CRH Medical Corporation

Second Quarter 2017 Results Conference Call

Date: **August 3, 2017**

Time: **8:00 AM PT**

Speakers: **Kettina Cordero**

Director, Investor Relations

Edward Wright

Chief Executive Officer

Richard Bear

Chief Financial Officer

Jay Kreger

President, CRH Anesthesia

Operator:

Welcome to the CRH Medical Second Quarter 2017 Results Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an Operator by pressing star, and zero.

I would now like to turn the conference over to Kettina Cordero, Director, Investor Relations. Please go ahead.

Kettina Cordero:

Thank you Operator, and good morning everyone. I am joined by our CEO, Edward Wright, our CFO, Richard Bear, and our President of CRH Anesthesia, Jay Kreger.

Before we start, I would like to remind everyone that certain statements you will hear today constitute forward-looking statements within the meaning of applicable securities laws. For important assumptions, definitions, and cautionary statements about forward-looking information and the risks inherent to our business, please refer to the Cautionary Notes in our financial report for the quarter ended June 30, 2017, and the Risks Factors section in our most recent Annual Information Form.

During this call, we will discuss non-IFRS measures as indicators of our performance. Please refer to our Management's Disclosure & Analysis for the quarter ended June 30, 2017 for reconciliations of non-IFRS measures to reported IFRS measures. These documents are available on SEDAR and on the Investors section of our website.

Please note that we use the abbreviation GI to refer to gastroenterologists. We also use the abbreviation CMS to refer to the Centers for Medicare and Medicaid Services. Finally, please be advised that our reporting and functional currency is the U.S. dollar. All dollar figures referenced today are in U.S. dollars.

With that, I leave you with Edward Wright.

Edward Wright:

Thank you, Kettina. In a few minutes, Richard will provide some colour on our second quarter financial results. After that, Jay Kreger will follow up with an update on our Anesthesia operations and our

business development activities. I will close our remarks with a brief commentary on our overall performance, and then open up the call for questions.

I'd like to welcome the President of CRH Anesthesia Management, Jay Kreger, to our quarterly conference call. Jay joined CRH last year from Hospital Corporation of America, where he had responsibility for growing their ambulatory surgical division to more than 130 ASCs through acquisitions and partnerships.

Jay recently celebrated his first anniversary with us, and we are very pleased with the work he's done since he joined the Company. We look forward to seeing our Anesthesia business grow under his direction.

Now, I'm going to turn it over to Richard for his financial review.

Richard Bear:

Thank you, Edward. I'd like to start by reminding everyone that in accordance with International Financial Reporting Standards, also known as IFRS, we report consolidated financial statements, which means that our financial statements include those of the subsidiaries in which we hold controlling interests, such as the Anesthesia practices that we own, or in which we hold a majority interest. This practice is in keeping with current accounting standards.

We had a strong second quarter with year-over-year gains in both our O'Regan and Anesthesia businesses. Yesterday we reported total revenue of $22.1 million for the three months ending June 30, 2017, a 33% increase compared to the second quarter of 2016.

Total revenues for the three months ending June 30, 2017 include Anesthesia revenues of $19.3 million, 38% more than in the second quarter of last year, as we've benefited from the acquisitions we completed in 2016 and the first quarter of this year. The year-to-date Anesthesia revenues were $39 million or 54% more than in the first half of 2016.

Changes in payor mix primarily related to GAA at practices acquired prior to 2016 have resulted in a decrease in the average revenue per case of 18% compared to the second quarter of 2016, and 13% compared to the first half of 2016. The decline in average revenue per case was partially offset by increases in patient cases of 6% and 5% for the three- and six-months period ending June 30, 2017,

respectively. This translates into a decline in revenue for entities acquired before 2016 of 13% for the second quarter of 2017, and 9% for the first half of 2017.

Also impacting the revenue and the relationship to prior year is the mix of commercial and government cases. Historically, we see government cases—commercial cases stronger in Q2 than in Q1, and this quarter we did not, which we believe will correct itself in the second half of the year.

During the second quarter of 2017, we serviced 46,188 patient cases, and during the first half of 2017 we serviced 88,551 cases.

Sales of our O'Regan System during the second quarter were $2.8 million, 5% higher than in the second quarter of 2016. Year-to-date, our O'Regan System sales were $5.6 million or 10% higher than in the first half of 2016.

Total adjusted operating EBITDA for the second quarter of 2017 was $10.2 million. Total adjusted operating EBITDA attributable to Shareholders was $7.4 million, and total operating EBITDA for non-controlling interests was $2.9 million. Our total adjusted operating EBITDA margin for the quarter was 46%.

During the second quarter, we generated $5.9 million in free cash flow. We define free cash flow as cash provided by operations, less cash payments made for interest, less distributions to non-controlling partners. Free cash flow is impacted by seasonality similar to our operating margins and income. Typically, free cash flow is lowest in Q1 and highest in Q4.

At June 30, 2017, we had $7.8 million in cash and cash equivalents and $10.7 million in working capital. In addition, we have $57.3 million available on our new credit facility to fund future growth.

With that, I will leave you with Jay for his updates.

Jay Kreger:

Good morning. Thank you, Richard, and thank you, Edward, for the opportunity to discuss the Anesthesia business development and operations with our Shareholders today.

As Edward mentioned, I just celebrated my one-year anniversary with CRH, and I'm happy to say that while the year has been full of both opportunities and challenges, my decision to join the Company has only been reinforced by my everyday conversations with our GI partners.

My experience in both developing and running ASCs, including many GI endoscopy centers, has been an excellent foundation for me for working with and developing our Anesthesia partnerships. The GI Anesthesia business model is similar to that of ASCs, with great long-term growth potential.

Many of you will recall that when CRH first introduced the O'Regan System to the GI community, it was a new, untapped market. But similarly, while the business model itself is similar to that of ASC's, the concept of joint ventures in Anesthesia is relatively new, and similar to the paradigm shift that created the new O'Regan business.

Likewise, when CRH entered the GI Anesthesia market with its initial acquisition in 2014, it not only entered a new vertical market for CRH, but it also established a new business opportunity for the GIs and the GI community.

It's this same dynamic which has continually made our O'Regan customers our best referral source for Anesthesia. They and the rest of the GI community see the value in being able to monetize their Anesthesia business with a partner who also provides long-term value, both operationally and financially.

I spent much of my first six months meeting our existing partners, reviewing our operational platform, and confirming that we were in fact fulfilling our promise of delivering value and operational excellence. Like our O'Regan customers, these partners represent our best resources and references for new business as we go forward.

Also as part of this process, we assessed our strengths and weaknesses, and in so doing, made some key additions to our Anesthesia leadership team.

Through the first two quarters of 2017, we have in part seen the value of these additions, and we've invested $7.5 million in two acquisitions. Then, just earlier this week, we added our third acquisition of the year, investing $5.8 million in a West Florida group. This joint venture was consistent with our mission to partner with the best gastroenterology physicians and practices across the United States.

Last year, we invested $34.1 million to grow our Anesthesia business, and I remain confident that we will meet or exceed that number through the rest of 2017. It is the strength of our pipeline, the relationships with our O'Regan customers and the current Anesthesia partners that feed this confidence. It's also worth noting that we believe that the previously proposed 2018 CMS changes

should in no way be a deterrent in our ability to grow this year and into the future. The investment we are making in our team will reap long-term rewards with both our GI partnerships and our overall patient care.

Earlier this year, we also launched our first Monitored Anesthesia Care program, or MAC, with Puget Sound Gastroenterology in the state of Washington. Again, our people and processes are ensuring a successful launch. This MAC program is a new initiative that helps us expand into a segment of GI practices that do not currently use deep sedation. These ventures also include a future transaction feature whereby CRH has the option to purchase a majority interest in the business after a year of operations—in this case, in 2018. I'm confident that we'll be able to expand this program to other practices in future quarters, as new groups accept MAC as their standard of care.

We've had a good start to the year and I look forward to updating you on our progress at the end of the third quarter. I will now leave you with Edward for his closing remarks.

Edward Wright:

Thanks, Jay. Our second quarter results demonstrate the strength of our business. We generated $10.2 million in adjusted operating EBITDA thanks to revenue gains in both O'Regan and Anesthesia. We've also expanded our credit facility from $55 million to $100 million and added a new lender to the syndicate. The new facility includes $50 million with Scotiabank, $25 million with U.S. Bank, and we're delighted that J.P. Morgan decided to participate as our partner with $25 million, after a very thorough review of our business.

The credit facility, along with our strong free cash flows, which was $5.8 million in the most recently completed quarter, will continue to fund future acquisitions. The credit facility has further strengthened our ability to execute our Anesthesia growth plans, while lowering our cost of capital to approximately 3.25%. This has also allowed us to retire the Crown debt early.

We're very confident that the remainder of 2017 will be significant in terms of acquisitions. Yesterday, we announced our third acquisition of 2017, which is our fourth acquisition in the state of Florida and our 12th overall. As Jay mentioned, we're also confident that we will achieve our goal, which is to match or exceed our 2016 acquisition spending of $34.1 million.

I'm very optimistic about our future and I'd like to thank our Shareholders for their continued support. With that, I'll now turn it back to the Operator to open up the call for questions. Thank you.

Operator:

Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you're using a speaker phone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

The first question is from Lennox Gibbs of TD Securities. Please go ahead.

Lennox Gibbs:

Good morning, thank you. I just want to get your views on two broader trends in the marketplace as it pertains to CRH. The first is the growing trend towards higher deductible plans, and the second is the growing number of insurers and possibly patients that are leaving the exchanges in various states and regions.

Richard Bear:

Thanks, Lennox. This is Richard. I'll answer your questions. The first one is the growing trend in deductibles. As we know, healthcare costs in the U.S. continues to rise. Most people in the U.S. receive their insurance through their employers; employers are bearing some of the costs of those increases, but in many cases pass on the cost to their employees through higher deductible plans. Those higher deductible plans is what actually creates seasonality in U.S. healthcare as a whole, and specifically, for us, where we typically see that the percentage of patients with commercial insurance increased between Q1 and Q2, then Q2 to Q3, and Q3 to Q4.

Interestingly enough, we didn't see that increase between Q1 and Q2 this year, like we've seen in other years, and as we've talked to our GI partners, they're suggesting that it's because of the construct of these commercial plans, where deductibles are getting higher, and we expect that the second half of the year will be much stronger from a commercial payors' standpoint than the first half of the year, and could even potentially be stronger than what we saw in the second half of 2016.

In terms of your second question, as we've stated previously, we have very little exposure to Affordable Care Act patients. Those plans just don't pay well, so our GI partners don't participate in those plans,

so as people are coming off those plans or insurance companies are choosing not to participate in certain states, we don't believe that will have an impact on our business.

Lennox Gibbs:

One last quick one. What are your thoughts on diversifying away from GI as a means of better managing reimbursement risk, and obviously, I'm asking in light of the July 14 proposal out of CMS.

Edward Wright:

Lennox, that's something that we currently—and continue to look at. We think that the runway in front of us in GI Anesthesia is extremely meaningful. As we stated, even with the CMS cuts that are coming into effect at the beginning of next year, that our business will still be in the very strong upper end of the 40s in terms of margins. We like the space; we like the relationships. As Jay has mentioned earlier today, in terms of our pipeline and where that is, this is—the business—if you look at the business today, 12 transactions in the last three years, close to $6 million in free cash this past quarter, the $100 million now in line with the facility. We believe strongly in this business. It's proved to be very meaningful in the last two-and-a-half, almost three years, and we see significant runway in this. We have looked at andwe continue to look at other things. We have looked at anesthesia in a couple of other verticals as well outside of GI, and while I wouldn't rule it out down the road, the decision at the moment was certainly to stay focused in this arena.**Lennox Gibbs:**

Thanks very much.

Operator:

The next question is from Richard Close of Canaccord Genuity. Please go ahead.**Richard Close:**

Yes, with respect to the average revenue per case, I think you noted GAA led to a 12%—or helped contribute to a 12% decline in the first quarter. I think you said, in the second quarter it was an 18% decline impact. Did you know that the second quarter was going to be worse than the first quarter, and if so, why not communicate that to the street?

Then, as a follow-up to that, what do you think the impact from GAA is going to be in the third and fourth quarter? Is the 18% in the second quarter the bottom here and things should improve, or less of a negative impact; any thoughts in and around that item?

Richard Bear:

Yes. First—I'll try to take your questions in order, Richard. The increase in the payor mix impact of GAA has less to do with what we disclosed in Q1 with the single payor issue that we had there in 2017 and also 2016, because the contribution of that single payor remained consistent in Q2 compared to Q1. This has more to do with what appears to be a shift in commercial cases to later in the year as a result of these high deductible plans that's causing the additional decrease compared to prior periods in the revenue per case and the ultimate revenue that we're recording for these entities and we, as stated previously, would expect that to correct itself in the second half of the year, with commercial being higher in the second half than we actually saw in previous years.

Did I get them all, Richard?

Richard Close:

Okay—well—so are you saying that, ex this commercial not coming in as strong, GAA would have had roughly a similar impact, the 12% negative impact, as it did in the first quarter because of the single payor there?

Richard Bear:

Yes, I would, if history repeated itself

Richard Close:

Should I think about it as 12% related to the single payor, and then 6% of that decline related to the high deductible plan?

Richard Bear:

Yes, I mean, in previous years, we've seen as much as a 3% shift increase in commercial vis-à-vis government between Q1 and Q2, and this quarter, that's flat, so that makes up for that difference.

Richard Close:

Okay. With respect to these high deductible plans and the shift in commercial, seeing it flat year-over-year in the second quarter, did you look at every practice, practice by practice, and you saw, across the board that it was flat? Or were there specific practices, maybe GAA in this case, that created most of the change?

Richard Bear:

We looked at all the practices that we have data for us to look at, and I would say it's fairly consistent. Some are worse than others. I mean, they're not all operating identically, but it's fairly consistent.

Richard Close:

Okay. With respect to—just real quick, on M&A, Jay, you mentioned that—you know, significant confidence in the pipeline and that you guys are going to spend $35 million or more potentially throughout the rest of the year, or come in at—for the year at $35 million or more. Can you really put more meat on the bone there, why you're so confident? M&A is hard to predict in terms of getting deals closed, and just—so if you can give us any more details in terms of why you guys are so confident there. Then also, as you look at these businesses that you're buying, obviously you've seen the financials, is it similar margin profiles as your previous acquisitions? What are you seeing there with the businesses you're looking at?**Jay Kreger:**

Thank you, Richard. To the first part of that question, as far as the pipeline goes—and you're right, obviously you can appreciate that the pipeline is an ever-moving fluid thing, and so there are many deals in the pipeline that are at different points in the process. So, it's fluid. At this point, where we are on the various stages of those deals is different from what it was, say, one quarter ago or two quarters ago, and it's that point in the process that I can point to and feel confident.

As far as the pricing goes, all of our deals before and after the most recent announcement have been priced conservatively and fairly. As we go forward, I believe that will continue to be the same.

Richard Close:

…and the margin profile is similar, in the—call it 45% to 55%?

Jay Kreger:

Yes, and with the margins per practice, of course, is based on payor profile but they seem to be in line with what we've acquired in the past.

Richard Close:

Okay. All right, I'll jump back in. Thank you.

Jay Kreger:

Sure.

Operator:

The next question is from Alan Ridgeway of Scotiabank. Please go ahead.

Alan Ridgeway:

Hey, good morning, guys. I just want to make sure that I fully understand the difference between Q1 and Q2 with GAA and its impact. When you say, in Q1 it was a 12% hit and in Q2 it's an 18% hit, is that revenue per case including all cases at GAA, so that not having the shift toward fewer government cases is really what the difference is year-over-year? Am I taking that the right way?

Richard Bear:

What we say in our disclosure, Al, is that we looked at all the properties that we acquired prior to 2016 where we would have—so we have apples to apples comparison, Q2 to Q1, and Q2—excuse me, that we'd have apples to apples comparison between 2017 and 2016. That would include, predominantly GAA, but also Knoxville, Cape Coral and other properties. Those numbers would include those declines, and the declines in revenue per case offset by the increase in cases would be for that family of properties as a whole, GAA being the largest. As we look at those practices as a whole, and we look at the revenue—the realized revenue that we received per unit, there has been very little change in that. That's why we're comfortable saying that it's a shift.

What's causing this is a shift, is what we believe is a change in the government to commercial that will offset—that will correct itself in the second half.

Alan Ridgeway:

So the 18% then, is actually not directly comparable to the 12% from Q1…

Richard Bear:

No, no.

Alan Ridgeway:

…because Q1 was GAA.

Richard Bear:

Yes, it's not directly comparable to the 12% in Q1, correct.

Alan Ridgeway:

Okay.

Richard Bear:

It's additive, because of the payor mix change.

Alan Ridgeway:

Okay. I also want to just ask, on the estimate changes, as far as the $900,000 and the $200,000 moves, how big have those magnitudes of estimate changes been, historically, prior to Q1? How big were they in the four quarters in 2016?

Richard Bear:

They vary in size. Sometimes, , they vary in terms of their impact. We haven't disclosed what those were previously because it didn't impact the comparability of the financials. Since these impact the comparability of the financials, primarily because we hadn't reported any acquisitions or a number of acquisitions, we felt it was necessary to talk about this—you know, what is a fairly routine change—corrections that anybody managing a fee-for-service healthcare company would have to do to best describe and interpret the financials. We haven't disclosed those in the past.

Alan Ridgeway:

Just to be clear that I'm doing my math correctly, we have to reduce Q1 by $900,000 and increase Q2 by $200,000 if we want to get to the real revenue per case?

Richard Bear:

Correct.

Alan Ridgeway:

Okay. So, based on the Q1 number then, the revenue per case that the street was using was inflated by the $900,000.

Richard Bear:

It was… Yes.

Alan Ridgeway:

Okay.

Richard Bear:

Don't know if I like the term inflated, but I'd say yes.

Alan Ridgeway:

Well, I think if you divide true number of cases across the business at a $900,000 higher rate, then it comes out to look like the business is generating more revenue per case than it actually was.

Richard Bear:

Fair enough.

Alan Ridgeway:

Okay. I'll leave it at that. Thanks, guys.

Operator:

The next question is from David Martin of Bloom Burton. Please go ahead.

David Martin:

Good morning. First one, I think Jay said CRH paid $5.8 million for the most recent acquisition, the 55% of West Florida, and the press release, it said $3 million in expected revenues. It looks like the price-to-revenue multiple you paid there is higher than other acquisitions you've made and I'm wondering, with the reimbursement cuts that are ahead, would you not be making offers at lower price-to-revenue multiples going forward?

Richard Bear:

David, yes. As we go forward, we look at the cuts in 2018 and include that in our valuation as we did with this transaction. This transaction is a little bit unique—or is unique compared to other transactions. Where this transaction, the Professional Services Agreement between the Anesthesia entity and the ASC that we acquired has a 15-year life, that's a very long-term contract that would dictate a little bit higher multiple.

David Martin:

Okay. Second question: are there any deferred considerations or note obligations that will be reduced for CRH because of the reimbursement cuts that are anticipated?

Richard Bear:

The only deferred consideration or notes that we have related to earnings is for GAA. As you recall, when we acquired that business in December of 2014, that was $58 million in cash upfront, $14.6 million on a deferred payout, and the deferred payout was based on that entity achieving accumulated EBITDA of $73.2 million in four-and-a-half years.

We have gone through and done testing as we do every quarter on the probability of that repayment, and have stated in our financials the probability; the probability of repayment has not changed. We have also gone through and done impairment testing on every single one of our acquisitions with the new revenue estimates based on the changes of CMS in Q1, and don't have any impairment charges related to any of our entities either.

David Martin:

Okay. Last question, going back to Alan's question about the revenue estimate adjustment. I just want to understand the mechanics of it. This quarter for instance, you had the negative adjustment of

$200,000; your reported revenue was $22.06 million. I assume that before the adjustment, you started with a revenue number of $22.26 million, and then you adjusted down by the $200,000.

What does the $22.06 million represent, and then what does the $200,000 adjustment represent?

Richard Bear:

Okay, we've got—it's a little bit complicated. We are billing and collecting revenues, obviously all the time, so at the end of every reporting period, monthly, quarterly reporting period, we have to estimate what we're going to get per unit, per payor, per site. Then, each quarter, each month, we compare that to what we've historically received to make sure that the relationship between what we have recorded in revenue and what we've actually received in revenue is representative, so that way we know that our receivables are fairly valued.

In some cases, we find that our historical collection rates may increase from one quarter to another, one month to another, that results in a change in estimate which has to be made, otherwise our receivables wouldn't be fairly valued, or it might go the other way, that our net realizable revenue is less than we expected. Those have to run through—again, not to get too accounting detailed here, they have to run through revenue, otherwise receivables would not be fairly valued. These are—would be considered ordinary course adjustments for anybody managing a fee-for-service business.

David Martin:

So the $200,000 adjustment that was made this quarter is—actually relates back to $200,000 that you expected you would have got from Q1 but you didn't get in the collection?

Richard Bear:

No, because we're collecting monies—we're still collecting monies from 2016 and sometimes we see monies coming in from 2015 - these change in estimates, these updates to our estimates, reflect back to multiple periods, not just the previous period.

David Martin:

Okay. But it is to previous periods; it's nothing really to do with this period.

Richard Bear:

No, because if it was this period, it wouldn't be an adjustment.

David Martin:

Okay. Okay, I'll get back in queue.

Richard Bear:

I look forward to it.

Operator:

The next question is from Andrew Leno of the National Bank of Canada. Please go ahead.

Andrew Leno:

Hi, good morning, thanks for taking my questions. The first question that I have, it relates to this enhancement of seasonality, I would say, as you have more commercial insurance shifting towards the second half of the year. If we look at the groups of insurers across the states where you operate, I mean, they're practically the same, perhaps except Massachusetts. Would we expect this kind of shift in seasonality, say next year, even in the acquisitions that were done after 2016?

Richard Bear:

Time will tell. Seasonality is an estimate, and we won't know exact seasonality for 2017 until we get done with 2017.

Typically, we don't see significant changes, because if you think about demographics, you'll see changes within the commercial payor mix through the renewal process, but you don't see shifts between commercial and Federal happen year-over-year. That's something you see more on a decade-by-decade basis because it's way more demographically driven in any market.

So, difficult to answer what we'll see. But, since we're seeing it consistently over our acquisitions prior to 2016, I'm going to assume that that also is going to impact our 2016 acquisitions as well.

Andrew Leno:

Great, thank you. The other question that I have, it's regarding the guidance that you gave following the CMS rate cut. This was based on 2016 EBITDA margin of 53% that is expected to come down to

47%. Now, that 600 basis points change, I mean, that does not include what happened in this first half of the year, right? If we are to keep a lower margin business coming out of 2017, that 600 basis points would be in addition to that, right? It'll likely be closer to 40%, perhaps?

Richard Bear:

No. No, I mean, it's interesting, we've spent a lot of time on those disclosures and read them and read them and read them, and think that they say what we believe that they should say, and as I review that one, I look at it now and I look at it a little bit differently, because the way we came up with those numbers was really taking our 2017 business to-date,so we looked at basically what we had done through Q1 and Q2, because at that time we put out that press release, we had a pretty good idea what Q2 was going to look like. We then annualized that, meaning we took our book of business, and we looked forward, assuming that's all of our business we have in 2017—excuse me, in 2018—and the impact we've provided was based on that.

The comparison to the 53%, which was really a 2016 number, to 47%, was not fairly communicated. We believe that our business will be at 47% or maybe plus or minus percent business in 2018, and really, is not a 600 point decline; that was not a fair representation.

Andrew Leno:

Okay. Thank you very much. That's all the questions I had, thanks.

Operator:

The next question is from Doug Miehm of RBC Capital Markets. Please go ahead.

Doug Miehm:

My question just has to do with acquisition multiples and those sorts of things. Based on where the shares are trading today, we estimate that you're trading at about seven times EV/EBITDA, and if I were to simply look at the most recent acquisition, $3 million in revenue, let's say it has even 65% margins, so $2 million in EBITDA, of which you're entitled to about a million. The multiples in around just shy of six times without performing, as it relates to the reduction next year, which would probably get us maybe six-and-a-half times, pushing closer to seven.

The acquisitions you expect to do in the future, are they going to be sub seven times, or are we looking at things that are going to be pushing now close towards your trading on an EV/EBITDA multiple basis.

Richard Bear:

Yes, I think what you're going to see in the future, because we tested—our valuations take into consideration the proposed changes to 2018 - is that we're going to be in that 4.5% to 5% range that we've always been. Now, as we spoke earlier, this one was tied to an incredibly long-term agreement that resulted in a little bit higher multiple.

Doug Miehm:

Okay, so at the end of the day, this was a bit of an outlier, and looking forward, you're still comfortable with 4.5% to 5%.

Richard Bear:

Yes, we are.

Doug Miehm:

Even relative to your depressed multiple today. Okay, that's great. That's my only question, thanks.

Richard Bear:

Thanks, good question.

Doug Miehm:

The next question is from Alan Ridgeway of Scotiabank. Please go ahead.

Alan Ridgeway:

Hey guys, thanks for taking the follow-up. I just wanted to touch on any changes that may have been happening at any of the individual commercial payors. Have you guys seen any rate changes from your commercial payors?

Richard Bear:

Yes, we see changes, Al, as we see changes in net realizable revenue, which impacts some of our adjustments, but none of the changes are material enough that would require disclosure.

Alan Ridgeway:

Okay. Would you characterize those changes though—are rates being pressured downward, I guess is what my question really is.

Richard Bear:

In some cases we see downward pressure but in other areas we see that we're seeing improvements. I mean, typically if we are in a contract situation, our contracts have three-year contracts with $5 escalators per unit every year, so they go back and forth.

Alan Ridgeway:

Okay. Then, the other thing I'm trying to see if there's any way we can get some information related to the impact of these high deductible plans. I would think that as the year moved along, you might start to slowly see a shift toward commercial, and I know you guys get monthly data. If you looked at the quarter, or did you look at the quarter and see if you were seeing a trend where the percent of commercial cases was increasing, sort of throughout the quarter?

Richard Bear:

You mean for Q2 or for Q3?

Alan Ridgeway:

Well, for Q2, so…

Richard Bear:

Well, commercial…

Alan Ridgeway:

Is it increasing in April, May and June?

Richard Bear:

Yes, yes, we monitor our business at a number of different levels. We track cases on a daily, weekly basis, we track payor mix and financials on a monthly basis and it all rolls up into our quarterly financials.

It's sometimes hard to really understand the impacts because each month can make a difference, and to communicate something without that full quarter would be difficult. Again, and not until the full quarter's done we see the impact and then we communicate that during these calls.

Alan Ridgeway:

Right. No, I appreciate that. I guess what my question is, are you guys seeing data that gives you confidence that H2 will be better, commercially?

Richard Bear:

Oh, sorry, Al. Right now, we haven't seen. We're just in the process of closing July. We won't get any of our billing reports for another week-and-a-half or so. That will then start to give us a sense of what we're going to see, but the quarter's made up of three months and we won't really have a full picture until that third month.

Alan Ridgeway:

Okay. Thanks, I appreciate the answers. Thanks, guys.

Richard Bear:

Thanks, Al.

Operator:

The next question is from Prakash Gowd of CIBC. Please go ahead.

Prakash Gowd:

Thanks, good morning everybody, a couple of items. First, for Richard, can you disclose what the level of materiality is before you would actually make a comment about payor changes?

Richard Bear:

Where it impacts the comparability of the financials, materiality is always subject to subjectivity. But when we believe that that information would need to be disclosed to understand the comparisons between reported financial periods, that's when we disclose it.

Prakash Gowd:

Is there a specific percentage decline over a quarter or over a year that would make that trigger?

Richard Bear:

Not that we've seen to-date.

Prakash Gowd:

Sorry, in your internal level of materiality, is there a percentage change that will trigger your requirement to disclose any payor reimbursement changes?

Richard Bear:

Again, when we look at our financials and we look at the comparison,we look at the relationships to prior quarter, prior year and any other comparable periods. If we feel that there's a rate change that requires disclosure to understand those, we would then disclose it.

Prakash Gowd:

Okay, that's fine. Then for Jay, if I can maybe ask Jay, in your discussions with GI ASCs, can you shed a little bit of light about how they're feeling about the recent CMS change, especially now that the delta between moderate sedation and deep sedation have narrowed? What sort of impact has it had on their willingness to engage in discussions with you and to reach a certain selling settlement? Could they be potentially waiting for subsequent changes that may be in the works at CMS?

Jay Kreger:

Sure, good question, and I think the first part of that is—or it's really the second part of your question, is the GIs, while not initially informed of the announcement, they have quickly become educated that the proposal has been made, and across the board they are of the belief that it will happen as we have disclosed. They realize that the impact on their business is a, for lack of a better word, a sure thing in 2018.

As it relates to how it would impact their decision-making process to partner or not partner, and why I say it's not a deterrent, when a physician decides to partner with us or sell their business, whether it's an ASC or their anesthesia business, they're doing so for really two reasons: a liquidity event, and long-term value. We provide value relative to the current value of those businesses, so while the proposed changes do cut reimbursement, it doesn't change the positive outlook of the business as a whole.

So, my belief, and what we're seeing and hearing, is that it really doesn't impact their decision-making process at all.

Prakash Gowd:

Do you see any that are possibly going back to doing some moderate sedation?

Jay Kreger:

No, not at all.

Prakash Gowd:

Okay. Great, thank you very much.

Jay Kreger:

Sure.

Operator:

The next question is from Richard Close with Canaccord Genuity. Please go ahead.

Richard Close:

Yes, as you look at your pipeline with respect to acquisitions, I think the Florida one that you just announced was not an O'Regan customer. How does your potential acquisitions breakdown, in terms of—are most O'Regan customers, or are there a good number of non-O'Regan customers in the pipeline?

Jay Kreger:

Richard, this is Jay. I'll answer that. With regards to Florida, the group there has actually been trained on O'Regan. However—and I can tell you that—and this is somewhat typical at times—we were first introduced to them almost a year-and-a-half ago, and they were actually introduced to us at our booth at an ACG show where we were exhibiting the O'Regan System. So I think you could argue that it was because of our standing with the O'Regan business that they came to us.

That continues to be consistent with, I think we've disclosed before, every one of our customers except for, or every one of our anesthesia partners with the exception of one, were a direct result of our O'Regan relationship, and I see that trend continuing.

Richard Close:

Richard, with respect to the true-ups that were made in the first and second quarter, $900,000 and $200,000, do you have the true-ups for the first quarter and second quarter of 2016?

Richard Bear:

Those have not been disclosed because they're not material to the understanding of those numbers.

Richard Close:

So, essentially in first quarter '16, it wasn't as significant as the $900,000. I guess I'm asking, why disclose the $900,000 for the first quarter (2017) if you didn't disclose it in the first quarter (2016).

Richard Bear:

Great question, Richard. The reason we disclosed it is because without the disclosure of the $900,000 and the $200,000, the Anesthesia revenue would have been flat in Q2 as compared to Q1, and we'd be getting sick of the amounts of questions why Anesthesia revenue was flat and we couldn't talk about the reasons without it being disclosed.

So, we disclose those things that are important for us to be able to answer questions from you and others, and don't disclose everything that's out there because it's not material.

Richard Close:

Okay, but like on a revenue per case, last year you were at $468 in the first quarter; this year you're at $467, you know, you exclude the $900,000 as was pointed out earlier, that $466 goes down to, what, $440 which is a pretty notable decline year-over-year.

Richard Bear:

Four forty-five, which would—a lot be driven by GAA.

Richard Close:

Okay. All right. Thank you.

Richard Bear:

Thank you.

Operator:

This concludes the question-and-answer session. I would like to turn the conference back over to Edward Wright for any closing remarks.

Edward Wright:

Okay, I would just like to thank everyone for their calls, and as always, Richard and myself are available to speak to you and look forward to hearing from you.

Thanks very much. Bye-bye.

Operator:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.