

COMMUNITY HEALTH SYSTEMS INC

Form 10-Q

October 31, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For the quarterly period ended September 30, 2008**

**Commission file number 001-15925**

**COMMUNITY HEALTH SYSTEMS, INC.**  
*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State or other jurisdiction of  
incorporation or organization)*

**13-3893191**  
*(I.R.S. Employer  
Identification Number)*

**4000 Meridian Boulevard  
Franklin, Tennessee**  
*(Address of principal executive offices)*

**37067**  
*(Zip Code)*

**(Registrant's telephone number)  
615-465-7000**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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Indicated by check mark whether the registrant is a shell company (as defined in Rule 126-2 of the Exchange Act). Yes  No

As of October 29, 2008, there were outstanding 93,267,194 shares of the Registrant's Common Stock, \$.01 par value.

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**Community Health Systems, Inc.**  
**Form 10-Q**  
**For the Three and Nine Months Ended September 30, 2008**

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(In thousands, except share data)**  
**(Unaudited)**

|   | <b>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| <i>Current assets</i> Cash and cash equivalents   | \$ 341,884                    | \$ 132,874                   |
| Patient accounts receivable, net of allowance for doubtful accounts of \$1,109,283 and \$1,033,516 at September 30, 2008, and December 31, 2007, respectively | 1,642,820                     | 1,533,798                    |
| Supplies  | 267,320                       | 262,903                      |
| Prepaid income taxes  |                               | 99,417                       |
| Deferred income taxes   | 111,101                       | 113,741                      |
| Prepaid expenses and taxes  | 91,239                        | 70,339                       |
| Other current assets  | 197,787                       | 339,826                      |
| Total current assets  | 2,652,151                     | 2,552,898                    |
| <i>Property and equipment</i>   | 6,861,907                     | 6,310,240                    |
| Less accumulated depreciation and amortization  | (1,117,441)                   | (797,666)                    |
| Property and equipment, net   | 5,744,466                     | 5,512,574                    |
| <i>Goodwill</i>   | 4,151,487                     | 4,247,714                    |
| <i>Other assets, net</i>  | 1,039,300                     | 1,180,457                    |
| <i>Total assets</i>   | \$ 13,587,404                 | \$ 13,493,643                |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                               |                              |
| <i>Current liabilities</i>  |                               |                              |
| Current maturities of long-term debt  | \$ 19,647                     | \$ 20,710                    |
| Accounts payable  | 477,064                       | 492,693                      |
| Current income taxes payable  | 38,312                        |                              |
| Accrued interest  | 82,849                        | 153,832                      |
| Accrued liabilities   | 811,011                       | 780,700                      |
| Total current liabilities   | 1,428,883                     | 1,447,935                    |
| <i>Long-term debt</i>   | 8,888,782                     | 9,077,367                    |

|   |               |               |
|---|---------------|---------------|
| <i>Deferred income taxes</i>  | 433,009       | 407,947       |
| <i>Other long-term liabilities</i>  | 617,350       | 483,459       |
| <i>Minority interests in equity of consolidated subsidiaries</i>  | 343,472       | 366,131       |
| <i>Stockholders equity</i>  |               |               |
| Preferred stock, \$.01 par value per share, 100,000,000 shares authorized; none issued  |               |               |
| Common stock, \$.01 par value per share, 300,000,000 shares authorized; 96,742,743 shares issued and 95,767,194 shares outstanding at September 30, 2008, and 96,611,085 shares issued and 95,635,536 shares outstanding at December 31, 2007 | 967           | 966           |
| Additional paid-in capital  | 1,258,637     | 1,240,308     |
| Treasury stock, at cost, 975,549 shares at September 30, 2008 and December 31, 2007   | (6,678)       | (6,678)       |
| Accumulated other comprehensive loss  | (93,367)      | (81,737)      |
| Retained earnings   | 716,349       | 557,945       |
| Total stockholders equity   | 1,875,908     | 1,710,804     |
| <i>Total liabilities and stockholders equity</i>  | \$ 13,587,404 | \$ 13,493,643 |

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except share and per share data)****(Unaudited)**

|  | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|--|---------------------------|------------------|--------------------------|------------------|
|  | <b>September 30,</b>      |                  | <b>September 30,</b>     |                  |
|  | <b>2008</b>               | <b>2007</b>      | <b>2008</b>              | <b>2007</b>      |
| <i>Net operating revenues</i>                                      | \$ 2,772,860              | \$ 2,247,009     | \$ 8,191,014             | \$ 4,599,152     |
| <i>Operating costs and expenses:</i>                               |                           |                  |                          |                  |
| Salaries and benefits  | 1,091,726                 | 903,424          | 3,258,872                | 1,839,035        |
| Provision for bad debts  | 326,213                   | 266,280          | 914,338                  | 536,154          |
| Supplies   | 383,142                   | 304,929          | 1,147,137                | 579,571          |
| Other operating expenses   | 529,363                   | 439,592          | 1,581,628                | 920,737          |
| Rent   | 58,842                    | 47,243           | 177,178                  | 98,965           |
| Depreciation and amortization                                      | 130,507                   | 100,632          | 378,164                  | 201,111          |
| <b>Total operating costs and expenses</b>                          | <b>2,519,793</b>          | <b>2,062,100</b> | <b>7,457,317</b>         | <b>4,175,573</b> |
| <i>Income from operations</i>                                      | 253,067                   | 184,909          | 733,697                  | 423,579          |
| <i>Interest expense, net</i>                                       | 167,785                   | 135,160          | 487,848                  | 192,777          |
| <i>Loss from early extinguishment of debt</i>                      |                           | 27,291           | 1,328                    | 27,291           |
| <i>Minority interest in earnings</i>                               | 10,360                    | 5,371            | 28,359                   | 6,189            |
| <i>Equity in earnings of unconsolidated affiliates</i>             | (8,691)                   | (14,284)         | (32,083)                 | (14,284)         |
| <i>Income from continuing operations before income taxes</i>       | 83,613                    | 31,371           | 248,245                  | 211,606          |
| <i>Provision for income taxes</i>                                  | 32,191                    | 11,672           | 95,574                   | 81,060           |
| <i>Income from continuing operations</i>                           | 51,422                    | 19,699           | 152,671                  | 130,546          |
| <i>Discontinued operations, net of taxes:</i>                      |                           |                  |                          |                  |
| Loss from operations of hospitals sold and hospitals held for sale | (1,038)                   | (6,811)          | (3,847)                  | (9,571)          |
| Gain (loss) on sale of hospitals and partnership interest, net     |                           | (2,428)          | 9,580                    | (2,428)          |
| <i>Income (loss) on discontinued operations</i>                    | (1,038)                   | (9,239)          | 5,733                    | (11,999)         |
| <i>Net income</i>  | \$ 50,384                 | \$ 10,460        | \$ 158,404               | \$ 118,547       |
| <i>Income from continuing operations per common share:</i>         |                           |                  |                          |                  |
| Basic  | \$ 0.55                   | \$ 0.21          | \$ 1.62                  | \$ 1.40          |

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|   |    |        |    |        |    |        |    |        |
|---|----|--------|----|--------|----|--------|----|--------|
| Diluted   | \$ | 0.54   | \$ | 0.21   | \$ | 1.61   | \$ | 1.38   |
| <i>Net income per common share:</i>                   |    |        |    |        |    |        |    |        |
| Basic   | \$ | 0.54   | \$ | 0.11   | \$ | 1.69   | \$ | 1.27   |
| Diluted   | \$ | 0.53   | \$ | 0.11   | \$ | 1.67   | \$ | 1.25   |
| <i>Weighted-average number of shares outstanding:</i> |    |        |    |        |    |        |    |        |
| Basic   |    | 94,045 |    | 93,652 |    | 93,995 |    | 93,468 |
| Diluted   |    | 95,160 |    | 94,842 |    | 95,106 |    | 94,563 |

See accompanying notes to the condensed consolidated financial statements.



**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2008</b>              | <b>2007</b> |
| <i>Cash flows from operating activities</i>   |                          |             |
| Net income  | \$ 158,404               | \$ 118,547  |
| Adjustments to reconcile net income to net cash provided by operating activities:             |                          |             |
| Depreciation and amortization   | 378,107                  | 210,406     |
| Minority interest in earnings   | 28,359                   | 5,329       |
| Stock-based compensation expense  | 39,812                   | 25,514      |
| (Gain) loss on sale of hospitals and partnership interest, net                                | (17,687)                 | 3,735       |
| Excess tax benefits relating to stock-based compensation                                      | (1,278)                  | (2,275)     |
| Loss on early extinguishment of debt  | 1,328                    | 27,291      |
| Other non-cash expenses, net  | 7,578                    | 1,820       |
| Changes in operating assets and liabilities, net of effects of acquisitions and divestitures: |                          |             |
| Patient accounts receivable   | (117,193)                | (53,585)    |
| Supplies, prepaid expenses and other current assets   | 3,099                    | 8,519       |
| Accounts payable, accrued liabilities and income taxes  | 184,995                  | 45,750      |
| Other   | 19,532                   | 13,599      |
| Net cash provided by operating activities   | 685,056                  | 404,650     |
| <i>Cash flows from investing activities</i>   |                          |             |
| Acquisitions of facilities and other related equipment  | (7,274)                  | (6,982,099) |
| Purchases of property and equipment   | (451,409)                | (278,543)   |
| Proceeds from disposition of hospitals and other ancillary operations                         | 365,635                  | 12,962      |
| Proceeds from sale of property and equipment  | 13,964                   | 601         |
| Increase in other assets  | (152,168)                | (66,025)    |
| Net cash used in investing activities   | (231,252)                | (7,313,104) |
| <i>Cash flows from financing activities</i>   |                          |             |
| Proceeds from exercise of stock options   | 1,688                    | 7,804       |
| Excess tax benefits relating to stock-based compensation                                      | 1,278                    | 2,275       |
| Stock buy-back  | (17,096)                 |             |
| Deferred financing costs  | (2,569)                  | (190,110)   |
| Proceeds from minority investors in joint ventures  | 11,652                   | 1,188       |
| Redemption of minority investments in joint ventures  | (53,485)                 | (1,339)     |
| Distributions to minority investors in joint ventures   | (24,351)                 | (2,774)     |
| Borrowings under credit agreement   | 30,596                   | 9,233,331   |
| Repayments of long-term indebtedness  | (192,507)                | (2,063,632) |

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|   |            |            |
|---|------------|------------|
| Net cash (used in) provided by financing activities     | (244,794)  | 6,986,743  |
| <i>Net change in cash and cash equivalents</i>          | 209,010    | 78,289     |
| <i>Cash and cash equivalents at beginning of period</i> | 132,874    | 40,566     |
| <i>Cash and cash equivalents at end of period</i>       | \$ 341,884 | \$ 118,855 |

See accompanying notes to the condensed consolidated financial statements.

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements of Community Health Systems, Inc. and its subsidiaries (the Company) as of September 30, 2008 and for the three and nine month periods ended September 30, 2008 and September 30, 2007, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, such information contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results for such periods. All intercompany transactions and balances have been eliminated. The results of operations for the three and nine months ended September 30, 2008, are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2008. Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted as permitted by the rules and regulations of the Securities and Exchange Commission (SEC). The Company believes the disclosures are adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2007, contained in the Company's Annual Report on Form 10-K.

**2. ACCOUNTING FOR STOCK-BASED COMPENSATION**

Stock-based compensation awards are granted under the Community Health Systems, Inc. Amended and Restated 2000 Stock Option and Award Plan (the 2000 Plan). The 2000 Plan allows for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code, as well as stock options which do not so qualify, stock appreciation rights, restricted stock, performance units and performance shares, phantom stock awards and share awards. Persons eligible to receive grants under the 2000 Plan include the Company's directors, officers, employees and consultants. To date, all options granted under the 2000 Plan have been nonqualified stock options for tax purposes. Generally, vesting of these granted options occurs in one-third increments on each of the first three anniversaries of the award date. Options granted prior to 2005 have a 10 year contractual term, options granted in 2005 through 2007 have an 8 year contractual term and options granted in 2008 have a 10 year contractual term. The exercise price of all options granted under the 2000 Plan is equal to the fair value of the Company's common stock on the option grant date. As of September 30, 2008, 4,059,150 shares of unissued common stock remain reserved for future grants under the 2000 Plan.

The Company has also awarded restricted stock under the 2000 Plan to its directors and employees. The restrictions on these shares generally lapse in one-third increments on each of the first three anniversaries of the award date, except for restricted stock granted on July 25, 2007, which restrictions lapse equally on the first two anniversaries of the award date. Certain of the restricted stock awards granted to the Company's senior executives contain a performance objective that must be met in addition to any vesting requirements. If the performance objective is not attained, the awards will be forfeited in their entirety. Once the performance objective has been attained, restrictions will lapse in one-third increments on each of the first three anniversaries of the award date with the exception of the July 25, 2007 restricted stock awards, which have no additional time vesting restrictions once the performance restrictions are met. Notwithstanding the above mentioned performance objectives and vesting requirements, the restrictions will lapse earlier in the event of death, disability, termination of employment of the holder of the restricted stock by the Company for any reason other than for cause, or change in control of the Company. Restricted stock awards subject to performance standards are not considered outstanding for purposes of determining earnings per share until the performance objectives have been satisfied.



Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table reflects the impact of total compensation expense related to stock-based equity plans under the Statement of Financial Accounting Standards ( SFAS ) No. 123(R), on the reported operating results for the respective periods (in thousands, except per share data):

|   | <b>Three Months Ended<br/>September 30,<br/>2008</b> |             | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2008</b>  | <b>2007</b> | <b>2008</b>   | <b>2007</b> |
| Effect on income from continuing operations before income taxes | \$ (13,129)  | \$ (11,219) | \$ (39,812)   | \$ (25,514) |
| Effect on net income  | \$ (7,976)   | \$ (6,816)  | \$ (24,185)   | \$ (15,500) |
| Effect on net income per share-diluted                          | \$ (0.08)  | \$ (0.07)   | \$ (0.25)   | \$ (0.16)   |

At September 30, 2008, \$69.8 million of unrecognized stock-based compensation expense from all outstanding unvested stock options and restricted stock is expected to be recognized over a weighted-average period of 16 months.

The fair value of stock options was estimated using the Black Scholes option pricing model during the three and nine months ended September 30, 2008 and 2007, with the following assumptions:

|                         | <b>Three Months Ended<br/>September 30,<br/>2008</b> |             | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |             |
|-------------------------|--|-------------|---|-------------|
|                         | <b>2008</b>  | <b>2007</b> | <b>2008</b>   | <b>2007</b> |
| Expected volatility     | 25.4%  | 24.0%       | 24.2%   | 24.4%       |
| Expected dividends      | 0  | 0           | 0   | 0           |
| Expected term           | 4 years  | 4 years     | 4 years   | 4 years     |
| Risk-free interest rate | 2.67%  | 4.53%       | 2.59%   | 4.52%       |

In determining expected return, the Company examined concentrations of option holdings, historical patterns of option exercises and forfeitures, as well as forward looking factors, in an effort to determine if there were any discernable employee populations. From this analysis, the Company identified two employee populations, one consisting primarily of certain senior executives and the other consisting of all other recipients.

The expected volatility rate was estimated based on historical volatility. In determining expected volatility, the Company also reviewed the market-based implied volatility of actively traded options of its common stock and determined that historical volatility did not differ significantly from the implied volatility.

The expected life computation is based on historical exercise and cancellation patterns and forward looking factors, where present, for each population identified. The risk-free interest rate is based on the U.S. Treasury yield curve in

effect at the time of the grant. The pre-vesting forfeiture rate is based on historical rates and forward looking factors for each population identified. The Company adjusts the estimated forfeiture rate to its actual experience.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Options outstanding and exercisable under the 2000 Plan as of September 30, 2008, and changes during the three and nine months then ended were as follows (in thousands, except share and per share data):

|                                   | Shares    | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term<br>(in Years) | Aggregate<br>Intrinsic<br>Value as of<br>September 30,<br>2008 |
|-----------------------------------|-----------|---|--|--|
| Outstanding at December 31, 2007  | 8,439,015 | \$ 30.90                                  |  |  |
| Granted                           | 996,500   | 32.28                                     |  |  |
| Exercised                         | (11,666)  | 23.26                                     |  |  |
| Forfeited and cancelled           | (172,600) | 35.02                                     |  |  |
| Outstanding at March 31, 2008     | 9,251,249 | 30.98                                     |  |  |
| Granted                           | 95,500    | 35.75                                     |  |  |
| Exercised                         | (36,998)  | 29.69                                     |  |  |
| Forfeited and cancelled           | (142,836) | 33.98                                     |  |  |
| Outstanding at June 30, 2008      | 9,166,915 | 30.99                                     |  |  |
| Granted                           | 97,000    | 34.76                                     |  |  |
| Exercised                         | (233,167) | 20.84                                     |  |  |
| Forfeited and cancelled           | (173,996) | 37.43                                     |  |  |
| Outstanding at September 30, 2008 | 8,856,752 | \$ 31.17                                  | 5.9 years  | \$ 25,756  |
| Exercisable at September 30, 2008 | 5,361,246 | \$ 27.82                                  | 5.3 years  | \$ 25,756  |

The weighted-average grant date fair value of stock options granted during the nine months ended September 30, 2008 and 2007, was \$7.71 and \$10.29, respectively. The aggregate intrinsic value (the number of in-the-money stock options multiplied by the difference between the Company's closing stock price on the last trading day of the reporting period (\$29.31) and the exercise price of the respective stock options) in the table above represents the amount that would have been received by the option holders had all option holders exercised their in-the-money options on September 30, 2008. This amount changes based on the market value of the Company's common stock. The aggregate intrinsic value of options exercised during the three months ended September 30, 2008 and 2007 was \$3.0 million and \$0.3 million, respectively, and the aggregate intrinsic value of options exercised during the nine months ended September 30, 2008 and 2007 was \$3.4 million and \$3.2 million, respectively. The aggregate intrinsic value of options vested and expected to vest approximates that of the outstanding options.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Restricted stock outstanding under the 2000 Plan as of September 30, 2008, and changes during the three and nine months then ended are as follows:

|                                | Shares    | Weighted-Average<br>Grant Date Fair<br>Value |
|--------------------------------|-----------|--|
| Unvested at December 31, 2007  | 1,956,543 | \$ 38.04                                     |
| Granted                        | 748,500   | 32.38  |
| Vested                         | (592,505) | 36.09  |
| Forfeited                      | (3,000)   | 37.20  |
| Unvested at March 31, 2008     | 2,109,538 | 36.58  |
| Granted                        | 25,000    | 35.33  |
| Vested                         | (17,832)  | 38.81  |
| Forfeited                      | (3,500)   | 32.88  |
| Unvested at June 30, 2008      | 2,113,206 | 36.55  |
| Granted                        |           |  |
| Vested                         | (343,499) | 40.27  |
| Forfeited                      | (91,001)  | 35.74  |
| Unvested at September 30, 2008 | 1,678,706 | 35.83  |

As of September 30, 2008, there was \$44.6 million of unrecognized stock-based compensation expense related to unvested restricted stock expected to be recognized over a weighted-average period of 15 months.

Under the Director's Fee Deferral Plan, the Company's outside directors may elect to receive share equivalent units in lieu of cash for their directors' fee. Share equivalent units are calculated by dividing the deferred directors' fees by the closing market price of the Company's common stock on the last trading day of the reporting period. These units are held in the plan until the director electing to receive the share equivalent units retires or otherwise terminates his/her directorship with the Company. Share equivalent units are converted to shares of common stock of the Company at the time of distribution. The following table represents the amount of directors' fees which were deferred and the equivalent units into which they converted for each of the respective periods:

|   | Three Months Ended<br>September 30,<br>2008 |        | September 30,<br>2007 |        | Nine Months Ended<br>September 30,<br>2008 |        | September 30,<br>2007 |        |
|---|---|--------|-----------------------|--------|--|--------|-----------------------|--------|
| Directors' fees earned and deferred into plan | \$  | 17,000 | \$                    | 31,875 | \$   | 74,875 | \$                    | 97,125 |



|                  |         |           |           |           |
|------------------|---------|-----------|-----------|-----------|
| Equivalent units | 580.007 | 1,013.836 | 2,313.076 | 2,757.772 |
|------------------|---------|-----------|-----------|-----------|

At September 30, 2008, there was a total of 15,721.608 units deferred in the plan with an aggregate fair value of \$0.5 million, based on the closing market price of the Company's common stock on the last trading day of the reporting period of \$29.31.

### 3. COST OF REVENUE

The majority of the Company's operating costs and expenses are cost of revenue items. Operating costs that could be classified as general and administrative by the Company would include the Company's corporate office costs at the Company's Franklin, Tennessee office, which were \$39.3 million and \$37.5 million for the three months ended September 30, 2008 and 2007, respectively, and \$120.4 million and \$84.5 million for the nine months ended September 30, 2008 and 2007, respectively. Included in these amounts is stock-based compensation expense of \$13.1 million and \$11.2 million for the three months ended September 30, 2008 and 2007, respectively, and \$39.8 million and \$25.5 million for the nine months ended September 30, 2008 and 2007, respectively.

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. USE OF ESTIMATES**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements. Actual results could differ from these estimates.

**5. ACQUISITIONS AND DIVESTITURES**

***Triad Acquisition***

On July 25, 2007, the Company completed its acquisition of Triad Hospitals, Inc. ( Triad ) for approximately \$6.857 billion, including the assumption of \$1.686 billion of existing indebtedness. Triad owned and operated 50 hospitals in non-urban and middle market communities in 17 states, as well as the Republic of Ireland. Immediately following the acquisition, on a combined basis, the Company owned and operated 128 hospitals in 28 states, as well as the Republic of Ireland. As of December 31, 2007, two hospitals acquired from Triad had been sold and six hospitals acquired from Triad were classified as held for sale. During the nine months ended September 30, 2008, the Company completed the sale of five of the six former Triad hospitals held for sale at December 31, 2007. The Company also provides management and consulting services on a contract basis to independent hospitals, through its subsidiary, Quorum Health Resources, LLC, which was acquired as part of the acquisition of Triad.

In connection with the consummation of the acquisition of Triad, the Company obtained \$7.215 billion of senior secured financing under a new credit facility (the New Credit Facility ) and its wholly-owned subsidiary CHS/Community Health Systems, Inc. ( CHS ) issued \$3.021 billion aggregate principal amount of 8.875% senior notes due 2015 (the Notes ). The Company used the net proceeds of \$3.000 billion from the Notes offering and the net proceeds of \$6.065 billion of term loans under the New Credit Facility to acquire the outstanding shares of Triad, to refinance certain of Triad s indebtedness and the Company s indebtedness, to complete certain related transactions, to pay certain costs and expenses of the transactions and for general corporate uses. This New Credit Facility also provides an additional \$750 million revolving credit facility and a \$300 million delayed draw term loan facility for future acquisitions, working capital and general corporate purposes. The delayed draw term loan was reduced from \$400 million to \$300 million at the request of the Company in the fourth quarter of 2007.

The total cost of the Triad acquisition has been allocated to the assets acquired and liabilities assumed based upon their respective fair values in accordance with SFAS No. 141. The purchase price represented a premium over the fair value of the net tangible and identifiable intangible assets acquired for reasons such as:

strategically, Triad had operations in five states in which the Company previously had no operations;

the combined company has smaller concentrations of credit risk through greater geographic diversification;

many support functions will be centralized; and

duplicate corporate functions will be eliminated.

The allocation process required the analysis of acquired fixed assets, contracts, contractual commitments, and legal contingencies to identify and record the fair value of all assets acquired and liabilities assumed. The Company completed the allocation of the total cost of the Triad acquisition in the third quarter of 2008, resulting in approximately \$2.790 billion of goodwill being recorded.

***Other Acquisitions***

Effective April 1, 2007, the Company completed its acquisition of Lincoln General Hospital (157 licensed beds), located in Ruston, Louisiana. The total consideration for this hospital was approximately \$48.2 million, of which \$44.7 million was paid in cash and \$3.5 million was assumed in liabilities. On May 1, 2007, the Company completed its acquisition of Porter Health (301 licensed beds), located in Valparaiso, Indiana, with a satellite campus in Portage, Indiana and outpatient medical campuses located in Chesterton, Demotte, and Hebron, Indiana.

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As part of this acquisition, the Company has agreed to construct a 225-bed replacement facility for the Valparaiso hospital no later than April 2011. The total consideration for Porter Health was approximately \$113.2 million, of which \$88.9 million was paid in cash and \$24.3 million was assumed in liabilities. The Company's purchase price allocation relating to these acquisitions resulted in approximately \$6.3 million of goodwill being recorded.

Effective June 30, 2008, the Company acquired the remaining 35% equity interest in Affinity Health Systems, LLC which indirectly owns and operates Trinity Medical Center (560 licensed beds) in Birmingham, Alabama, from Baptist Health Systems, Inc. of Birmingham, Alabama ( Baptist ), giving the Company 100% ownership of that facility. The purchase price for this minority interest was \$51.5 million in cash and the cancellation of a promissory note issued by Baptist to Affinity Health Systems, LLC in the original principal amount of \$32.8 million.

***Discontinued Operations***

Effective March 1, 2008, the Company sold Woodland Medical Center (100 licensed beds) located in Cullman, Alabama; Parkway Medical Center (108 licensed beds) located in Decatur, Alabama; Hartselle Medical Center (150 licensed beds) located in Hartselle, Alabama; Jacksonville Medical Center (89 licensed beds) located in Jacksonville, Alabama; National Park Medical Center (166 licensed beds) located in Hot Springs, Arkansas; St. Mary's Regional Medical Center (170 licensed beds) located in Russellville, Arkansas; Mineral Area Regional Medical Center (135 licensed beds) located in Farmington, Missouri; Willamette Valley Medical Center (80 licensed beds) located in McMinnville, Oregon; and White County Community Hospital (60 licensed beds) located in Sparta, Tennessee, to Capella Healthcare, Inc., headquartered in Franklin, Tennessee. The proceeds from this sale were \$315 million in cash.

Effective February 21, 2008, the Company sold THI Ireland Holdings Limited, a private limited company incorporated in the Republic of Ireland, which leased and managed the operations of Beacon Medical Center (122 licensed beds) located in Dublin, Ireland, to Beacon Medical Group Limited, headquartered in Dublin, Ireland. The proceeds from this sale were \$1.5 million in cash.

Effective February 1, 2008, the Company sold Russell County Medical Center (78 licensed beds) located in Lebanon, Virginia to Mountain States Health Alliance, headquartered in Johnson City, Tennessee. The proceeds from this sale were \$48.6 million in cash.

Effective November 30, 2007, the Company sold Barberton Citizens Hospital (312 licensed beds) located in Barberton, Ohio to Summa Health System of Akron, Ohio. The proceeds from this sale were \$53.8 million in cash.

Effective October 31, 2007, the Company sold its 60% membership interest in Northeast Arkansas Medical Center, a 104 bed facility in Jonesboro, Arkansas to Baptist Memorial Health Care ( Baptist ), headquartered in Memphis, Tennessee, for \$16.8 million. In connection with this transaction, the Company also sold real estate and other assets to a subsidiary of Baptist for \$26.2 million in cash.

Effective September 1, 2007, the Company sold its partnership interest in River West L.P., which owned and operated River West Medical Center (80 licensed beds) located in Plaquemine, Louisiana, to an affiliate of Shiloh Health Services, Inc. of Lubbock, Texas. The proceeds from this sale were \$0.3 million in cash.

As of September 30, 2008, the Company had one hospital classified as held for sale.

In connection with the above actions and in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the Company has classified the results of operations of the above mentioned hospitals as discontinued operations in the accompanying condensed consolidated statements of income.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net operating revenues and income (loss) on discontinued operations for the respective periods are as follows (in thousands):

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Net operating revenues   | \$ 19,669                                   | \$ 145,496  | \$ 144,787                                 | \$ 246,478  |
| Income (loss) from operations of hospitals sold or held for sale before income taxes | (1,064)                                     | (9,487)     | (5,247)                                    | (13,970)    |
| Gain (loss) on sale of hospitals   |   | (3,735)     | 17,687                                     | (3,735)     |
| Income (loss) from discontinued operations, before taxes                             | (1,064)                                     | (13,222)    | 12,440                                     | (17,705)    |
| Income tax expense (benefit)   | 26  | 3,983       | (6,707)                                    | 5,706       |
| Income (loss) from discontinued operations, net of tax                               | \$ (1,038)                                  | \$ (9,239)  | \$ 5,733                                   | \$ (11,999) |

The computation of income (loss) from discontinued operations, before taxes, for the nine months ended September 30, 2008 includes the net write-off of \$96.3 million of tangible assets and \$32.5 million of goodwill (including \$21.3 million of goodwill included in non-current assets held for sale at December 31, 2007) at the hospitals sold during the nine months ended September 30, 2008.

Interest expense was allocated to discontinued operations based on estimated sale proceeds available for debt repayment.

The assets and liabilities of one hospital held for sale as of September 30, 2008 are included in the accompanying condensed consolidated balance sheet as follows: current assets of \$16.8 million, included in other current assets; net property and equipment of \$35.1 million and other long-term assets of \$1.6 million, included in other assets; and current liabilities of \$20.1 million, included in other accrued liabilities.

The assets and liabilities of the hospitals held for sale as of December 31, 2007 are included in the accompanying condensed consolidated balance sheet as follows: current assets of \$118.9 million, included in other current assets; net property and equipment of \$331.1 million and other long-term assets of \$31.4 million, included in other assets; and current liabilities of \$67.6 million, included in accrued liabilities.

**6. INCOME TAXES**

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. The total amount of unrecognized benefit that would affect the effective tax rate, if recognized, is approximately \$6.3 million as of September 30, 2008. It is the Company's policy to recognize interest and penalties accrued related to unrecognized benefits in its condensed consolidated statements of income as income

tax expense. During the three months and nine months ended September 30, 2008, the Company recorded approximately \$0.2 million and \$0.6 million, respectively, in interest and penalties related to prior state income tax returns through its income tax provision from continuing operations and which are included in its FIN 48 liability at September 30, 2008. A total of approximately \$1.9 million of interest and penalties is included in the amount of FIN 48 liability at September 30, 2008.

The Company's unrecognized tax benefits consist primarily of state exposure items. The Company believes that it is reasonably possible that approximately \$1.2 million of its current unrecognized tax benefit may decrease within the next twelve months as a result of a lapse of the statute of limitations and settlements with taxing authorities.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations for years prior to 2003.

The IRS has concluded an examination of the federal income tax returns of Triad for the short taxable years ended April 27, 2001, September 30, 2001 and December 31, 2001, and the taxable years ended December 31, 2002 and 2003. The Company has received a closing letter from the IRS with respect to the examination for those tax years. The settlement was not material to the Company's consolidated results of operations or consolidated financial position.

Cash paid for income taxes, net of refunds received, resulted in a net cash refund of \$3.2 million and \$52.4 million for the three and nine months ended September 30, 2008, respectively, and net cash paid of \$55.4 million and \$84.8 million for the three and nine months ended September 30, 2007, respectively.

**7. GOODWILL AND OTHER INTANGIBLE ASSETS**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2008, are as follows (in thousands):

|  |              |
|--|--------------|
| Balance as of December 31, 2007  | \$ 4,247,714 |
| Goodwill acquired as part of acquisitions during 2008  | 26,348       |
| Consideration adjustments and purchase price allocation adjustments for acquisitions in 2007 | (111,234)    |
| Goodwill written-off as part of disposals  | (11,341)     |
| Balance as of September 30, 2008   | \$ 4,151,487 |

SFAS No. 142 requires that goodwill be allocated to each identified reporting unit, which is defined as an operating segment or one level below the operating segment (referred to as a component of the entity). At September 30, 2008, the hospital operations, home health agencies and hospital management services reporting units had \$4.086 billion, \$32.0 million and \$33.3 million, respectively, of goodwill.

The Company completes its annual impairment test in the fourth quarter of each year using a measurement date of September 30. The Company completed its most recent annual goodwill impairment test as required by SFAS No. 142, Goodwill and Other Intangible Assets, during 2007. Based on the results of the impairment test, the Company was not required to recognize an impairment of goodwill in 2007.

The gross carrying amount of the Company's other intangible assets subject to amortization was \$67.5 million at September 30, 2008 and \$76.3 million at December 31, 2007, and the net carrying amount was \$53.5 million at September 30, 2008 and \$62.7 million at December 31, 2007. The carrying amount of the Company's other intangible assets not subject to amortization was \$37.9 million and \$118.3 million at September 30, 2008 and December 31, 2007, respectively. Other intangible assets are included in other assets, net on the Company's condensed consolidated balance sheets.



The weighted-average amortization period for the intangible assets subject to amortization is approximately ten years. There are no expected residual values related to these intangible assets. Amortization expense on these intangible assets during the three months ended September 30, 2008 and 2007 was \$0.7 million and \$2.4 million, respectively. Amortization expense on these intangible assets during the nine months ended September 30, 2008 and 2007 was \$3.9 million and \$3.4 million, respectively. Amortization expense on intangible assets is estimated to be \$2.1 million for the remainder of 2008, \$11.6 million in 2009, \$9.8 million in 2010, \$4.6 million in 2011, \$3.6 million in 2012, and \$21.5 million in 2013 and thereafter.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. EARNINGS PER SHARE**

The following table sets forth the components of the numerator and denominator for the computation of basic and diluted income from continuing operations per share (in thousands, except share data):

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |            |
|--|---|-------------|--|-------------|------------|
|  | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |            |
| Numerator:   |   |             |  |             |            |
| Numerator for basic earnings per share   |   |             |  |             |            |
| Income from continuing operations available to common stockholders   | basic                                       | \$ 51,422   | \$ 19,699                                  | \$ 152,671  | \$ 130,546 |
| Numerator for diluted earnings per share   |   |             |  |             |            |
| Income from continuing operations available to common stockholders   | diluted                                     | \$ 51,422   | \$ 19,699                                  | \$ 152,671  | \$ 130,546 |
| Denominator:   |   |             |  |             |            |
| Weighted-average number of shares outstanding  |   |             |  |             |            |
|  | basic                                       | 94,044,564  | 93,651,645                                 | 93,995,343  | 93,467,608 |
| Effect of dilutive securities:   |   |             |  |             |            |
| Non-employee director options  |   |             |  |             | 3,942      |
| Restricted stock awards  |   | 318,447     | 286,473                                    | 265,091     | 169,850    |
| Employee options   |   | 796,608     | 903,631                                    | 845,681     | 922,005    |
| Weighted-average number of shares outstanding  | diluted                                     | 95,159,619  | 94,841,749                                 | 95,106,115  | 94,563,405 |
| Dilutive securities outstanding not included in the computation of earning per share because their effect is antidilutive: |   |             |  |             |            |
| Employee options   |   | 3,677,807   | 3,601,075                                  | 3,859,669   | 2,186,571  |

**9. STOCKHOLDERS EQUITY**

Authorized capital shares of the Company include 400,000,000 shares of capital stock consisting of 300,000,000 shares of common stock and 100,000,000 shares of preferred stock. Each of the aforementioned classes of capital stock has a par value of \$0.01 per share. Shares of preferred stock, none of which are outstanding as of September 30, 2008, may be issued in one or more series having such rights, preferences and other provisions as determined by the Board of Directors without approval by the holders of common stock.

On December 13, 2006, the Company commenced an open market repurchase program for up to 5,000,000 shares of the Company's common stock, not to exceed \$200 million in repurchases. This program will conclude at the earlier of three years or when the maximum number of shares has been repurchased. During the nine months ended September 30, 2008, the Company repurchased 517,000 shares at a weighted-average price of \$33.03 per share, which is the cumulative number of shares that have been repurchased under this program.

Table of Contents**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****10. COMPREHENSIVE INCOME (LOSS)**

The following table presents the components of comprehensive income, net of related taxes. The net change in fair value of interest rate swap agreements is a function of the spread between the fixed interest rate of each swap and the underlying variable interest rate under the Company's New Credit Facility, the change in fair value of available for sale securities is the unrealized gain (losses) on the related investments and the amortization of unrecognized pension cost components is the amortization of prior service costs and credits and actuarial gains and losses (in thousands):

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net income  | \$ 50,384                 | \$ 10,460   | \$ 158,404               | \$ 118,547  |
| Net change in fair value of interest rate swaps           | (15,528)                  | (38,036)    | (10,714)                 | (28,236)    |
| Net change in fair value of available for sale securities | (386)                     | (37)        | (1,244)                  | (13)        |
| Amortization of unrecognized pension components           | 440                       | 1,250       | 328                      | 1,250       |
| Comprehensive income (loss)                               | \$ 34,910                 | \$ (26,363) | \$ 146,774               | \$ 91,548   |

The net change in fair value of the interest rate swaps, the net change in fair value of available for sale securities and amortization of unrecognized pension cost components are included in accumulated other comprehensive loss on the accompanying condensed consolidated balance sheets.

**11. EQUITY INVESTMENTS**

The Company owns equity interests of 27.5% in four hospitals in Las Vegas, Nevada, and 26.1% in one hospital in Las Vegas, Nevada, in which Universal Health Systems, Inc. owns the majority interest; an equity interest of 38.0% in three hospitals in Macon, Georgia in which HCA, Inc. owns the majority interest; and an equity interest of 50.0% in a hospital in El Dorado, Arkansas in which the SHARE Foundation, a not-for-profit foundation, owns the remaining 50.0%. These equity investments were acquired as part of the acquisition of Triad. The Company uses the equity method of accounting for its investments in these entities. During the three months ended September 30, 2008, the Company adjusted the carrying amount of these equity investments based on the final Triad asset valuations. The difference between the fair value of these equity investments and the underlying equity in net assets is approximately \$128.1 million and represents goodwill under the equity method of accounting. The Company's investment in unconsolidated affiliates is \$415.8 million and \$267.8 million at September 30, 2008 and December 31, 2007, respectively, and is included in other assets in the accompanying condensed consolidated balance sheets. Included in the Company's results of operations is \$8.7 million and \$32.1 million, respectively, for the three and nine months ended September 30, 2008, and \$14.3 million for the three and nine months ended September 30, 2007, representing the Company's equity in pre-tax earnings from investments in unconsolidated affiliates during our period of ownership.

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Summarized combined financial information for the three months and nine months ended September 30, 2008 and 2007, for the unconsolidated entities in which the Company owns an equity interest is as follows (in thousands):

|                              | <b>Three Months<br/>Ended<br/>September 30, 2008</b> | <b>Nine Months<br/>Ended<br/>September 30,<br/>2008</b> | <b>Three and<br/>Nine Months<br/>Ended<br/>September 30,<br/>2007</b> |
|------------------------------|--|---|---|
| Revenues                     | \$ 351,378   | \$ 1,074,740  | \$ 213,037  |
| Operating costs and expenses | 324,536  | 966,450   | 186,934   |
| Net income                   | 29,865   | 118,142   | 21,902  |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. LONG-TERM DEBT*****Terminated Credit Facility and Notes***

On August 19, 2004, CHS entered into a \$1.625 billion senior secured credit facility with a consortium of lenders which was subsequently amended on December 16, 2004, July 8, 2005 and December 13, 2006 (the *Terminated Credit Facility* ). The purpose of the *Terminated Credit Facility* was to refinance and replace the Company's previous credit agreement, repay specified other indebtedness, and fund general corporate purposes, including amending the credit facility to permit declaration and payment of cash dividends, to repurchase shares or make other distributions, subject to certain restrictions. The *Terminated Credit Facility* consisted of a \$1.2 billion term loan that was due to mature in 2011 and a \$425 million revolving credit facility that was due to mature in 2009. The *First Incremental Facility Amendment*, dated as of December 13, 2006, increased the Company's term loans by \$400 million (the *Incremental Term Loan Facility* ) and also gave the Company the ability to add up to \$400 million of additional term loans. The full amount of the *Incremental Term Loan Facility* was funded on December 13, 2006, and the proceeds were used to repay the full outstanding amount (approximately \$326 million) of the revolving credit facility under the *Terminated Credit Agreement* and the balance was available to be used for general corporate purposes. The Company was able to elect from time to time an interest rate per annum for the borrowings under the term loan, including the incremental term loan, and revolving credit facility equal to (a) an alternate base rate, which would have been equal to the greatest of (i) the Prime Rate (as defined) in effect and (ii) the Federal Funds Effective Rate (as defined), plus 50 basis points, plus (1) 75 basis points for the term loan and (2) the Applicable Margin (as defined) for revolving credit loans or (b) the Eurodollar Rate (as defined) plus (1) 175 basis points for the term loan and (2) the Applicable Margin for Eurodollar revolving credit loans. The Company also paid a commitment fee for the daily average unused commitments under the revolving credit facility. The commitment fee was based on a pricing grid depending on the Applicable Margin for Eurodollar revolving credit loans and ranged from 0.250% to 0.500%. The commitment fee was payable quarterly in arrears and on the revolving credit termination date with respect to the available revolving credit commitments. In addition, the Company paid fees for each letter of credit issued under the credit facility.

On December 16, 2004, the Company issued \$300 million 6.50% senior subordinated notes due 2012. On April 8, 2005, the Company exchanged these notes for notes having substantially the same terms as the outstanding notes, except the exchanged notes were registered under the Securities Act of 1933, as amended (the *1933 Act* ). These exchanged notes were repaid in 2007.

***New Credit Facility and Notes***

On July 25, 2007, the *New Credit Facility* was entered into with a syndicate of financial institutions led by Credit Suisse, as administrative agent and collateral agent. The *New Credit Facility* consists of a \$6.065 billion funded term loan facility with a maturity of seven years, a \$400 million delayed draw term loan facility with a maturity of seven years and a \$750 million revolving credit facility with a maturity of nine years. As of December 31, 2007, the \$400 million delayed draw term loan facility had been reduced to \$300 million at the request of the Company. The revolving credit facility also includes a subfacility for letters of credit and a swingline subfacility. In connection with the consummation of the acquisition of Triad, the Company used a portion of the net proceeds from its *New Credit Facility* and the Notes offering to repay its outstanding debt under the *Terminated Credit Facility*, the 6.50% senior subordinated notes due 2012 and certain of Triad's existing indebtedness. During the third quarter of 2007, the Company recorded a pre-tax write-off of approximately \$13.9 million in deferred loan costs relative to the early

extinguishment of the debt under the Terminated Credit Facility and incurred tender and solicitation fees of approximately \$13.4 million on the early repayment of the Company's \$300 million aggregate principal amount of 6.50% senior subordinated notes due 2012 through a cash tender offer and consent solicitation.

The New Credit Facility requires quarterly amortization payments of each term loan facility equal to 0.25% of the outstanding amount of the term loans, if any, with the outstanding principal balance payable on July 25, 2014.

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The term loan facility must be prepaid in an amount equal to (1) 100% of the net cash proceeds of certain asset sales and dispositions by the Company and its subsidiaries, subject to certain exceptions and reinvestment rights, (2) 100% of the net cash proceeds of issuances of certain debt obligations or receivables based financing by the Company and its subsidiaries, subject to certain exceptions, and (3) 50%, subject to reduction to a lower percentage based on the Company's leverage ratio (as defined in the New Credit Facility generally as the ratio of total debt on the date of determination to the Company's EBITDA, as defined, for the four quarters most recently ended prior to such date), of excess cash flow (as defined) for any year, commencing in 2008, subject to certain exceptions. Voluntary prepayments and commitment reductions are permitted in whole or in part, without any premium or penalty, subject to minimum prepayment or reduction requirements.

The obligor under the New Credit Facility is CHS. All of the obligations under the New Credit Facility are unconditionally guaranteed by the Company and certain existing and subsequently acquired or organized domestic subsidiaries. All obligations under the New Credit Facility and the related guarantees are secured by a perfected first priority lien or security interest in substantially all of the assets of the Company, CHS and each subsidiary guarantor, including equity interests held by the Company, CHS or any subsidiary guarantor, but excluding, among others, the equity interests of non-significant subsidiaries, syndication subsidiaries, securitization subsidiaries and joint venture subsidiaries.

The loans under the New Credit Facility will bear interest on the outstanding unpaid principal amount at a rate equal to an applicable percentage plus, at the Company's option, either (a) an Alternate Base Rate (as defined) determined by reference to the greater of (1) the Prime Rate (as defined) announced by Credit Suisse or (2) the Federal Funds Effective Rate (as defined) plus one-half of 1.0%, or (b) a reserve adjusted London interbank offered rate for dollars (Eurodollar Rate) (as defined). The applicable percentage for term loans is 1.25% for Alternate Base Rate loans and 2.25% for Eurodollar rate loans. The applicable percentage for revolving loans is initially 1.25% for Alternate Base Rate revolving loans and 2.25% for Eurodollar revolving loans, in each case subject to reduction based on the Company's leverage ratio. Loans under the swingline subfacility bear interest at the rate applicable to Alternate Base Rate loans under the revolving credit facility.

CHS has agreed to pay letter of credit fees equal to the applicable percentage then in effect with respect to Eurodollar rate loans under the revolving credit facility times the maximum aggregate amount available to be drawn under all letters of credit outstanding under the subfacility for letters of credit. The issuer of any letter of credit issued under the subfacility for letters of credit will also receive a customary fronting fee and other customary processing charges. CHS is initially obligated to pay commitment fees of 0.50% per annum (subject to reduction based upon the Company's leverage ratio) on the unused portion of the revolving credit facility. For purposes of this calculation, swingline loans are not treated as usage of the revolving credit facility. CHS is also obligated to pay commitment fees of 0.50% per annum for the first nine months after the closing of the New Credit Facility, 0.75% per annum for the next three months thereafter and 1.0% per annum thereafter, in each case on the unused amount of the delayed draw term loan facility. The Company paid arrangement fees on the closing of the New Credit Facility and will pay an annual administrative agent fee.

The New Credit Facility contains customary representations and warranties, subject to limitations and exceptions, and customary covenants restricting, subject to certain exceptions, the Company's and its subsidiaries' ability to, among other things (1) declare dividends, make distributions or redeem or repurchase capital stock, (2) prepay, redeem or repurchase other debt, (3) incur liens or grant negative pledges, (4) make loans and investments and enter into



acquisitions and joint ventures, (5) incur additional indebtedness or provide certain guarantees, (6) make capital expenditures, (7) engage in mergers, acquisitions and asset sales, (8) conduct transactions with affiliates, (9) alter the nature of the Company's businesses, (10) grant certain guarantees with respect to physician practices, (11) engage in sale and leaseback transactions or (12) change the Company's fiscal year. The Company is also required to comply with specified financial covenants (consisting of a leverage ratio and an interest coverage ratio) and various affirmative covenants.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Events of default under the New Credit Facility include, but are not limited to, (1) the Company's failure to pay principal, interest, fees or other amounts under the credit agreement when due (taking into account any applicable grace period), (2) any representation or warranty proving to have been materially incorrect when made, (3) covenant defaults subject, with respect to certain covenants, to a grace period, (4) bankruptcy events, (5) a cross default to certain other debt, (6) certain undischarged judgments (not paid within an applicable grace period), (7) a change of control, (8) certain ERISA-related defaults and (9) the invalidity or impairment of specified security interests, guarantees or subordination provisions in favor of the administrative agent or lenders under the New Credit Facility.

The Notes were issued by CHS in connection with the Triad acquisition in the principal amount of \$3.021 billion. These Notes will mature on July 15, 2015. The Notes bear interest at the rate of 8.875% per annum, payable semiannually in arrears on January 15 and July 15, commencing January 15, 2008. Interest on the Notes accrues from the date of original issuance. Interest is calculated on the basis of 360-day year comprised of twelve 30-day months.

Except as set forth below, CHS is not entitled to redeem the Notes prior to July 15, 2011.

On and after July 15, 2011, CHS is entitled, at its option, to redeem all or a portion of the Notes upon not less than 30 nor more than 60 days notice, at the redemption prices (expressed as a percentage of principal amount on the redemption date), plus accrued and unpaid interest, if any, to the redemption date (subject to the right of holders of record on the relevant record date to receive interest due on the relevant interest payment date), if redeemed during the 12-month period commencing on July 15 of the years set forth below:

| <b>Period</b>       | <b>Redemption Price</b> |
|---------------------|-------------------------|
| 2011                | 104.438%                |
| 2012                | 102.219%                |
| 2013 and thereafter | 100.000%                |

In addition, any time prior to July 15, 2010, CHS is entitled, at its option, on one or more occasions to redeem the Notes (which include additional Notes (the "Additional Notes"), if any which may be issued from time to time under the indenture under which the Notes were issued) in an aggregate principal amount not to exceed 35% of the aggregate principal amount of the Notes (which includes Additional Notes, if any) originally issued at a redemption price (expressed as a percentage of principal amount) of 108.875%, plus accrued and unpaid interest to the redemption date, with the Net Cash Proceeds (as defined) from one or more Public Equity Offerings (as defined) (provided that if the Public Equity Offering is an offering by the Company, a portion of the Net Cash Proceeds thereof equal to the amount required to redeem any such Notes is contributed to the equity capital of CHS); provided, however, that:

- 1) at least 65% of such aggregate principal amount of Notes originally issued remains outstanding immediately after the occurrence of each such redemption (other than the Notes held, directly or indirectly, by the Company or its subsidiaries); and
- 2) each such redemption occurs within 90 days after the date of the related Public Equity Offering.

CHS is entitled, at its option, to redeem the Notes, in whole or in part, at any time prior to July 15, 2011, upon not less than 30 or more than 60 days notice, at a redemption price equal to 100% of the principal amount of Notes redeemed plus the Application Premium (as defined), and accrued and unpaid interest, if any, as of the applicable redemption date.

Pursuant to a registration rights agreement entered into at the time of the issuance of the Notes, as a result of an exchange offer made by CHS, substantially all of the Notes issued in July 2007 were exchanged in November 2007 for new notes (the Exchange Notes ) having terms substantially identical in all material respects to the Notes (except that the Exchange Notes were issued under a registration statement pursuant to the 1933 Act). References to the Notes shall also be deemed to include Exchange Notes unless the context provides otherwise.

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the nine months ended September 30, 2008, the Company repurchased on the open market and cancelled \$62.7 million of principal amount of the Notes. This resulted in a loss from early extinguishment of debt of \$1.3 million with an after-tax impact of \$0.9 million.

As of September 30, 2008, the availability for additional borrowings under the New Credit Facility was \$1.050 billion (consisting of a \$750 million revolving credit facility and a \$300 million delayed draw term loan facility), of which \$78.3 million was set aside for outstanding letters of credit. CHS also has the ability to add up to \$300 million of borrowing capacity from receivable transactions (including securitizations) under the New Credit Facility which has not yet been accessed. CHS also has the ability to amend the New Credit Facility to provide for one or more tranches of term loans in an aggregate principal amount of \$600 million, which CHS has not yet accessed. As of September 30, 2008, the weighted-average interest rate under the New Credit Facility was 5.4%.

Cash paid for interest, net of interest income, was \$232.4 million and \$54.7 million during the three months ended September 30, 2008 and 2007, respectively, and \$558.8 million and \$115.0 million during the nine months ended September 30, 2008 and 2007, respectively.

**13. FAIR VALUE**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value, provides a framework for measuring fair value, and expands disclosures required for fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require fair value measurement; it does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and was adopted by the Company as of January 1, 2008. The adoption of this statement has not had a material effect on the Company's consolidated results of operations or consolidated financial position.

In February 2008, the FASB issued FASB Statement of Position No. 157-2, Effective Date of FASB Statement No. 157, (FSP 157-2). FSP 157-2 deferred the effective date of the provisions of SFAS No. 157 for all non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value on a recurring basis to fiscal years beginning after November 15, 2008, and will be adopted by the Company in the first quarter of 2009. The Company is currently assessing the potential impact of SFAS No. 157 for non-financial assets and non-financial liabilities on its consolidated financial position and consolidated results of operations.

***Fair Value Hierarchy***

SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

*Level 1:* Quoted market prices in active markets for identical assets or liabilities.

*Level 2:* Observable market-based inputs or unobservable inputs that are corroborated by market data.

*Level 3:* Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Company's own assumptions.



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The following table sets forth, by level within the fair value hierarchy, the financial assets and liabilities recorded at fair value on a recurring basis as of September 30, 2008 (in thousands):

|   | <b>September 30,<br/>2008</b> | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
|---|-------------------------------|----------------|----------------|----------------|
| Available-for-sale securities               | \$ 7,694                      | \$ 7,694       | \$             | \$             |
| Trading securities                          | 29,926                        | 29,926         |                |                |
| Total assets                                | \$ 37,620                     | \$ 37,620      | \$             | \$             |
| Fair value of interest rate swap agreements | \$ 145,693                    | \$             | \$ 145,693     | \$             |
| Contractual obligation                      | \$ 61,000                     | \$             | \$             | \$ 61,000      |
| Total liabilities                           | \$ 206,693                    | \$             | \$ 145,693     | \$ 61,000      |

Available-for-sale securities and trading securities classified as Level 1 are measured using quoted market prices. The fair value of the Company's interest rate swap agreements are classified as Level 2, and are estimated using an income approach based on the LIBOR swap rate, which is observable at commonly quoted intervals for the full terms of the swap agreements. The contractual obligation recorded during the three months ended September 30, 2008, represents the fair value of a liability assumed in connection with a business combination.

**14. RECENT ACCOUNTING PRONOUNCEMENTS**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. SFAS No. 159 permits an entity, on a contract-by-contract basis, to make an irrevocable election to account for certain types of financial instruments and warranty and insurance contracts at fair value, rather than historical cost, with changes in the fair value, whether realized or unrealized, recognized in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 as of January 1, 2008 and did not elect to re-measure any assets or liabilities. The adoption of this statement has not had a material effect on the Company's consolidated results of operations or consolidated financial position.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) replaces SFAS No. 141 and addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. This standard will require more assets and liabilities to be recorded at fair value and will require expense recognition (rather than capitalization) of certain pre-acquisition costs. This standard also will require any adjustments to acquired deferred tax assets and liabilities occurring after the related allocation period to be made through earnings. Furthermore, this standard requires this treatment of acquired deferred tax assets and liabilities also be applied to acquisitions occurring prior to the effective date of this standard. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and is

required to be adopted prospectively with no early adoption permitted. SFAS No. 141(R) will be adopted by the Company in the first quarter of 2009. The Company does not currently have on its balance sheet any material deferred costs related to prospective acquisitions that would be required to be expensed upon the adoption of SFAS No. 141(R). Any outstanding deferred costs will be expensed in 2009 for any acquisitions that are not closed by December 31, 2008. Furthermore, the impact of SFAS No. 141(R) on the Company's consolidated results of operations or consolidated financial position in future periods will be largely dependent on the number of acquisitions pursued by the Company; however, it is not anticipated at this time that such impact will be material.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS No. 160 ). SFAS No. 160 addresses the accounting and reporting framework for noncontrolling ownership interests in consolidated subsidiaries of the parent. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent company and the interests of

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the noncontrolling owners and that require minority ownership interests be presented separately within equity in the consolidated financial statements. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by the Company in the first quarter of 2009. The Company is currently assessing the potential impact that SFAS No. 160 will have on its consolidated results of operations and consolidated financial position.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS No. 161 ). SFAS No. 161 expands the disclosure requirements for derivative instruments and for hedging activities in order to provide additional understanding of how an entity uses derivative instruments and how they are accounted for and reported in an entity's financial statements. The new disclosure requirements for SFAS No. 161 are effective for fiscal years beginning after November 15, 2008, and will be adopted by the Company in the first quarter of 2009.

**15. SEGMENT INFORMATION**

The Company operates in three distinct operating segments, represented by the hospital operations (which includes its general acute care hospitals and related healthcare entities that provide inpatient and outpatient health care services), the home health agencies operations (which provide in-home outpatient care), and its hospital management services business (which provides executive management and consulting services to non-affiliated acute care hospitals). Only the hospital operations segment meets the criteria in SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information ( SFAS No. 131 ), as a separate reportable segment. The financial information for the home health agencies and management services segments do not meet the quantitative thresholds defined in SFAS No. 131 and are combined into the corporate and all other reportable segment.

The distribution between reportable segments of the Company's revenues and income from continuing operations before income taxes is summarized in the following tables (in thousands):

|  | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|--|---------------------------|--------------|--------------------------|--------------|
|  | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|  | <b>2008</b>               | <b>2007</b>  | <b>2008</b>              | <b>2007</b>  |
| Revenues:  |                           |              |                          |              |
| Hospital operations                                    | \$ 2,714,974              | \$ 2,196,408 | \$ 8,009,271             | \$ 4,499,143 |
| Corporate and all other                                | 57,886                    | 50,601       | 181,743                  | 100,009      |
|  | \$ 2,772,860              | \$ 2,247,009 | \$ 8,191,014             | \$ 4,599,152 |
| Income from continuing operations before income taxes: |                           |              |                          |              |
| Hospital operations                                    | \$ 116,456                | \$ 86,761    | \$ 352,920               | \$ 307,617   |
| Corporate and all other                                | (32,843)                  | (55,390)     | (104,675)                | (96,011)     |
|  | \$ 83,613                 | \$ 31,371    | \$ 248,245               | \$ 211,606   |



## 16. CONTINGENCIES

The Company is a party to various legal proceedings incidental to its business. In the opinion of management, any ultimate liability with respect to these actions will not have a material adverse effect on the Company's consolidated financial position, cash flows or results of operations. In addition, in connection with the closing of the Triad acquisition on July 25, 2007, the Company has assumed both recorded and unrecorded contingencies of Triad. The Company's management is not aware of any unrecorded contingencies assumed in connection with the Triad acquisition, whose ultimate outcome will have a material adverse effect on the Company's consolidated financial position, cash flows or results of operations.

In a letter dated October 4, 2007, the Civil Division of the Department of Justice notified the Company that, as a result of an investigation into the way in which different state Medicaid programs apply to the federal government

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**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

for matching or supplemental funds that are ultimately used to pay for a small portion of the services provided to Medicaid and indigent patients, it believes the Company and three of its New Mexico hospitals have caused the State of New Mexico to submit improper claims for federal funds in violation of the federal False Claims Act. In a letter dated January 22, 2008, the Civil Division notified the Company that based on its investigation, it has calculated that these three hospitals received ineligible federal participation payments from August 2000 to September 2006 of approximately \$27.5 million. The Civil Division also advised the Company that were it to proceed to trial, it would seek treble damages plus an appropriate penalty for each of the violations of the False Claims Act. On May 28, 2008, the Company received a letter from the Office of the U.S. Attorney for the State of New Mexico requesting additional information. The Company is in the process of responding to the government. The Company continues to believe that it has not violated the False Claims Act, and is continuing discussions with the Civil Division in an effort to resolve this matter.

**17. SUBSEQUENT EVENTS**

On October 1, 2008, the Company completed its acquisition of Deaconess Medical Center (388 licensed beds) and Valley Hospital and Medical Center (123 licensed beds), located in Spokane, Washington, from Empire Health Services. The total consideration for these hospitals was approximately \$175.1 million, of which approximately \$149.2 million was paid in cash and \$25.9 million was assumed in liabilities.

During October 2008, the Company repurchased 2,500,000 shares of its common stock under its open market repurchase program (see Note 9) at a weighted-average price of \$20.73 per share. Also, during October 2008, the Company repurchased on the open market and cancelled \$42.8 million of principal amount of the Notes.

**18. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

In connection with the consummation of the Triad acquisition in July 2007, the Company obtained \$7.215 billion of senior secured financing under the New Credit Facility and CHS issued the Notes in the aggregate principal amount of \$3.021 billion. The Notes are senior unsecured obligations of CHS and are guaranteed on a senior basis by the Company and by certain existing and subsequently acquired or organized 100% owned domestic subsidiaries.

The Notes are fully and unconditionally guaranteed on a joint and several basis. The following condensed consolidating financial statements present Community Health Systems, Inc. (as parent guarantor), CHS (as the issuer), the subsidiary guarantors, the subsidiary non-guarantors and eliminations. These supplemental condensed consolidating financial statements have been prepared and presented in accordance with SEC Regulation S-X Rule 3-10 Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered .

The presentation of intercompany balances and allocated income tax expense in the Company's previously issued supplemental condensed consolidating financial statements is being corrected as follows:

Intercompany receivables and payables are presented gross in the supplemental consolidating balance sheets; the intercompany balances were previously reported net as intercompany (receivable) payable . In addition, a portion of the intercompany (receivable) payable was netted against long-term debt payable (receivable) of the issuer and other guarantors.

Cash flows from intercompany transactions are presented in cash flows from financing activities, as changes in intercompany balances with affiliates, net; these cash flows were previously reported in cash flows from operating activities as advances to subsidiaries, net of return of investment and other operating cash flows.

Income tax expense is allocated from the parent guarantor to the income producing operations (other guarantors and non-guarantors) and the issuer through a deemed capital contribution; income tax expense

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was previously allocated entirely to the parent guarantor, which is the tax paying entity. As this approach represents an allocation, the income tax expense allocation is considered non-cash for statement of cash flow purposes.

Interest expense, net has been presented to reflect net interest expense and interest income from outstanding long-term debt and intercompany balances; these interest expense and interest income amounts were previously netted within certain subsidiaries.

The Company's intercompany activity consists primarily of daily cash transfers for purposes of cash management, the allocation of certain expenses and expenditures paid for by the parent on behalf of the subsidiaries, and the push down of investment in its subsidiaries. The Company's subsidiaries generally do not purchase services from one another and therefore the intercompany transactions do not represent revenue generating transactions. All intercompany transactions eliminate in consolidation. Therefore, the aforementioned corrections do not impact the Company's consolidated balance sheet, consolidated statement of income or consolidated statement of cash flows for any period presented. Management believes the effects of these corrections are not material to the Company's previously issued consolidated financial statements and intends, for those prior period supplemental condensed consolidating financial statements not presented as part of this footnote, to reflect these corrections in future filings whenever such supplemental condensed consolidating financial statements are included. The following table discloses the impact of these corrections on each of the respective line items of the supplemental condensed consolidating financial statements as of and for the periods ending September 30, 2007 (in thousands).

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
| Condensed<br>Consolidating<br>Balance Sheet<br>As of<br>September 30,<br>2007<br><b>As reported</b> |                             |               |                             |                            |                     |                     |
| Prepaid expenses<br>and taxes(1)  | \$                          | \$            | \$ 160,897                  | \$ 39,477                  | \$                  | \$ 200,374          |
| Total current assets  | 53,157                      |               | 1,697,012                   | 959,615                    |                     | 2,709,784           |
| Intercompany<br>receivables<br>(non-current)  |                             |               |                             |                            |                     |                     |
| Goodwill  |                             |               | 3,456,057                   | 590,756                    |                     | 4,046,813           |
| Net investment in<br>subsidiaries   | 1,248,497                   | 1,290,709     | 1,480,483                   |                            | (4,019,689)         |                     |
| Total Assets  | 1,301,654                   | 1,490,546     | 10,566,213                  | 4,099,973                  | (4,019,689)         | 13,438,697          |
| Long-term debt  | 4                           | 9,026,440     | 210,620                     | (153,681)                  |                     | 9,083,383           |

|   |           |           |            |           |             |            |
|---|-----------|-----------|------------|-----------|-------------|------------|
| Intercompany payables (non-current)       |           |           |            |           |             |            |
| Additional paid-in capital                | 1,227,623 |           |            |           |             | 1,227,623  |
| Retained earnings                         | 646,203   | 1,269,694 | 1,291,211  | 1,673,391 | (4,234,296) | 646,203    |
| Total stockholders equity                 | 1,846,913 | 1,248,493 | 1,284,932  | 1,673,393 | (4,206,818) | 1,846,913  |
| Total liabilities and stockholders equity | 1,301,654 | 1,490,546 | 10,566,213 | 4,099,973 | (4,019,689) | 13,438,697 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
| <b>As adjusted(2)</b>   |                             |               |                             |                            |                     |                     |
| Prepaid expenses<br>and taxes   | 104,832                     |               | 54,914                      | 40,628                     |                     | 200,374             |
| Total current assets  | 157,989                     |               | 1,558,735                   | 993,060                    |                     | 2,709,784           |
| Intercompany<br>receivables<br>(non-current)  | 936,148                     | 9,024,139     | 8,611,864                   | 4,666,546                  | (23,238,697)        | 4,046,813           |
| Goodwill  |                             |               | 2,365,710                   | 1,681,103                  |                     | 4,046,813           |
| Net investment in<br>subsidiaries   | 1,175,838                   | 3,966,843     | 2,340,306                   |                            | (7,482,987)         |                     |
| Total Assets  | 2,269,975                   | 13,190,819    | 18,742,674                  | 9,956,913                  | (30,721,684)        | 13,438,697          |
| Long-term debt  | 4                           | 9,026,440     | 37,941                      | 18,998                     |                     | 9,083,383           |
| Intercompany<br>payables<br>(non-current)   | 93,649                      | 2,819,804     | 16,563,659                  | 9,016,593                  | (28,493,705)        |                     |
| Additional paid-in<br>capital   | 1,227,623                   | 457,890       | 469,654                     |                            | (927,544)           | 1,227,623           |
| Retained earnings   | 646,203                     | 734,532       | 753,403                     | (160,022)                  | (1,327,913)         | 646,203             |
| Total stockholders<br>equity  | 1,846,913                   | 1,171,221     | 1,216,778                   | (160,020)                  | (2,227,979)         | 1,846,913           |
| Total liabilities and<br>stockholders equity  | 2,269,975                   | 13,190,819    | 18,742,674                  | 9,956,913                  | (30,721,684)        | 13,438,697          |
| <b>Condensed<br/>Consolidating<br/>Statement of Cash<br/>Flows<br/>For the nine<br/>months ended<br/>September 30,<br/>2007</b> |                             |               |                             |                            |                     |                     |
| <b>As reported</b>  |                             |               |                             |                            |                     |                     |
| Net cash provided<br>by (used in)<br>operating activities   | 289,866                     | (454,841)     | 481,874                     | 87,751                     |                     | 404,650             |
| Changes in<br>intercompany<br>balances with<br>affiliates, net  | (299,996)                   | (1,719,000)   | (23,568)                    | (21,068)                   |                     | (2,063,632)         |

|  |           |             |          |          |             |
|--|-----------|-------------|----------|----------|-------------|
| (Repayments)<br>borrowings of<br>long-term<br>indebtedness<br>Net cash provided<br>by (used in)<br>financing activities      | (289,866) | 7,284,373   | (23,568) | 15,804   | 6,986,743   |
| <b>As adjusted(2)</b><br>Net cash provided<br>by (used in)<br>operating activities   | (117,277) | 95,115      | 370,813  | 55,999   | 404,650     |
| Changes in<br>intercompany<br>balances with<br>affiliates, net<br>(Repayments)<br>borrowings of<br>long-term<br>indebtedness | 407,143   | (549,956)   | 133,807  | 9,006    |             |
| Net cash provided<br>by (used in)<br>financing activities  | (299,996) | (1,719,000) | (23,402) | (21,234) | (2,063,632) |
|  | 117,277   | 6,734,417   | 110,405  | 24,644   | 6,986,743   |
|  |           |             | 23       |          |             |

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|  | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
| Condensed Consolidating<br>Statement of Income<br>For the three months ended<br>September 30, 2007 |                             |               |                             |                            |                     |                     |
| <b>As reported</b>   |                             |               |                             |                            |                     |                     |
| Interest expense, net  |                             |               | 141,146                     | (1,639)                    |                     | 139,507             |
| Other operating expenses   |                             |               | 309,842                     | 139,981                    |                     | 449,823             |
| Equity in earnings of<br>unconsolidated affiliates   | (20,040)                    | (47,331)      | (5,047)                     |                            | 72,418              |                     |
| Income (loss) from<br>continuing operations before<br>income taxes                                 | 20,040                      | 20,040        | 45,303                      | 12,885                     | (72,418)            | 25,850              |
| Provision for income taxes   | 9,580                       |               |                             |                            |                     | 9,580               |
| Income (loss) from<br>continuing operations  | 10,460                      | 20,040        | 45,303                      | 12,885                     | (72,418)            | 16,270              |
| Net income   | 10,460                      | 20,040        | 45,303                      | 7,075                      | (72,418)            | 10,460              |
| <b>As adjusted(2)</b>  |                             |               |                             |                            |                     |                     |
| Interest expense, net  |                             | 9,962         | 117,655                     | 7,543                      |                     | 135,160             |
| Other operating expenses   |                             |               | 283,139                     | 156,453                    |                     | 439,592             |
| Equity in earnings of<br>unconsolidated affiliates   | (10,460)                    | (40,299)      | 5,091                       |                            | 31,384              | (14,284)            |
| Income (loss) from<br>continuing operations before<br>income taxes                                 | 10,460                      | 3,046         | 65,364                      | (16,115)                   | (31,384)            | 31,371              |
| Provision for income taxes   |                             | (7,414)       | 25,284                      | (6,198)                    |                     | 11,672              |
| Income (loss) from<br>continuing operations  | 10,460                      | 10,460        | 40,080                      | (9,917)                    | (31,384)            | 19,699              |
| Net income   | 10,460                      | 10,460        | 40,080                      | (19,156)                   | (31,384)            | 10,460              |



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|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
| Condensed Consolidating<br>Statement of Income<br>For the nine months ended<br>September 30, 2007 |                             |               |                             |                            |                     |                     |
| <b>As reported</b>  |                             |               |                             |                            |                     |                     |
| Interest expense, net   |                             |               | 191,803                     | 9,263                      |                     | 201,066             |
| Other operating expenses  |                             |               | 698,683                     | 252,024                    |                     | 950,707             |
| Equity in earnings of<br>unconsolidated affiliates  | (195,820)                   | (223,111)     | (1,088)                     |                            | 420,019             |                     |
| Income (loss) from<br>continuing operations<br>before income taxes                                | 195,820                     | 195,820       | 222,078                     | 7,981                      | (420,019)           | 201,680             |
| Provision for income taxes  | 77,273                      |               |                             |                            |                     | 77,273              |
| Income (loss) from<br>continuing operations   | 118,547                     | 195,820       | 222,078                     | 7,981                      | (420,019)           | 124,407             |
| Net income  | 118,547                     | 195,820       | 222,078                     | 2,121                      | (420,019)           | 118,547             |
| <b>As adjusted(1)</b>   |                             |               |                             |                            |                     |                     |
| Interest expense, net   |                             | 13,736        | 158,064                     | 20,977                     |                     | 192,777             |
| Other operating expenses  |                             |               | 648,637                     | 272,100                    |                     | 920,737             |
| Equity in earnings of<br>unconsolidated affiliates  | (118,547)                   | (154,956)     | 15,230                      |                            | 243,989             | (14,284)            |
| Income (loss) from<br>continuing operations<br>before income taxes                                | 118,547                     | 113,929       | 249,875                     | (26,756)                   | (243,989)           | 211,606             |
| Provision for income taxes  |                             | (4,618)       | 95,952                      | (10,274)                   |                     | 81,060              |
| Income (loss) from<br>continuing operations   | 118,547                     | 118,547       | 153,923                     | (16,482)                   | (243,989)           | 130,546             |
| Net income  | 118,547                     | 118,547       | 153,923                     | (28,481)                   | (243,989)           | 118,547             |

(1) Prepaid expenses and prepaid taxes were previously reported separately and have been reported together in this schedule to conform with the current presentation.

(2) Includes effects of reclassification for discontinued operations and for conforming corrections as applied to other periods presented.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Balance Sheet  
September 30, 2008**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors<br/>(In thousands, except share data)</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|---|----------------------------|---------------------|---------------------|
| <b>ASSETS</b>                                 |                             |               |   |                            |                     |                     |
| Current assets                                |                             |               |   |                            |                     |                     |
| Cash and cash equivalents                     | \$                          | \$            | \$ 304,892  | \$ 36,992                  | \$                  | \$ 341,884          |
| Patient accounts receivable, net of allowance |                             |               | 1,018,623   | 624,197                    |                     | 1,642,820           |
| Supplies                                      |                             |               | 166,317   | 101,003                    |                     | 267,320             |
| Deferred income taxes                         | 111,101                     |               |   |                            |                     | 111,101             |
| Prepaid expenses and taxes                    |                             | 156           | 89,811  | 1,272                      |                     | 91,239              |
| Other current assets                          |                             | 560           | 105,397   | 91,830                     |                     | 197,787             |
| Total current assets                          | 111,101                     | 716           | 1,685,040   | 855,294                    |                     | 2,652,151           |
| Intercompany receivable                       | 1,037,633                   | 8,880,703     | 10,150,657  | 3,166,520                  | (23,235,513)        |                     |
| Property and equipment, net                   |                             |               | 3,498,364   | 2,246,102                  |                     | 5,744,466           |
| Goodwill                                      |                             |               | 2,445,928   | 1,705,559                  |                     | 4,151,487           |
| Other assets, net                             |                             | 177,929       | 347,260   | 514,111                    |                     | 1,039,300           |
| Net investment in subsidiaries                | 1,250,154                   | 4,612,813     | 2,448,504   |                            | (8,311,471)         |                     |
| Total assets                                  | \$ 2,398,888                | \$ 13,672,161 | \$ 20,575,753   | \$ 8,487,586               | \$ (31,546,984)     | \$ 13,587,404       |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>    |                             |               |   |                            |                     |                     |
| Current liabilities                           |                             |               |   |                            |                     |                     |
| Current maturities of long-term debt          | \$                          | \$            | \$ 13,235   | \$ 6,412                   | \$                  | \$ 19,647           |
| Accounts payable                              |                             | 66            | 327,861   | 149,137                    |                     | 477,064             |

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|   |              |               |               |              |                 |               |
|---|--------------|---------------|---------------|--------------|-----------------|---------------|
| Current income taxes payable                              | 38,312       |               |               |              |                 | 38,312        |
| Accrued liabilities                                       | 12,126       |               | 454,280       | 344,605      |                 | 811,011       |
| Interest payable (receivable)                             |              | 82,090        | 1,180         | (421)        |                 | 82,849        |
| Total current liabilities                                 | 50,438       | 82,156        | 796,556       | 499,733      |                 | 1,428,883     |
| Long-term debt payable (receivable)                       | 4            | 8,825,296     | 56,391        | 7,091        |                 | 8,888,782     |
| Intercompany payable                                      | 23,306       | 3,376,337     | 18,256,699    | 7,662,455    | (29,318,797)    |               |
| Deferred income taxes                                     | 433,009      |               |               |              |                 | 433,009       |
| Other long-term liabilities                               | 16,223       | 138,222       | 230,180       | 232,725      |                 | 617,350       |
| Minority interests in equity of consolidated subsidiaries |              |               | 7,153         | 336,319      |                 | 343,472       |
| Stockholders' equity                                      |              |               |               |              |                 |               |
| Preferred stock   |              |               |               |              |                 |               |
| Common stock  | 967          |               | 1             | 2            | (3)             | 967           |
| Additional paid-in capital                                | 1,258,637    | 517,254       | 474,966       |              | (992,220)       | 1,258,637     |
| Treasury stock, at cost, 975,549 shares                   | (6,678)      |               |               |              |                 | (6,678)       |
| Accumulated other comprehensive income (loss)             | (93,367)     | (93,367)      | (4,905)       |              | 98,272          | (93,367)      |
| Retained earnings   | 716,349      | 826,263       | 758,712       | (250,739)    | (1,334,236)     | 716,349       |
| Total stockholders' equity                                | 1,875,908    | 1,250,150     | 1,228,774     | (250,737)    | (2,228,187)     | 1,875,908     |
| Total liabilities and stockholders' equity                | \$ 2,398,888 | \$ 13,672,161 | \$ 20,575,753 | \$ 8,487,586 | \$ (31,546,984) | \$ 13,587,404 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Balance Sheet  
December 31, 2007**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors<br/>(In thousands, except share data)</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|---|----------------------------|---------------------|---------------------|
| <b>ASSETS</b>   |                             |               |   |                            |                     |                     |
| Current assets  |                             |               |   |                            |                     |                     |
| Cash and cash equivalents   | \$                          | \$            | \$ 114,075  | \$ 18,799                  | \$                  | \$ 132,874          |
| Patient accounts receivable, net of allowance for doubtful accounts |                             |               | 954,106   | 579,692                    |                     | 1,533,798           |
| Supplies  |                             |               | 163,961   | 98,942                     |                     | 262,903             |
| Deferred income taxes   | 113,741                     |               |   |                            |                     | 113,741             |
| Prepaid expenses and taxes  | 99,417                      | 102           | 57,316  | 12,921                     |                     | 169,756             |
| Other current assets  |                             |               | 129,147   | 210,679                    |                     | 339,826             |
| Total current assets  | 213,158                     | 102           | 1,418,605   | 921,033                    |                     | 2,552,898           |
| Intercompany receivable   | 1,085,684                   | 9,129,859     | 18,854,467  | 884,296                    | (29,954,306)        |                     |
| Property and equipment, net   |                             |               | 3,667,487   | 1,845,087                  |                     | 5,512,574           |
| Goodwill  |                             |               | 2,259,113   | 1,988,601                  |                     | 4,247,714           |
| Other assets, net   |                             | 189,140       | 276,589   | 714,728                    |                     | 1,180,457           |
| Net investment in subsidiaries                                      | 957,750                     | 4,168,316     | 2,485,035   |                            | (7,611,101)         |                     |
| Total assets  | \$ 2,256,592                | \$ 13,487,417 | \$ 28,961,296   | \$ 6,353,745               | \$ (37,565,407)     | \$ 13,493,643       |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                          |                             |               |   |                            |                     |                     |
| Current liabilities   |                             |               |   |                            |                     |                     |
| Current maturities of long-term debt                                | \$                          | \$            | \$ 16,603   | \$ 4,107                   | \$                  | \$ 20,710           |
| Accounts payable  |                             | 19            | 276,503   | 216,171                    |                     | 492,693             |

|   |              |               |               |              |                 |               |
|---|--------------|---------------|---------------|--------------|-----------------|---------------|
| Current income taxes payable                              |              |               |               |              |                 |               |
| Deferred income taxes current                             |              |               |               |              |                 |               |
| Accrued liabilities                                       |              |               | 437,808       | 342,892      |                 | 780,700       |
| Interest payable (receivable)                             |              | 153,085       | 8,042         | (7,295)      |                 | 153,832       |
| Total current liabilities                                 |              | 153,104       | 738,956       | 555,875      |                 | 1,447,935     |
| Long-term debt payable                                    | 4            | 8,987,090     | 62,792        | 27,481       |                 | 9,077,367     |
| Intercompany payable                                      | 137,837      | 3,267,993     | 27,008,767    | 5,378,021    | (35,792,618)    |               |
| Deferred income taxes                                     | 407,947      |               |               |              |                 | 407,947       |
| Other long-term liabilities                               |              | 121,482       | 188,316       | 173,661      |                 | 483,459       |
| Minority interests in equity of consolidated subsidiaries |              |               | 13,491        | 352,640      |                 | 366,131       |
| Stockholders equity                                       |              |               |               |              |                 |               |
| Preferred stock   |              |               |               |              |                 |               |
| Common stock  | 966          |               | 1             | 2            | (3)             | 966           |
| Additional paid-in capital                                | 1,240,308    | 434,505       | 398,338       |              | (832,843)       | 1,240,308     |
| Treasury stock, at cost, 975,549 shares                   | (6,678)      |               |               |              |                 | (6,678)       |
| Accumulated other comprehensive income (loss)             | (81,737)     | (81,737)      | (3,989)       |              | 85,726          | (81,737)      |
| Retained earnings   | 557,945      | 604,980       | 554,624       | (133,935)    | (1,025,669)     | 557,945       |
| Total stockholders equity                                 | 1,710,804    | 957,748       | 948,974       | (133,933)    | (1,772,789)     | 1,710,804     |
| Total liabilities and stockholders equity                 | \$ 2,256,592 | \$ 13,487,417 | \$ 28,961,296 | \$ 6,353,745 | \$ (37,565,407) | \$ 13,493,643 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Income  
Three Months Ended September 30, 2008**

|  | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
|  | <b>(In thousands)</b>       |               |                             |                            |                     |                     |
| Net operating revenues                                       | \$                          | \$            | \$ 1,709,941                | \$ 1,062,919               | \$                  | \$ 2,772,860        |
| Operating costs and expenses:                                |                             |               |                             |                            |                     |                     |
| Salaries and benefits  |                             |               | 637,464                     | 454,262                    |                     | 1,091,726           |
| Provision for bad debts                                      |                             |               | 206,030                     | 120,183                    |                     | 326,213             |
| Supplies   |                             |               | 221,195                     | 161,947                    |                     | 383,142             |
| Other operating expenses                                     |                             |               | 308,042                     | 221,321                    |                     | 529,363             |
| Rent   |                             |               | 29,164                      | 29,678                     |                     | 58,842              |
| Depreciation and amortization                                |                             |               | 80,720                      | 49,787                     |                     | 130,507             |
|  |                             |               | 1,482,615                   | 1,037,178                  |                     | 2,519,793           |
| Income from operations                                       |                             |               | 227,326                     | 25,741                     |                     | 253,067             |
| Interest expense, net  |                             | 25,074        | 133,799                     | 8,912                      |                     | 167,785             |
| Loss from early extinguishment of debt                       |                             |               |                             |                            |                     |                     |
| Minority interest in earnings                                |                             |               | 510                         | 9,850                      |                     | 10,360              |
| Equity in earnings of subsidiary                             | (50,384)                    | (64,641)      | (11,719)                    |                            | 118,053             | (8,691)             |
| Income (loss) from continuing operations before income taxes | 50,384                      | 39,567        | 104,736                     | 6,979                      | (118,053)           | 83,613              |
| Provision for income taxes                                   |                             | (10,817)      | 40,324                      | 2,684                      |                     | 32,191              |
| Income (loss) from continuing operations                     | 50,384                      | 50,384        | 64,412                      | 4,295                      | (118,053)           | 51,422              |
| Discontinued operations, net of taxes:                       |                             |               |                             |                            |                     |                     |
| Income (loss) from operations of hospitals                   |                             |               |                             | (1,038)                    |                     | (1,038)             |

sold and held for sale  
 Gain (loss) on sale of  
 hospitals, net

|   |    |        |    |        |         |        |         |       |    |           |    |        |
|---|----|--------|----|--------|---------|--------|---------|-------|----|-----------|----|--------|
| Income (loss) on<br>discontinued operations |    |        |    |        | (1,038) |        | (1,038) |       |    |           |    |        |
| Net income                                  | \$ | 50,384 | \$ | 50,384 | \$      | 64,412 | \$      | 3,257 | \$ | (118,053) | \$ | 50,384 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Income  
Three Months Ended September 30, 2007**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
|   | <b>(In thousands)</b>       |               |                             |                            |                     |                     |
| Net operating revenues  | \$                          | \$            | \$ 1,521,900                | \$ 725,109                 | \$                  | \$ 2,247,009        |
| Operating costs and expenses:                                     |                             |               |                             |                            |                     |                     |
| Salaries and benefits   |                             |               | 572,667                     | 330,757                    |                     | 903,424             |
| Provision for bad debts   |                             |               | 187,492                     | 78,788                     |                     | 266,280             |
| Supplies  |                             |               | 195,429                     | 109,500                    |                     | 304,929             |
| Other operating expenses  |                             |               | 283,139                     | 156,453                    |                     | 439,592             |
| Rent  |                             |               | 26,474                      | 20,769                     |                     | 47,243              |
| Depreciation and amortization                                     |                             |               | 67,876                      | 32,756                     |                     | 100,632             |
|   |                             |               | 1,333,077                   | 729,023                    |                     | 2,062,100           |
| Income from operations  |                             |               | 188,823                     | (3,914)                    |                     | 184,909             |
| Interest expense, net   |                             | 9,962         | 117,655                     | 7,543                      |                     | 135,160             |
| Loss from early extinguishment of debt                            |                             | 27,291        |                             |                            |                     | 27,291              |
| Minority interest in earnings                                     |                             |               | 713                         | 4,658                      |                     | 5,371               |
| Equity in earnings of subsidiary                                  | (10,460)                    | (40,299)      | 5,091                       |                            | 31,384              | (14,284)            |
| Income (loss) from continuing operations before income taxes      | 10,460                      | 3,046         | 65,364                      | (16,115)                   | (31,384)            | 31,371              |
| Provision for income taxes  |                             | (7,414)       | 25,284                      | (6,198)                    |                     | 11,672              |
| Income (loss) from continuing operations                          | 10,460                      | 10,460        | 40,080                      | (9,917)                    | (31,384)            | 19,699              |
| Discontinued operations, net of taxes:                            |                             |               |                             |                            |                     |                     |
| Income (loss) from operations of hospitals sold and held for sale |                             |               |                             | (6,811)                    |                     | (6,811)             |



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|  |           |           |           |             |             |           |
|--|-----------|-----------|-----------|-------------|-------------|-----------|
| Gain (loss) on sale of hospitals, net    |           |           |           | (2,428)     |             | (2,428)   |
| Income (loss) on discontinued operations |           |           |           | (9,239)     |             | (9,239)   |
| Net income                               | \$ 10,460 | \$ 10,460 | \$ 40,080 | \$ (19,156) | \$ (31,384) | \$ 10,460 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Income  
Nine Months Ended September 30, 2008**

|  | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors<br/>(In thousands)</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|-----------------------------|---------------|--|----------------------------|---------------------|---------------------|
| Net operating revenues                                       | \$                          | \$            | \$ 5,057,176                                   | \$ 3,133,838               | \$                  | \$ 8,191,014        |
| Operating costs and expenses:                                |                             |               |  |                            |                     |                     |
| Salaries and benefits  |                             |               | 1,899,228                                      | 1,359,644                  |                     | 3,258,872           |
| Provision for bad debts                                      |                             |               | 584,292  | 330,046                    |                     | 914,338             |
| Supplies   |                             |               | 669,709  | 477,428                    |                     | 1,147,137           |
| Other operating expenses                                     |                             |               | 909,085  | 672,543                    |                     | 1,581,628           |
| Rent   |                             |               | 90,323   | 86,855                     |                     | 177,178             |
| Depreciation and amortization                                |                             |               | 235,618  | 142,546                    |                     | 378,164             |
|  |                             |               | 4,388,255                                      | 3,069,062                  |                     | 7,457,317           |
| Income from operations                                       |                             |               | 668,921  | 64,776                     |                     | 733,697             |
| Interest expense, net  |                             | 52,596        | 401,483  | 33,769                     |                     | 487,848             |
| Loss from early extinguishment of debt                       |                             | 1,328         |  |                            |                     | 1,328               |
| Minority interest in earnings                                |                             |               | (174)  | 28,533                     |                     | 28,359              |
| Equity in earnings of subsidiary                             | (158,404)                   | (189,020)     | (38,705)                                       |                            | 354,046             | (32,083)            |
| Income (loss) from continuing operations before income taxes | 158,404                     | 135,096       | 306,317  | 2,474                      | (354,046)           | 248,245             |
| Provision for income taxes                                   |                             | (23,308)      | 117,932  | 950                        |                     | 95,574              |
| Income (loss) from continuing operations                     | 158,404                     | 158,404       | 188,385  | 1,524                      | (354,046)           | 152,671             |

|   |            |            |            |          |              |    |         |
|---|------------|------------|------------|----------|--------------|----|---------|
| Discontinued operations, net of taxes:                            |            |            |            |          |              |    |         |
| Income (loss) from operations of hospitals sold and held for sale |            |            |            | (3,847)  |              |    | (3,847) |
| Gain (loss) on sale of hospitals, net                             |            |            |            | 9,580    |              |    | 9,580   |
| Income (loss) on discontinued operations                          |            |            |            | 5,733    |              |    | 5,733   |
| Net income  | \$ 158,404 | \$ 158,404 | \$ 188,385 | \$ 7,257 | \$ (354,046) | \$ | 158,404 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Income  
Nine Months Ended September 30, 2007**

|  | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors<br/>(In thousands)</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|-----------------------------|---------------|--|----------------------------|---------------------|---------------------|
| Net operating revenues                                       | \$                          | \$            | \$ 3,374,157                                   | \$ 1,224,995               | \$                  | \$ 4,599,152        |
| Operating costs and expenses:                                |                             |               |  |                            |                     |                     |
| Salaries and benefits  |                             |               | 1,272,902                                      | 566,133                    |                     | 1,839,035           |
| Provision for bad debts                                      |                             |               | 406,297  | 129,857                    |                     | 536,154             |
| Supplies   |                             |               | 409,973  | 169,598                    |                     | 579,571             |
| Other operating expenses                                     |                             |               | 648,637  | 272,100                    |                     | 920,737             |
| Rent   |                             |               | 62,161   | 36,804                     |                     | 98,965              |
| Depreciation and amortization                                |                             |               | 150,305  | 50,806                     |                     | 201,111             |
|  |                             |               | 2,950,275                                      | 1,225,298                  |                     | 4,175,573           |
| Income from operations                                       |                             |               | 423,882  | (303)                      |                     | 423,579             |
| Interest expense, net  |                             | 13,736        | 158,064  | 20,977                     |                     | 192,777             |
| Loss from early extinguishment of debt                       |                             | 27,291        |  |                            |                     | 27,291              |
| Minority interest in earnings                                |                             |               | 713  | 5,476                      |                     | 6,189               |
| Equity in earnings of subsidiary                             | (118,547)                   | (154,956)     | 15,230   |                            | 243,989             | (14,284)            |
| Income (loss) from continuing operations before income taxes | 118,547                     | 113,929       | 249,875  | (26,756)                   | (243,989)           | 211,606             |
| Provision for income taxes                                   |                             | (4,618)       | 95,952   | (10,274)                   |                     | 81,060              |
| Income (loss) from continuing operations                     | 118,547                     | 118,547       | 153,923  | (16,482)                   | (243,989)           | 130,546             |

|   |            |            |            |             |              |    |          |
|---|------------|------------|------------|-------------|--------------|----|----------|
| Discontinued operations, net of taxes:                            |            |            |            |             |              |    |          |
| Income (loss) from operations of hospitals sold and held for sale |            |            |            | (9,571)     |              |    | (9,571)  |
| Gain (loss) on sale of hospitals, net                             |            |            |            | (2,428)     |              |    | (2,428)  |
| Income (loss) on discontinued operations                          |            |            |            | (11,999)    |              |    | (11,999) |
| Net income  | \$ 118,547 | \$ 118,547 | \$ 153,923 | \$ (28,481) | \$ (243,989) | \$ | 118,547  |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Cash Flows  
Nine Months Ended September 30, 2008**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
|   | <b>(In thousands)</b>       |               |                             |                            |                     |                     |
| Cash flows from operating activities:                               |                             |               |                             |                            |                     |                     |
| Net cash provided by(used in) operating activities                  | \$ 75,635                   | \$ (90,495)   | \$ 671,418                  | \$ 28,498                  | \$                  | \$ 685,056          |
| Cash flows from investing activities:                               |                             |               |                             |                            |                     |                     |
| Acquisitions of facilities and other related equipment              |                             |               | (7,054)                     | (220)                      |                     | (7,274)             |
| Purchases of property and equipment                                 |                             |               | (323,169)                   | (128,240)                  |                     | (451,409)           |
| Proceeds from disposition of hospitals and other ancillary services |                             |               |                             | 365,635                    |                     | 365,635             |
| Proceeds from sale of property and equipment                        |                             |               | 11,833                      | 2,131                      |                     | 13,964              |
| Investment in other assets  |                             | (16,100)      | (121,259)                   | (14,809)                   |                     | (152,168)           |
| Net cash provided by (used in) investing activities                 |                             | (16,100)      | (439,649)                   | 224,497                    |                     | (231,252)           |
| Cash flows from financing activities:                               |                             |               |                             |                            |                     |                     |
| Proceeds from exercise of stock options                             | 1,688                       |               |                             |                            |                     | 1,688               |
| Stock buy-back  | (17,096)                    |               |                             |                            |                     | (17,096)            |
| Excess tax benefits relating to stock-based compensation            | 1,278                       |               |                             |                            |                     | 1,278               |
| Deferred financing costs  |                             | (2,569)       |                             |                            |                     | (2,569)             |
| Proceeds from minority investors in joint ventures                  |                             |               |                             | 11,652                     |                     | 11,652              |
| Redemption of minority investments in joint ventures                |                             |               |                             | (53,485)                   |                     | (53,485)            |

|   |          |           |            |           |          |            |
|---|----------|-----------|------------|-----------|----------|------------|
| Distributions to minority investors in joint ventures |          |           |            | (24,351)  |          | (24,351)   |
| Changes in intercompany balances with affiliates, net | (61,505) | 270,958   | (13,119)   | (196,334) |          |            |
| Borrowings under credit agreement                     |          | 25,000    |            | 31,787    | (26,191) | 30,596     |
| (Repayments) borrowings of long-term indebtedness     |          | (186,794) | (27,833)   | (4,071)   | 26,191   | (192,507)  |
| Net cash provided by (used in) financing activities   | (75,635) | 106,595   | (40,952)   | (234,802) |          | (244,794)  |
| Net change in cash and cash equivalents               |          |           | 190,817    | 18,193    |          | 209,010    |
| Cash and cash equivalents at beginning of period      |          |           | 114,075    | 18,799    |          | 132,874    |
| Cash and cash equivalents at end of period            | \$       | \$        | \$ 304,892 | \$ 36,992 | \$       | \$ 341,884 |

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Cash Flows  
Nine Months Ended September 30, 2007**

|   | <b>Parent<br/>Guarantor</b> | <b>Issuer</b> | <b>Other<br/>Guarantors</b> | <b>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------|---------------|-----------------------------|----------------------------|---------------------|---------------------|
|   | <b>(In thousands)</b>       |               |                             |                            |                     |                     |
| Cash flows from operating activities:                               |                             |               |                             |                            |                     |                     |
| Net cash provided by(used in) operating activities                  | \$ (117,277)                | \$ 95,115     | \$ 370,813                  | \$ 55,999                  | \$                  | \$ 404,650          |
| Cash flows from investing activities:                               |                             |               |                             |                            |                     |                     |
| Acquisitions of facilities and other related equipment              |                             | (6,829,532)   | (105,610)                   | (46,957)                   |                     | (6,982,099)         |
| Purchases of property and equipment                                 |                             |               | (253,233)                   | (25,310)                   |                     | (278,543)           |
| Proceeds from disposition of hospitals and other ancillary services |                             |               |                             | 12,962                     |                     | 12,962              |
| Proceeds from sale of property and equipment                        |                             |               | 502                         | 99                         |                     | 601                 |
| Investment in other assets  |                             |               | (53,509)                    | (12,516)                   |                     | (66,025)            |
| Net cash provided by (used in) investing activities                 |                             | (6,829,532)   | (411,850)                   | (71,722)                   |                     | (7,313,104)         |
| Cash flows from financing activities:                               |                             |               |                             |                            |                     |                     |
| Proceeds from exercise of stock options                             | 7,804                       |               |                             |                            |                     | 7,804               |
| Excess tax benefits relating to stock-based compensation            | 2,275                       |               |                             |                            |                     | 2,275               |
| Deferred financing costs  |                             | (190,110)     |                             |                            |                     | (190,110)           |
| Proceeds from minority investors in joint ventures                  | 51                          |               |                             | 1,137                      |                     | 1,188               |
| Redemption of minority investments in joint ventures                |                             |               |                             | (1,339)                    |                     | (1,339)             |



|   |           |             |           |           |    |             |
|---|-----------|-------------|-----------|-----------|----|-------------|
| Distributions to minority investors in joint ventures |           |             |           | (2,774)   |    | (2,774)     |
| Changes in intercompany balances with affiliates, net | 407,143   | (549,956)   | 133,807   | 9,006     |    |             |
| Borrowings under credit agreement                     |           | 9,193,483   |           | 39,848    |    | 9,233,331   |
| (Repayments) borrowings of long-term indebtedness     | (299,996) | (1,719,000) | (23,402)  | (21,234)  |    | (2,063,632) |
| Net cash provided by (used in) financing activities   | 117,277   | 6,734,417   | 110,405   | 24,644    |    | 6,986,743   |
| Net change in cash and cash equivalents               |           |             | 69,368    | 8,921     |    | 78,289      |
| Cash and cash equivalents at beginning of period      |           |             | 28,560    | 12,006    |    | 40,566      |
| Cash and cash equivalents at end of period            | \$        | \$          | \$ 97,928 | \$ 20,927 | \$ | \$ 118,855  |

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### **Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

You should read this discussion together with our unaudited condensed consolidated financial statements and accompanying notes included herein.

Unless the context otherwise requires, Community Health Systems, the Company, we, us and our refer to Community Health Systems, Inc. and its consolidated subsidiaries.

#### **Executive Overview**

We are the largest publicly traded operator of hospitals in the United States in terms of number of facilities and net operating revenues. We provide healthcare services through these hospitals that we own and operate in non-urban and selected urban markets. We generate revenue primarily by providing a broad range of general hospital healthcare services to patients in the communities in which we are located. We currently have 116 general acute care hospitals included in continuing operations. In addition, we own four home health agencies, located in markets where we do not operate a hospital and through our wholly-owned subsidiary, Quorum Health Resources, LLC ( QHR ), we provide management and consulting services to non-affiliated general acute care hospitals located throughout the United States. We are paid for our services by governmental agencies, private insurers and directly by the patients we serve.

Effective July 25, 2007, we completed our acquisition of Triad Hospitals, Inc., or Triad, for an aggregate consideration of \$6.857 billion, including \$1.686 billion of assumed indebtedness. In connection with this acquisition, one of our subsidiaries issued \$3.021 billion principal amount of 8.875% senior notes due 2015 (the Notes ) and we entered into a new \$7.215 billion credit facility (the New Credit Facility ) consisting of a \$6.065 billion term loan, a \$750 million revolving credit facility and a \$400 million delayed draw term loan facility. The delayed draw term loan facility was subsequently reduced in the fourth quarter of 2007, per our request, from \$400 million to \$300 million. The proceeds of these financings were used to pay the cash consideration under the merger agreement and to refinance substantially all of both the assumed indebtedness and our existing indebtedness and to pay related fees and expenses. The revolving credit facility and the delayed draw term loan facility remain available to us for future acquisitions, working capital, and general corporate purposes. We believe the acquisition of Triad will continue to benefit us since it has expanded the number of markets we serve, expanded our operations into five states where we previously did not operate, and reduced our concentration of credit risk in any one state. We also believe that synergies obtained from eliminating duplicate corporate functions and centralizing many support functions will allow us to improve Triad's margins. During the three and nine months ended September 30, 2008, we have realized approximately \$38 million and \$115 million, respectively, of our estimated synergies related to the Triad acquisition.

Since July 25, 2007, we have sold seven hospitals acquired from Triad and seven hospitals owned by us prior to our acquisition of Triad. Accordingly, these hospitals have been classified in discontinued operations in the condensed consolidated statements of income for the three and nine months ended September 30, 2008 and three and nine months ended September 30, 2007 to the extent that the hospitals were owned by us during the respective periods.

Effective June 30, 2008, we acquired the remaining 35% equity interest in Affinity Health Systems, LLC which indirectly owns and operates Trinity Medical Center (560 licensed beds) located in Birmingham, Alabama, from Baptist Health Systems, Inc. of Birmingham, Alabama ( Baptist ), giving us 100% ownership of that facility.

On October 1, 2008, subsequent to the end of the third quarter of 2008, we completed the acquisition of Deaconess Medical Center and Valley Hospital and Medical Center located in Spokane, Washington, from Empire Health Services. This represents our first hospital acquisition since the acquisition of Triad in July, 2007. We have completed our initial integration efforts related to Triad, and therefore selectively pursue additional favorable acquisition opportunities during the remainder of 2008 and into 2009.

In the quarter ended June 30, 2008, we were informed that we would not receive the full amount of previously estimated reimbursements under certain Indiana Medicaid programs. The reductions are due partly to the state not receiving a federal waiver for one of its programs and partly as a result of changes to its disproportionate share

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program which were different from what had previously been communicated to us. This represents an approximately \$8.0 million reduction in expected payments from these programs on an annual basis.

For the three months ended September 30, 2008, we generated \$2.773 billion in net operating revenues, a growth of 23.4% over the three months ended September 30, 2007, and \$50.4 million of net income, an increase of 381.7% over the three months ended September 30, 2007. For the three months ended September 30, 2008, consolidated admissions increased 22.6% and adjusted admissions increased 21.9% over the three months ended September 30, 2007. The increases in net operating revenue and volume reflect our acquisition of the former Triad hospitals and improvements in revenue per adjusted admission.

For the nine months ended September 30, 2008, we generated \$8.191 billion in net operating revenues, a growth of 78.1% over the nine months ended September 30, 2007, and \$158.4 million of net income, an increase of 33.6% over the nine months ended September 30, 2007. For the nine months ended September 30, 2008, consolidated admissions increased 68.9% and adjusted admissions increased 63.9% over the nine months ended September 30, 2007. The increases in net operating revenue and volume reflect our acquisition of the former Triad hospitals and improvements in revenue per adjusted admission.

We believe there continues to be ample opportunity for growth in substantially all of our markets by decreasing the need for patients to travel outside their communities for health care services. Furthermore, we continue to benefit from synergies from the Triad acquisition and will continue to strive to improve operating efficiencies and procedures in order to improve our profitability at all of our hospitals.

**Sources of Consolidated Net Operating Revenue**

The following table presents the approximate percentages of net operating revenue derived from Medicare, Medicaid, managed care and other third party payors, and self-pay for the periods indicated. The data for the periods presented are not strictly comparable due to the significant effect that hospital acquisitions have had on these statistics.

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Medicare                                  | 26.2%                                       | 27.8%       | 27.4%                                      | 29.0%       |
| Medicaid                                  | 9.3%  | 10.5%       | 8.8%                                       | 10.7%       |
| Managed Care and other third party payors | 53.3%                                       | 50.9%       | 52.8%                                      | 48.7%       |
| Self-pay                                  | 11.2%                                       | 10.8%       | 11.0%                                      | 11.6%       |
| Total                                     | 100.0%                                      | 100.0%      | 100.0%                                     | 100.0%      |

Net operating revenues include amounts estimated by management to be reimbursable by Medicare and Medicaid under prospective payment systems and provisions of cost-based reimbursement and other payment methods. In addition, we are reimbursed by non-governmental payors using a variety of payment methodologies. Amounts we receive for treatment of patients covered by these programs are generally less than the standard billing rates. We account for the differences between the estimated program reimbursement rates and the standard billing rates as contractual allowance adjustments, which we deduct from gross revenues to arrive at net operating revenues. Final settlements under some of these programs are subject to adjustment based on administrative review and audit by third parties. We account for adjustments to previous program reimbursement estimates as contractual allowance

adjustments and report them in the periods that such adjustments become known. Adjustments related to final settlements that increased revenue were insignificant to both net operating revenue and net income in each of the three and nine months ended September 30, 2008 and 2007. In the future, we expect the percentage of revenues received from the Medicare program to increase due to the general aging of the population.

The payment rates under the Medicare program for inpatient acute services are based on a prospective payment system, depending upon the diagnosis of a patient's condition. These rates are indexed for inflation annually, although increases have historically been less than actual inflation. Reductions in the rate of increase in Medicare reimbursement may cause our net operating revenue growth to decline.

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In addition, specified managed care programs, insurance companies, and employers are actively negotiating the amounts paid to hospitals. The trend toward increased enrollment in managed care may adversely affect our net operating revenue growth.

**Results of Operations**

Our hospitals offer a variety of services involving a broad range of inpatient and outpatient medical and surgical services. These include orthopedics, cardiology, occupational medicine, diagnostic services, emergency services, rehabilitation treatment, home health and skilled nursing. The strongest demand for hospital services generally occurs during January through April and the weakest demand for these services occurs during the summer months.

Accordingly, eliminating the effect of new acquisitions, our net operating revenues and earnings are historically highest during the first quarter and lowest during the third quarter.

The following tables summarize, for the periods indicated, selected operating data.

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Consolidated(a)                                       |   |             |  |             |
| Net operating revenues                                | 100.0%                                      | 100.0%      | 100.0%                                     | 100.0%      |
| Operating expenses(b)                                 | (86.2)                                      | (87.3)      | (86.4)                                     | (86.4)      |
| Depreciation and amortization                         | (4.7)                                       | (4.5)       | (4.6)                                      | (4.4)       |
| Income from operations                                | 9.1   | 8.2         | 9.0  | 9.2         |
| Interest expense, net                                 | (6.1)                                       | (6.0)       | (6.0)                                      | (4.2)       |
| Loss from early extinguishment of debt                |   | (1.2)       |  | (0.6)       |
| Minority interest in earnings                         | (0.3)                                       | (0.2)       | (0.4)                                      | (0.1)       |
| Equity in earnings of unconsolidated affiliates       | 0.3   | 0.6         | 0.4  | 0.3         |
| Income from continuing operations before income taxes | 3.0   | 1.4         | 3.0  | 4.6         |
| Provision for income taxes                            | (1.1)                                       | (0.5)       | (1.1)                                      | (1.8)       |
| Income from continuing operations                     | 1.9   | 0.9         | 1.9  | 2.8         |
| Loss on discontinued operations                       | (0.1)                                       | (0.4)       |  | (0.2)       |
| Net income  | 1.8%  | 0.5%        | 1.9%                                       | 2.6%        |

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2008</b> | <b>Nine Months<br/>Ended<br/>September 30,<br/>2008</b> |
|--|--|---|
| Percentage increase (decrease) from same period prior year(a): |  |   |
| Net operating revenues   | 23.4%  | 78.1%   |
| Admissions   | 22.6   | 68.9  |

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|   |       |      |
|---|-------|------|
| Adjusted admissions(c)  | 21.9  | 63.9 |
| Average length of stay  | (2.4) | 0.0  |
| Net income(d)   | 381.7 | 33.6 |
| Same-store percentage increase from same period prior year(a)(e): |       |      |
| Net operating revenues  | 8.2%  | 6.3% |
| Admissions  | 2.3   | 2.8  |
| Adjusted admissions(c)  | 2.5   | 2.9  |

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- (a) Pursuant to Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we have restated our prior period financial statements and statistical results to reflect discontinued operations.
- (b) Operating expenses include salaries and benefits, provision for bad debts, supplies, rent and other operating expenses.
- (c) Adjusted admissions is a general measure of combined inpatient and outpatient volume. We computed adjusted admissions by multiplying admissions by gross patient revenues and then dividing that number by gross inpatient revenues.
- (d) Includes loss from operations of discontinued hospitals and gain on sale of discontinued hospitals.
- (e) Includes former Triad hospitals during the comparable periods and other acquired hospitals to the extent we operated them in both years.

**Three months Ended September 30, 2008 Compared to Three months Ended September 30, 2007**

Net operating revenues increased \$525.9 million to \$2.773 billion for the three months ended September 30, 2008, from \$2.247 billion for the three months ended September 30, 2007. On a combined basis, the hospitals acquired in the Triad acquisition and growth from those hospitals owned throughout both periods contributed \$514.8 million of that increase and \$11.1 million was contributed by other hospitals acquired in 2007. On a same-store basis, including the former Triad hospitals during the comparable periods, this represents an increase in same-store net revenue of 8.2%. The increase from hospitals that we owned throughout both periods was attributable to volume increases, rate increases, payor mix and the acuity level of services provided.

On a consolidated basis, inpatient admissions increased by 22.6% and adjusted admissions increased by 21.9%. With respect to the increase in consolidated admissions, approximately 50.3% of the admissions were contributed from newly acquired hospitals, including those hospitals acquired from Triad, and 49.7% of the admissions were contributed by hospitals we owned throughout both periods. On a same-store basis, which includes the hospitals acquired from Triad, as if we owned them during both periods, admissions increased by 2.3% during the three months ended September 30, 2008.

Operating expenses, excluding depreciation and amortization, as a percentage of net operating revenues, decreased to 86.2% for the three months ended September 30, 2008 compared to 87.3% for the three months ended September 30, 2007. Salaries and benefits, as a percentage of net operating revenues, decreased 0.8% to 39.4% for the three months ended September 30, 2008, compared to 40.2% for the three months ended September 30, 2007. This decrease is primarily the result of efficiency improvements realized at our hospitals owned throughout both periods. These improvements were offset by an increase in the number of employed physicians as well as an increase in salaries for certain IT employees who were previously treated as leased employees with related expense previously being included in other operating expense. Provision for bad debts, as a percentage of net operating revenues, decreased 0.1% to 11.8% for the three months ended September 30, 2008 compared to 11.9% for the three months ended September 30, 2007. Supplies, as a percentage of net operating revenues, increased 0.2% to 13.8% for the three months ended September 30, 2008, as compared to 13.6% for the three months ended September 30, 2007. This increase is primarily the result of the acquisition of the former Triad hospitals whose higher acuity of services resulted in higher supply costs than our other hospitals taken collectively, offsetting improvements from greater utilization of and improved pricing under our purchasing program. Rent and other operating expenses, as a percentage of net operating revenues, decreased 0.4% to 21.2% for the three months ended September 30, 2008, from 21.6% for the three months ended



September 30, 2007. As part of our acquisition of Triad, we acquired minority ownership interests in several hospitals. Our percentage of ownership interests in these joint ventures provided earnings of 0.3% of net operating revenues for the three months ended September 30, 2008, as compared to 0.6% for the three months ended September 30, 2007. Prior to the Triad acquisition, we did not have any material investments in unconsolidated subsidiaries.

Depreciation and amortization increased from 4.5% of net operating revenues for the three months ended September 30, 2007 to 4.7% of net operating revenues for the three months ended September 30, 2008. The increase in depreciation and amortization as a percentage of net operating revenue is primarily due to the acquisition of the

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former Triad hospitals which, as a result of a higher level of capital spending, had a higher fair market valuation in relation to their respective revenue than that of our other hospitals in the comparable period.

Interest expense, net, increased by \$32.6 million from \$135.2 million for the three months ended September 30, 2007 to \$167.8 million for the three months ended September 30, 2008. An increase in interest rates during the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, accounted for \$3.5 million of this increase, while an increase in our average outstanding debt during the three months ended September 30, 2008, as compared to the three months ended September 30, 2007, accounted for the remaining \$29.1 million.

Income from continuing operations as a percentage of net operating revenue increased from 0.9% for the three months ended September 30, 2007 to 1.9% for the three months ended September 30, 2008. Net income as a percentage of net operating revenue increased from 0.5% for the three months ended September 30, 2007 to 1.8% for the three months ended September 30, 2008. The increase in income from continuing operations as a percentage of net operating revenue and net income as a percentage of net operating revenue are reflective of the net decreases in operating expenses, as discussed above.

The net results of the above mentioned changes resulted in income from continuing operations before income taxes increasing \$52.2 million from \$31.4 million for the three months ended September 30, 2007 to \$83.6 million for the three months ended September 30, 2008.

Provision for income taxes increased from \$11.7 million for the three months ended September 30, 2007 to \$32.2 million for the three months ended September 30, 2008, due primarily to an increase in taxable income in the comparable period resulting from both the acquisition of Triad as well as reducing operating expenses as a percentage of net operating revenues.

Net income was \$50.4 million for the three months ended September 30, 2008 compared to \$10.5 million for the three months ended September 30, 2007, representing an increase of 381.7%.

**Nine months Ended September 30, 2008 Compared to Nine months Ended September 30, 2007**

Net operating revenues increased \$3.592 billion to \$8.191 billion for the nine months ended September 30, 2008, from \$4.599 billion for the nine months ended September 30, 2007. On a combined basis, the hospitals acquired in the Triad acquisition and growth from those hospitals owned throughout both periods contributed \$3.460 billion of that increase and \$132.0 million was contributed by other hospitals acquired in 2007. On a same-store basis, including the former Triad hospitals during the comparable periods, this represents an increase in same-store net revenue of 6.3%. The increase from hospitals that we owned throughout both periods was attributable to volume increases, rate increases, payor mix and the acuity level of services provided. Our revenue and volume increases were benefited by the current year being a leap year thus have one additional business day.

On a consolidated basis, inpatient admissions increased by 68.9% and adjusted admissions increased by 63.9%. With respect to the increase in consolidated admissions, approximately 51.2% of the admissions were contributed from newly acquired hospitals, including those hospitals acquired from Triad, and 48.8% of the admissions were contributed by hospitals we owned throughout both periods. On a same-store basis, which includes the hospitals acquired from Triad, as if we owned them during both periods, admissions increased by 2.8% during the nine months ended September 30, 2008.

Operating expenses, excluding depreciation and amortization, as a percentage of net operating revenues, remained consistent at 86.4% for the nine months ended September 30, 2008 and 2007. Salaries and benefits, as a percentage of

net operating revenues, decreased 0.2% to 39.8% for the nine months ended September 30, 2008, compared to 40.0% for the nine months ended September 30, 2007. This decrease is primarily the result of efficiency improvements realized at our hospitals owned throughout both periods. These improvements are offset by an increase in the number of employed physicians as well as an increase in salaries for certain IT employees who were previously treated as leased employees with related expense previously being included in other operating expense. Provision for bad debts, as a percentage of net operating revenues, decreased 0.5% to 11.2% for the nine months ended September 30, 2008 compared to 11.7% for the nine months ended September 30, 2007. This decrease is primarily the result of the former Triad hospitals having a self-pay discount program and historically

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lower provision for bad debts, as well as our phasing in of a discounting program at those hospitals where one previously did not exist. Supplies, as a percentage of net operating revenues, increased 1.4% to 14.0% for the nine months ended September 30, 2008, as compared to 12.6% for the nine months ended September 30, 2007. This increase is primarily the result of the acquisition of the former Triad hospitals whose higher acuity of services resulted in higher supply costs than our other hospitals taken collectively, offsetting improvements from greater utilization of and improved pricing under our purchasing program. Rent and other operating expenses, as a percentage of net operating revenues, decreased from 22.1% for the nine months ended September 30, 2007 to 21.4% for the nine months ended September 30, 2008. As part of our acquisition of Triad, we acquired minority ownership interests in several hospitals. Our percentage of ownership interests in these joint ventures provided earnings of 0.4% of net operating revenues for the nine months ended September 30, 2008, as compared to 0.1% for the nine months ended September 30, 2007. Prior to the Triad acquisition, we did not have any material investments in unconsolidated subsidiaries.

Depreciation and amortization increased from 4.4% of net operating revenues for the nine months ended September 30, 2007 to 4.6% of net operating revenues for the nine months ended September 30, 2008. The increase in depreciation and amortization as a percentage of net operating revenue is primarily due to the acquisition of the former Triad hospitals which, as a result of a higher level of capital spending, had a higher fair market valuation in relation to their respective revenue than that of our other hospitals in the comparable period.

Interest expense, net, increased by \$295.0 million from \$192.8 million for the nine months ended September 30, 2007 to \$487.8 million for the nine months ended September 30, 2008. Since the current year is a leap year, one additional day in the nine months resulted in \$0.3 million of the increase in interest expense. An increase in interest rates during the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007, accounted for \$30.1 million of this increase, while an increase in our average outstanding debt during the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007, accounted for the remaining \$264.6 million.

Income from continuing operations as a percentage of net operating revenue decreased from 2.8% for the nine months ended September 30, 2007 to 1.9% for the nine months ended September 30, 2008. Net income as a percentage of net operating revenue decreased from 2.6% for the nine months ended September 30, 2007 to 1.9% for the nine months ended September 30, 2008. The decrease in income from continuing operations as a percentage of net operating revenue and net income as a percentage of net operating revenue are reflective of the net increase in depreciation and amortization and interest expense, as discussed above.

The net results of the above mentioned changes resulted in income from continuing operations before income taxes increasing \$36.6 million from \$211.6 million for the nine months ended September 30, 2007 to \$248.2 million for the nine months ended September 30, 2008.

Provision for income taxes increased from \$81.1 million for the nine months ended September 30, 2007 to \$95.6 million for the nine months ended September 30, 2008, due primarily to an increase in taxable income in the comparable period.

Net income was \$158.4 million for the nine months ended September 30, 2008 compared to \$118.5 million for the nine months ended September 30, 2007, representing an increase of 33.7%.

## **Liquidity and Capital Resources**

Net cash provided by operating activities increased \$280.4 million, from \$404.7 million for the nine months ended September 30, 2007 to \$685.1 million for the nine months ended September 30, 2008. The increase in cash flows, in

comparison to the prior year period reflects improved profitability, noted by the increase in net income of \$39.9 million, an increase in cash flow not reflected in net income due to increases in non-cash expenses of \$164.4 million, consisting primarily of depreciation, an increase in cash flow from the change in accounts payable, accrued liabilities and income taxes of \$139.2 million and an increase in cash from the net changes in other operating assets and liabilities of \$5.9 million. These cash inflows were offset by a decrease in cash flows from growth in accounts receivable of \$63.6 million, reflecting our growth in net operating revenues and volume as

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compared to the prior year, and a decrease in cash flows of \$5.4 million from the net activity of supplies, prepaid expenses and other current assets.

The cash used in investing activities was \$231.3 million for the nine months ended September 30, 2008 compared to \$7.313 billion for the nine months ended September 30, 2007. This decrease in cash used in investing activities was due to the acquisition of Triad during the nine months ended September 30, 2007, compared to the sale of 11 hospitals, as well as not completing any hospital acquisitions during the nine months ended September 30, 2008. This change is offset by an increase in capital expenditures compared to the nine months ended September 30, 2007.

Cash provided by financing activities decreased from a net cash inflow of \$6.987 billion for the nine months ended September 30, 2007 to a net cash outflow of \$244.8 million for the nine months ended September 30, 2008. This change is primarily due to the \$6.903 billion of financing received in 2007 from our New Credit Facility and issuance of Notes in connection with the acquisition of Triad, compared to the \$192.5 million of repayment of our long-term indebtedness during the nine months ended September 30, 2008.

### ***Capital Expenditures***

Cash expenditures related to purchases of facilities were \$7.3 million for the nine months ended September 30, 2008, compared to \$6.982 billion for the nine months ended September 30, 2007. These expenditures during the nine months ended September 30, 2008 include the purchase of the remaining 35% equity interest of our hospital in Birmingham, Alabama, and the acquisition of ten physician practices and four clinics. The expenditures during the nine months ended September 30, 2007 included \$6.830 billion related to the acquisition of Triad and \$145.5 million for the acquisition of two hospitals, the contingent settlements of working capital items from acquisitions in the prior year and the acquisition of five physician practices and \$7.1 million for the purchase of information systems and other equipment to integrate recently acquired hospitals.

Excluding the cost to construct replacement hospitals, our capital expenditures for the nine months ended September 30, 2008, totaled \$329.1 million, compared to \$177.4 million for the nine months ended September 30, 2007. Costs to construct replacement hospitals totaled \$122.4 million during the nine months ended September 30, 2008 compared to \$101.1 million during the nine months ended September 30, 2007. Pursuant to a hospital purchase agreement in effect as of September 30, 2008, where required certificate of need approval has been obtained, we are required to build a replacement facility in Valparaiso, Indiana by April 2011. Three previously required replacement hospitals were recently completed and opened: one in Clarksville, Tennessee (June 2008), one in Shelbyville, Tennessee (July 2008), and one in Petersburg, Virginia (August 2008). Also, as required by an amendment to a lease agreement entered into in 2005, we agreed to build a replacement hospital at our Barstow, California location by 2013. Estimated construction costs, including equipment, of the two hospitals required to be completed and where certificate of need approval has been obtained is \$295.0 million. To date, approximately \$7.2 million of these costs have been incurred. The construction costs, including equipment, of the three facilities completed and opened in 2008 was \$371.2 million, all of which has been incurred to date. In addition, in October 2008, after the purchase of the minority owner's interest in our Birmingham, Alabama facility, we have initiated the purchase of an alternate site for a replacement hospital rather than the one previously selected by Triad. The new site includes a partially constructed hospital structure, for which we are currently assessing completion costs, to be used for relocating our existing Birmingham facility. This project is subject to our application for and approval of a certificate of need. Upon receiving the certification of need we will undertake completion of the unfinished facility.

### ***Capital Resources***

Net working capital was \$1.223 billion at September 30, 2008, compared to \$1.105 billion at December 31, 2007. The \$156.7 million increase was attributable primarily to an increase in cash and accounts receivable and a decrease in

accounts payable, which reflects the timing of our cash collections and payments.

In connection with the consummation of the Triad acquisition in July 2007, we obtained \$7.215 billion of senior secured financing under a New Credit Facility with a syndicate of financial institutions led by Credit Suisse, as administrative agent and collateral agent. The New Credit Facility consists of a \$6.065 billion funded term loan

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facility with a maturity of seven years, a \$300 million delayed draw term loan facility (reduced from \$400 million) with a maturity of seven years and a \$750 million revolving credit facility with a maturity of nine years. The revolving credit facility also includes a subfacility for letters of credit and a swingline subfacility. The New Credit Facility requires us to make quarterly amortization payments of each term loan facility equal to 0.25% of the initial outstanding amount of the term loans, if any, with the outstanding principal balance of each term loan facility payable on July 25, 2014.

The term loan facility must be prepaid in an amount equal to (1) 100% of the net cash proceeds of certain asset sales and dispositions by us and our subsidiaries, subject to certain exceptions and reinvestment rights, (2) 100% of the net cash proceeds of issuances of certain debt obligations or receivables based financing by us and our subsidiaries, subject to certain exceptions, and (3) 50%, subject to reduction to a lower percentage based on our leverage ratio (as defined in the New Credit Facility generally as the ratio of total debt on the date of determination to our EBITDA, as defined, for the four quarters most recently ended prior to such date), of excess cash flow (as defined) for any year, commencing in 2008, subject to certain exceptions. Voluntary prepayments and commitment reductions are permitted in whole or in part, without premium or penalty, subject to minimum prepayment or reduction requirements.

The obligor under the New Credit Facility is CHS/Community Health Systems, Inc., or CHS, a wholly-owned subsidiary of Community Health Systems, Inc. All of our obligations under the New Credit Facility are unconditionally guaranteed by Community Health Systems, Inc. and certain existing and subsequently acquired or organized domestic subsidiaries. All obligations under the New Credit Facility and the related guarantees are secured by a perfected first priority lien or security interest in substantially all of the assets of Community Health Systems, Inc., CHS and each subsidiary guarantor, including equity interests held by us or any subsidiary guarantor, but excluding, among others, the equity interests of non-significant subsidiaries, syndication subsidiaries, securitization subsidiaries and joint venture subsidiaries.

The loans under the New Credit Facility will bear interest on the outstanding unpaid principal amount at a rate equal to an applicable percentage plus, at our option, either (a) an Alternate Base Rate (as defined) determined by reference to the greater of (1) the Prime Rate (as defined) announced by Credit Suisse or (2) the Federal Funds Effective Rate (as defined) plus one-half of 1.0%, or (b) a reserve adjusted London interbank offered rate for dollars (Eurodollar rate) (as defined). The applicable percentage for term loans is 1.25% for Alternate Base Rate loans and 2.25% for Eurodollar rate loans. The applicable percentage for revolving loans will initially be 1.25% for Alternate Base Rate revolving loans and 2.25% for Eurodollar revolving loans, in each case subject to reduction based on our leverage ratio. Loans under the swingline subfacility bear interest at the rate applicable to Alternate Base Rate loans under the revolving credit facility.

We have agreed to pay letter of credit fees equal to the applicable percentage then in effect with respect to Eurodollar rate loans under the revolving credit facility times the maximum aggregate amount available to be drawn under all letters of credit outstanding under the subfacility for letters of credit. The issuer of any letter of credit issued under the subfacility for letters of credit will also receive a customary fronting fee and other customary processing charges. We are initially obligated to pay commitment fees of 0.50% per annum (subject to reduction based upon on our leverage ratio), on the unused portion of the revolving credit facility. For purposes of this calculation, swingline loans are not treated as usage of the revolving credit facility. We are also obligated to pay commitment fees of 0.50% per annum for the first nine months after the close of the New Credit Facility, 0.75% per annum for the next three months thereafter and 1.0% per annum thereafter, in each case on the unused amount of the delayed draw term loan facility. We also paid arrangement fees on the closing of the New Credit Facility and will pay an annual administrative agent fee.

The New Credit Facility contains customary representations and warranties, subject to limitations and exceptions, and customary covenants restricting our and our subsidiaries' ability to, among other things and subject to various exceptions, (1) declare dividends, make distributions or redeem or repurchase capital stock, (2) prepay, redeem or



repurchase other debt, (3) incur liens or grant negative pledges, (4) make loans and investments and enter into acquisitions and joint ventures, (5) incur additional indebtedness or provide certain guarantees, (6) make capital expenditures, (7) engage in mergers, acquisitions and asset sales, (8) conduct transactions with affiliates, (9) alter the nature of our businesses, (10) grant certain guarantees with respect to

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physician practices, (11) engage in sale and leaseback transactions or (12) change our fiscal year. We and our subsidiaries are also required to comply with specified financial covenants (consisting of a leverage ratio and an interest coverage ratio) and various affirmative covenants.

Events of default under the New Credit Facility include, but are not limited to, (1) our failure to pay principal, interest, fees or other amounts under the credit agreement when due (taking into account any applicable grace period), (2) any representation or warranty proving to have been materially incorrect when made, (3) covenant defaults subject, with respect to certain covenants, to a grace period, (4) bankruptcy events, (5) a cross default to certain other debt, (6) certain undischarged judgments (not paid within an applicable grace period), (7) a change of control, (8) certain ERISA-related defaults and (9) the invalidity or impairment of specified security interests, guarantees or subordination provisions in favor of the administrative agent or lenders under the New Credit Facility.

As of September 30, 2008, there was approximately \$1.050 billion of available borrowing capacity under our New Credit Facility, of which \$78.3 million was set aside for outstanding letters of credit.

During the nine months ended September 30, 2008, we repurchased on the open market and cancelled \$62.7 million of principal amount of the Notes. This resulted in a loss from early extinguishment of debt of \$1.3 million with an after-tax impact of \$0.9 million.

As of September 30, 2008, we are currently a party to the following interest rate swap agreements to limit the effect of changes in interest rates on a portion of our long-term borrowings. On each of these swaps, we received a variable rate of interest based on the three-month London Inter-Bank Offer Rate ( LIBOR ), in exchange for the payment by us of a fixed rate of interest. We currently pay, on a quarterly basis, a margin above LIBOR of 225 basis points for revolving credit and term loans under the New Credit Facility.

| Swap # | Notional Amount<br>(in 000 s) | Fixed Interest Rate | Termination Date   | Fair Value<br>(in 000 s) |
|--------|-------------------------------|---------------------|--------------------|--------------------------|
| 1      | 100,000                       | 3.9350%             | June 6, 2009       | \$ (626)                 |
| 2      | 100,000                       | 4.3375%             | November 30, 2009  | (1,534)                  |
| 3      | 200,000                       | 2.8800%             | September 17, 2010 | 2,152                    |
| 4      | 100,000                       | 4.9360%             | October 4, 2010    | (3,360)                  |
| 5      | 100,000                       | 4.7090%             | January 24, 2011   | (3,058)                  |
| 6      | 300,000                       | 5.1140%             | August 8, 2011     | (13,140)                 |
| 7      | 100,000                       | 4.7185%             | August 19, 2011    | (3,268)                  |
| 8      | 100,000                       | 4.7040%             | August 19, 2011    | (3,175)                  |
| 9      | 100,000                       | 4.6250%             | August 19, 2011    | (3,001)                  |
| 10     | 200,000                       | 4.9300%             | August 30, 2011    | (7,773)                  |
| 11     | 200,000                       | 3.0920%             | September 18, 2011 | 3,110                    |
| 12     | 200,000                       | 4.4815%             | October 26, 2011   | (5,130)                  |
| 13     | 200,000                       | 4.0840%             | December 3, 2011   | (1,557)                  |
| 14     | 100,000                       | 3.8470%             | January 4, 2012    | (521)                    |
| 15     | 100,000                       | 3.8510%             | January 4, 2012    | (541)                    |
| 16     | 100,000                       | 3.8560%             | January 4, 2012    | (590)                    |
| 17     | 200,000                       | 3.7260%             | January 8, 2012    | (319)                    |
| 18     | 200,000                       | 3.5065%             | January 16, 2012   | 1,184                    |
| 19     | 250,000                       | 5.0185%             | May 30, 2012       | (11,186)                 |

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|    |         |         |                    |         |
|----|---------|---------|--------------------|---------|
| 20 | 150,000 | 5.0250% | May 30, 2012       | (6,760) |
| 21 | 200,000 | 4.6845% | September 11, 2012 | (6,584) |
| 22 | 125,000 | 4.3745% | November 23, 2012  | (2,654) |
| 23 | 75,000  | 4.3800% | November 23, 2012  | (2,598) |
| 24 | 150,000 | 5.0200% | November 30, 2012  | (7,046) |

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| <b>Swap #</b> | <b>Notional Amount<br/>(in 000 s)</b> | <b>Fixed Interest Rate</b> | <b>Termination Date</b> | <b>Fair Value<br/>(in 000 s)</b> |
|---------------|---------------------------------------|----------------------------|-------------------------|----------------------------------|
| 25            | 100,000                               | 5.0230%                    | May 30, 2013            | (4,880)                          |
| 26            | 300,000                               | 5.2420%                    | August 6, 2013          | (17,812)                         |
| 27            | 100,000                               | 5.0380%                    | August 30, 2013         | (5,009)                          |
| 28            | 100,000                               | 5.0500%                    | November 30, 2013       | (5,123)                          |
| 29            | 100,000                               | 5.2310%                    | July 25, 2014           | (6,269)                          |
| 30            | 100,000                               | 5.2310%                    | July 25, 2014           | (6,340)                          |
| 31            | 200,000                               | 5.1600%                    | July 25, 2014           | (11,872)                         |
| 32            | 75,000                                | 5.0405%                    | July 25, 2014           | (3,950)                          |
| 33            | 125,000                               | 5.0215%                    | July 25, 2014           | (6,463)                          |

The New Credit Facility and/or the Notes contain various covenants that limit our ability to take certain actions including, among other things, our ability to:

- incur, assume or guarantee additional indebtedness;
- issue redeemable stock and preferred stock;
- repurchase capital stock;
- make restricted payments, including paying dividends and making investments;
- redeem debt that is junior in right of payment to the notes;
- create liens without securing the notes;
- sell or otherwise dispose of assets, including capital stock of subsidiaries;
- enter into agreements that restrict dividends from subsidiaries;
- merge, consolidate, sell or otherwise dispose of substantial portions of our assets;
- enter into transactions with affiliates; and
- guarantee certain obligations.

In addition, our New Credit Facility contains restrictive covenants and requires us to maintain specified financial ratios and satisfy other financial condition tests. Our ability to meet these restricted covenants and financial ratios and tests can be affected by events beyond our control, and we cannot assure you that we will meet those tests. A breach of any of these covenants could result in a default under our New Credit Facility and/or the Notes. Upon the occurrence of an event of default under our New Credit Facility or the Notes, all amounts outstanding under our New Credit Facility and the Notes may become due and payable and all commitments under the New Credit Facility to extend further credit may be terminated.

We believe that internally generated cash flows, availability for additional borrowings under our New Credit Facility of \$1.050 billion (consisting of a \$750 million revolving credit facility and a \$300 million delayed draw term loan facility) and our ability to add up to \$300 million of borrowing capacity from receivable transactions (including securitizations) will be sufficient to finance acquisitions, capital expenditures and working capital requirements through the next 12 months. We believe these same sources of cash flows, borrowings under our credit agreement and, despite the current conditions in the financial and capital markets resulting from the global credit and liquidity issues, access to bank credit and capital markets will be available to us beyond the next 12 months and into the foreseeable future.

**Off-balance sheet arrangements**

Excluding the hospitals whose leases terminated in conjunction with our sale of interests in the partnerships holding the leases and whose operating results are included in discontinued operations, our consolidated operating

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results for the nine months ended September 30, 2008 and 2007, included \$212.2 million and \$203.8 million, respectively, of net operating revenue and \$14.2 million and \$14.9 million, respectively, of income from operations generated from nine hospitals operated by us under operating lease arrangements. In accordance with accounting principles generally accepted in the United States of America, or GAAP, the respective assets and the future lease obligations under these arrangements are not recorded on our condensed consolidated balance sheet. Lease payments under these arrangements are included in rent expense when paid and totaled approximately \$12.5 million for the nine months ended September 30, 2008, compared to \$11.5 million for the nine months ended September 30, 2007. The current terms of these operating leases expire between June 2010 and December 2019, not including lease extension options. If we allow these leases to expire, we would no longer generate revenue nor incur expenses from these hospitals.

In the past, we have utilized operating leases as a financing tool for obtaining the operations of specified hospitals without acquiring, through ownership, the related assets of the hospital and without a significant outlay of cash at the front end of the lease. We utilize the same management and operating strategies to improve operations at those hospitals held under operating leases as we do at those hospitals that we own. We have not entered into any operating leases for hospital operations since December 2000.

## **Joint Ventures**

We have sold minority interests in certain of our subsidiaries or acquired subsidiaries with existing minority interest ownership positions. Triad implemented this strategy to a greater extent than we did, and in conjunction with the acquisition of Triad, we acquired 19 hospitals containing minority ownership interests ranging from less than 1% to 35%. As of September 30, 2008, 20 of our hospitals were owned by physician joint ventures, of which two also had non-profit entities as partners. In addition, five other hospitals had non-profit entities as partners. Effective June 30, 2008, we acquired the remaining 35% equity interest in Affinity Health Systems, LLC which indirectly owns and operates Trinity Medical Center (560 licensed beds) in Birmingham, Alabama, from Baptist, giving us 100% ownership of that facility. Minority interests in equity of consolidated subsidiaries was \$343.5 million and \$366.1 million as of September 30, 2008 and December 31, 2007, respectively, and the amount of minority interest in earnings was \$10.4 million and \$5.4 million for the three months ended September 30, 2008 and 2007, respectively, and \$28.4 million and \$6.2 million for the nine months ended September 30, 2008 and 2007, respectively.

## **Reimbursement, Legislative and Regulatory Changes**

Legislative and regulatory action has resulted in continuing change in the Medicare and Medicaid reimbursement programs which will continue to limit payment increases under these programs and in some cases implement payment decreases. Within the statutory framework of the Medicare and Medicaid programs, there are substantial areas subject to administrative rulings, interpretations, and discretion which may further affect payments made under those programs, and the federal and state governments might, in the future, reduce the funds available under those programs or require more stringent utilization and quality reviews of hospital facilities. Additionally, there may be a continued rise in managed care programs and future restructuring of the financing and delivery of healthcare in the United States. These events could cause our future financial results to decline.

## **Inflation**

The healthcare industry is labor intensive. Wages and other expenses increase during periods of inflation and when labor shortages occur in the marketplace. In addition, our suppliers pass along rising costs to us in the form of higher prices. We have implemented cost control measures, including our case and resource management program, to curb increases in operating costs and expenses. We have generally offset increases in operating costs by increasing reimbursement for services, expanding services and reducing costs in other areas. However, we cannot predict our

ability to cover or offset future cost increases.

**Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these

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financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our condensed consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting policies are limited to those described below.

***Third Party Reimbursement***

Net operating revenues include amounts estimated by management to be reimbursable by Medicare and Medicaid under prospective payment systems and provisions of cost-reimbursement and other payment methods. In addition, we are reimbursed by non-governmental payors using a variety of payment methodologies. Amounts we receive for treatment of patients covered by these programs are generally less than the standard billing rates. Excluding the former Triad hospitals, contractual allowances are automatically calculated and recorded through our internally developed automated contractual allowance system. Within the automated system, actual Medicare DRG data, coupled with all payors' historical paid claims data, is utilized to calculate the contractual allowances. This data is automatically updated on a monthly basis. For the former Triad hospitals, contractual allowances are determined through a manual process wherein contractual allowance adjustments, regardless of payor or method of calculation, are reviewed and compared to actual payment experience. The methodology used is similar to the methodology used within our automated contractual allowance system. The former Triad hospitals are being phased into the automated contractual allowance system. All hospital contractual allowance calculations are subjected to monthly review by management to ensure reasonableness and accuracy. We account for the differences between the estimated program reimbursement rates and the standard billing rates as contractual allowance adjustments, which we deduct from gross revenues to arrive at net operating revenues. The process of estimating contractual allowances requires us to estimate the amount expected to be received based on payor contract provisions. The key assumption in this process is the estimated contractual reimbursement percentage, which is based on payor classification and historical paid claims data. Due to the complexities involved in these estimates, actual payments we receive could be different from the amounts we estimate and record. If the actual contractual reimbursement percentage under government programs and managed care contracts differed by 1% from our estimated reimbursement percentage, net income for the nine months ended September 30, 2008 would have changed by approximately \$24.5 million, and net accounts receivable would have changed by \$39.9 million. Final settlements under some of these programs are subject to adjustment based on administrative review and audit by third parties. We account for adjustments to previous program reimbursement estimates as contractual allowance adjustments and report them in the periods that such adjustments become known. Contractual allowance adjustments related to final settlements increased net operating revenue and net income by an insignificant amount in each of the three and nine months ended September 30, 2008 and September 30, 2007.

***Allowance for Doubtful Accounts***

Substantially all of our accounts receivable are related to providing healthcare services to our hospitals' patients. Collection of these accounts receivable is our primary source of cash and is critical to our operating performance. Our primary collection risks relate to uninsured patients and outstanding patient balances for which the primary insurance payor has paid some but not all of the outstanding balance, with the remaining outstanding balance (generally deductibles and co-payments) owed by the patient. At the point of service, for patients required to make a co-payment, we generally collect less than 15% of the related revenue. For all procedures scheduled in advance, our policy is to verify insurance coverage prior to the date of the procedure. Insurance coverage is not verified in advance of procedures for walk-in and emergency room patients.



We estimate the allowance for doubtful accounts by reserving a percentage of all self-pay accounts receivable without regard to aging category, based on collection history, adjusted for expected recoveries and, if present, anticipated changes in trends. For all other payor categories we reserve 100% of all accounts aging over 365 days from the date of discharge. The percentage used to reserve for all self-pay accounts is based on our collection history. We believe that we collect substantially all of our third-party insured receivables which include receivables

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from governmental agencies. During the quarter ended December 31, 2007, in conjunction with our ongoing process of monitoring the net realizable value of our accounts receivable, as well as integrating the methodologies, data and assumptions used by the former Triad management, we performed various analyses including updating a review of historical cash collections. As a result of these analyses, we noted deterioration in certain key cash collection indicators.

The primary key cash collection indicator that experienced deterioration during the fourth quarter of 2007 was cash receipts as a percentage of net revenue less bad debts. This percentage decreased to the lowest percentage experienced by us since the quarter ended September 30, 2006. Further analysis indicated the primary causes of this deterioration were a continuing increase in the volume of indigent non-resident aliens, an increase in the number of patients qualifying for charity care and a greater than expected impact of the removal of participants from TennCare (Tennessee's state provided Medicaid program) which increased the number of uninsured patients with limited financial means receiving care at our eight Tennessee hospitals. During the fourth quarter of 2007, due to the deteriorating cash collections and desire to standardize processes with those of the former Triad hospitals, we undertook a detailed programming effort to develop data around the deteriorating classes of accounts receivable needed to update our historical cash collections percentages as well as enable us to estimate how much of certain self-pay categories ultimately convert to Medicaid, charity and indigent programs. Triad's processes for establishing contractual allowances and allowances for bad debts related to accounts classified as Medicaid pending, charity pending and indigent non-resident alien included inputs and assumptions based on the historical percentage of these accounts which ultimately qualified for specific government programs or for write-off as charity care.

We used these new inputs and assumptions regarding Medicaid pending, charity pending, and indigent non-resident alien in conjunction with the new data developed in the fourth quarter as described above to evaluate the realizability of accounts receivable and to revise our estimate of contractual allowances for estimated amounts of self-pay accounts receivable that will ultimately qualify as charity care, or that will ultimately qualify for Medicaid, indigent care or other specific governmental reimbursement, resulting in an increase to our contractual reserves of \$96.3 million as of December 31, 2007. Previous estimates of uncollectible amounts for such receivables were included in our bad debt reserves for each period.

Furthermore, in updating the historical collection statistics of all our hospitals, we also took into account a detailed study of the historical collection information for the hospitals acquired from Triad. The updated collection statistics of the hospitals acquired from Triad also showed subsequent deterioration in cash collections similar to those experienced by the other hospitals that we own. Therefore, we also standardized the processes for calculating the allowance for doubtful accounts of the hospitals acquired from Triad to that of our other hospitals which, along with the allowance percentages determined from the new collection data, resulted in the recording of an additional \$70.1 million of allowance for bad debts as of December 31, 2007.

The resulting impact, net of taxes, for the year ended December 31, 2007 was a decrease to income from continuing operations of \$105.4 million. We believe this lower collectability was primarily the result of an increase in the number of patients qualifying for charity care, reduced enrollment in certain state Medicaid programs and an increase in the number of indigent non-resident aliens. Collections are impacted by the economic ability of patients to pay and the effectiveness of our collection efforts. Significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental healthcare coverage could affect our collection of accounts receivable. The process of estimating the allowance for doubtful accounts requires us to estimate the collectability of self-pay accounts receivable, which is primarily based on our collection history, adjusted for expected recoveries and, if available, anticipated changes in collection trends. Significant change in payor mix, business office operations, economic conditions, trends in federal and state governmental healthcare coverage or other third party payors could affect our estimates of accounts receivable collectability. If the actual collection percentage differed by 1% from our estimated collection percentage as a result of a change in expected recoveries, net income for the nine months ended

September 30, 2008 would have changed by \$11.1 million, and net accounts receivable would have changed by \$18.1 million. We also continually review our overall reserve adequacy by monitoring historical cash collections as a percentage of trailing net revenue less provision for bad debts, as well as by analyzing current period net revenue and admissions by payor classification, aged accounts receivable by payor, days revenue outstanding, and the impact of recent acquisitions and dispositions.

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Our policy is to write-off gross accounts receivable if the balance is under \$10.00 or when such amounts are placed with outside collection agencies. We believe this policy accurately reflects our ongoing collection efforts and is consistent with industry practices. We had approximately \$1.4 billion and \$1.5 billion at September 30, 2008 and December 31, 2007, respectively, being pursued by various outside collection agencies. We expect to collect less than 3%, net of estimated collection fees, of the amounts being pursued by outside collection agencies. As these amounts have been written-off, they are not included in our gross accounts receivable or our allowance for doubtful accounts. Collections on amounts previously written-off are recognized in income when received. However, we take into consideration estimated collections of these future amounts written-off in evaluating the reasonableness of our allowance for doubtful accounts.

All of the following information is derived from our hospitals, excluding clinics, unless otherwise noted.

Patient accounts receivable from our hospitals represent approximately 95% of our total consolidated accounts receivable.

Days revenue outstanding was 54 days at September 30, 2008 and 54 days at December 31, 2007. Our target range for days revenue outstanding is 52 - 58 days.

Total gross accounts receivable (prior to allowance for contractual adjustments and doubtful accounts) was approximately \$5.522 billion as of September 30, 2008 and approximately \$4.761 billion as of December 31, 2007. The approximate percentage of total gross accounts receivable (prior to allowance for contractual adjustments and doubtful accounts) summarized by aging categories is as follows:

|                 | As of                 |                      |
|-----------------|-----------------------|----------------------|
|                 | September 30,<br>2008 | December 31,<br>2007 |
| 0 to 60 days    | 62.5%                 | 61.1%                |
| 61 to 150 days  | 17.3%                 | 18.8%                |
| 151 to 360 days | 15.9%                 | 15.4%                |
| Over 360 days   | 4.3%                  | 4.7%                 |
| Total           | 100.0%                | 100.0%               |

The approximate percentage of total gross accounts receivable (prior to allowances for contractual adjustments and doubtful accounts) summarized by payor category is as follows:

|                      | As of                 |                      |
|----------------------|-----------------------|----------------------|
|                      | September 30,<br>2008 | December 31,<br>2007 |
| Insured receivables  | 67.8%                 | 66.5%                |
| Self-pay receivables | 32.2%                 | 33.5%                |
| Total                | 100.0%                | 100.0%               |

For the hospital segment, the combined total of the allowance for doubtful accounts and related allowances for other self-pay discounts and contractals, as a percentage of gross self-pay receivables, was approximately 80% at September 30, 2008 and 79% at December 31, 2007. If the receivables that have been written-off, but where collections are still being pursued by outside collection agencies, were included in both the allowances and gross self-pay receivables specified above, the percentage of combined allowances to total self-pay receivables would have been approximately 89% at September 30, 2008 and 89% at December 31, 2007.

***Goodwill and Other Intangibles***

Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill arising from business combinations is accounted for under the provisions of SFAS No. 141 Business Combinations and SFAS No. 142

Goodwill and Other Intangible Assets and is not amortized. SFAS No. 142 requires goodwill to be evaluated for impairment at the same time every year and when an event occurs or circumstances change such that it is reasonably possible that an impairment may exist. We selected September 30th as our annual testing date.

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The SFAS No. 142 goodwill impairment model requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. We estimated the fair values of the related operations using both a debt free discounted cash flow model as well as an adjusted EBITDA multiple model. These models are both based on our best estimate of future revenues and operating costs and are reconciled to our consolidated market capitalization. The cash flow forecasts are adjusted by an appropriate discount rate based on our weighted-average cost of capital. We perform our evaluation, as required by SFAS No. 142, during the fourth quarter of each year using a measurement date of September 30. No impairment has been indicated by these evaluations. Estimates used to conduct the impairment review, including revenue and profitability projections or fair values, could cause our analysis to indicate that our goodwill is impaired in subsequent periods and result in a write-off of a portion or all of our goodwill.

***Impairment or Disposal of Long-Lived Assets***

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, whenever events or changes in circumstances indicate that the carrying values of certain long-lived assets may be impaired, we project the undiscounted cash flows expected to be generated by these assets. If the projections indicate that the reported amounts are not expected to be recovered, such amounts are reduced to their estimated fair value based on a quoted market price, if available, or an estimate based on valuation techniques available in the circumstances.

***Professional Liability Insurance Claims***

We accrue for losses resulting from professional liability claims. The liability primarily consists of estimates established based upon discounted actuarial calculations utilizing case specific facts and circumstances, projected settlement dates and the Company's history of reported and settled claims, as well as, an estimate for incurred but not reported claims, which is based on historical loss patterns, claim reporting patterns and actuarially determined projections. The actuarially determined projections are based on our actual historic payment patterns over approximately a 20 year period. The net present value of the projected payments was discounted using a weighted-average risk-free discount rate of 4.1% and 4.6% in 2007 and 2006, respectively. The liability is adjusted for new claims information in the period such information becomes known. There have been no material adjustments during the three and nine month periods ending September 30, 2008 or 2007. We do not believe that changes to its historical loss patterns or to its discounting assumptions would be both reasonable likely to occur and material to our financial condition or operating performance. Professional liability expense is presented within other operating expenses on the accompanying condensed consolidated statement of income.

Our insurance is underwritten on a *claims-made* basis. Prior to June 1, 2002, substantially all of our professional and general liability risks were subject to a \$0.5 million per occurrence deductible; for claims reported from June 1, 2002 through June 1, 2003, these deductibles were \$2.0 million per occurrence. Additional coverage above these deductibles was purchased through captive insurance companies in which we had a 7.5% minority ownership interest in each and to which the premiums paid by us represented less than 8% of the total premium revenues of each captive insurance company. With the formation of our own wholly-owned captive insurance company in June 2003, we terminated our minority interest relationships in those entities. Substantially all claims reported after June 1, 2003 and before June 1, 2005 are self-insured up to \$4 million per claim. Substantially all claims reported on or after June 1, 2005 are self-insured up to \$5 million per claim. Management on occasion has selectively increased the insured risk at certain hospitals based upon insurance pricing and other factors and may continue that practice in the future. Excess insurance for all hospitals was purchased through commercial insurance companies and generally covers us for liabilities in excess of the self-insured amount and up to \$100 million per occurrence for claims reported on or after June 1, 2003.

Effective January 1, 2008, the former Triad Hospitals are insured on a claims-made basis through a policy purchased through our wholly-owned captive insurance company and commercial insurance companies as described above for substantially all claims occurring on or after January 1, 2007 and reported on or after January 1, 2008. Substantially all losses for the former Triad hospitals in periods prior to May 1999 were insured through a wholly-owned insurance subsidiary of HCA, Inc., or HCA, Triad's owner prior to that time, and excess

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loss policies maintained by HCA. HCA has agreed to indemnify the former Triad hospitals in respect of claims covered by such insurance policies arising prior to May 1999. After May 1999 through December 31, 2006, the former Triad hospitals obtained insurance coverage on a claims incurred basis from HCA's wholly-owned insurance subsidiary with excess coverage obtained from other carriers that is subject to certain deductibles. Effective for claims incurred after December 31, 2006, Triad began insuring its claims from \$1 million to \$5 million through its wholly-owned captive insurance company, replacing the coverage provided by HCA. Substantially all claims reported during 2007 were self-insured up to \$10 million per claim.

There have been no significant changes in our estimate of the reserve for professional liability claims during the nine months ended September 30, 2008.

## ***Income Taxes***

We must make estimates in recording provision for income taxes, including determination of deferred tax assets and deferred tax liabilities and any valuation allowances that might be required against the deferred tax assets. We believe that future income will enable us to realize these deferred tax assets, subject to the valuation allowance we have established.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). The total amount of unrecognized benefit that would affect the effective tax rate, if recognized, is approximately \$6.3 million as of September 30, 2008. It is our policy to recognize interest and penalties accrued related to unrecognized benefits in our condensed consolidated statements of income as income tax expense. During the three months and nine months ended September 30, 2008, we recorded approximately \$0.2 million and \$0.6 million, respectively, in interest and penalties related to prior state income tax returns through our income tax provision from continuing operations and which are included in our FIN 48 liability at September 30, 2008. A total of approximately \$1.9 million of interest and penalties is included in the amount of FIN 48 liability at September 30, 2008.

Our unrecognized tax benefits consist primarily of state exposure items. We believe it is reasonably possible that approximately \$1.2 million of our current unrecognized tax benefit may decrease within the next twelve months as a result of a lapse of the statute of limitations and settlements with taxing authorities.

We or one of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal or state income tax examinations for years prior to 2003.

The IRS has concluded an examination of the federal income tax returns of Triad for the short taxable years ended April 27, 2001, June 30, 2001 and December 31, 2001, and the taxable years ended December 31, 2002 and 2003. We have since received a closing letter with respect to the examination for those tax years. The settlement was not material to our consolidated results of operations or consolidated financial position.

## ***Recent Accounting Pronouncements***

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. SFAS No. 159 permits an entity, on a contract-by-contract basis, to make an irrevocable election to account for certain types of financial instruments and warranty and insurance contracts at fair value, rather than historical cost, with changes in the fair value, whether realized or unrealized, recognized in earnings. SFAS No. 159 is effective for fiscal



years beginning after November 15, 2007. We adopted SFAS No. 159 as of January 1, 2008 and did not elect to re-measure any assets or liabilities. The adoption of this statement has not had a material effect on our consolidated results of operations or consolidated financial position.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations ( SFAS No. 141(R) ). SFAS No. 141(R) replaces SFAS No. 141 and addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. This standard will require more assets and liabilities be recorded at fair value and will require expense recognition (rather than capitalization)

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of certain pre-acquisition costs. This standard will also require any adjustments to acquired deferred tax assets and liabilities occurring after the related allocation period to be made through earnings. Furthermore, this standard requires this treatment of acquired deferred tax assets and liabilities also be applied to acquisitions occurring prior to the effective date of this standard. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and is required to be adopted prospectively with no early adoption permitted. We will begin applying SFAS No. 141(R) in the first quarter of 2009. We do not currently have on our balance sheet any material deferred costs related to prospective acquisitions that would be required to be expensed upon the adoption of SFAS No. 141(R). Any outstanding deferred costs will be expensed in 2009 for any acquisitions that are not closed by December 31, 2008. Furthermore, the impact of SFAS No. 141(R) on our consolidated results of operations and consolidated financial position in future periods will be largely dependent on the number of acquisitions we pursue; however, it is not anticipated at this time that such impact will be material.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements ( SFAS No. 160 ). SFAS No. 160 addresses the accounting and reporting framework for noncontrolling ownership interests in consolidated subsidiaries of the parent. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent company and the interests of the noncontrolling owners and that require minority ownership interests to be presented separately within equity in the consolidated financial statements. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by us in the first quarter of 2009. We are currently assessing the potential impact that SFAS No. 160 will have on our consolidated results of operations and consolidated financial position.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS No. 161 ). SFAS No. 161 expands the disclosure requirements for derivative instruments and for hedging activities in order to provide additional understanding of how an entity uses derivative instruments and how they are accounted for and reported in an entity's financial statements. The new disclosure requirements for SFAS No. 161 are effective for fiscal years beginning after November 15, 2008, and will be adopted by us in the first quarter of 2009.

## **FORWARD-LOOKING STATEMENTS**

Some of the matters discussed in this report include forward-looking statements. Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as expects, anticipates, intends, plans, believes, estimates, thinks, and similar expressions are forward-looking statements. These statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results and performance to be materially different from any future results or performance expressed or implied by these forward-looking statements. These factors include, but are not limited to, the following:

general economic and business conditions, both nationally and in the regions in which we operate;

our ability to successfully integrate any acquisitions or to recognize expected synergies from such acquisitions, including facilities acquired from Triad;

risks associated with our substantial indebtedness, leverage and debt service obligations;

demographic changes;

existing governmental regulations and changes in, or the failure to comply with, governmental regulations;

legislative proposals for healthcare reform;

potential adverse impact of known and unknown government investigations;

our ability, where appropriate, to enter into managed care provider arrangements and the terms of these arrangements;

changes in inpatient or outpatient Medicare and Medicaid payment levels;

increases in the amount and risk of collectability of patient accounts receivable;

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increases in wages as a result of inflation or competition for highly technical positions and rising supply costs due to market pressure from pharmaceutical companies and new product releases;

liabilities and other claims asserted against us, including self-insured malpractice claims;

competition;

our ability to attract and retain, without significant employment costs, qualified personnel, key management, physicians, nurses and other healthcare workers;

trends toward treatment of patients in less acute or specialty healthcare settings including ambulatory surgery centers or specialty hospitals;

changes in medical or other technology;

changes in GAAP;

the availability and terms of capital to fund additional acquisitions or replacement facilities;

our ability to successfully acquire additional hospitals and complete the sale of hospitals held for sale;

our ability to obtain adequate levels of general and professional liability insurance; and

timeliness of reimbursement payments received under government programs.

Although we believe that these statements are based upon reasonable assumptions, we can give no assurance that our goals will be achieved. Given these uncertainties, prospective investors are cautioned not to place undue reliance on these forward-looking statements. These forward-looking statements are made as of the date of this filing. We assume no obligation to update or revise them or provide reasons why actual results may differ.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

We are exposed to interest rate changes, primarily as a result of our senior secured credit facility which bears interest based on floating rates. In order to manage the volatility relating to the market risk, we entered into interest rate swap agreements described under the heading "Liquidity and Capital Resources" in Item 2. We do not anticipate any material changes in our primary market risk exposures in 2008. We utilize risk management procedures and controls in executing derivative financial instrument transactions. We do not execute transactions or hold derivative financial instruments for trading purposes. Derivative financial instruments related to interest rate sensitivity of debt obligations are used with the goal of mitigating a portion of the exposure when it is cost effective to do so.

A 1% change in interest rates on variable rate debt in excess of that amount covered by interest rate swaps would have resulted in interest expense fluctuating approximately \$3.4 million for the three months ended September 30, 2008 and \$10.7 million for the nine months ended September 30, 2008.

**Item 4. *Controls and Procedures***

Our Chief Executive Officer and Chief Financial Officer, with the participation of other members of management, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)).

15(e) under the Securities and Exchange Act of 1934, as amended), as of the end of the period covered by this report. Based on such evaluations, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective (at the reasonable assurance level) to ensure that the information required to be included in this report has been recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and to ensure that the information required to be included in this report was accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

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There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2008, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. *Legal Proceedings***

From time to time, we receive various inquiries or subpoenas from state regulators, fiscal intermediaries, the Centers for Medicare and Medicaid Services and the Department of Justice regarding various Medicare and Medicaid issues. In addition, we are subject to other claims and lawsuits arising in the ordinary course of our business. We are not aware of any pending or threatened litigation that is not covered by insurance policies or reserved for in our financial statements or which we believe would have a material adverse impact on us; however, some pending or threatened proceedings against us may involve potentially substantial amounts as well as the possibility of civil, criminal, or administrative fines, penalties, or other sanctions, which could be material. Settlements of suits involving Medicare and Medicaid issues routinely require both monetary payments as well as corporate integrity agreements. Additionally, *qui tam* or whistleblower actions initiated under the civil False Claims Act may be pending but placed under seal by the court to comply with the False Claims Act's requirements for filing such suits.

#### **Community Health Systems, Inc. Legal Proceedings**

In May 1999, we were served with a complaint in *U.S. ex rel. Bledsoe v. Community Health Systems, Inc.*, subsequently moved to the Middle District of Tennessee, Case No. 2-00-0083. This *qui tam* action sought treble damages and penalties under the False Claims Act against us. The Department of Justice did not intervene in this action. The allegations in the amended complaint were extremely general, but involved Medicare billing at our White County Community Hospital in Sparta, Tennessee. By order entered on September 19, 2001, the U.S. District Court granted our motion for judgment on the pleadings and dismissed the case, with prejudice. The *qui tam* whistleblower (also referred to as a relator) appealed the district court's ruling to the U.S. Court of Appeals for the Ninth Circuit. On September 10, 2003, the Ninth Circuit Court of Appeals rendered its decision in this case, affirming in part and reversing in part the district court's decision to dismiss the case with prejudice. The court affirmed the lower court's dismissal of certain of plaintiff's claims on the grounds that his allegations had been previously publicly disclosed. In addition, the appeals court agreed that, as to all other allegations, the relator had failed to include enough information to meet the special pleading requirements for fraud under the False Claims Act and the Federal Rules of Civil Procedure. However, the case was returned to the district court to allow the relator another opportunity to amend his complaint in an attempt to plead his fraud allegations with particularity. In May 2004, the relator in *U.S. ex rel. Bledsoe* filed an amended complaint alleging fraud involving Medicare billing at White County Community Hospital. We then filed a renewed motion to dismiss the amended complaint. On January 6, 2005, the District Court dismissed with prejudice the bulk of the relator's allegations. The only remaining allegations involve a small number of 1997-98 charges at White County. After further motion practice between the relator and the United States Government regarding the relator's right to participate in a previous settlement with the Company, the District Court again dismissed all claims in the case on December 13, 2005. On January 9, 2006, the relator filed a notice of appeal to the U.S. Court of Appeals for the Ninth Circuit and on September 6, 2007, the Court of Appeals issued its 25 page opinion affirming in part, reversing in part (and in doing so, reinstating a number of the allegations claimed by the relator), and remanding the case to the District Court for further proceedings. The relator has filed a motion for rehearing. That motion for rehearing was denied. The relator has amended his complaint to conform to the decision of the Court of Appeals and we have filed an answer. A case management conference was held August 18, 2008. The parties have exchanged initial written discovery. We will continue to vigorously defend this case.

In August 2004, we were served a complaint in *Arleana Lawrence and Robert Hollins v. Lakeview Community Hospital and Community Health Systems, Inc. (now styled Arleana Lawrence and Lisa Nichols vs. Eufaula Community Hospital, Community Health Systems, Inc., South Baldwin Regional Medical Center and Community Health Systems Professional Services Corporation)* in the Circuit Court of Barbour County, Alabama (Eufaula

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Division). This alleged class action was brought by the plaintiffs on behalf of themselves and as the representatives of similarly situated uninsured individuals who were treated at our Lakeview Hospital or any of our other Alabama hospitals. The plaintiffs allege that uninsured patients who do not qualify for Medicaid, Medicare or charity care are charged unreasonably high rates for services and materials and that we use unconscionable methods to collect bills. The plaintiffs seek restitution of overpayment, compensatory and other allowable damages and injunctive relief. In October 2005, the complaint was amended to eliminate one of the named plaintiffs and to add our management company subsidiary as a defendant. In November 2005, the complaint was again amended to add another plaintiff, Lisa Nichols and another defendant, our hospital in Foley, Alabama, South Baldwin Regional Medical Center. After a hearing held on June 13, 2007, on October 29, 2007 the Circuit Court ruled in favor of the plaintiffs' class action certification request. On summary judgment, the Circuit Court dismissed the case against Community Health Systems, Inc. only. All other parties remain. We disagree with the certification ruling and have pursued our automatic right of appeal to the Alabama Supreme Court. We are vigorously defending this case.

On March 3, 2005, we were served with a complaint in *Sheri Rix v. Heartland Regional Medical Center and Health Care Systems, Inc.* in the Circuit Court of Williamson County, Illinois. This alleged class action was brought by the plaintiff on behalf of herself and as the representative of similarly situated uninsured individuals who were treated at our Heartland Regional Medical Center. The plaintiff alleges that uninsured patients who do not qualify for Medicaid, Medicare or charity care are charged unreasonably high rates for services and materials and that we use unconscionable methods to collect bills. The plaintiff seeks recovery for breach of contract and the covenant of good faith and fair dealing, violation of the Illinois Consumer Fraud and Deceptive Practices Act, restitution of overpayment, and for unjust enrichment. The plaintiff class seeks compensatory and other damages and equitable relief. The Circuit Court Judge recently granted our motion to dismiss the case, but allowed the plaintiff to re-plead her case. The plaintiff elected to appeal the Circuit Court's decision in lieu of amending her case. Oral argument was heard on this case on January 9, 2008. On June 16, 2008, the Appellate Court upheld the dismissal of the consumer fraud claim but reversed dismissal of the contract claim. We filed a Petition for Leave of Appeal to the Illinois Supreme Court. Leave to appeal was denied on June 16, 2008. We are vigorously defending this case.

On April 8, 2005, we were served with a first amended complaint, styled *Chronister, et al. v. Granite City Illinois Hospital Company, LLC d/b/a Gateway Regional Medical Center*, in the Circuit Court of Madison County, Illinois. The complaint seeks class action status on behalf of the uninsured patients treated at Gateway Regional Medical Center and alleges statutory, common law, and consumer fraud in the manner in which the hospital bills and collects for the services rendered to uninsured patients. The plaintiff seeks compensatory and punitive damages and declaratory and injunctive relief. Our motion to dismiss has been granted in part and denied in part and discovery has commenced. *Gateway Regional Medical Center v. Holman* is a companion case to the *Chronister* action, seeking counterclaim recovery on a collections case. *Holman* has been stayed pending the outcome of the *Chronister* action. We are vigorously defending these cases.

On February 10, 2006, we received a letter from the Civil Division of the Department of Justice requesting documents in an investigation they are conducting involving the Company. The inquiry relates to the way in which different state Medicaid programs apply to the federal government for matching or supplemental funds that are ultimately used to pay for a small portion of the services provided to Medicaid and indigent patients. These programs are referred to by different names, including intergovernmental payments, upper payment limit programs, and Medicaid disproportionate share hospital payments. The February 10th letter focused on our hospitals in 3 states: Arkansas, New Mexico, and South Carolina. On August 31, 2006, we received a follow up letter from the Department of Justice requesting additional documents relating to the programs in New Mexico and the payments to the Company's three hospitals in that state. We have provided the Department of Justice with the requested documents. In a letter dated October 4, 2007, the Civil Division notified us that, based on its investigation to date, it preliminarily believes that we and these three New Mexico hospitals have caused the State of New Mexico to submit improper claims for federal funds, in violation of the Civil False Claims Act. The DOJ asserted that these allegedly improper claims and payments



began in 2000 and may be ongoing, but provided no information about the amount of any improper claims or the possible damages or penalties it may seek. After a meeting between us and the DOJ held in November 2007, by letter dated January 22, 2008, the Civil Division notified us that they continued to believe that the False Claims Act had been violated and had calculated that the three hospitals received ineligible federal participation payments from August 2000 to June 2006 of approximately \$27.5 million. The Civil Division

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advised us that if they proceeded to trial, they would seek treble damages plus an appropriate penalty for each of the violations of the False Claims Act. Discussions are continuing with the Civil Division in an effort to resolve this matter. On May 28, 2008, we received a letter from the Office of the U.S. Attorney for the state of New Mexico requesting additional information. The Company is in the process of responding to the government. We continue to believe that we have not violated the Federal False Claims Act in the manner described in the government's letter of January 22, 2008.

In August 2006, our facility in Petersburg, Virginia (Southside Regional Medical Center) was notified of the pendency of a federal False Claims Act case styled *U.S. ex rel. Vuyyuru v. Jadhav et al.* filed in the Eastern District of Virginia. In addition to naming the hospital, Community Health Systems Professional Services Corporation, our management subsidiary, has also been named. The suit alleges that Dr. Jadhav, Southside Regional Medical Center, and other healthcare providers performed medically unnecessary procedures and billed federal healthcare programs and also alleges that the defendants defamed Dr. Vuyyuru in the process of terminating his medical staff privileges. Almost all of the allegations pre-date our acquisition of this facility and the seller's successor-in-interest has agreed to indemnify the Company and its affiliates. We believe that the allegations in this case are without merit and are vigorously defending the case. A motion to dismiss the case has been granted and the relator has appealed the ruling to the U.S. Court of Appeals for the Fourth Circuit.

On August 28, 2007, Texas Health Resources of Arlington, Texas, or THR, notified us of its decision to exercise a call right to acquire our 80% interest in the limited partnership that owns Presbyterian Hospital of Denton, Texas, together with certain land and buildings that we own in Denton (including rights under a lease for such land and buildings). We acquired these interests in connection with the Triad acquisition. This call right became exercisable under the terms of the limited partnership agreement by reasons of our acquisition of Triad. Shortly after we initiated efforts to set the purchase price, which is determined by various formulas set forth in the limited partnership agreement and related documents, THR filed suit in Texas state court seeking injunctive and declaratory relief to extend the 90-day closing date and to set the purchase price. We removed the case to Federal District Court and proceedings are underway in that court with respect to THR's renewed motions for relief. Pursuant to the limited partnership agreement, the closing was to occur on or before November 26, 2007. The closing did not occur on November 26, 2007, as THR failed to properly tender adequate closing consideration. The case will proceed and the pre-trial and trial scheduling conference is set for January 5, 2009.

On June 12, 2008, two of our hospitals received letters from the U.S. Attorney's Office for the Western District of New York requesting documents in an investigation they are conducting into billing practices with respect to kyphoplasty procedures performed during the period January 1, 2002, through June 9, 2008. On September 16, 2008, one of our hospitals in South Carolina also received an inquiry. Kyphoplasty is a surgical spine procedure that returns a compromised vertebrae (either from trauma or osteoporotic disease process) to its previous height, reducing or eliminating severe pain. We have been informed there may be as many as fourteen (14) non-affiliated facilities in Alabama, other non-affiliated hospitals in South Carolina and Indiana and possibly other states that have received an identical or substantially similar letter from the same U.S. Attorney's office. We believe that this investigation is related to a recent qui tam settlement between the same U.S. Attorney's office and the manufacturer and distributor of the Kyphon product, which is used in performing the kyphoplasty procedure. We intend to cooperate with the investigation by collecting and producing material responsive to the requests. At this early stage, we do not have sufficient information to determine whether our hospitals have engaged in inappropriate billing for kyphoplasty procedures.

### **Triad Hospitals, Inc. Legal Proceedings**

Triad, and its subsidiary, Quorum Health Resources, Inc. are defendants in a qui tam case styled *U.S. ex rel. Whitten vs. Quorum Health Resources, Inc. et al.*, which is pending in the Southern District of Georgia, Brunswick Division.

Whitten, a long-term employee of a two hospital system in Brunswick and Camden, Georgia sued both his employer and Quorum Health Resources, Inc. and its predecessors, which had managed the facility from 1989 through September 2000; upon his termination of employment, Whitten signed a release and was paid \$124,000. Whitten's original qui tam complaint was filed under seal in November 2002 and the case was unsealed in 2004. Whitten alleges various charging and billing infractions, including charging for routine equipment supplies and services not separately billable, billing for observation services that were not medically necessary or for which there

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was no physician order, billing labor and delivery patients for durable medical equipment that was not separately billable, inappropriate preparation of patients' histories and physicals, billing for cardiac rehabilitation services without physician supervision, performing outpatient dialysis without Medicare certification, and performing mental health services without the proper staff assignments. In October 2005, the district court granted Quorum's motion for summary judgment on the grounds that his claims were precluded under his severance agreement with the hospital, without reaching two other arguments made by Quorum, which included that a prior settlement agreement between the hospital and the federal government precluded the claims brought by Whitten as well as the doctrine of prior public disclosure. On appeal to the 11th Circuit Court of Appeals, the court reversed the findings of the district court regarding the severance agreement, but remanded the case to the district court for findings on Quorum's other two defenses. Limited discovery has been conducted and renewed motions by Quorum to dismiss the action and to stay further discovery were filed in September 2007. On August 5, 2008, our motion to dismiss was denied. Discovery is continuing and trial is set for January 2009. We continue to believe that the relator's claims are without merit and will continue to vigorously defend this case.

In a case styled *U.S. ex rel. Bartlett vs. Quorum Health Resources, Inc.*, et al., pending in the Western District of Pennsylvania, Johnstown Division, the relator alleges in his second amended complaint, filed in January 2006 (the first amended complaint having been dismissed), that Quorum conspired with an unaffiliated hospital to pay a illegal remuneration in violation of the anti-kickback statute and the Stark laws, thus causing false claims to be filed. A renewed motion to dismiss that was filed in March 2006 asserting that the second amended complaint did not cure the defects contained in the first amended complaint. In September 2006, the hospital and one of the other defendants affiliated with the hospital filed for protection under Chapter 11 of the federal bankruptcy code, which imposed an automatic stay on proceedings in the case. We believe that this case is without merit and should the stay be lifted, will continue to vigorously defend it.

On January 14, 2004, Relator Mark E. Thompson filed a Qui Tam Complaint under seal, styled *U.S. ex rel. Mark E. Thompson v. Quorum Health Resources, LLC and Triad Hospitals, Inc.*, which is pending in the United States District Court, Western District of Kentucky, Bowling Green Division. The Complaint alleges Quorum Health Resources, LLC ( Quorum ) and Triad Hospitals, Inc. (collectively, the Defendants ) filed or caused to be filed false claims against the United States of America. Relator was the CEO of Monroe County Medical Center ( MCMC ) in Tompkinsville, Kentucky and served as the CEO of MCMC pursuant to a contractual arrangement between MCMC and Quorum. Plaintiff alleges certain activities of Defendants relating to: (1) MCMC's participation in HealthTrust Purchasing Group, a group purchasing organization (GPO) in which Triad Hospital, Inc. maintained a 20% ownership interest; (2) agreements with strategic service partners (SSPs) acting as vendors of supplies, services and equipment; and (3) encouraging hospitals to employ American Healthcare Facilities Development, LLC (a subsidiary of Quorum) for capital project management services violated the Federal Antikickback Statute. Plaintiff alleges Quorum received certain administrative fees from these arrangements and that Quorum, directly and indirectly, manipulated and/or coerced MCMC to participate in these relationships. The Defendants cooperated with the government's investigation and on May 5, 2008, the United States of America declined to intervene in the case and the complaint was subsequently unsealed by the Court by order dated May 20, 2008. By order entered October 24, 2008, the court dismissed the relator's claims with prejudice (and the government's claims, without prejudice). In 2006, Plaintiff also filed a wrongful discharge case styled, *Mark Thompson v. Quorum Health Resources, LLC and Triad Hospitals, Inc.* in the same court, alleging he was wrongfully suspended and subsequently terminated because of his actions regarding his False Claims Act filing. We are vigorously defending these allegations as well. Because the qui tam complaint has been dismissed, we will no longer refer to these cases.

**Item 1A. Risk Factors**

There have been no material changes with regard to risk factors previously disclosed in our most recent annual report on Form 10-K.



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The following table contains information about our purchases of common stock during the three months ended September 30, 2008.

| <b>Period</b>                          | <b>Total Number of Share Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans(a)</b> | <b>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs(a)</b> |
|--|--|-------------------------------------|--|--|
| July 1, 2008 - July 31, 2008           | 86,600                                 | \$ 33.11                            | 86,600   | 4,608,000  |
| August 1, 2008 - August 31, 2008       | 125,000                                | 32.21                               | 125,000  | 4,483,000  |
| September 1, 2008 - September 30, 2008 |  |                                     |  | 4,483,000  |
| <b>Total</b>                           | <b>211,600</b>                         | <b>32.58</b>                        | <b>211,600</b>   | <b>4,483,000</b>   |

- (a) On December 13, 2006, we commenced an open market repurchase program for up to 5,000,000 shares of our common stock not to exceed \$200 million in purchases. This purchase program will conclude at the earlier of three years or when the maximum number of shares have been repurchased. During the nine months ended September 30, 2008, the Company repurchased 517,000 shares at a weighted-average price of \$33.03 per share under this program.

We have not paid any cash dividends since our inception, and do not anticipate the payment of cash dividends in the foreseeable future. Our New Credit Facility limits our ability to pay dividends and/or repurchase stock to an amount not to exceed \$400 million in the aggregate (but not in excess of \$200 million unless we receive confirmation from Moody's and S&P that dividends or repurchases would not result in a downgrade, qualification or withdrawal of the then corporate credit rating). The indenture governing our Notes also limits our ability to pay dividends and/or repurchase stock. As of September 30, 2008, the amount of permitted dividends and/or stock repurchases permitted under the indenture was limited by our New Credit Facility to \$400 million.

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMUNITY HEALTH SYSTEMS, INC.  
(Registrant)

Wayne T. Smith  
Chairman of the Board,  
President and Chief Executive Officer  
(principal executive officer)

By: /s/ Wayne T. Smith

W. Larry Cash  
Executive Vice President, Chief Financial  
Officer and Director  
(principal financial officer)

By: /s/ W. Larry Cash

T. Mark Buford  
Vice President and Corporate Controller  
(principal accounting officer)

By: /s/ T. Mark Buford

Date: October 31, 2008



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**Index to Exhibits**

| <b>No.</b> | <b>Description</b>  |
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