



CRH Medical Corporation

Fourth Quarter and Year End 2019 Results

Conference Call Transcript

Date: March 12, 2020

Time: 8:00 a.m. E.T.

Speakers:

Dr. Tushar Ramani

CRH Medical Corporation — Chief Executive Officer

Richard Bear

CRH Medical Corporation — Chief Financial Officer

Jay Kreger

CRH Anesthesia — President

Tom Sanders

CRH Medical Corporation — Vice President, Commercial Development



Operator

Good morning, ladies and gentlemen, and welcome to the CRH Medical Fourth Quarter 2019 Results Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded on Thursday, March 12, 2020.

I would now like to turn the conference over to Richard Bear. Please go ahead

Richard Bear — Chief Financial Officer, CRH Medical Corporation

Thank you, Jessica, and good morning, everyone. I am joined today by our CEO, Dr. Tushar Ramani; the President of CRH Anesthesia, Jay Kreger; and Vice President of Commercial Development, Tom Sanders.

Before we start, I'd like to remind everyone that certain statements you will hear today constitute forward-looking statements within the meaning of the applicable security laws. For important assumptions, definitions and cautionary statements about forward-looking information and the risk inherent to our business, please refer to the cautionary notes in our Annual 10-K.

During this call, we will discuss non-GAAP financial measures as indicators of our performance. You can refer to our Management's Discussion and Analysis for the three and twelve months ended December 31, 2019 for the reconciliation of non-GAAP measures to reported GAAP measures. These documents are available on SEDAR, EDGAR, and the investors section of our website. In addition, please note that we will be using abbreviation GI to refer to gastroenterologist.

Finally, please be advised that our reporting and functional currency is the US dollar and that all dollar figures referenced today are in US dollars.

With that, I will now turn the call over to Dr. Tushar Ramani.



Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Thank you, Richard. Good morning to everyone. Thank you also to everyone on the call. We know that there are some very important things going on in the world, but we appreciate you joining us here as we discuss CRH's fourth quarter and year end 2019 results.

We are pleased to report that we have generated yet another highly profitable quarter on the back of 17% anesthesia volume growth and we closed two acquisitions from our robust pipeline. Despite a challenging finish to 2019, we'll note our continued progress and execution as we managed through our payer-related headwinds in order to best position the company for sustainable long-term growth. These headwinds impacted our fourth quarter growth and profitability more than we had anticipated and, while frustrating to us, they also strongly validated our earlier decision to transition away from non-contracted volumes in order to become a more fully contracted provider. So let me just discuss this and our other initiatives in some further detail.

First, with respect to business development, during the fourth quarter of 2019 we doubled the size of our business development team. In addition to expanding this BD team, we also expanded the variety of approaches that we can use to engage with prospective targets. We envision growing our anesthesia business now through a portfolio approach with a mix of de novo deals coupled with more traditional capital deployment related transactions. We view these de novos as an attractive means of development as they tend to be a cashless, sweat equity means of entry into a market. That being said, we have a multitude of deals in our expanded pipeline that are either pending closing or in late stage negotiation and we're actively working to close those deals. We expect our acquisition capital spending in 2020 to approximate our recent historical levels of spend.

Second, a key part of our anesthesia plan revolves around our payer contracting strategy, and in mid-2019 we made a decision to transition towards a more fully contracted case mix with an eye towards revenue per case and margin stability and visibility, especially given the heightened industry focus on non-contracted billing, and we find ourselves right now very much in the middle of that transition. When the original surprise billing legislation with its very payer-favourable framework seemed likely to pass towards



the end of 2019, payers sensed their upper hand and became very aggressive in driving down non-contracted payments throughout the industry significantly more than we expected.

While this validated our strategy to a more fully contracted business mix, it did have the effect of reducing our 2019 per-case revenue and profitability, as we adopted a less aggressive response so that we don't impair our payer relations, as compared to our peers who have employed litigation and high patient balance billing among our other tactics in their responses. The other effect of that impending legislation though is that it appears to us that payers are not engaging in good faith negotiations until the final bill is passed and with the slippage in the timing of the final legislation to now May 2020, this dynamic has created some headwinds for us that have extended into the first part of 2020. Fortunately, the current versions of the surprising billing legislation appear much more provider friendly and we look forward to finality within the next couple of months, facilitating our continued transition back to our more fully contracted book of business.

The third initiative for us involves implementing strategies to generate growth in hemorrhoid treatment volumes and more fully maximizing the potential of our O'Regan segment. Tom Sanders, who has been leading the O'Regan segment now since January, will introduce himself a little later in this call. And then finally, we look to evaluate other ways to serve the GI practice community. These efforts remain ongoing and we continue to actively explore new opportunities.

I will now hand it off to Jay and then Tom, before turning it over to Richard to review our financials in some more detail.

Jay Kreger — President, CRH Anesthesia

Thank you, Tushar. Thank you, Tushar.

As Tushar noted, we completed two transactions during the fourth quarter. The first was the exercise of an option to acquire a controlling interest in a prior MAC development program, Triad Sedation



Associates. The second transaction was the acquisition of a majority interest in Florida Panhandle Anesthesia Associates.

As I mentioned on the last quarter's call and as Tushar alluded to earlier, in addition to our core acquisition-oriented BD activity, our expanding pipeline contains an increasing amount of non-traditional opportunities that we believe can contribute to shareholder EBITDA. We believe that our path forward is to grow from being a niche acquirer of embedded anesthesia services into a market leading provider, acquirer, and developer of these services. Providing anesthesia services to 58 ASCs across 11 states and serving nearly 400,000 patients per year provides us the scale that no one else in the GI space has earned or enjoys.

We believe that the portfolio approach towards business development that Tushar spoke of gives us greater flexibility as we go to market. One such non-traditional approach we expect to be employing more is our de novo approach, where we develop a new anesthesia entity jointly with the target gastroenterologist group without a corresponding acquisition capital outlay, which yields CRH a modest minority interest in these entities. I note that these de novos, which have more of a below-the-line impact initially, present future accretive acquisition opportunities for the company.

At the end of 2019 we effectively doubled the size of our business development team, again as Tushar noted, and we look forward to executing across the multiple business development fronts as we go into 2020. We expect our acquisition capital spend this year to approximate recent historical spending levels.

And I will now turn the call over to Tom Sanders.

Tom Sanders — Vice President, Commercial Development, CRH Medical Corporation

Thank you, Jay.



I'd like to start by saying how excited I am to have joined CRH in January. Although it's still fairly early in my tenure, I've been very impressed with the team and our capabilities. As you know, I've been charged with overseeing the O'Regan franchise, which is the first time CRH has named a dedicated executive in charge of O'Regan.

O'Regan is far and away the leader for hemorrhoid treatment within the GI community. We have great relationships with the GI community, having trained over 3,000 GI physicians to use O'Regan, and we are actively looking to strengthen and deepen those relationships even further. We remain extremely excited about the long-term market opportunity for O'Regan, as we expect patient demand to continue to grow. Although I'm still wrapping my arms around O'Regan, we see a great synergy potential with the anesthesia business and we're actively developing initiatives that will once again enable O'Regan to realize its growth potential. I expect to have more detail to share with you later this year.

Thank you.

Richard Bear — Chief Financial Officer, CRH Medical Corporation

Thanks, Tom.

We reported Q4 revenue of \$30.4 million, a decline of 5.2% compared to the fourth quarter of 2018. Anesthesia revenue declined 4.5% on a 22% decline in revenue per case. While this is an unusually large decline in revenue per case, we faced a number of headwinds in the fourth quarter related primarily to the issues that Tushar outlined earlier. With the pending surprise billing legislation, payers have aggressively reduced non-contracted payments more than we expected, resulting in us having to adjust our 2019 estimated payer rates in the fourth quarter. We have been frustrated by these dynamics, but we believe visibility into these trends has improved and should continue to strengthen following the expected passage of surprise billing legislation in 2020.

We serviced a record 94,503 patient cases in the fourth quarter, representing a 17% increase over the same period in 2018. Sales of the O'Regan System were \$2.7 million for the fourth quarter, a drop of



11% as compared to the fourth quarter 2018. Total adjusted operating EBITDA for the quarter was \$12.3 million compared to \$15.9 million during the fourth quarter of 2018. Adjusted operating EBITDA attributable to shareholders was \$8.8 million during the quarter compared to \$10.7 million for the fourth quarter of 2018, and total adjusted operating EBITDA margin was 40% in Q4 2019.

We finished 2019 with \$6.6 million in cash and cash equivalents and total borrowings of \$69.3 million. We generated \$29.1 million in free cash flow after distributions to non-controlling interests during 2019, an increase over the \$21.7 million that we generated during 2018. We have \$130 million in unused borrowing capacity available to us through our syndicated debt facility.

I will now turn it back to Tushar for his closing comments and then we'll open it up for questions.

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Thank you, Richard.

So, I will finish here with some additional colour for the anesthesia business specifically in 2020. First, we are projecting now full year revenue per anesthesia case to be in the range of \$300 to \$310 per case. This contemplates a continued conservatism around estimated reimbursement rates reflecting the current standstill environment that the payers are in given the legislative delays. We believe that our cooperative approach towards payer relations will yield positive results as billing legislation is passed and payers resume working with us towards more holistic contracting, likely before midyear.

Second, in terms of the quarterly cadence of our 2020 financials, we would expect that first quarter and second quarter revenue per case will be in line with fourth quarter 2019 and we expect that as we transition throughout the year towards a more fully contracted case mix, our strongest revenue per case for the year will be delivered towards the end of 2020 at what we estimate to be around \$330 per case.

And then third, as I mentioned earlier, we expect to deploy at least as much capital towards acquisitions in 2020 as we have in recent years. At the same time, we're expecting to communicate other



non-traditional forms of BD activity in the coming weeks that will nicely complement our acquisition-related growth. And we expect that throughout the year as well.

And then finally as the healthcare company, we do have a particular interest in the progression of COVID-19, coronavirus as it's known, throughout our geographic footprint in 11 states in the United States. It has the potential to affect our gastroenterologist partners and customers, our providers, our frequently travelling administrative staff, and our patient population. And given the daily, even hourly updates on the spread of COVID-19 these days and the resulting responses, we're unable to estimate the likely impact to our business. From a business standpoint, we acknowledge there is a high potential for disruption to our case volumes, while we remain concerned for the wellbeing of our employees and our patients. We are watching these developments very closely and we will take any advised actions as they become necessary for the safety of our constituents.

I will now turn it back to Jessica for questions.

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press the star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys.

Your first question comes from Richard Close of Canaccord Genuity. Please go ahead.

Richard Close – Analyst, Canaccord Genuity

Yes, thanks for the questions. First of all, on the payer contracting, Tushar, I was wondering, I think your commercial book of business or percentage of cases was around 60% in the fourth quarter. Is there



any way to give us some sort of range in terms of how much of that 60% was related to non-contracted cases?

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Richard, Tushar here. Thanks for the question. We normally do not disclose our non-contracted mix. It's ever changing and, as you know, strategically we want that to be a declining number. And typically you'll see the effects of our strategy in our increasing revenue per case number throughout the year, but it's not a data point that we have disclosed.

Richard Close – Analyst, Canaccord Genuity

Okay. And then with respect to, I guess this question might be for Jay, but with respect to the pipeline including non-traditional opportunities and you mentioned de novo, are there any other non-traditional opportunities or is it just de novo? And then how many de novo projects, yeah, projects I guess is the right word, do you expect to announce or start up during 2020?

Jay Kreger — President, CRH Anesthesia

Hey, Richard. Thanks for the question. I think I mentioned on the last quarter's call that the breakdown between de novos and acquisitions was now starting to approach more of a 50/50 mix and I think that will hold for this year and so half of the deals that we do will be in this de novo category. I think the range of what we call de novo though is there's more flexible structures on those. The sweat equity model that I think we referenced is the big one, but to the extent that we're flexible on how much that sweat equity is and how we work with groups is what enlarges the market as we go forward.

Richard Close – Analyst, Canaccord Genuity

Okay. And then my final question is on COVID-19. I know you did have one of the MAC programs that you ultimately acquired in the state of Washington area. Can you give any thoughts in terms of what



the impact on case volumes was maybe as we sit here in the, you know, what, second week of March, ah, provide any indication. Obviously, Washington was (inaudible) most states so far.

Jay Kreger — President, CRH Anesthesia

Obviously, our operators are in almost daily contact with our group out in Washington, as they are all of our sites. It's a changing daily report. I don't think we've seen a substantial difference at this point, but next week and next month can be different stories, as Tushar alluded to. I think it's just too early to tell.

Richard Close – Analyst, Canaccord Genuity

Okay, thanks. I'll jump back into queue.

Operator

Your next question comes from Endri Leno of National Bank. Please go ahead.

Endri Leno – Analyst, National Bank Financial

Hi. Good morning. Thanks for taking my questions. First I will start with network negotiations. How long do you expect this negotiation to last? And I mean why would you expect payers to be rushing to get you guys in network around the second half of the year?

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Endri, thanks. Thanks for asking that. We expect that the payers should resume those discussions. Remember, it's a resumption of discussions. Most of these are things that were sort of in process before they kind of pulled back towards the end of 2019. So, we anticipate that we should be able to pick things back up once they've kind of understood what the lay of the land is with the new legislation.



The reason for them wanting to do it is fairly easy. It's important to payers that they have as complete a network as possible for their own sponsors, for their own internal book of business, so they can better compete for their own contracts with employer-sponsored plans, et cetera. So, not having complete networks, not having contracted providers in their key markets is obviously not ideal for their business and so they have a strong motivation to get to the table as well.

Endri Leno – Analyst, National Bank Financial

Okay. Thanks for that. And one more question: Is there any state or region in particular where you had more of these out-of-network contracts or are they all over at the place?

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Yeah, I think it is fairly disbursed throughout our network.

Endri Leno – Analyst, National Bank Financial

Okay. Thank you. And last one for me, days sales outstanding, perhaps for Richard, how do you see that? We're a little bit higher in Q4 and we had, ah, I think you had guided to a bit lower range, like how do you see that developing in 2020?

Richard Bear — Chief Financial Officer, CRH Medical Corporation

Yeah, I think as we've moved to being more fully in contracted 2020 we'll see that number go down. I think that number that you see that has gone up is representative of the aggressiveness on our non-contracted payers. It's just taking longer for us to get paid and we're getting paid less

Endri Leno – Analyst, National Bank Financial

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

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the one.

Your next question comes from Ammar Shah of Eight Capital. Please go ahead.

Ammar Shah – Analyst, Eight Capital

Good morning, guys, and thanks for taking my questions. The first question I had was just hoping you can provide some colour on the increasing case volumes just on the prospective of kind of what you saw organically versus from acquisitions.

Richard Bear — Chief Financial Officer, CRH Medical Corporation

Yeah, during the year, if we look at the entities that we had owned at the end of 2018 and what those did in 2019 we saw pretty close to a 5% organic growth rate overall on those. 3% was the growth rate fourth quarter compared to fourth quarter 2018, so then the rest of the growth would have come from acquisitions.

Ammar Shah – Analyst, Eight Capital

Great. And majority of my questions were asked, so just one final one is I was hoping you could provide a little bit of context in terms of, maybe this is for Tom, just the kind of the go-to-market strategy and just the strategy in general on how you anticipate product sales could see a return back to growth. Just any colour there would be great. Thanks.

Tom Sanders — Vice President, Commercial Development, CRH Medical Corporation

Thanks. So, as I mentioned earlier, I'm about 60 days in, so it is early. Right now we're really in the mode of kind of discovering and planning, meeting with both existing and prospective practices, so



identifying areas of opportunities. Probably in the next 30 to 60 days we'll have formulated more of our strategy and plan to approach the market.

Ammar Shah – Analyst, Eight Capital

Thanks, guys. I will turn it back.

Operator

Your next question comes from Richard Close of Canaccord Genuity. Please go ahead.

Richard Close – Analyst, Canaccord Genuity

Great. Thanks for the follow-up. Tushar, I guess on the guidance with respect to the rate case and the progression through 2020, just help us out with your confidence in setting those rate ranges. What provides you that confidence? Is it based on where the negotiations were before they stalled out? Is it based on any finalized negotiations using that as a rule of thumb? Just what are your thoughts there?

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Yeah, Richard. So, the way you should think about that is that we'll go into 2020 sort of at par with where we finished 2019. Normally we would actually see a drop between fourth quarter and the following first quarter because our case mix changes, it's more of a Medicare/Medicaid mix. This year we have already seen the benefit of some of our contracting strategy that's going to start to take hold in Q1, so we're not forecasting that drop, because I think we have good visibility into the new rates with one of our key payers. As we progress throughout the year, and again the wildcard, of course, is getting that legislation done, but as we progress throughout the year we expect to complete negotiations with several of the other major payers.

Our confidence comes around what we've been led to believe, ah, the range of outcomes, I would say, in those negotiations will be based on some early discussions we have already been having, based on



some things that we're being advised from our partners on as well. So, as those pop in and then as we get providers' credentialed through the course of the year, you'll see our revenue per case rate grow up. As I mentioned, we expect to exit 2020 at \$330 per case.

Richard Bear — Chief Financial Officer, CRH Medical Corporation

It's Richard. Let me just add something to that. I mean as we exit 2020 we won't be fully implemented, so we'll continue, as we head into 2021, completing our implementation strategy, which we expect would yield additional improvements in revenue per case.

Richard Close — Analyst, Canaccord Genuity

Okay. And then as we think about, I mean obviously there's, I guess, four major payers out there. Is that a majority of the 60% of your commercial cases? Or maybe you could help us out with the size of that book of business of those four payers, insurers.

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Yeah, the majority actually is probably Blue Cross/Blue Shield and the various siblings of the Blues. And then of course United, Cigna, Aetna, and Humana make up the large part of the rest. And then we have any number of sort of smaller splinter payers throughout the portfolio that probably are maybe 5% to 7%.

Richard Close — Analyst, Canaccord Genuity

Okay. And my final question would be on the legislation itself. Obviously, hard to get legislation passed through (inaudible)...here, although I guess this is one area that there is bipartisan support, but still hard to get things passed. So, just give us your thoughts in terms of what are the key points of the legislation for you guys, for CRH? And then I assume that you deal with associations or have lobbyists yourselves that are providing perspectives on the status of the legislation in terms of mix (inaudible), you know, maybe the magical date and whatnot. So, thoughts in and around the legislation.



Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Yes, the important thing to us is that any surprise billing legislation be as fair as possible to providers as well as payers. Obviously, we advocate more strongly for the provider side, but it needs to be a level playing field, which I think the original one that looked very close to passing at end of 2019 was not. It was very payer friendly in that it didn't allow for an arbitration process if indeed the payer and the provider hit an impasse in trying to negotiate an out-of-network or non-contracted bill.

That's an important provision for us to be able to have that arbitration opportunity, not because strategically we expect to be adjudicating a whole bunch of non-contract bills, but the ability to be able to do that forces a more fair negotiation process in order to achieve a direct contract with the insurer, and that's ultimately CRH's goal. I can't speak to other providers or provider sets. And so we'll be watching that legislation very carefully to make sure that the arbitration provision that's in there currently persists and that it's a truly accessible pathway, again, not because we expect to be using it or hitting it often, but we do want that to create, again, a fair negotiating arena for us.

Richard Close — Analyst, Canaccord Genuity

Okay. Thank you.

Operator

We have no further questions at this time. Please proceed.

Dr. Tushar Ramani — Chief Executive Officer, CRH Medical Corporation

Well, I think we'll close it out. Thank you, everybody, again, for the time and attention this morning and we'll caution to be safe and healthy out there.

Richard Bear — Chief Financial Officer, CRH Medical Corporation

Take care, everyone.



Operator

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