FINAL TRANSCRIPT

Medical Facilities Corporation

First Quarter Results Conference Call

Event Date/Time: May 10, 2018 — 8:30 a.m. E.T.

Length: 25 minutes

CORPORATE PARTICIPANTS

Rob Horrar
Medical Facilities Corporation — President and Chief Executive Officer

Tyler Murphy
Medical Facilities Corporation — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Endri Leno
National Bank — Analyst

Neil Linsdell
Industrial Alliance — Analyst

Neil Maruoka
Canaccord Genuity — Analyst

PRESENTATION

Operator

Good morning, everyone. Welcome to the Medical Facilities Corporation 2018 First Quarter Results Conference Call.

Before turning the call over to management, listeners are cautioned that today's presentation and the 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 the Canadian securities regulations (sic).

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, James, and good morning, everyone. Joining me today is Tyler Murphy, our Chief Financial Officer, and Jim Rolfe, our Chief Development Officer.

Prior to market open today, we released our 2018 first quarter financial results. Our news release, financial statements, and MD&A may be access through our corporate website at www.medicalfacilitiescorp.ca, and were also filed on SEDAR today.

For today’s call, I will start by discussing the results of the past quarter, Tyler will review the financial results, and I will then provide some comments on our outlook, after which we will open the call to your questions.

In the first quarter of 2018, we completed a significant step in executing on our growth strategy when we increased the number of facilities in our portfolio with the acquisition of a controlling interest in seven ambulatory surgery centres on February 1st from Meridian Surgical Partners.

MFC now has a presence in 11 states from 5, and its new service centres provide outpatient procedures, such as orthopedic surgery, neurosurgery, and pain management adjacent to those of our legacy portfolio.

An exciting aspect of this acquisition is that we made it in partnership with NueHealth, who will provide management services to the centres without an increase in cost. NueHealth has been in the facility management business for over 20 years, and are experts in developing new ambulatory surgery centres and generating additional value and growth from established centres.

We expect to create synergies with these new centres and any future ASCs we may acquire or develop with this new platform. For example, one key synergy that we receive is the centres will be included in NueHealth’s corporate procurement program, which leverages their 50-plus facilities under management to achieve cost savings.

We see a significant pipeline of opportunities to acquire and develop attractive ASCs through this partnership, which combines NueHealth’s management expertise with our skills at identifying, evaluating, and acquiring facilities, creating a strong platform for growth.

Now Tyler will provide more detail and insight into our financial performance for the first quarter of 2018.

Tyler?

Tyler Murphy — Chief Financial Officer, Medical Facilities Corporation

Thanks, Rob. As on our previous calls, I would like to note that all of the dollar amounts expressed in today’s call are in US dollars, unless otherwise stated.

In Q1 2018, MFC had revenue of $97.6 million, a 9.7 percent increase over $89 million in Q1 2017. The majority of the increase came from the MFC Nueterra ASCs, which generated $6 million of incremental revenue with the remainder of the growth coming from our legacy facilities.

Surgical cases increased by 29.1 percent overall in the quarter. The majority of that growth was from outpatient cases, which grew 43.3 percent. This mainly reflects the additional volume we gained from the new ASCs. The majority of the growth came from commercial insurance, private payers, and Medicare, which grew 73.5 percent and 45.8 percent, respectively.

EBITDA in Q1 2018 was $20.1 million, flat with 20.1 million in Q1 of 2017, and represents a margin of 20.6 percent compared to 22.6 percent a year earlier.

At Unity, we saw improvement the first quarter of 2018 compared to the same quarter of the previous year, as a result of our success in adding physicians to the facility and a new finance team in place there. Revenue at Unity increased by 57.2 percent from 5.7 million to $9 million, and the net loss was reduced by $2.7 million.

In addition, the Unity team has a mandate to look at all expenses across the board, as well as to execute on our strategic growth plan, which we expect to result in further improvement.

Cash available for distribution in Q1 2018 was C$9.4 million, down from C$10.8 million a year earlier relating to increased corporate expenses mainly due to acquisition-related expenses.

On a per share basis, our cash available for distribution was C$0.305 in Q1 2018 compared to C$0.348 per share in Q1 2017. The resulting payout ratio was 92.2 percent for the quarter compared to 80.9 percent for the previous year.

We had cash and cash equivalents and short-term investments of $45.1 million, and about US$12.2 million available from our credit facility at the end of the quarter, which provides sufficient resources to continue to execute on our growth strategy.

For additional detail on the specific results for each centre, please refer to our MD&A.

Rob will now provide some comments on outlook, and then we'll take your questions.

Rob?

Rob Horrar

Yeah. Thanks, Tyler. With the first quarter of 2018, we started the year off with an acquisition in line with our strategy to expand our investment in outpatient services, and a partnership that enhances our ability to continue to execute on that strategy.

Looking ahead to the rest of 2018, we see many opportunities to add quality facilities to our ambulatory surgery centre portfolio, and as anticipated, the number of targets have increased in the few months we've been associated with NueHealth.

We continue to be prudent, and every acquisition opportunity will be assessed with a thorough due diligence process to ensure any new facility we acquire matches the high-quality, strong performance, and growth opportunities in the existing portfolio.

Organic growth also remains a priority, and we will continue to focus on enhancing and adding services at our existing facilities, including the recruitment of new physicians and the addition of ancillary services, such as urgent care clinics.

In fact, we open two urgent care clinics in our Arkansas and Sioux Falls market at the beginning of the year, and continue to identify new strategic locations in our existing markets.

As we grow, we'll also look for more opportunities to leverage operational efficiencies, and assist facility partners to improve efficiencies in value-added services like group purchasing and the sharing the best practices.

For example, in Q1 of this year we finalized an affiliation agreement with Vanderbilt Supply Chain Services Collaborative to improve our pricing under our existing group purchasing organization. We expect this affiliation to continue to add value to our legacy portfolio as we continue to identify pricing opportunities with supplies and equipment throughout 2018.

All of this is based on our long track record of delivering the highest quality of care. Our local leadership teams and physician partners are committed to maintaining high quality and patient satisfaction scores that have placed them among the best in the United States. This will not change. MFC's facilities will continue to be the first choice in terms of places where patients want to receive care and physicians wants practice.

I would like to acknowledge the sincere commitment of our physician partners, facility leaders, and associates who provide high-quality patient-centred care every day.

On behalf of Medical Facilities Corporation's management team and the Board of Directors, thank you for your ongoing support.

With that, we would now like to open the line for questions. Operator?

Q&A

Operator

At this time, I'd like to remind everyone in order to ask a question, please press *, followed by the number 1 on your telephone keypad. And we'll pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Endri Leno from National Bank. Go ahead, please. Your line is open.

Endri Leno — National Bank

Hi. Good morning, and thanks for taking my question.

Rob Horrar

Yes. Good morning.

Endri Leno

I'll start off—I mean, the first question is at the Arkansas surgical, the decline year over year, I was wondering if you can quantify how much of the drop was due to lower cases done, how much of it was due to case mix, and what did cause the drop in volumes? Is it permanent? Or should we expect an increase beyond seasonality over the course of the year?

Rob Horrar

Yes. For the most part we saw in Arkansas we had some physician … a little bit more physician absences than we have typically seen; particularly year over year was vacations and in one case an illness, which was impactful the first quarter. And then just in terms of that was probably most of it. Then some of it was case mix.

Typically in our business we see a very large demand for commercial services in the fourth quarter, which is not the same compressions that you see in the Medicare business, so we typically see an uptick, and that was certainly the case. And then just to note that that was also one of the markets that we opened an urgent care centre in the first quarter, and that's starting to ramp up, as we would expect as well, so.

Endri Leno

Okay. Thank you. And next one for Oklahoma Spine. I mean, it's this third quarter of year-over-year decreasing operating income. I mean, how do you see this evolving? Would it be like a permanent shift to this level of operating income? Or would we expect a pickup in coming quarters?

Tyler Murphy

Yeah. I think as we said I think on previous calls, we had a pain doctor that left, I think, believe the second quarter of last year. We are actively recruiting some new physicians in that market. So once they are on board and start to ramp up, I think we will see that operating income come back.

So it's temporarily in nature. I mean it's a couple quarters. It takes a little while to recruit and get a new person in, and get them ramped up to the level of the previous physician that retired. But we do expect it to come back.

Rob Horrar

And they have added some physicians in that market in the first quarter, which we're pleased to see. There's some expense work to do there. And we're very happy with the—and everyone is excited about the Vanderbilt Collaborative that we've signed, the affiliation agreement that'll continue to add pricing opportunities the on supply, equipment, and implants.

Endri Leno

Great. Thank you. And one more question for me, just more of a housekeeping one, but first like what—on the tax side, I mean what impact do you expect on changes in the US tax code? And what kind of tax level would you expect for 2018?

Tyler Murphy

Yes. It's not a huge change. Obviously, the corporate tax rate coming down is positive for us from the facilities, but there are also in addition to that tax code the limitations on the deductibility of intercompany loans and things of that nature kind of offset a lot of that savings.

So in 2018, it wouldn't be materially different from the previous year.

Endri Leno

Okay. Great. Thank you. That's the questions I have. Thanks.

Operator

Your next question comes from the line of Neil Linsdell from Industrial Alliance. Go ahead please. Your line is open.

Neil Linsdell — Industrial Alliance

Hey. Good morning, guys.

Rob Horrar

Good morning.

Tyler Murphy

Good morning.

Neil Linsdell

All right. A bunch of things I want to cover here, so I'll try to be quick. So between NueHealth and Vanderbilt you're talking about purchasing synergies available through both groups.

Rob Horrar

Yes.

Neil Linsdell

Is there any kind of overlap? And is there any ability to benefit certain facilities or certain products from both of these relationships somehow?

Rob Horrar

Yeah.

Neil Linsdell

And so I'm trying to understand how they mix together. And if you've quantified any kind of low-hanging fruit dollar savings over, say, the next 12 months that you think you can accomplish?

Rob Horrar

Yes. So taking that step-wise, when we initially investigated and evaluated the Vanderbilt opportunity, we're excited about that. It increased our savings opportunities. We're under the same GPO, so it was a matter of just benefitting from already existing contracts and just getting better pricing.

With the NueHealth team, we did an in-depth study to see if there any differences or synergies between the two. It made no difference. But what it did do is create more of a seamless operating platform for NueHealth. So we elected to keep that consistent, just for ease of continuing to integrate those centres.

There's no difference in pricing between the two after we studied that, so. And we think that the first—there's a first of this. The first level are just basic supplies that we're buying that we're already doing, and we think that there's probably in the neighbourhood of an easy $0.5 million just in an initial savings there.

But on an ongoing basis, we'll save in capital equipment purchases, implants, and their teams and clinical teams will be able to advise us and help our hospitals and clinical staff to continue to drill down.

So this will be at ongoing savings initiative that we think will pay off, and continue to pay off in the next year.

Neil Linsdell

So 0.5 million benefit over, say, the first year and then just ongoing after that.

Rob Horrar

That's just the flip of the switch right out of the gate.

Neil Linsdell

Oh, right off the gate.

Rob Horrar

Yeah. Yes. And so we anticipate—

Neil Linsdell

Nice.

Rob Horrar

—that will build. That's just on things that we're buying right now today with absolutely no significant disruption to operations.

Neil Linsdell

Okay. And then flipping to the payout ratio, so I think you've talked before about guiding about 70 percent payout ratio for the entire year. Does that change with some of the—you mentioned—growth initiatives, extra spending, impacting your cash available for distribution?

Rob Horrar

No, not really. As you've seen in previous years, I mean obviously the first quarter the ratio is higher, and then as we get to the fourth quarter, which is obviously the strongest quarter on the commercial side, that number comes way down when you average it over the year. So we wouldn't expect a material difference.

Obviously we had extra costs this first quarter, especially on the M&A side of things, that are impacting that ratio. So it's not because we're spending more because of our growth; it was really more onetime in nature.

Neil Linsdell

Okay. And then just on the overall, I mean, cost savings. If I look at your operating expenses, your salaries, supplies, G&A, they're all up 10 to 16 percent and your revenues are up just under 10 percent. Now is that something that is more we're building out for the benefit later on? Is that something that's going to be addressed with specific cost-saving initiatives? How does that come better in line? And how do you get the revenues growing faster?

Rob Horrar

Yeah. I think a couple things. First off, part of our growth initiatives have been to add, recruit doctors and add urgent care centres. And those development costs are realized when you first open them, and you don't have any patients or income to offset that. The same with recruiting physicians. As we're adding the new physicians, they come in with all the costs, yet none of the benefit yet. So those things will take a while to continue to ramp up.

And like I said, we've invested in two urgent care centres and they are ramping up, but they—it was a bit of an investment. So that was a big piece of that.

Tyler Murphy

Yes. And again, as you look at the operating expenses, I mean, much of that increases, 5 million of it's because of the new ASCs, which is obviously offset by the revenue that came in with those ASCs also, so.

But no, we continue—our markets are continuing—I mean, every day they're drilling down on expenses. Obviously on implants and drugs and everything else are what's growing so much on the cost side of things, and they're are all over it. So we look at that thing every day.

Neil Linsdell

Okay. But it's really more an investment now for the growth potential that you're seeing?

Tyler Murphy

Yes. Yes. To Rob's point, especially on when you're looking at the urgent care centres and hiring …. bringing on new physicians you get the costs up front and then the revenue comes after.

Neil Linsdell

Okay. And then on a high-level on regulatory challenges or changes coming in, obviously we've talked about Obamacare and potential impacts. Can you just go through a high-level of things that you're seeing changed? How you reacting to them? And I'm thinking, say, the outpatient knee surgeries, for example, that we should be watching.

Rob Horrar

Yeah. Our data is shown and our study into this that inpatient needs are going to grow over the course of next 10 years at 2 to 3 percent, but the outpatient total knee opportunity will grow 400 to 450 percent. So this is something that we see as more of an opportunity, especially given our efficient facilities in terms of operating and doing these procedures.

So we haven't seen that, just the very edge of a very few of these procedures. Again, it's a narrow patient that can do an outpatient total knee; they have to be very healthy. So we've just seen very, very few of that, but over time we're watching this as more of an opportunity going forward.

As far as health care reform, I think that's something that we're not looking to see any change on that. We're not seeing any activity on any repeal, and for the most part that's good for health care. It's not a significant piece of our business, but it's always good when people have more insurance.

And then, Neil, again, we study the physician 6000—the health bill of 6002 in terms of the physician ownership, to whether that will be repealed, and at this time we don't—again, there's not been any significant movement on any of the bills, so.

Neil Linsdell

Okay. And to address some of the comments you made there, all your initiatives that you're doing with the ASCs seem to put you in a better position with some of these changes that are coming down the line.

Rob Horrar

That's absolutely right. I mean, more and more cases move to outpatient, shifting the outpatient; well, this is our intended diversification strategy.

Neil Linsdell

All right. And just one last thing and then I'll leave it. South Dakota, obviously there's always concerns or thoughts about what's going on with the competitive environment there with new facilities. Can you just touch on that if you've seen any kind of reaction or talk from doctors as far as recruiting or doctors leaving?

Rob Horrar

No. There hasn't been any of that activity. Of course, we get these questions all the time, and we just say that every market that we're in is competitive. Both these markets, these are not new competitors. It's the existing competition building a new facility. We still have an extremely high quality and efficient hospital that's partnered with the premier physicians in that area, and we feel very good about our position.

We continue to execute on our growth strategies adding complementary services, so—

Neil Linsdell

All right.

Rob Horrar

—competition. Yeah.

Neil Linsdell

Yeah. Thanks.

Rob Horrar

Thank you.

Operator

Your next question comes from the line of Neil Maruoka from Canaccord Genuity. Go ahead, please. Your line is open.

Neil Maruoka — Canaccord Genuity

And good morning.

Rob Horrar

Good morning.

Neil Maruoka

Most of my questions have been asked, but maybe just focus on Unity and still posting a loss there. I think if we look back to the same quarter last year it underscores a heavy reliance on one physician. What do you need to do at that facility in order to establish a firmer growth trend there and reach consistent positive operating income?

Rob Horrar

Well, we need to grow. We think we've talked about this hospital in terms of its platform and its ability to do more and to grow. It's a very nice hospital, good quality, good outcomes, very attractive. We have added several physicians there as well in the first quarter.

We have a significant strategy and plan in this market, both for growth and for expense management, and we're executing on that. We brought in a new financial executive, and this team is very focused on operating to its existing volumes.

But we see a good opportunity to grow this hospital.

Neil Maruoka

And is that something that you expect that you'd be able to achieve over coming months? Or is this a process that will take several quarters to get consistent operating profit?

Rob Horrar

I think it's not unrealistic to think several quarters because we continue—again, we'll continue to add again services and doctors. And I think over the next several months to several quarters this strategy is going to continue to unfold.

It's not an unrealistic expectation.

Neil Maruoka

Okay. Great. That's all for me.

Rob Horrar

Great.

Operator

And with that, I'd like to turn the call back over to Mr. Rob Horrar for some closing remarks.

Rob Horrar

Thank you, Operator. Thank you for participating on today's call, and for your continued interest in MFC. We look forward to reporting on our progress next quarter.

Thank you.

Operator

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

*****