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Medical Facilities Corp. (DR.CA)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

OTHER PARTICIPANTS

Endri Leno
Analyst, National Bank Financial, Inc.

Douglas Miehm
Analyst, RBC Dominion Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone. Welcome to Medical Facilities Corporation's 2022 Fourth 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 over to management, listeners are reminded that today's call 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, 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. Mr. Redman.

Jason Redman

Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

Thank you, operator, and good morning, everyone. Joining me today is our Chief Financial Officer, David Watson.

We reported our fourth quarter and year-end results earlier this morning. Our news release, financial statements and MD&A may be accessed through our website at medicalfacilitiescorp.ca and have also been filed with SEDAR.

The fourth quarter was highlighted by the continued strength of our core business. Our facility service revenue is an all-time high for the quarter due to a more favorable case and payer mix, combined with a 5.7% increase in surgical volumes at our four specialty surgical hospitals.

In the quarter, we returned additional capital to shareholders through a substantial issuer bid as well as our normal course issuer bid program. Under our SIB, we purchased 3.1 million shares at an aggregate purchase price of $25.5 million. Additionally, under our NCIB program, we purchased 433,300 shares at an aggregate purchase price of $2.5 million. Combined, we purchased just under 4.9 million shares or about 16% of our total shares in 2022, representing a significant return of capital.

We continue to pursue opportunities to reduce expenses, including overhead cost reductions. During the quarter, we concluded a separation agreement with MFC's former CEO. And this, combined with the retirement of our former COO, will result in significant savings in salaries and benefits on a prospective basis. We also dealt with onetime items that negatively impacted our results for the quarter. We reversed $12.3 million in Paycheck Protection Program or PPP loans from government stimulus income. This month consists of all PPP loan balances for facilities whose forgiveness applications have been denied or under review. Nonetheless, we are pursuing all reasonably available channels for reversing any denials. Any loans that are subsequently forgiven will result in a recognition of income.

We recorded a noncash impairment charge of $16.5 million related to the continued underperformance of the MFC Nueterra ASCs. This was a noncash item, and it is important to highlight that these ASCs do not contribute materially to our results. In December, we sold the remaining 31.7% interest in Unity Medical and Surgical Hospital and settled the associated loan receivable for gross proceeds of $2 million.

Before turning the call over to David, I'd like to give a shout out to our hospitals, which continue to rank among the best hospitals in the US for high quality of care. In fact, Sioux Falls Specialty Hospital, Black Hills Surgical Hospital and Arkansas Surgical Hospital were each recognized by Healthgrades as one of America's best hospitals for joint replacement surgery in 2023. A little over a month ago, Black Hills Surgical Hospital was ranked as the number one hospital in the United States for major orthopedic surgery for medical excellence by CareChex, which also ranked Black Hills as the number one hospital in the market for overall hospital care, overall surgical care and general surgery for 2023 in both medical excellence and patient safety categories. Around the same time, Arkansas Surgical Hospital was named the 2022 Human Experience Guardian of Excellence award winner by Press Ganey for the fourth year in a row. This award, as part of an annual ranking of the top hospitals in the country, is based on direct feedback from patients. ASH was the only hospital in Arkansas to receive this award.

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

David N. T. Watson

Chief Financial Officer, Medical Facilities Corp.

Thank you, Jason.

Good morning, everyone. I'll discuss our financial performance for the quarter and provide an update on our balance sheet and liquidity. I would also like to remind everyone that all dollar amounts expressed in today's call are in US dollars, unless stated otherwise.

Facility service revenue for the quarter increased 7.9% to $119.4 million compared to Q4 2021. As Jason, mentioned, each of our specialty surgical hospitals experienced higher volumes for the quarter, with their combined case volumes increasing 5.7% compared to the fourth quarter the year before and 1.5% when compared to the fourth quarter of 2019. The higher facility service revenue was also attributable to the combined positive impact of case and payer mix, as well as $1 million related to ASH moving its anesthesia service and related billing in-house earlier in 2022. Total revenue and other income decreased by $9.3 million to $107.1 million for the quarter. The 8% decrease was primarily attributable to a reduction in government stimulus income driven by the onetime reversal of $12.3 million in PPP income recognized in prior years.

On the expense side, consolidated salaries and benefits were up 6.1% over Q4 2021. Contributing to this was a combination of annual merit increases, full-time equivalent increases and market wage pressures due to the shortage of nurses, as well as the separation costs for our previous CEO. This was partly offset by the forfeiture of stock options by former executives, a lower incentive pay at the corporate level and decreased health plan utilization.

Consolidated drugs and supplies grew 10% mostly due to case mix and higher surgical case volumes at surgical hospitals and inflationary pressure on prices. This is partly offset by the reclassification of costs pertaining to Sioux Falls as an Accountable Care Organization in 2022. Consolidated SG&A increased by 11.1%. The $1.7 million increase was mainly attributable to $1.4 million of costs pertaining to Sioux Falls as Accountable Care Organization being mostly reclassified from drugs and supplies into G&A, combined with a $1.3 million impact of Arkansas Surgical Hospital moving its anesthesia service and related billing in-house. This was partly offset by lower corporate level costs, a reduction in lease-related costs, and the gain recorded on the sale of the remaining equity in Unity.

It's important to note, when adjusted for the impact of the impairment charge and the reversal of the PPP income, our income from operations was $22.3 million and adjusted EBITDA was $27.6 million for the quarter. In comparison, in Q4 2021, we had income from operations of $25.5 million and adjusted EBITDA of $32 million. As Jason mentioned earlier, the fundamentals remain strong in our four hospitals.

In the quarter, we generated cash available for distribution totaling CAD 9.9 million, resulting in a payout ratio of 21.2%. At the end of December, we had consolidated net working capital of $32.5 million, including $34.9 million of cash and equivalents. This compares to working capital of $60.9 million, including cash and equivalents of $61 million at the end of 2021.

At year-end, we had $36 million outstanding in our corporate credit facility, and the $12.3 million reversed from government stimulus income was recorded as a liability under payer advances and government stimulus funds payable. Any PPP loans subsequently forgiven or result not only in recognition of income but also a reversal of the corresponding liability. Inclusive of lease liabilities, our net debt-to-equity stands at 0.94 times, which means well below that of our US-listed peers.

This concludes our prepared remarks. At this time, we would like to turn it back over to the operator to open up the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Endri Leno with National Bank. Please, go ahead.

Endri Leno
Analyst, National Bank Financial, Inc.
Q

Hey. Good morning. Thanks for taking my questions. I have a few. So, I'll start with the personal, I'll start from the top with the revenue [indiscernible] (00:09:54) reversal. So, I just wanted to ask, is that the one you recognized this quarter, does that include everything? Or is there other parts of it under consideration or appeal or anything like that? And more could come.

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.
A

Yeah, Endri. So, that is everything that has either been denied or is under review. So, anything else that's remaining was forgiven and is not under further review.

Endri Leno
Analyst, National Bank Financial, Inc.
Q

Okay. That's great to hear. Thank you, David. The other question I have, it was, Jason, you mentioned on your prepared remarks that you're looking to further reduce overhead costs at the corporate. So, I was wondering if you can talk a little bit to that? I mean, beyond the changes you've made to senior management, what else can you do to – be further changes or be kind of like what levers can you pull to reduce costs further at the corporate?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.
A

Yeah. So, we obviously look at every expense category. We have obviously personnel, salaries and benefits as a large portion of our corporate overhead costs. But we've been through and continue to go through our entire expenses, making sure that we adjust it to ensure that it's optimal for the business that we have.

Endri Leno
Analyst, National Bank Financial, Inc.
Q

And you'd say it's not optimal -it's not optimized yet at this point, is that fair to say?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.
A

There's other expenses there that we continue to look at. We're always looking at opportunities to reduce expenses. So, we engaged in that in the latter part of Q4 of 2022 and we're going to continue that process into 2023.

Endri Leno
Analyst, National Bank Financial, Inc.
Q

Yeah. Okay, great. Thanks for the color. And when it comes to expenses and costs of the hospital level, you called out the shortage of nurses in MD&A, which has been going through the whole US healthcare. But how do you see that situation developing into 2023 be for nurses? And also, inflation in drugs and supplies, are you able to pass these costs on or to partially offset them in some way?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

So, we'll start with salaries and labor pressure. The nursing shortage existed pre-COVID. COVID exacerbated that problem, so it continues into 2023. Things are improving somewhat. There's a little bit of less pressure. There's not as much requirement for signing bonuses and state bonuses and things like that. So, overall, we are seeing improvement. But there's going to be a continued shortage and we'll just have to maintain our competitiveness in those markets.

On drugs, supplies, other expenses, generally, many of those are under contract which maintains pricing. So, you're looking at somewhere in the 3% to 4% increases. Other non-contract, implants, things like that can be more expensive. And so, we're going to continue seeing price increases as everyone else in the industry is.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Okay. Thank you. Is there any way to offset them or pass them on or not really? [ph] I mean, is that a (00:13:27) discussion you have with insurance companies or something to that effect?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Yes. So, typically, the insurance company contracts are multi-year. When we got the opportunity to negotiate those contracts, we make the best case we can. We've got roughly a third of our revenues coming from government payers under the Medicare and Medicaid plans. Those increases are determined by government and are indexed to inflation. I would say, in general, the increases don't necessarily keep up exactly with the underlying price increases.

Operator: It looks like Mr. Leno disconnected. Your next question comes from Doug Miehm at RBC Capital Markets. Please, go ahead.

Douglas Miehm
Analyst, RBC Dominion Securities, Inc.

Q

Yeah. Good morning and thanks for taking the questions. First question, just as continuing on some of the expenses commentary that you just made. When you think about 2023, let's say on a year-over-year basis, would you expect EBITDA margin contraction this year based on the commentary you just provided, or is there a chance that it could be stable, or you could even see some strength relative to last year?

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Yeah. Hey, Doug. Thanks for the question. As we go into 2023, we, obviously, don't provide guidance. But I would say, in general, the facilities are going to continue looking to expand on the top line growth that they saw in 2022. Yeah, we will see some of the pricing pressure slow down a bit than what we've seen over the past year. So, there's certainly an opportunity for improvement.

Douglas Miehm
Analyst, RBC Dominion Securities, Inc.

Q

Okay, great. Second question just has to do with the dividend. I think we were at 20% – just above 20% payout ratio. Has any thought been given to potentially increasing the dividend rates as we think about 2023 and 2024, or is that something that is not on the table right now?

David N. T. Watson
Chief Financial Officer, Medical Facilities Corp.

A

Yeah. So, the board hasn't made any decision with respect to adjusting the dividend yet. We'll have to look at their performance going forward. Well, we're always looking for ways to optimize shareholder returns, so it is a consideration item but no decisions are made yet, Doug.

Douglas Miehm
Analyst, RBC Dominion Securities, Inc.

Q

Okay. Okay. Excellent. And then, my last question just has to do with the competitive environment, especially now that your facilities in South Dakota and Arkansas are scoring so well. I think it was Avera that just announced last week that they're going to be opening up a new 70,000 square foot facility in Tea, and that won't be ready till 2025. But can you talk about the competitive dynamics in the marketplace, especially given the quality scores that your hospitals are receiving and what that means from a practical perspective for the ability to attract patients relative to your competition?

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Yeah. So, thanks. I mean, I think you're absolutely right. I mean, the market is becoming a lot more competitive. I mean, our hospitals continue to do a very good job at attracting and retaining talent. That's going to be even more important. We're making sure that we retain the doctors and the clinical staff is going to be paramount going forward. So, I mean, likely, we see the competition increasing. We continue to differentiate ourselves on performance standards and, obviously, that's something we're never going to compromise but it's something we watch very closely. But our doctor portfolio remains strong and patients tend to be very loyal.

Douglas Miehm
Analyst, RBC Dominion Securities, Inc.

Q

Okay. Excellent. That's it for me today. Thank you.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Thank you, Doug.

Operator: Thank you. You have a follow-on question from Mr. Endri Leno. Please, go ahead.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Oh, thank you for the follow-up. Just one more for me. As it pertains more to kind of where you're looking in your portfolio. And congrats on getting that UMASH finally out. I mean, is there – is it still on the table, the noncore divestments and many kind of developments you can talk in there? What are you seeing in terms of interest, in terms of multiple, or is that off the table? So, any color there, I would appreciate it. Thank you.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

So, that's still definitely on the table. That was one of our stated goals that we mentioned back in Q4 of last year. That's still on the table. We can't speak to any particular transaction if there's ways to optimize value for the shareholders and we will definitely pursue those opportunities. But I can't speak to anything specific right now.

Endri Leno
Analyst, National Bank Financial, Inc.

Q

Thank you.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

A

Sure.

Operator: Thank you. There are no further questions at this time. You may proceed.

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

Okay. Thank you, operator. And thank you, everyone, for joining our call this morning. We look forward to updating you again next quarter.

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

Jason Redman
Interim President, Chief Executive Officer & Director, Medical Facilities Corp.

Thank you.