CRH Medical Corporation

Q2 2020 Results

Conference Call Transcript

Date: August 11, 2020

Time: 8:30 a.m. E.T.

Speakers:

Richard Bear

CRH Medical Corporation — Chief Financial Officer

Dr. Tushar Ramani

CRH Medical Corporation — Chief Executive Officer

Jay Kreger

CRH Anesthesia — President

Tom Sanders

CRH Medical Corporation — Vice President, Commercial Development

Conference Call Participants:

Richard Close

Canaccord Genuity — Analyst

Ammar Shah

Eight Capital — Analyst

Endri Leno

National Bank Financial — Analyst

Presentation:

Operator

Good morning, ladies and gentlemen. Welcome to the CRH Medical Q2 2020 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 need assistance, please press star zero for the operator. This call is being recorded on August 11, 2020.

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

Richard Bear:

Thank you, operator, and good morning, everyone. I am joined today by our CEO, Dr. Tushar Ramani; the President of CRH Anesthesia, Jay Kreger; and the 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. Please refer to our Management's Discussion and Analysis for the three and six months ended June 30, 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 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:

Thank you, Richard. Thank you also to everyone on the call for joining us to discuss CRH's second quarter 2020 results. Like most of you, we're again doing this call from our homes, so please bear with us in the event that we experience any technical issues during this call.

So let's get started. On our first conference call in May, the first quarter conference call, excuse me, we attempted to provide as much colour as possible on the impact that COVID-19 was exerting on our customer base and our business. Recall that in April our anesthesia volumes were around 10% of pre-COVID expected volumes whereas by early May, at the time of that call, our volumes had rebounded to roughly 25% of pre-COVID levels and were improving. We are pleased to report that as we stand here today volumes had further rebounded to approximately 90% of our pre-COVID expected levels and we are optimistic that these levels will remain sustained, as our ASC partners have implemented strict safety protocols and are likely to be ideal locations for non-emergent procedures as we go forward.

But of course, we remain mindful as we enter the fall and winter months. We remain mindful of the continued uncertainty with respect to this evolving trajectory of COVID-19. And although the pandemic has pressured our customer base and our business, we believe the experience has highlighted the attractiveness of our model, our ability to quickly respond to these types of challenges and adapt as volumes normalize.

As with before here, let me just provide an update around three primary pillars of our business strategy that we're focused on.

First, we continue to remain in active dialogue to implement our rate strategy and optimize our contracted case mix. We remain committed to reducing our non-contracted case volumes on the strength of our capabilities and our commitment to patient care, as well as our expanding scale now across 13 states. We expect that further progress on our rate strategy will continue to improve revenue stability and profit visibility for our anesthesia segment. Now, COVID-19 has temporarily slowed some of our progress here, but we expect to deliver continued progress throughout the balance of 2020.

Second, as we've demonstrated in recent weeks, we remained quite active with respect to our business development pipeline. Recall that earlier this year we temporarily halted our acquisition-related capital spent due to the impact of COVID-19; however, since June 8th we've announced four majority acquisitions and one de novo expansion, a start-up joint venture, with the acquisitions bringing now nearly $10 million in consolidated revenues on an annualized basis into our anesthesia business. Looking out from here, we believe the financial and operational pressures on GIs associated with COVID-19 have helped to spur additional business development opportunities for our company and we would continue to characterize our pipeline as robust. We're optimistic that our business development momentum can continue through the remainder of 2020.

Then finally, we remain focused on implementing strategies to accelerate growth in our O'Regan segment. While our O'Regan business was a bit slower to rebound relative to our anesthesia segment, it has done so and we would describe our engagement level with target practices as very strong and remain confident in our plan to capitalize on what we believe remains a compelling addressable market opportunity.

So, overall, despite what was admittedly a challenging quarter in terms of our financial results, I could not be more proud of how our team has navigated an incredibly difficult operating environment. I believe it has only served to boost our reputation among our current and potential GI partners and has further validated our business model. Our ongoing execution across these primary strategic priorities will now help position CRH for strong long-term growth.

So, with that, I'll turn this call over to Jay Kreger, our President of CRH Anesthesia.

Jay Kreger:

Thank you, Tushar, and good morning, everyone. Thank you for joining us on today's call.

I would like to provide some highlights for the anesthesia segment during the second quarter, which was obviously a challenging one for CRH, as it was for nearly all of our fellow industry participants.

Second quarter anesthesia revenue fell 55.7% from the second quarter of 2019 to $12.4 million. The segment generated adjusted operating EBITDA of $3 million, which was a drop of 77.6% versus the prior year second quarter.

As Tushar mentioned, and as we announced on our last quarter call, we had suspended acquisition spending while this unprecedented pandemic impacted both our business and the economy in general. As the methodical reopening started to occur in May, we made sure that we had strict guidelines in place to assess the level of our acquisition targets' go-forward case volumes and to assure that valuations were appropriate. Only then did we begin to resume our acquisition spending on a case-by-case basis.

With that, I'm pleased that we've been successful in completing a number of business development activities since our last conference call. In June we completed two acquisitions and one start-up joint venture. Subsequent to the quarter end we also completed two more acquisitions, including our first acquisition in the State of Virginia, which expands our operational footprint to 13 states. To date, we've completed $17.2 million in acquisition spending and we now provide anesthesia services at 64 locations, which is up from 58 ASCs that we had at the end of the first quarter. Our business development team is looking forward to building on the momentum for the rest of the year and then on into 2021. As Tushar noted, these difficult times have only highlighted value proposition a CRH anesthesia partnership can bring to our GI physician partners and we're encouraged by their willingness to hear our offerings.

Lastly, I think it's worth noting that at this point all of our affiliates are open and operational with many ASCs operating at or near 100% of their pre-COVID expected volumes. We continue to work in close partnership with our GI associates to ensure that ASC operations are always safe and efficient for patients and staff alike.

I'll now turn the call over to Tom Sanders, who oversees our O'Regan business segment.

Tom Sanders:

Thank you, Jay. Good morning, everyone.

Second quarter O'Regan sales totalled $1.2 million, a drop of 52.9% versus second quarter of 2019. The segment generated adjusted operating EBITDA of $0.46 million, a drop of 65.1% versus the second quarter of 2019. We found that as the restrictions on non-emergent outpatient procedures were lifted in May and more so in June, GI prioritized their office staffing and ASC operations towards restoring their endoscopy volumes. As a result, the clinics are not yet operating at 100% of capacity, which has impacted a ramp up in the volume of O'Regan procedures. We are, however, seeing a positive trend with July 2020 O'Regan sales being at 84% compared to July 2019. In addition, we've been progressively trending higher even into the past week.

During the past quarter we were able to evaluate current future needs of our partners more deeply and our team focused in on three key initiatives.

First is the GI market looks for diversification for the practices through better treatment options for their patients and for new revenue opportunities. We're increasingly able to position O'Regan hemorrhoid treatment as a welcome ancillary service line. This ancillary strategy includes co-developing turnkey hemorrhoid treatment programs, initially for our larger regional practice partners. Interest for the programs has been very encouraging thus far.

Secondly, we're developing a digital strategy and platform to support our practice partners, patients, and the medical community. This is aimed at identifying and closing care gaps in the practices' existing patient base, as well as identifying and supporting patient demand for hemorrhoid treatment.

Lastly, we continue to improve and develop our CRM infrastructure to provide process automation, business intelligence, enhanced reporting decision, support tools. This will allow us to prioritize our highly specialized resources and personnel for maximum effect. We want to reaffirm that, especially after the pandemic, the hemorrhoid market remains as massively undertreated as ever and we are well positioned to execute on the above strategies to take advantage of our market-leading position.

I'd like to now turn the call over Richard Bear, our Chief Financial Officer.

Richard Bear:

Thanks, Tom.

We reported consolidated second quarter revenue of $13.6 million, a decrease of 55.4% versus the second quarter of 2019. Anesthesia revenue per case for the quarter came in at $290. However, I would note that this includes a roughly $600,000 negative adjustment reported in Q2 from prior periods. Excluding these adjustments, our revenue per case would have been approximately $303 compared to $297 we reported in the first quarter.

Total adjusted operating EBITDA for the quarter totalled $6.9 million compared to $13.3 million in the second quarter of 2019. We note that our second quarter 2020 adjusted operating EBITDA includes $4.9 million related to government assistance programs, including the Paycheck Protection Program and funds received from the CARES Act HHS Stimulus Fund. Adjusted operating EBITDA attributable to shareholders during the quarter was $4.7 million compared to $9.7 million in the prior period.

We finished the quarter with $5.2 million in cash and equivalents and $65.5 million in total borrowings. We generated $9.2 million in cash flow from operations as well as $6.7 million in free cash flow. We invested $8.2 million during the quarter, which doesn't include what we did post quarter, towards acquisitions. As of

June 30th we have drawn approximately \$66 million from our credit facility. As reminder, the facility includes \$125 million committed portion and an accordion feature that could increase to \$200 million. Importantly, we note that the company remains in compliance with all credit covenants at the end of the second quarter.

I will now turn the call over to Tushar for his closing comments.

Dr. Tushar Ramani:

Thanks, Richard.

Before I finish out here, let me just re emphasize that our treatment volumes as of last week, both in the anesthesia and the O'Regan segment, are now in the 95% range, so the rebound has been steady across the company.

I'd like to expand on just a few topics that we highlighted earlier in the call.

First, with respect to our rate strategy, we would like to provide investors with some insight into our progress and our expectations here. Our non-contracted case mix currently represents approximately 16% of our second quarter total volume compared to 19% back in fourth quarter of 2019. We note that COVID-19 has negatively impacted timing on our year-to-date strategy progress but our objective remains on track to further reduce this non-contracted case mix to less than 10% of our overall cases. As we've stated in the past, we believe that our plan here will prove accretive to our consolidated revenue per case and will greatly improve both our revenue stability and our profit visibility. We look forward to updating you on that progress as circumstances warrant.

Second, given the unpredictable and evolving nature of the COVID-19 pandemic, we're continuing to refrain from communicating forecasts on revenue per case, but we can say we're encouraged by the stability that we've seen in this metric since the fourth quarter of 2019, albeit during a period of greatly reduced case volumes.

And then finally, we remain bullish on our ability to extend our BD momentum through the balance of 2020 and beyond but, as we indicated on our first quarter conference call, and given the lack of some transactions during the first several months of 2020, our acquisition-related capital spend 2020 may not reach our recent historic levels.

So, with that, thank you for hearing our prepared remarks and I'll turn this over to the operator for your questions.

Operator:

Thank you. Ladies and gentlemen, we will now take questions from analysts. 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. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

First question comes from Richard Close from Canaccord Genuity. Please go ahead.

Richard Close:

Great, thanks. Congratulations on the performance in the quarter despite a challenging environment. So, Tushar, just on the 16% of case mix versus 19% at the end of last year, fourth quarter of last year, what is the timeline to getting to less than 10%? Has that changed at all? Is it pushed out like into, you know, call it mid-2021? Or just any thoughts there.

Dr. Tushar Ramani:

Yeah, Richard, I think previously we had communicated that we would strive to finish that in 2020, but as I'm indicating the pandemic has certainly affected these timelines. I think our goal remains the same, but the ability to predict that I think has waned.

Richard Close:

Okay. And does the level of acquisitions impact the percent of case mix that's out of network versus in network? I know when you do an acquisition it changes ownership, so all the existing contracts from the acquired essentially go away and you're operating out of network or off contract, I guess. Does that impact the percentages at all?

Richard Bear:

Hey, Richard. I'll take that one. It will have a slight impact, but if you think about our old model, when we set up a new company we'd start a contracting process at that entity level. What we're talking here is contracts that will be in place that we can just attach to a new entity. So it will be a much shorter period of time, if any time at all, that they remain in that un-contracted state when we set up a new entity.

Richard Close:

Okay. Appreciate that. Maybe a question for Jay, in terms of, you know, as you look at the pipeline, is there anything to call out in terms of the quality, the size, anything along that line of potential opportunities?

Jay Kreger:

I think what we're looking at today, Richard, has been consistent with what we've been looking at the last couple of years. I think we have a mid-size practice group that seems to be our sweet spot, groups that that we can provide a lot of value to as a partner, and that continues to be the primary piece of the pipeline as we go forward.

Richard Close:

Okay. And then a follow up on that pipeline, yeah, I'm just curious, you called out the financial difficulties or operational difficulties or pressures, I guess, is the right word during this time. I'm curious, are you getting more in-bound calls from practices saying hey, you know, we'd like to talk to you? Or is the current environment driving some of that? Thanks.

Jay Kreger:

Well, I think I've made the following comment in past quarters and years and that's that any kind of chaos can create opportunities. You know, there was a month, April, where many physicians had more time on their hands. Unfortunately, you also couldn't meet with them in person. I think that did create some increased interest in speaking with us. And so I think we have and will continue to use that as a springboard for future opportunities.

Richard Close:

Okay. I'll jump back in the queue. Thank you.

Operator:

Thank you. The next question comes from Ammar Shah from Eight Capital. Please go ahead.

Ammar Shah:

Hey. Good morning, guys, and thanks for taking my questions this morning. I'd like to start with the colour that you'd given on the sort of, I guess, utilization levels to show you had sort of said 95% or 90%, let's say, is the most recent number. Wondering if you can sort of give us your take on what you think that average might be for Q3 and onwards. Like do you do you think that, let's say, by Q4 we could, it's reasonable to assume that that number gets to 100%? Or do you still think that we're going to hover sort of almost at pre-COVID but, you know, that 90% mark for some time?

Dr. Tushar Ramani:

Ammar, thanks for the question and good morning. We actually do believe that we're going to see continued progress towards 100%. In fact, this week as well we've seen a slight lift from last week.

Ammar Shah:

Great. And then, now going—

Dr. Tushar Ramani:

Wait, wait, I should say that, you know, we have to condition all of our answers with the great unknown, right, with any external impact from a second recurrence or unexpected responses to a second occurrence could certainly impact our business but, absent that, we continue to see a trend towards 100%.

Ammar Shah:

Absolutely. Absolutely. I think the questions this morning probably should caveat holding that variable.

Dr. Tushar Ramani:

Yeah. (Inaudible) that qualifier.

Ammar Shah:

But I guess just staying on that topic, you'd kind of alluded to the fact that post-COVID there'd be more demand for things like hemorrhoid treatments and the services you guys provide. For that line of thinking, is that something that is more longer term or do you actually think that that sort of pent-up demand, let's say, sees itself through in the near term? How should we think about that?

Dr. Tushar Ramani:

I see that as a sort of a continued longer-term sustained trend. I don't think this is resulting of catch-up and pent-up demand or anything.

Ammar Shah:

Got it. And then just finally, sort of still sticking on this, this COVID-19 topic, do you think—I guess I just wanted to get some colour on, you know, obviously every business that has some sort of service element now has to take into account social distancing, et cetera, et cetera. How does that sort of impact operating efficiencies within centers and kind of how do you think about that or how should we think about that? And I'll turn it back after that. Thank you.

Jay Kreger:

Tushar, I can take that. This is Jay. You know, I think initially, because of social distancing, I think we thought we would see some inefficiencies, but to our physicians' credit and our providers and everyone that provides patient safety and quality, what we've seen is that the efficiency hasn't really waned. I think that some groups have gotten very creative and this starts with, you know, even the initial how do they see a patient before an endoscopic procedure where they're using telehealth to bringing patients. And then their scheduling has been altered slightly, but it really hasn't created a large negative impact on our scheduling and how our providers are scheduled. Also our pay structure, I think, allows for some room, whether that's longer days or even additional days within the clinic scheduling.

Ammar Shah:

Thanks, guys.

Operator:

Thank you. Ladies and gentlemen, as a reminder, should you have any questions, please press star followed by one.

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

Endri Leno:

Hi. Good morning. Thanks for taking my questions. A couple for me. First of all, I'll start a little bit more on the BD and, Jay, you mentioned that there were some more interest that you saw from doctors, especially in April when things were down. I just wanted to clarify. So the latest acquisitions that you did late June, early July, were they from leads in April or were they a bit more sort of longer term in that pipeline?

And then the second question for Tushar is that you made a comment, Tushar, that you might not reach the recent deployments that you've seen in terms of kind of the acquisitions, but (inaudible) is positive and you're getting more, your balance is strong, you have an unlevered balance sheet, why wouldn't you deploy to levels that you have bought before?

Jay Kreger:

You want me to go through, Tushar?

Dr. Tushar Ramani:

Go ahead.

Jay Kreger:

Sure. Sure. In regards to the four acquisitions that we did, as well as the start-up in the last two months, all of those conversations were at varying points during COVID, but also they had started prior to. Our sales cycle is normally longer than just a couple of months. So I think it's fair to say they were already in our pipeline. And so what I think you'll see is that those conversations that started in April would potentially bear fruit either late this year or early next year. So, we've consistently talked about our robust pipeline and that's only strengthened due to this time.

Dr. Tushar Ramani:

Thanks, Jay. And, Endri, as far as the second part of your question, all we're doing is we're pulling back our guidance that we had previously indicated where we would spend historic levels of business development activities. We got a little bit of a late start as a result of COVID this year, so we're just not, I guess we're not guiding that we will complete that number of deals this year. Our momentum remains strong. Our goal is still the same, we're just not putting a number there, let's put it that way.

Endri Leno:

Okay. Okay, great. Thanks for the colour. And one last one for Richard. Days sales outstanding, I mean they ticked up in the quarter. I suppose insurers we're working remotely as well. But how have you seen it developing at least in Q3 and I guess for the rest of the year? Thanks.

Richard Bear:

Yeah. I mean, yeah, so DSOs picked up in Q2 primarily as a result of the equation. Revenue was down but receivables remained relatively steady as the timing of payments were delayed as part of COVID. We expect to get back down to pre-COVID levels by the end of the year. I don't have any indication that that's going to any different at this time.

Endri Leno:

Okay. And you're making good progress, I'm assuming, in Q3 you're starting to see some of those payments.

Richard Bear:

Yeah, we're starting to see collections pick up, yes.

Endri Leno:

Great. Thank you. That's it from me.

Operator:

Thank you. At this time there are no further questions. You may proceed.

Dr. Tushar Ramani:

Thank you. Again, I would just like to thank everybody this morning for joining us on the call. Appreciate everybody's interest in CRH Medical. And with that, I will complete the call. Thank you again.

Operator:

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and we ask that you please disconnect your lines. Enjoy the rest of your day.