemic, we are pleased with our progress at the new ASC and look forward to ramping up over the next several months.

Finally, we continue to have a robust pipeline of acquisition targets and remain focused on adding scale to our platform. And with that, I would like to turn the call over to David to review our financial results for the quarter. David?

David Watson

Thanks Rob, and good morning, everyone. As usual, a reminder that all dollar amounts expressed in today's call are in US dollars unless otherwise stated. I'll discuss our third quarter financial performance then provide an update on our balance sheet and liquidity. The pandemic did continue to affect the volume of elective surgeries in some facilities during the quarter. However, this was partly offset by the combined impact of favorable case and payor mix, as well as the recognition of additional government stimulus income of $2.5 million received by facilities during the quarter. As Rob mentioned, surgical case volumes continue to rebound in the third quarter, but were down 3.5% from the same quarter last year. The largest decrease was in inpatient cases, which declined 5.3%, while outpatient cases were down 4.4%. Observation cases on the other hand, increased by 19.3%.

Our total revenue and other income for the quarter, which includes the $2.5 million of government stimulus income was $98.8 million. This represents an increase of $2.3 million or 2.4% compared to the third quarter of 2019.

Facilities service revenue for the quarter totaled $96.3 million, down 0.2% from the same quarter last year. As a reminder, within the government stimulus income, the loan amounts received by Facilities for PPP program are eligible for forgiveness to the extent they were used for certain qualifying expenses and to maintain payroll levels and related costs. While our Facilities believe they've met the qualifications, there can be no assurances that the loans will be forgiven until applications are submitted and their review process completed.

Operating expenses for the quarter totaled $81.2 million, representing a decrease of $22.2 million, or 21.5% compared to the third quarter of last year. Almost all the decrease relates to a goodwill impairment charge taken in the third quarter of last year that was not repeated in the current quarter. As a percentage of total revenue and other income, operating expenses decreased to 82.2% from 107.2% for the comparable period. Within operating expenses, the next largest variance was in general and administrative expenses, which decreased by $2.1 million, or 13.9%. This reduction resulted primarily from a decrease in a loss from a lease termination in the prior year, lower physician recruitment costs and a gain on the sale of Two Rivers Surgical Center.

As a percentage of total revenue and other income, G&A decreased to 12.9% from 15.4% a year ago. EBITDA for the quarter was $24.6 million, or 24.9% of revenue, compared to $0.4 million or 0.4% of revenue in the third quarter of last year. During the quarter, we generated cash available for distribution, totaling $12.7 million Canadian dollars, resulting in a payout ratio of 17.1%. This represents a significant improvement over the prior year payout ratio of 165.3%. We approach the end of the year with a strong balance sheet, well positioned for the opportunities and challenges that may arise. As of September 30, we had approximately $83.4 million of cash and equivalents. Of this amount $23.2 million represents advances from Medicare that will be offset against future billings. Excluding the Medicare advances, total Facilities cash was $35.6 million and MSC corporate cash was $24.6 million.

At the end of the quarter, debt outstanding on the corporate credit facility totaled $58.8 million, after reducing it by $26 million in July with proceeds from the sale of the UMASH real estate. Net debt to adjusted EBITDA leverage was 1.06 as of September 30, after netting out available cash. This concludes my review of the third quarter financial results. For additional detail, including specific results for each facility, please refer to our MD&A. We would now like to open the call for questions. Operator?

Question-and-Answer Session

Operator

[Operator Instructions]

Your first question comes from Endri Leno with National Bank.

Endri Leno

Hi, good morning, guys. Thanks for taking my questions. So a few for me actually; so I'll start at the facility level. But it appears that OSH was the only one that's not received government support. Is there any particular reason for that?

David Watson

No. OSH has received government support. I just don't believe they recognized any this quarter.

Endri Leno

Okay, so there will be some and definitely figure in -- another -- of my other questions. But how much of this government support will then be recognized in Q4, or is there any left?

David Watson

No. They, unless there's additional stimulus. They recognized the stimulus they received in the second quarter.

Endri Leno

Okay, great. Thank you. And all the other obstacles that you recognized in the quarter. I mean, can you at least provide some sort of directionality or broad breakdown of how it was distributed between the other hospitals, which funded your system or the most on facility?

David Watson

Endri, we don't have that breakout handy at the moment.

Endri Leno

Okay. But just kind of very broadly. I mean, are we to assume, for example, that ASH received the most since they performed better than everybody else, or can we make that statement?

David Watson

No, no, actually. So ASH received about $0.5 million, Sioux Falls and Black Hills, both about $900,000.

Endri Leno

Okay, thank you. And then in terms of the cases that you saw in Q3 and this trend that you're seeing continuing into October. Do you have any kind of inclination or indication of how many of these cases were scheduling from Q2 and how many are sort of your normal course procedures for Q3 and even into October?

Rob Horrar

Yes. For the most part, Endri, we have seen a little bit more -- most of our, I guess, backlog if you'll call it has occurred in the second quarter, we did see some more in terms of rescheduling for the most part, though, those volumes have rebounded, as we said, it's new cases, the clinic volumes are rebounding. So for the most part, the majority of the volumes were generated in the quarter.

Endri Leno

Okay, yes, great. Thank you. And I mean, still on that kind of cases and volume, but outside of the planned procedures or even the rescheduling, I mean, but can you provide any color? What would you say are some cases that would be sort of permanently lost, like, for example, cases from contact sports or fewer people driving to work and things of that nature?

Rob Horrar

Well, for the most part, if the case is medically necessary, Endri it’s going to get done. I think at this point, in terms of any type of a backlog, it would be just those patients that have less of an acute surgery that's pending, and perhaps they don't feel comfortable at this point having the procedure done in any setting. So that's certainly the minority, but for the higher acute necessary cases, and we see those continuing to come back and get done and get scheduled.

Endri Leno

Okay, so you're still adding a few, right, you said, of the least acute ones, you're still adding a few to the quote / unquote, backlog?

Rob Horrar

I think the color on that is that are those patients particularly the higher risk age categories that are reticent. And we will probably… our estimation and the feedback we get from the markets and hospitals and clinics is that they'll see those, when there's more clarity on the COVID surge here, and when they feel more comfortable coming back. In the fourth quarter; in the first quarter next year and into the spring.

Endri Leno

Okay, no, thanks for the color. And as far as COVID cases, South Dakota is reporting some of the highest cases and positivity rates in the country. I mean, are you seeing an impact of patients deferring procedures particularly into the hospitals in that market.

Rob Horrar

Well, Endri, you can see by the results that you continue to see a fair number of patients coming through, as I've said, they're no different than any other market, patients who don't feel comfortable, but our facilities are taking every precaution. We don't treat COVID patients; they have robust testing and screening, and are considered, very, very safe places in terms of that every facility has testing and screening capabilities, not only pre-surgically for patients, but also for staff and for physicians as well. So I think that is a very big positive for us. In fact, we've had anecdotally here recently, calls from physicians who are not a part or owners in the hospitals, to do cases in our facility as hospitals are starting to be impacted on their elective cases. So it's a good fact for us.

Endri Leno

Okay, great. Thank you. And as a continuation to the answer you gave, Rob, I mean could that kind of be segue for you to add some of the doctors to the hospitals?

Rob Horrar

Well that would be the hope. I think in the short term, the answer is that is yes. And the long term would be remains to be seen.

Endri Leno

Okay. Great. Thank you. The next question is on the acquisitions. I mean, you mentioned that you continue to evaluate for acquisitions out there. I mean can you do anything during the pandemic over the next two or three months? I mean can you do due diligence and is anybody active? Or is this more of a long-term target, let's say, second half of 2021 something of that nature?

Rob Horrar

Of course, COVID has presented a challenge for everyone in the industry in evaluating the impact on acquisitions. But we have seen, continued to see pipeline opportunities for us. And so it's very, it's what we just described as robust. But I'll tell you that there's a fair amount of work that we're doing and we'll continue to do around due diligence and evaluating those opportunities for the company, but they do exist in a fairly robust fashion.

Endri Leno

Okay, great. Thank you and the last one for me. If you can talk a little bit and perhaps I missed it because I got in a bit late in the call, but the strategic rationale for selling the Two Rivers ASC and are there other divestments on the table for other ASCs?

Rob Horrar

Well, we will always make the best decisions for the shareholders and for the company. And we're focused on our growth. So, I'll tell you that's our first goal. The divestitures we made this year were facilities where in which circumstances changed, or they were no longer markets where we saw a lot of growth opportunity. And in the case of Unity, it made sense to sell more ownership, and that to strengthen the partnership, so those were strategic, they were -- strengthen the company going forward, and we’ll always make those decisions, but we’re focused on growing the company.

Operator

Next question comes from Doug Miehm with RBC Capital Markets.

Doug Miehm

Yes. Thank you. Just to continue on the commentary around acquisitions. First off, have you seen any change in terms of multiples during this period? And is it making it a challenge for you to get things done? And then secondly, as it relates to acquisitions; could you tell us if there's anything that the company has learned as it relates to the Unity situation, or Nueterra that is helping you guide your look for new acquisitions and how you're going to approach those?

Rob Horrar

Sure, just the first part of that, is that multiples really have not changed. I think in terms of, where acquisitions want to be and where the market is that they're, you evaluate this in terms of neutralizing the COVID impact. And so on the acquisition front, that's the case. When we do see and we talk about acquisitions, we also need to talk about development, and that is the new de novo projects like St. Luke's. And there is a great opportunity. We've talked about many times there are 5,500 ASCs in the country today. And we expect that number to double over the next decade. So significant opportunities on the new development front, which as you know take some time to develop and syndicate, but are essentially the cost of equipment and development of those centers.

So that is an important part of our growth strategy. The acquisition front lessons learned. Number one is clearly our platform will benefit from scale, in terms of circumstances changing and partnerships that happens in a smaller partnership, those with larger scale have less impact. And so scale is our number one priority for that. And I think that we've got a good platform, a lot of experience in that in evaluating both the acquisitions and the de novo opportunities for the company.

Doug Miehm

Okay, great. And then just my last question has to do with, you touched on this a little bit, but the benefit you might be seeing as a result of the severity or acuity of cases that community hospitals are seeing with respect to COVID… Is it reasonable to assume that you may be seeing over index number of patients for procedures as they try to identify hospitals, surgical hospitals that are not dealing with the cases directly?

Rob Horrar

Well, I will tell you this, that as a part of our Q3 results, we haven't really seen any of that impact from physicians or partners that are not a part of our existing partnership. I think the opportunities we mentioned, called out presents itself, as hospitals are starting to reduce their elective procedures. I think that's an opportunity. We don't know; we don't have any color in terms of what size that may be going forward. But we do know in a number of our market, several of our markets, that there is a demand for elective cases, and to the extent that cannot be done in the hospital -- acute care setting, that we've got the venue to do that. And so going forward, we see that as a potential add on.

Operator

The next question comes from Chelsea Stellick with IA Securities.

Chelsea Stellick

Hi, good morning, gentlemen. So I know we've kind of been talking all year about pent-up demand happening in the fourth quarter and since it's traditionally your busiest quarter, as well, I'm just wanting to see how that's going to shake out as we're seeing COVID cases rise in the US. How are you handling any additional stresses on the system and backlog potential as patients who are unable to be treated during the lockdown, combined with normal patients? What's that looking like, are you evaluating that on a center by center basis? Or is there sort of like a company-wide plan to handle any backlogs?

Rob Horrar

Well, it is clearly individual market and individual facility level. For right now, Chelsea, we're not yet to 2019 levels. We do expect that the fourth quarter will be fairly robust as it always is for us. And so hospitals are gearing up for that in terms of staffing, adequacy and PPE, but I'll tell you that the impact of COVID, that it has today and the potential for the fourth quarter is something that remains uncertain and we will continue to track going forward.

Chelsea Stellick

Yes. I figured that would be the answer. Also, I've had some conversations lately, just about how in the US there's been, because there's been a lot of layoffs, there's been sort of a shift in the ability to acquire good talent at a good rate. Are we seeing this in this space? Are we seeing the ability to staff up about lower expenses and what not?

Rob Horrar

That's certainly one of the challenges going forward, it's not necessarily that we don't have the staff. It will be important challenge in the fourth quarter in terms of how COVID impacts the staff in terms of family members being ill, or the need to quarantine. All of our facilities have plans around that, and very detailed plans on how to address staffing and staffing challenges with both the demand for patients in the fourth quarter. We feel they're as prepared as they can be for those challenges, as well as maintaining, again, a robust screening and testing and safe environment and having supplies necessary to take care of those patients.

Chelsea Stellick

Perfect, thank you. I think most of my questions have been answered previously. But I guess my last question, just in terms of the ramp up for St. Luke's. Can you give us sort of a picture of what that curve is going to look like in the fourth quarter, H1 2021 kind of deal?

Rob Horrar

I'll tell you the normal cadence for a ramp up… an ASC will do its first cases, they'll obtain its Medicare certification. And then after that, they'll receive various accreditations that they'll need, and then subsequent to that they'll be eligible and sign up for the managed care commercial plan insurance plans. So that generally that cadence is generally three to six months that's built into our pro forma and our ramp up on any de novo. We are very pleased with the progress of St. Luke's; we added four to five new physicians to that partnership above where we had anticipated opening. So our hope and our belief is that will ramp up a little quicker than we had planned. So it's a good fact for us.

Operator

And at this time, I'll turn the call over to Mr. Horrar for closing remarks.

Rob Horrar

Thank you, operator. We appreciate everyone joining the call this morning. And look forward to reporting on our progress again next quarter. Before we go, I wanted to say how proud we are of the performance of our surgical hospitals and ASCs during this pandemic. It certainly has not been easy. And I wanted to acknowledge and thank the teams at each of our facilities, including our physician partners, and all medical professionals and employees. Keep well and stay safe. Thank you.

Operator

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