

FINAL TRANSCRIPT

Medical Facilities Corporation

2018 Third Quarter Results Conference Call

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PRESENTATION

Operator

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

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 security 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 and Risk Factor 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 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.

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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 on the call today is Tyler Murphy, our Chief Financial Officer; and Jim Rolfe, our Chief Development Officer.

Earlier this morning, we released our 2018 third quarter financial results. Our news release, financial statements, and MD&A may be accessed through our corporate website at www.medicalfacilitiescorp.ca and were also filed on SEDAR today.

For today's call, I will start by highlighting results from past quarter, Tyler will then review our financial results, and I will then provide further comment on our outlook and ramp up, after which we will open the line to questions.

Looking at our results for the quarter, our revenue was up 17.1 percent, including organic growth of 7.4 percent, and the balance from our acquisition of the seven ambulatory surgery centres in February of this year through our partnership with NueHealth, which we refer to as MFC Nueterra.

We had a 47.4 percent increase in total surgical cases for the quarter. Outpatient cases were up 73.3 percent, while inpatient cases were down 3.6 percent. Our MFC Nueterra ASCs again drove significant growth, contributing 3,598 outpatient cases in Q3.

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Looking at our organic growth for the quarter, same-facility surgical case volume was higher, as Unity, Oklahoma Spine, and Black Hills had notable increases, partially offset by a decrease at Arkansas Surgical.

Our results continue to demonstrate the strength and diversification of our portfolio. The fact that we have 13 facilities in 11 different states is worth highlighting, as some quarters we see different facilities driving our results more than others.

Importantly, our physician partners at each of our facilities share the same commitment to providing the highest quality of care to our patients. Our facilities rank among the highest in industry surveys and studies of patient satisfaction and quality scores.

Our diverse portfolio of high-quality facilities, combined with exceptional patient care and prudent financial management, are the hallmarks behind our long track record of solid returns.

I will discuss elements of our go-forward strategy later in the call, but for now I would like to turn the call over to Tyler to discuss our third quarter financial results.

Tyler?

Tyler Murphy — Chief Financial Officer, Medical Facilities Corporation

Good morning, everyone. As per usual, I'd like to note that all of the dollar amounts expressed in today's call are US dollars, unless otherwise stated.

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Revenue and EBITDA for the quarter saw significant year-over-year growth, including strong organic growth. Our third quarter revenue was up 15.2 million, or 17.1 percent to 104.2 million compared to about 89 million in Q3 of last year.

The acquisition of MFC Nueterra ASCs contributed 8.6 million to the overall increase.

As Rob mentioned, same-facility surgical case volume was higher in the quarter. Including the impact of the MFC Nueterra ASCs, surgical case volume growth over the same period last year came predominantly from commercial insurance and Medicare, which grew by 106.9 percent and 74.7 percent, respectively.

Our EBITDA for the quarter was 22.6 million, up from 19.3 million in Q3 of last year.

In terms of margin, our EBITDA in the quarter held steady at 21.7 percent of revenue. The acquisition of MFC Nueterra's ASCs contributed 1 million to the overall increase in EBITDA for the quarter, while increases at Unity, Oklahoma Spine, and Black Hills were partially offset by decreases at some of our other facilities.

Cash available for distribution in Q3 was 9.4 million Canadian compared to 12.3 million Canadian in Q3 of last year. On a per common share basis, cash available for distribution of C\$0.30 was \$0.10 lower than the same quarter last year.

Distributions remained constant at C\$0.28, resulting in a payout ratio of 92.4 percent in Q3 of this year compared to 70.7 percent in the same period last year.

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The decline in cash available for distribution and the increase in payout ratio were mostly due to higher current taxes in the current quarter of 4.4 million, mainly stemming from a net unfavourable difference in book-to-tax adjustment of 2.7 million.

At the end of September, we had consolidated net working capital of 51.6 million compared to 33.8 million in December 31, 2017. The change was due mainly to the reclassification of our corporate credit facility to noncurrent when the facility was renewed during the quarter, offset partially by the use of cash to finance acquisitions.

As a reminder, in August we entered into an agreement providing for a new US\$150 million revolving credit facility. This facility replaced our C\$100 million facility that was due to mature at the end of 2018.

At the end of the quarter, we had cash and cash equivalents of 33.6 million and about 81.2 million available on our credit facility. As usual, for additional detail on our financial results, including specific results for each facility, please refer to our MD&A.

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

Rob?

Rob Horrar

Thank you. As we discussed on previous calls, the story for MFC remains consistent. We are committed to executing on our growth strategy, both organically and through acquisition.

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Our recently increased credit facility and the establishment of MFC Nueterra partnership strengthen our position as we look to pursue additional targets within our acquisition pipeline.

Further, we remain committed to expanding our capacity in our existing facilities by acting on a number of initiatives, including recruiting new physicians and adding operating and procedure rooms.

Now is an exciting time for Medical Facilities Corporation. Demand for health care services continues to grow, as a result of a growing and aging population, as well as increasing in breadth and scope of procedures, such as knee replacement surgery.

In addition, we expect there to be a significant increase in the number of ASCs in the United States over the next 5 to 10 years, providing us with even more opportunity.

And while our current pipeline of acquisition opportunities remains strong, I would again add that the ASC acquisition market today is characterized by a highly competitive buyer landscape.

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

Operator?

Q&A

Operator

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At this time, I'd like to advise 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 questions. A couple for me to start. But first of all, I mean congrats on margin stabilization, I'll say. So how do you see this evolving? I mean, it was flat year over year and how do you see it for the remainder of the year? And even going forward if you have any views on 2019? Thank you.

Tyler Murphy

Yeah. I think, I mean again, I mean we've undertaken a lot of efforts to help our hospitals on controlling some of the supply costs, some of the other things. So I think some of that's coming to fruition.

Obviously, the fourth quarter is going to be our highest volume quarter, so the margins should be little bit better anyway because of that. But again, I mean we continue to try to help our hospitals, our new ASCs, and everything on the ... bending that cost curve. So it's going to be constant battle.

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You're still going to have pressures on wages and other things, but we are starting to make some headway, I think.

Rob Horrar

And, Andrew, we've talked about our affiliation agreement for our GPO, and that continues to pay dividends for us, bending the cost curve as Tyler indicated. Our addition of urgent current centres this year continues to ramp up as well as, as Tyler mentioned, recruitment of physicians.

So we think going into the fourth quarter, which is typically our busiest season, we think we're well positioned.

Endri Leno

Okay. Great. And just to follow up on that a little bit, with the GPO and the purchases and the margins gain that you're having there, I mean, do you think you have realized all that you could realize already? Or there is still a little bit more room for you to gain a few points on the margin there?

Rob Horrar

No, we think there's continued opportunity. Our first pass really was just on items that we were already purchasing. So we have a number of initiatives that will continue to go forward, and we think that will continue to pay dividends for our facilities.

Endri Leno

Okay. That's great. Thank you for that. And on ... if you can talk a little bit about like with Arkansas in general, I mean there was a little bit of a decrease in revenue, and what contributed the

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lower case volume because at least from my view, I would have expected especially the addition of a new surgeon to contribute a little bit into Arkansas?

Rob Horrar

Well, that's right. And I'll just talk, we did recruit a new neurosurgeon we talked about last year. And he continues to ramp up. And new physicians, particularly in that specialty, take a little bit longer to ramp up. Additionally, we've seen this facility add a new orthopedic surgeon that will begin to start in fourth quarter.

But really the story here is a physician who's been out, one of our largest admitters has been out and unavailable to perform surgeries. So that's just been the story. And we hope that gets rectified, but they're continuing to grow and look to the opportunities on the recruitment side, as well as the urgent care we put in last year.

Operator

And once again as a reminder, if you'd like to ask a question, please press *, then 1 on your telephone keypad.

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

Neil Linsdell — Industrial Alliance

Yeah. Thanks. Good morning, guys. There's been a lot of improvements as far as—or a lot of additions to the partnerships that you've been working with in the last couple of years. Could you

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run through some of the partners like NueHealth and others that you're expecting to get some cost savings through your buying groups or NueHealth being a source of acquisitions? And just give us an update on how each one of those partnerships is going? And what contributions we might be able to see or expect over the next, say, 12 months?

Rob Horrar

So you're asking is relating to the supply costs?

Tyler Murphy

And NueHealth.

Rob Horrar

And the NueHealth? Yeah.

Neil Linsdell

On some of the partners on the NueHealth as far as I think there's both management and acquisition potential there.

Rob Horrar

There are. So our partnership with NueHealth is very positive. We've talked about that. They brought their own purchasing power to bear as we've integrated that acquisition. It's been a good story in terms of bringing them online, bringing them under the NueHealth purchasing contracts. We think that we have that fully baked and fully integrated by second quarter, so that will continue to improve.

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NueHealth in general gives us a very good platform to go forward and look at developing— not only acquiring new ASCs, but developing partnerships with health systems and adding de novo ASCs to the platform. So that's been a good piece, addition to our pipeline opportunity.

So we continue to see that pay off.

Neil Linsdell

And there's been some other stuff like Vanderbilt, AIA, the different partnerships that you've entered into?

Rob Horrar

Yeah. So we really did an affiliation with Vanderbilt underneath our group purchasing cooperative that brought us higher-tier pricing. So it was a nice affiliation. We did that last ... beginning of the year, actually entered into it the fourth quarter for this year. And as we said, it continues to pay forward for us, and we think that's been a terrific partnership.

Neil Linsdell

Okay.

Rob Horrar

Mm-hmm.

Neil Linsdell

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Can you talk about your—in addition to that, the credit facility that you have, the cash that you have on hand? So how much dry powder do you kind of look at right now that you have available for acquisitions and other sources, say, through real estate that you could access?

Tyler Murphy

Yeah. I mean, we have, as I said in my comments, about 80 million on the credit facility available. We got another 33 million, \$35 million of cash. We do own some real estate, but we're not looking to monetize the real estate side of anything right now.

So we feel pretty good about our financial position. We have very low leverage. So for the right opportunities, we feel pretty good about having the opportunity either just through cash, or if we needed to go raise some money for some reason, we feel good about either side of that.

Operator

And your next question comes from the line of Bob Gibson from PI Financial. Go ahead, please. Your line is open.

Bob Gibson — PI Financial

Thank you. Good morning.

Rob Horrar

Good morning.

Bob Gibson

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So let's just continue that. The M&A environment out there, what's it looking like? And has it changed over the last quarter?

Rob Horrar

Yeah. Bob, I'll let Jim Rolfe, our Chief Development Officer, answer that.

Jim Rolfe — Chief Development Officer, Medical Facilities Corporation

Yeah. Hey, Bob. Good morning. Yeah. We've been very active in our pursuit in trying to find accretive acquisitions. At any point in time, we investigate many potential targets and we're currently in advanced discussions with three to four accretive acquisitions right now.

But also keep in mind, too, one thing that we have to think about is that we are aggressively looking for acquisitions. But we also are very aggressive on our diligence and finding the ones that are adjacent to our core business, and also the ones that are accretive to our company and our shareholders. So we've actually walked away from several opportunities this year.

But yeah, the pipeline remains strong. As Rob mentioned earlier, the universe of ASCs and ... they're getting larger. They're growing, but it's still a very competitive environment. But there's still some great activity for us.

Bob Gibson

Okay. Great. And then on the revenue side, anything you want to call out as far as the percentage changes in each grouping? Anything that stands out?

Tyler Murphy

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No, I don't think so. As we talked about multiple times, I mean obviously the commercial side will get busier for Q4. Medicare has crept up a bit over time just with the aging population, but Q4 is really about the commercial side of things. And then we'll kind of go back to the cycle for next year.

Bob Gibson

Perfect. Thanks so much.

Rob Horrar

Thank you.

Operator

Your next question comes from the line of Lennox Gibbs from TD Securities. Go ahead, please. Your line is open.

Lennox Gibbs — TD Securities

Good morning. Thank you. Just again on the cost-savings question, can you speak more directly to your cost-savings performance relative to the \$500,000 target you discussed previously?

Rob Horrar

Yes. On an annual basis, Lennox, we've doubled that number. We're over 1 million in savings on an annual run rate for the initiative. And as I've said earlier, it will continue to pay and is continuing to pay off as we go initiative-by-initiative, hospital-to-hospital identifying more opportunities to have better bundled pricing.

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Lennox Gibbs

Are you willing to revise the target and give us a new target perhaps?

Rob Horrar

No, I think, not at this time.

Lennox Gibbs

All right.

Rob Horrar

I think, look, I think for the most part this has been a really good win for the Company. And again, it really ... the hard work begins now. We've done the easy work that was sort of the low-hanging fruit. The next part of that is just finding ways to collaborate initiatives that bring value to the hospital, as well as under the affiliation. So it's a little bit harder work.

It's certainly a lot more analysis and discussion with our partner facilities. But again, it's a good initiative, and it'll continue to pay forward.

Lennox Gibbs

Okay. Then and secondly—thanks—and secondly, the MD&A notes that you increased your stake in UMASH in August.

Tyler Murphy

Yeah.

Lennox Gibbs

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Can you step us through that transaction, the rationale or the trigger what really happened there?

Tyler Murphy

Yeah. So the original purchase of UMASH, there was—it was a contractual obligation to over time buy out one of the physicians. So it's purely per the original purchase agreement that we are buying additional shares from one of our physicians there that was the original big owner of the facility. So there's nothing out of the ordinary. It was just per the contract.

The nice thing is is we expect to use those shares now to recruit new physicians into the hospital and resell those shares, but it's all ... it was all just per the contract.

Lennox Gibbs

And what is that physician's status currently at the facility?

Tyler Murphy

Oh, still an owner, still will be an owner. It was just that as opposed to buying everything up front, it was just done over time, per the original purchase contract.

Lennox Gibbs

Got it. Got it. And then finally, what competitive intelligence can you share with respect to the Rapid City expansion? Because you're getting close to their scheduled year-end launch, what are you seeing? What are you hearing? And Black Hills appears to be doing quite well, but I don't know if you want to comment on any impact that you might be seeing at Black Hills?

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**Rob Horrar**

Black Hills continues to be a strong facility for us. As we've have said time and again, Lennox, that this is—we are partnered groups; both on orthopedics and on the neurosurgery are the bellwether groups in this area. We feel continued optimism in terms of the strength of the physician there, the quality, the patient satisfaction.

No update; no additional competition. And again just to remind the group, it is not a new competitor. It is an existing competitor who's building a new building. And so as of today, it's not open.

Lennox Gibbs

Okay. Good. Thank you very much.

Rob Horrar

Thank you. Thanks for the question.

Operator

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

Endri Leno

Thanks for the follow-up for me. Just trying to follow up very quickly, on Arkansas Hospital you mentioned that one of your best-producing docs was out. Has this physician left? Or is he just out temporarily?

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Rob Horrar

He's not left.

Tyler Murphy

Yeah, temporarily.

Endri Leno

When do you expect him back? I mean Q4? Or early next year?

Rob Horrar

To be determined.

Endri Leno

Okay. Okay. Thank you. And the next question on like how would you characterize the performance of MFC Nuetera in Q3? Is this a normal quarter? Or would we expect some sort of improvement in coming months as far as Q3 goes?

Tyler Murphy

No. I think we would expect improvement. I think some of the growth plans that we have in our pro forma and what we're looking at have been a little bit slower to take hold, but we have feet on the ground. We're recruiting new physicians at some of these ASCs.

And so we would expect in the future those numbers get better.

Operator

And with that, I'd like to turn the call back over to Mr. Horrar.

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Rob Horrar

Good. Thank you for participating on today's call and for your continued interest in MFC.

We look forward to reporting on our progress again next quarter.

Thank you.

Operator

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

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