CRH Medical Corporation

Q1 2020 Results

Conference Call Transcript

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Time: 8:30 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 Q1 2020 Results Conference Call.

At this time all lines are in a listen-only mode. Following the presentation we will conduct a question-and-answer session. If at any time during this call you require assistance, please press star, zero for the Operator. This call is being recorded on May 13, 2020.

I'd now like to turn this conference over to Richard Bear. Please go ahead.

Richard Bear:

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

Before we start, I would 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 Months Ended March 31, 2020 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 the abbreviation GI to refer to gastroenterologist.

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

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

Tushar Ramani:

Thank you, Richard. Thank you also to everyone on the call for joining us to discuss CRH's first quarter 2020 results.

We hope everybody's safe and healthy as we work to navigate through these unique and challenging times out there. Like most of you, we're doing this call from our homes, so please bear with us in the event that we experience any technical challenges here during this call.

While we began to see a sharp impact of COVID-19 in mid-March on our procedure volumes, we do expect the impact in the second quarter to be even more pronounced. As you are aware, many states, many health systems, in response to the pandemic implemented guidelines that restricted elective procedures at most health facilities in order to prioritize hospital resources towards the care of COVID-19 patients. This dynamic coupled with the restrictive distancing policies has significantly impacted the number of patients that the ASCs that our anesthesia businesses serve.

Exactly how long we experience these decreased volumes remains uncertain. Most of the regions in the country are still under some measure of restrictive sheltering and distancing.

We're cautiously heartened to see a number of ASCs customers are beginning to open now, at least in part, or they have set opening schedules throughout the rest of this month.

Now, once they're reopened, we think it will take a number of weeks for these ASCs to return to normal patient levels. Throughout most of April our anesthesia volumes were down 90% from our normal operating volumes, whereas this week our volume deficit has improved to around 75%. So we're still down 75% from what we would consider a normal. Further improvements are scheduled, and barring any relapses or delays, we do expect that to continue to increase.

Also, as you might expect, the pandemic has decreased demand for our O'Regan segment as many physician offices are only open for essential visits. That, too, has started to increase as these offices open up. We hope that we can see continue to increase there. Our hemorrhoid treatment volumes have therefore been limited so far to the more urgent cases.

In order to mitigate the financial impact of this lower demand for our products and services, we worked swiftly to reduce costs and have taken steps to bolster our liquidity in advance of the heightened uncertainty in the financial system as well.

Richard will address some of those measures later, but we remain confident that we have an enduring business that will survive this crisis, and we continue to forge ahead with the key initiatives that we have, fully prepared to service our ASC partners as these volumes begin to normalize.

Let me just address a couple of our primary initiatives.

First, with respect to our payer negotiations and rate strategy, we remain in active external dialogue to optimize our contracted case mix. Recall that on our last conference call we discussed some of the challenging payer dynamics that impacted our fourth quarter 2019 results given the delays in the passage of the surprise billing legislation in Congress.

We had contemplated the passage of that legislation this May to facilitate our contracting transition throughout 2020. However, with the passage of certain Medicare provisions in the CARES Act, ones that were originally coupled to this passage of the surprise billing legislation, we no longer anticipate the passage of the billing legislation in the near term.

Yet we continue to make progress on our rate objectives largely because of a more positively biased provider backdrop in light of the pressures on the healthcare industry in this pandemic. As a result, we believe that our rate strategy has been decoupled from the surprise billing legislation, and we continue our work to strengthen our long-term ties with our payer partners, which we believe will improve the overall revenue and pricing visibility of our business.

Also supporting our ongoing payer strategy, we'd like to point out that Brian Griffin has recently joined our Board of Directors. For those of you who may not know Brian, he has extensive operational and strategic experience at some of the largest payer-related entities in the country, and we're keen to get his guidance and leverage his expertise and insight.

Second issue, we remain optimistic with regards to our business development pipeline. Our team remains in discussions with all our prospective targets and partners. We've actually been moving deals forward during the phase. As you may suspect, we've temporarily paused capital deployment towards acquisitions as a result of this pandemic, though. We believe that many smaller providers facing unprecedented financial and operational pressures may actually drive more BD opportunities for CRH as we emerge from the pandemic.

Finally, we are focused on implementing strategies to drive growth in our O'Regan segment. We continue to believe the segment has a market opportunity well north of the current level of business that we're seeing. Tom Sanders will talk more about O'Regan shortly.

With that, I'll turn this call over now to Jay Kreger who will talk more about the anesthesia business.

Jay Kreger:

Good morning, everyone.

I'd like to echo Tushar's comments and thank all of our shareholders for their support and for joining us today. Additionally, I want to thank our employees and our provider partners for their continued devotion to patient care during these difficult times.

Our first quarter anesthesia revenue fell 13% to $23.2 million on a 0.6% increase in cases. Revenue per case of $297 represented a 1.3% sequential improvement from the fourth quarter of 2019. The anesthesia segment generated Adjusted Operating EBITDA of $8.1 million representing a 37.6% drop from the first quarter of 2019.

Prior to COVID-19, same-store cases in January and February 2020 were actually up 4% when compared to the same period in 2019; however, as Tushar noted, after a solid start to Q1, we began to see COVID-19 related pressures on our business in March. That pressure only worsened in April as procedure demand continued to decelerate.

Let me provide some color on these trends. In terms of our ASC footprint, we finished 2019 providing services at 58 ASCs. The number of operational ASCs fell to 30 by the end of Q1 and then to 20 by the end of April.

Let me caution you that the term operational is not necessarily uniform across all of our ASCs. In some cases, it could mean fully operational status, while in most cases, it means only partial operational status. For example, limited days when a center is open or reduced capacity or potentially both.

As a result, whereas our weekly volume had fallen to below 40% of normal by the end of Q1 and as low as 10% of normal during April, we are now at approximately 25% and improving, although we can't yet predict the sustainability or the extent of any improvement at this point.

We are encouraged that some states and health systems have now just recently started to lift restrictions on elective procedures. We are diligently monitoring procedure scheduling patterns, but it just remains too premature to reliably communicate any expectation around when our case volume could begin to rebound in a meaningful way.

With respect to business development, while we remain in active dialogue with potential targets and partners as Tushar noted, we have temporarily suspended acquisition spending until we aresure our prospective partners have restored operations to an adequate level.

We expect to resume normal travel and increase BD activity once some of this uncertainty lifts, but we are currently unable to predict when this might occur. Our team remains engaged, actively prospecting for acquisition and de novo prospects. We hope to share more with you during the second quarter earnings call.

As an aside, while the circumstances are unfortunate, we think some of the financial strain on many of our target provider groups could actually work to drive more BD opportunities to CRH as these businesses begin to view their anesthesia operations as transactable sources of liquidity for their core operations.

I'll now turn the call over the Tom Sanders.

Tom Sanders:

Thanks, Jay. Good morning, everyone.

Prior to the COVID outbreak, O'Regan revenue for January and February was up 9% over the same period of 2019, before experiencing a fall-off in mid-March due to the pandemic's impact on GI visits. First Quarter O'Regan sales totaled $2.3 million, a decrease of 5% in the first quarter 2019. We reported segment Adjusted Operating EBITDA of $1.2 million representing a 54.1% margin.

Coming into 2020, we had begun to initiate additional practice support measures aimed at identifying and treating more patients to drive revenue growth. The targeted program places greater emphasis on maximizing the real potential of our installed base, retraining physicians, particularly in practices where usage had decreased. As we ramp back up, we will continue to engage in retraining initiatives, while qualifying new inquiries to identify the most efficient opportunities to deploy our training and support resources.

In addition, we've utilized the available downtime to evaluate process improvement opportunities for sales and training. We are working collaboratively with some of our top partner practices to identify best practices in hemorrhoid treatment growth opportunities. This includes working with them to better understand their patient data and to identify the proper patients, educate providers on curative treatments and grow hemorrhoid banding volumes in response. Within the last week we are beginning to see our customer practices engage, as indicated by our orders and rescheduled trainings. We believe that post-COVID the opportunity for CRH O'Regan remains as high as ever.

I will now hand the call over to Richard Bear our Chief Financial Officer.

Richard Bear:

Thanks, Tom.

We reported consolidated Q1 revenue of $25.5 million, a decline of $12.6 million compared to the first quarter of 2019. Total Adjusted Operating EBITDA for the quarter was $7.5 million, compared to $13.1 million in the first quarter of 2019. Adjusted Operating EBITDA, attributable to shareholders, was $4.9 million during the quarter.

We finished the first quarter of 2020 with $13.3 million in cash and equivalents and total borrowings of $70.5 million. We generated free cash flow of $5.6 million after distributions to non-controlling interests. We note that these distributions were suspended in mid-March as a result of COVID-19.

I would like to comment a bit more about steps we have taken that will help us mitigate some of the impact of COVID-19 on our operational and financial metrics. We have reduced staffing costs as much as possible, primarily in our 1099 and third-party provider workforce. Additionally, we reduced bi-monthly pay for much of our Senior Executive team and to a majority of non-provider employees.

Prior to March 31, we drew down $5 million from our credit facility, deferred distributions to joint venture partners, and took the necessary steps to participate in several relief programs. Additionally, as Tushar and Jay both noted, we temporarily suspended our anesthesia acquisition program and we also decreased capital allocated to our share buyback program to further preserve liquidity and maximize operational readiness.

As of March 31, 2020, we had drawn $70.5 million on our credit facility. That facility includes $125 million committed facility with an accordion feature that could increase available credit to $200 million.

I will now turn it over to Tushar.

Tushar Ramani:

Thank you, Richard.

In closing, I'd just like to comment on a couple of the targets that we had provided on our fourth quarter earnings calls.

First, with respect to revenue per case, although we were pleased with our first quarter revenue per case, we are pleased that it met the expectation that we had communicated on our last conference call, we are temporarily withdrawing our 2020 target ranges given the current nature of the operating environment that we are in now and the reduced ability to communicate a reliable rate expectation. We assure investors we are continuing to make progress on our rate strategy, but unpredictable volume andcase mix dynamics will likely yield rates in the upcoming periods that just would not provide stakeholders with any useful insight on the progress we're making.

Second, as we have noted a few times in this call, we have curbed the pace of our acquisition program. As such, our acquisition related capital spend may not achieve the recent historical levels as we had indicated we might before.

In closing, I want to thank our leadership team and employees for their hard work during this crisis. We remain confident in our long-term strategy, remaining committed to providing the outstanding service and care to our customers.

The necessary steps that we've taken to mitigate the costs and conserve capital should allow us to navigate this crisis while at the same time ensuring that we can be in a state of readiness as volumes begin to normalize.

With that, we will take your questions.

Operator:

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star, followed by 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 star, followed by two. If you are using a speakerphone, please lift your handset before pressing any keys. One moment for your firstquestion.

Your first question comes from David Martin with Bloom Burton. Please go ahead.

David Martin:

Good morning everyone.

A couple of questions for you. The first one is, prior to COVID, did your ASC partners have much excess capacity? If there has been a backlog built up during the shutdowns, do we expect a spike in business following COVID?

Jay Kreger:

I can take a shot at that. This is Jay Kreger.

David, thanks for the question. I think generally speaking, most ASCs run at a 75% to 80% capacity level. They also have the ability to run Saturdays if they want to or later hours if they wanted to increase that capacity more. I think the pent-up demand is something that we could see actually, at least the short-term bump in historical volumes. Thank you.

David Martin:

All right. Next question. How much can you titrate down your anesthesia service expense? If an ASC closes, can you furlough the employees without any salary, without any severance?

Richard Bear:

Let me start with that one. This is Richard.

We have three types of staffing models. We have 1099s, we have third-party providers, and we have W2 providers. The easiest for us, the easiest expenses for us to control would be the 1099 and then the third-party providers and W2. We did furlough as many of those as possible.

David Martin:

Okay. Do you have any visibility on what your anesthesia service expense is going to be in Q2?

Richard Bear:

We are doing everything in our power to control the cost. Most of the costs on the anesthesia expense side relates to providers. As it relates to the 1099s and third-party providers, those expenses are dropping down as far as possible. There will be some costs associated with maintaining at some level the W2 providers. We are not providing specific guidance on what that number is going to be forQ2.

David Martin:

Okay. My last question is, the rate strategy, you mentioned that it will improve visibility on pricing once we're beyond COVID and you execute the full rate strategy. Is it expected the rate per procedure will go down or will go up with the increased visibility?

Tushar Ramani:

David, it's Tushar.

It's hard for us to project that, which is the reason that we have sort of withdrawn our guidance. We are not anticipating changes in our previously communicated expected rates, but we don't know if and when we're going to be able to get the payers to negotiate and engage. I think timing is an issue for us.

David Martin:

Okay, okay. Thank you.

Operator:

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

Richard Close:

Yes, thanks for the questions.

I'm curious. You operate in various states. I assume some are reopened, some are not. With respect to the 25% level that you mentioned, can you maybe—I assume that's the company average across all the centers. Can you maybe provide some details in terms of maybe what the percentage is in the states that have opened up? Obviously, Georgia and Florida, you guys are in. I think South Carolina as well. Those are open. I assume Texas, but maybe the Washington is not open and Massachusetts, I assume, as well. Anyways, any details there that could be helpful in terms of what is happening in the reopen states.

Jay Kreger:

Yes, Richard, it's Jay.

Thanks for the question. To clarify that, 25% represents a case volume, not an ASC opening volume. What you may have is, you may have a multi-site group who only has one or two of their multiple sites open because they're consolidating volume. So it's hard to say.

What we've seen is, and we track every single site on a daily basis, so we have a look into what our forecast is, at least in the next few days. Of course, it's ever changing with COVID.

Some of those states you mentioned like Washington and Massachusetts are just beginning to open this week or next. Whereas some of those other states that we are heavy in such as Georgia, Texas, Colorado, have been open for some time, and it's just a matter of their volumes getting back up to normal levels.

The 25% really just represents the percentage of volume as compared to our baseline.

Richard Close:

Okay. Then as we think about O'Regan, I suspect that because of the fall-off overall for volumes, not only O'Regan but other procedures, do you envision that maybe the value proposition as you go out and try to market that improves as providers try to maybe catch up or increase revenue streams. Not sure if you've had discussions during the emergency situation or not. Just trying to gauge in terms of maybe if you'll benefit from this once things do open up.

Tom Sanders:

Sure. Tushar I'm going to take this. This is Tom Sanders.

Tushar Ramani:

Yes. Please go ahead.

Tom Sanders:

Yes, we've spent a lot of time, the O'Regan team has, because we've had time to really look and do a lot of analysis and actually still engage with quite a few of our practices. To your point exactly, is I think there is an opportunity O'Regan because it doesn't need to be performed in a surgical center.

There's opportunities, and practices are looking now, like you said, to gain, to look for revenue opportunities both in existing services that got where we sit nicely there and new ancillaries where we also can strategically set looking at banding out is more than ancillary.

We're optimistic, and it's been kind of basically backed by some of the discussions we have had with our practices. I believe there is a really good opportunity for us there. We are ramped up to kind of change the messaging in that format.

Richard Close:

Okay. Then maybe a question for Richard in terms of the distribution, I understand holding that off. What are your thoughts in terms of when the distribution starts back up? Is it when you hit a certain steady state in terms of cases, or any thoughts with respect to that?

Richard Bear:

Good question, Richard. Distributions will commence when we are comfortable that collections have commenced and we can meet future working capital needs without requesting capital calls from our joint venture partners.

Richard Close:

Okay. Thanks for the questions and answers.

Operator:

Your next question comes from Doug Miehm with RBC Capital. Please go ahead.

Douglas Miehm:

Yes, thank you.

A couple of questions. I guess the first one is, are you getting a sense of how your patient population that's typically over 50 is thinking about going back to healthcare sites? We have observed that outside of COVID a lot of hospitals and other types of clinics are well below normal. Do you think that that could remain that way until we get to maybe 2021 or after a vaccine? Thankyou.

Tushar Ramani:

Doug, this is Tushar. Again, thanks for the questions, good morning.

I think this is one giant experiment, right? I don't know that anybody really knows the psychology of the patient groups, what the dynamics are going to be as they come back, what patient flow looks like, the new procedures for shielding, etc.

At the same time, there is some level of urgency to some of the procedures that are performed, to many of the procedures that are performed, and they can be deferred for some point, but at a certain time they do need to get done. I think that there is going to be a base level of demand and base level of volume that just has to get done.

Some of the stuff at the margins will depend on not just people's comfort, but the efficiency that these centers can operate on once we are back up and running. There's a lot of uncertainty there I guess is really what I'm trying to say.

Douglas Miehm:

Yes, okay. No. That's what I thought, but just was wondering if you had a better gauge of it based on commentary or anything, but that's fine.

The second one you touched on briefly just with respect to capacity utilization. I know that Jay mentioned that normal is around 75% to 80%, but if social distancing measures or some other types of measures have to be put in place, what's that 75% to 80% likely to drop to; or in the event they do have to do that, they would open up on the Saturday or something like that? I know this is all sort of notional, but could you give me an idea?

Tushar Ramani:

I'll let Jay provide some of that color, but I will tell you that all of our partners are prepared to be able to extend their hours and try and capture as much of the pent-up demand as possible.

Jay, go ahead.

Jay Kreger:

Sure. Well, I'll clarify my comment about 75% to 80% first, and I don't know that that is a planned occurrence. Generally, physicians build their endo centers to meet their needs. That includes how many rooms they have, how big the center is. Some of these centers are built with larger footprints that will accommodate potential screening areas or social distancing that you referenced. Others may not, and it

may require them to either make some changes functionally or even construction-wise. Others may just do it with their time schedule.

Like Tushar said, I think it's too early. We have groups right now that have told us that they are already up at a high percentage, greater than 75% running, and they're not seeing any difference in the efficiency of how their center is running. Then those that haven't gotten to that level yet, we don't know what's going to happen. Will they fall into that category or will they be less efficient? I think it's just too early to tell.

Douglas Miehm:

Okay. That's a great answer. My final question just has to do with on the private pay side, do you have any idea of how many people may have lost insurance that you would consider potential clients?

Jay Kreger:

We wouldn't have visibility into that. We know that unemployment levels are at an all-time high, and it's primarily service industry related, but to correlate between what type of insurance service related industries have versus other related industries, we don't have that level ofinformation.

Douglas Miehm:

Okay, great. Thank you very much.

Jay Kreger:

That's one of the reasons why we're withdrawing guidance because the payer mix dynamics is something that we just don't have visibility into right now.

Douglas Miehm:

Thank you.

Operator:

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

Endri Leno:

Hi, good morning, guys.

Thanks for taking my questions. I have a couple from me. First, I was wondering if you have any visibility in the conversation you have with your partners of how rebookings are going, let's say for June or July or August. Beyond that, any of the procedures that are being canceled? Are they being booked at all? Any visibility or comments there?

Jay Kreger:

I'll answer that, Endri. It's Jay.

Thanks for the question. All groups are every day booking new cases. It's just a matter of how far out in the future they book them. What we are hearing is that they all have two-to-three-months backlogs at a minimum and so it's really more a matter of when they can book them and how long it takes to catch up to that pent-up demand.

I'm sorry, what was other part of your question?

Endri Leno:

No, no. That was—I was just wondering if they're seeing any kind of uptick, right, like so yes, there is this backlog, but are those cases ever being canceled, being rebooked at all? I don't know if you have that kind of visibility at all.

Jay Kreger:

Yes. I think initially when COVID started, no one knew how long it would take, and so they were rebooking those cases at the time. Then, once it became apparent that there was an unknown to the end, they just started canceling the cases, with the idea that they would rebook at a future date.

That has now begun, that there seems to be a light at the end of the tunnel for most of these groups and so they started rebooking again. How their priority is taken, I don't really know, because each group does it a little bit different, but they are filling the schedules as much as they are open.

Endri Leno:

Okay. No, great. Thank you. That's a great answer.

The other question is, on the O'Regan side, have you seen, or do you expect any issues in terms of inventory or production there at all once things start ramping up?

Tom Sanders:

Richard, this is Tom. I'll jump in.

Richard Bear:

Yes, go ahead, Tom.

Tom Sanders:

Yes, go ahead, Richard.

Richard Bear:

Yes, no issues. I mean, we maintain a number of months of supply of the O'Regan system. And we're always working on new builds with our contract provider. No impacts to inventory during this shutdown.

Endri Leno:

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

Operator:

There are no further questions at this time. Please proceed.

Tushar Ramani:

Okay. Well, with no further questions, thank you, Operator, and let me thank everyone again for participating this morning. Thank you for your interest in CRH. We look forward to speaking with you again next quarter.

Thank you.

Richard Bear:

Thank you.

Operator:

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