

UNIVERSAL HEALTH SERVICES INC

Form 10-Q

August 09, 2010

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from            to

Commission file number 1-10765

**UNIVERSAL HEALTH SERVICES, INC.**

(Exact name of registrant as specified in its charter)

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

**23-2077891**  
 (I.R.S. Employer  
 Identification No.)

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

**KING OF PRUSSIA, PENNSYLVANIA 19406**

(Address of principal executive offices) (Zip Code)

**Registrant's telephone number, including area code (610) 768-3300**

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 has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding, as of July 31, 2010:

Class A	6,656,808
Class B	89,853,975
Class C	665,400
Class D	35,298

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**Table of Contents****PART I. FINANCIAL INFORMATION****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net revenues	\$ 1,338,315	\$ 1,303,640	\$ 2,685,468	\$ 2,616,059
Operating charges:				
Salaries, wages and benefits	563,552	541,950	1,142,478	1,083,247
Other operating expenses	249,114	232,894	496,142	506,115
Supplies expense	179,926	176,411	363,742	350,378
Provision for doubtful accounts	143,764	120,670	269,154	239,648
Depreciation and amortization	54,025	51,085	107,536	102,219
Lease and rental expense	18,185	17,587	36,119	34,659
	1,208,566	1,140,597	2,415,171	2,316,266
Income from operations	129,749	163,043	270,297	299,793
Interest expense, net	12,277	11,879	24,654	24,517
Income before income taxes	117,472	151,164	245,643	275,276
Provision for income taxes	41,057	57,187	86,466	99,265
Net income	76,415	93,977	159,177	176,011
Less: Income attributable to noncontrolling interests	10,843	13,084	21,786	27,577
Net income attributable to UHS	\$ 65,572	\$ 80,893	\$ 137,391	\$ 148,434
Basic earnings per share attributable to UHS	\$ 0.68	\$ 0.82	\$ 1.42	\$ 1.51
Diluted earnings per share attributable to UHS	\$ 0.67	\$ 0.82	\$ 1.40	\$ 1.50
Weighted average number of common shares basic	96,703	97,700	96,621	98,056
Add: Other share equivalents	1,351	404	1,131	202
Weighted average number of common shares and equivalents diluted	98,054	98,104	97,752	98,258

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(amounts in thousands, unaudited)

	June 30, 2010	(Note 15) December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 12,337	\$ 9,180
Accounts receivable, net	618,855	602,559
Supplies	84,683	84,272
Other current assets	38,985	27,270
Deferred income taxes	51,109	51,336
Current assets held for sale	16,250	21,580
<b>Total current assets</b>	<b>822,219</b>	<b>796,197</b>
Property and equipment	3,818,209	3,738,818
Less: accumulated depreciation	(1,510,592)	(1,423,580)
	2,307,617	2,315,238
<b>Other assets:</b>		
Goodwill	732,754	732,685
Deferred charges	8,864	8,643
Other	118,303	111,700
	<b>\$ 3,989,757</b>	<b>\$ 3,964,463</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 2,032	\$ 2,573
Accounts payable and accrued liabilities	552,794	578,617
Federal and state taxes	3,298	1,627
<b>Total current liabilities</b>	<b>558,124</b>	<b>582,817</b>
Other noncurrent liabilities	346,310	375,580
Long-term debt	881,344	956,429
Deferred income taxes	68,386	60,091
Redeemable noncontrolling interests	205,463	197,152
UHS common stockholders' equity	1,887,365	1,751,071
Noncontrolling interests	42,765	41,323
<b>Total equity</b>	<b>1,930,130</b>	<b>1,792,394</b>

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(amounts in thousands, unaudited)

	Six months ended June 30,	
	2010	2009
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 159,177	\$ 176,011
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation & amortization	107,536	102,219
Net gain on sale of assets	(1,993)	0
Stock-based compensation expense	8,327	6,602
<i>Changes in assets &amp; liabilities, net of effects from acquisitions and dispositions:</i>		
Accounts receivable	(16,523)	4,392
Construction management and other receivable	0	21,003
Accrued interest	(1,757)	106
Accrued and deferred income taxes	3,946	7,934
Other working capital accounts	(15,753)	(1,499)
Other assets and deferred charges	(6,870)	3,844
Other	(4,513)	(3,273)
Accrued insurance expense, net of commercial premiums paid	15,491	13,323
Payments made in settlement of self-insurance claims	(27,698)	(29,823)
Net cash provided by operating activities	219,370	300,839
<b>Cash Flows from Investing Activities:</b>		
Property and equipment additions, net of disposals	(121,640)	(183,248)
Proceeds received from sale of assets	5,000	0
Acquisition of property and business	0	(9,006)
Net cash used in investing activities	(116,640)	(192,254)
<b>Cash Flows from Financing Activities:</b>		
Reduction of long-term debt	(77,974)	(77,356)
Additional borrowings	0	170
Repurchase of common shares	(3,703)	(15,437)
Dividends paid	(9,693)	(7,890)
Issuance of common stock	3,833	1,350
Profit distributions to noncontrolling interests	(12,336)	(4,259)
Proceeds from sale of noncontrolling interest in majority owned business	300	0
Net cash used in financing activities	(99,573)	(103,422)
Increase in cash and cash equivalents	3,157	5,163
Cash and cash equivalents, beginning of period	9,180	5,460
Cash and cash equivalents, end of period	\$ 12,337	\$ 10,623

**Supplemental Disclosures of Cash Flow Information:**

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Interest paid	\$ 29,783	\$ 28,723
Income taxes paid, net of refunds	\$ 79,943	\$ 90,942

The accompanying notes are an integral part of these consolidated financial statements.



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**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) General**

This Report on Form 10-Q is for the quarterly period ended June 30, 2010. In this Quarterly Report, we, us, our, UHS and the Company refer to Universal Health Services, Inc. and its subsidiaries.

You should carefully review the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, expects, plans, anticipates, believes, estimates, potential, or continue or the negative of those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks related to healthcare industry trends and those detailed in our filings with the SEC including those set forth in our Annual Report on Form 10-K for the year ended December 31, 2009 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements and Risk Factors*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

The condensed consolidated financial statements include the accounts of our majority-owned subsidiaries and partnerships and limited liability companies controlled by us, or our subsidiaries, as managing general partner or managing member. The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements, significant accounting policies and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009.

**(2) Relationship with Universal Health Realty Income Trust and Related Party Transactions**

***Relationship with Universal Health Realty Income Trust:***

At June 30, 2010, we held approximately 6.4% of the outstanding shares of Universal Health Realty Income Trust (the Trust). We serve as Advisor to the Trust under an annually renewable advisory agreement pursuant to the terms of which we conduct the Trust's day-to-day affairs, provide administrative services and present investment opportunities. In addition, certain of our officers and directors are also officers and/or directors of the Trust. Management believes that it has the ability to exercise significant influence over the Trust, therefore we account for our investment in the Trust using the equity method of accounting. We earned an advisory fee from the Trust, which is included in net revenues in the accompanying condensed consolidated statements of income, of \$465,000 and \$389,000 during the three-month periods ended June 30, 2010 and 2009, respectively, and \$903,000 and \$779,000 during the six-month periods ended June 30, 2010 and 2009, respectively. Our pre-tax share of income from the Trust was \$300,000 during each of the three-month periods ended June 30, 2010 and 2009 and \$600,000 for each of the six-month periods ended June 30, 2010 and 2009, respectively. The carrying value of this investment was \$7.2 million and \$8.1 million at June 30, 2010 and December 31, 2009, respectively, and is included in other assets in the accompanying condensed consolidated balance sheets. The market value of this investment, based on the closing price of the Trust's stock on the respective dates, was \$25.3 million at June 30, 2010 and \$25.2 million at December 31, 2009.

Total rent expense under the operating leases on the hospital facilities with the Trust was \$4.0 million and \$4.1 million during the three-month periods ended June 30, 2010 and 2009, respectively, and \$8.2 million for each of the six-month periods ended June 30, 2010 and 2009. In addition, certain of our subsidiaries are tenants in several medical office buildings owned by limited liability companies in which the Trust holds non-controlling ownership interests.

The table below details the renewal options and terms for each of our four hospital facilities leased from the Trust:

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<b>Hospital Name</b>	<b>Type of Facility</b>	<b>Annual Minimum Rent</b>	<b>End of Lease Term</b>	<b>Renewal Term (years)</b>
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,648,000	December, 2011	20(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

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- (a) We have four 5-year renewal options at existing lease rates (through 2031).
- (b) We have two 5-year renewal options at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).
- (c) We have two 5-year renewal options at fair market value lease rates (2015 through 2024).

***Other Related Party Transactions:***

A member of our Board of Directors and member of the Executive Committee is Of Counsel to the law firm used by us as our principal outside counsel. This Board member is also the trustee of certain trusts for the benefit of our Chief Executive Officer ( CEO ) and his family. This law firm also provides personal legal services to our CEO.

**(3) Other Noncurrent liabilities and Redeemable/Noncontrolling Interests**

Other noncurrent liabilities include the long-term portion of our professional and general liability, workers compensation reserves, and pension liability.

In connection with certain of our acute care hospitals, outside owners hold noncontrolling, minority ownership interests of: (i) approximately 28% in our five acute care facilities located in Las Vegas, Nevada; (ii) 20% in an acute care facility located in Washington, D.C., and; (iii) approximately 11% in an acute care facility located in Laredo, Texas. The redeemable noncontrolling interests balance of \$205.5 million as of June 30, 2010 and \$197.2 million as of December 31, 2009 (see Note 15), and the noncontrolling interests balance of \$42.8 million as of June 30, 2010 and \$41.3 million as of December 31, 2009 (see Note 15), consist primarily of the third-party ownership interests in these hospitals.

In connection with the five acute care facilities located in Las Vegas, Nevada, the minority ownership interests of which are reflected as redeemable noncontrolling interests on our Condensed Consolidated Balance Sheet, the outside owners have certain put rights , that are currently exercisable, that if exercised, require us to purchase the minority member s interests. The put rights are exercisable upon the occurrence of: (i) certain specified financial conditions falling below established thresholds; (ii) breach of the management contract by the managing member (a subsidiary of ours), or; (iii) if the minority member s ownership percentage is reduced to less than certain thresholds.

**(4) Long-term debt**

We have an \$800 million, unsecured non-amortizing revolving credit agreement, as amended ( Credit Agreement ) which is scheduled to expire in July, 2011. The Credit Agreement includes a \$100 million sub-limit for letters of credit. The interest rate on the borrowings is determined, at our option, as either: (i) the one, two, three or six month London Inter-Bank Offer Rate ( LIBOR ) plus a spread of 0.33% to 0.575%; (ii) at the higher of the Agent s prime rate or the federal funds rate plus 0.50%, or; (iii) a competitive bid rate. A facility fee ranging from 0.07% to 0.175% is required on the total commitment. The applicable margins over LIBOR and the facility fee are based upon our credit ratings from Standard & Poor s Ratings Services and Moody s Investors Service, Inc. At June 30, 2010, the applicable margin over the LIBOR rate was 0.50% and the facility fee was 0.125%. There are no compensating balance requirements. As of June 30, 2010, we had \$166 million of borrowings outstanding under our revolving credit agreement and \$571 million of available borrowing capacity, net of \$63 million of outstanding letters of credit.

In August, 2007, we entered into a \$200 million accounts receivable securitization program ( Securitization ) with a group of conduit lenders and liquidity banks. The patient-related accounts receivable ( Receivables ) for substantially all of our acute care hospitals serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of .35%. The initial term of this Securitization was 364 days and the term can be extended for incremental 364 day periods upon mutual agreement of the parties. The facility was extended for a third 364-day term in August, 2009 and will mature in August, 2010. We have accounted for this Securitization as borrowings. We maintain effective control over the Receivables since, pursuant to the terms of the Securitization, the Receivables are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The wholly-owned special purpose entities use the Receivables to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. As of June 30, 2010, we had \$100 million of borrowings outstanding pursuant to this program and \$100 million of available borrowing capacity. The outstanding borrowings pursuant to the Securitization program are classified as long-term on our balance sheet since they can be refinanced through available borrowings under the terms of our Credit Agreement, which is scheduled to expire in July of 2011.

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In June, 2006, we issued \$250 million of senior notes (the Notes) which have a 7.125% coupon rate and mature on June 30, 2016. Interest on the Notes is payable semiannually in arrears on June 30 and December 30 of each year. In June, 2008, we issued an additional \$150 million of Notes which formed a single series with the original Notes issued in June, 2006. Other than their date of issuance and initial price to the public, the terms of the Notes issued in June, 2008 are identical to, and trade interchangeably with, the Notes which were originally issued in June, 2006.

During 2001, we issued \$200 million of senior notes which have a 6.75% coupon rate and which mature on November 15, 2011. The interest on the senior notes is paid semiannually in arrears on May 15 and November 15 of each year. The senior notes can be redeemed in whole at any time and in part from time to time.

The carrying amount and fair value of our long-term debt was \$881 million and \$901 million at June 30, 2010, respectively. The fair value of our debt was computed based upon quotes received from financial institutions.

Our revolving credit agreement includes a material adverse change clause that must be represented at each draw. The facility also requires compliance with maximum debt to capitalization and minimum fixed charge coverage ratios. We are in compliance with all required covenants as of June 30, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

Our \$200 million Securitization facility, under which we had \$100 million of outstanding borrowings at June 30, 2010, matures in August, 2010. Upon maturity, or shortly thereafter, we plan to replace the existing Securitization with a new \$250 million accounts receivable securitization program. Our existing \$800 million Credit Agreement, under which we had \$166 million of outstanding borrowings at June 30, 2010, matures on July 28, 2011. In May, 2010, we announced our intent to acquire, through a merger, Psychiatric Solutions, Inc. ( Merger ). In association with the Merger, we have obtained a debt financing commitment for a total of \$3.45 billion consisting of an \$800 million revolving credit agreement, a \$1.05 billion term loan A and a \$1.6 billion term loan B (collectively The Credit Facilities ). The Credit Facilities will become effective upon closing of the Merger which is expected to occur in the fourth quarter of 2010. Should the Merger be completed and the Credit Facilities become effective, our existing \$800 million Credit Agreement, which is scheduled to mature on July 28, 2011, will be replaced by The Credit Facilities. We also have \$200 million of 6.75% senior notes which are scheduled to mature November 15, 2011. Although our refinancing plans for these bonds have not yet been determined, we believe we will have sufficient capacity under The Credit Facilities to repay the \$200 million of 6.75% senior notes upon their maturity in November, 2011.

Effective January 1, 2009, we adopted the authoritative guidance for disclosures in connection with derivative instruments and hedging activities which requires additional disclosure about a company's derivative activities, but does not require any new accounting related to derivative activities. During the fourth quarter of 2007, we entered into two interest rate swaps whereby we pay a fixed rate on a total notional principal amount of \$150 million and receive 3-month LIBOR. Each of the two interest rate swaps has a notional principal amount of \$75 million. The fixed rate payable on the first interest rate swap is 4.7625% and matures on October 5, 2012. The fixed rate payable on the second interest rate swap is 4.865% and the maturity date is October, 17, 2011. The notional amount of the second interest rate swap reduces to \$50 million on October 18, 2010. We measure our interest rate swaps at fair value on a recurring basis. The fair value of our interest rate swaps is based primarily on quotes from banks. We consider those inputs to be level 3 in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with derivative instruments and hedging activities. The fair value of our interest rate swaps was a liability of \$10.8 million at June 30, 2010 and \$11.5 million at December 31, 2009 which are included in other long-term liabilities on the accompanying balance sheet.

**(5) Commitments and Contingencies*****Professional and General Liability Claims and Property Insurance***

Effective January 1, 2008, most of our subsidiaries became self-insured for malpractice exposure up to \$10 million per occurrence, as compared to \$20 million per occurrence in the prior year. We purchased several excess policies through commercial insurance carriers which provide for coverage in excess of \$10 million up to \$195 million per occurrence and in the aggregate. However, we are liable for 10% of the claims paid pursuant to the commercially insured coverage in excess of \$10 million up to \$60 million per occurrence and in the aggregate.

Our estimated liability for self-insured professional and general liability claims is based on a number of factors including, among other things, the number of asserted claims and reported incidents, estimates of losses for these claims based on recent and historical settlement amounts, estimate of incurred but not reported claims based on historical experience, and estimates of amounts recoverable under our commercial insurance policies. While we continuously monitor these factors, our ultimate liability for professional and general liability claims could change materially from our current estimates due to inherent uncertainties involved in making this estimate. Given our significant self-insured exposure for professional and general liability claims, there can be no assurance that a sharp increase in claims asserted against us will not have a material adverse effect on our future results of operations.



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As of June 30, 2010, the total accrual for our professional and general liability claims was \$256 million, of which \$46 million is included in accounts payable and accrued liabilities. As of December 31, 2009, the total accrual for our professional and general liability claims was \$266 million, of which \$46 million is included in other current liabilities.

During the second quarters of 2010 and 2009, based upon reserve analyses, we recorded reductions to our professional and general liability self-insurance reserves relating to prior years. These favorable changes in our estimated future claims payments, amounting to \$16 million during the second quarter of 2010 and \$23 million during the second quarter of 2009, were partially due to the favorable impact of medical malpractice tort reform experienced in several states in which we operate as well as a decrease in claims related to certain higher risk specialties (such as obstetrical) due to a company-wide patient safety initiative undertaken during the last few years.

Effective April 1, 2009, we have commercial property insurance policies covering catastrophic losses resulting from windstorm damage up to a \$1 billion policy limit per occurrence. Losses resulting from non-named windstorms are subject to a \$250,000 deductible. Losses resulting from named windstorms are subject to deductibles between 3% and 5% (based upon the location of the facility) of the declared total insurable value of the property. In addition, we have commercial property insurance policies covering catastrophic losses resulting from earthquake and flood damage, each subject to aggregated loss limits (as opposed to per occurrence losses). Our earthquake limit is \$250 million, except for facilities in Alaska, California and the New Madrid (which includes certain counties located in Arkansas, Illinois, Kentucky, Mississippi, Missouri and Tennessee) and Pacific Northwest Seismic Zones which are subject to a \$100 million limitation. The earthquake limit in Puerto Rico is \$25 million. Earthquake losses are subject to a \$250,000 deductible for our facilities located in all states except California, Alaska, Washington, Puerto Rico and the New Madrid where earthquake losses are subject to deductibles ranging from 1% to 5% (based upon the location of the facility) of the declared total insurable value of the property. Flood losses have either a \$250,000 or \$500,000 deductible, based upon the location of the facility. Due to an increase in property losses experienced nationwide in recent years, the cost of commercial property insurance has increased. As a result, catastrophic coverage for earthquake and flood has been limited to annual aggregate losses (as opposed to per occurrence losses). Given these insurance market conditions, there can be no assurance that a continuation of these unfavorable trends, or a sharp increase in uninsured property losses sustained by us, will not have a material adverse effect on our future results of operations.

### ***Other***

As of June 30, 2010 we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds. Our outstanding letters of credit and surety bonds as of June 30, 2010 totaled \$80 million consisting of: (i) \$64 million related to our self-insurance programs; (ii) \$14 million related primarily to pending appeals of legal judgments (including judgments related to professional and generally liability claims), and; (iii) \$2 million of other debt guarantees related to public utilities and entities in which we own a minority interest.

### ***Legal Proceedings***

We are subject to claims and suits in the ordinary course of business, including those arising from care and treatment afforded by our hospitals and are party to litigation, as outlined below.

#### ***False Claims Act Case Against Virginia Behavioral Health Facilities:***

In late 2007 and again on July 3, 2008 and January 27, 2009, the Office of Inspector General for the Department of Health and Human Services (OIG) issued subpoenas to two of our facilities, Marion Youth Center and Mountain Youth Academy, seeking documents related to the treatment of Medicaid beneficiaries at the facilities. It was our understanding at that time that the OIG was investigating whether claims for reimbursement submitted by those facilities to the Virginia Medicaid program were supported by adequate documentation of the services provided which could be considered to be a basis for a false claims act violation. On August 4, 2008, the Office of the Attorney General for the Commonwealth of Virginia issued a subpoena to Keystone Newport News, another of our facilities. It was our understanding at that time that the Office of Attorney General was investigating whether Keystone Newport News complied with various Virginia laws and regulations, including documentation requirements.

In response to these subpoenas, we produced the requested documents on a rolling basis and we cooperated with the investigations in all respects. We also met with representatives of the OIG, the Virginia Attorney General, the United States Attorney for the Western District of Virginia, and the United States Department of Justice Civil Division on several occasions to discuss a possible resolution of this matter. However, the parties were not able to reach a resolution.

Consequently, on November 4, 2009, the United States Department of Justice and the Virginia Attorney General intervened in a qui tam case that had been filed under seal in 2007 against Universal Health Services, Inc. (UHS), and Keystone Marion, LLC and Keystone Education and Youth Center (Keystone). The Department of Justice and the Commonwealth of Virginia filed and served their complaint which, at present,

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relates solely to the Marion Youth Center. The complaint alleges causes of action pursuant to the federal and state false claims acts, Virginia fraud statutes, and unjust enrichment. The former employees filed a separate amended complaint,

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alleging employment and retaliation claims as well as false claim act violations. On April 30, 2010, UHS and Keystone filed separate motions to dismiss the government's claims in their entirety. Keystone also filed a separate motion to dismiss the relators' employment claims. The court recently ruled on the motions granting them in part and denying them in part. The court has allowed the government's False Claim Act case to proceed and parts of the relators' employment related claims. We have established a reserve in connection with this matter which did not have a material impact on our financial statements. We will continue to defend ourselves vigorously against the government's and former employees' allegations. There can be no assurance that we will prevail in the litigation or that the case will be limited to the Marion Youth Center.

### *Ethridge v. Universal Health Services et. al:*

In June, 2008, we and one of our acute care facilities, Lancaster Community Hospital, were named as defendants in a wage and hour lawsuit in Los Angeles County Superior Court. This is a purported class action lawsuit alleging that the hospital failed to provide sufficient meal and break periods to certain employees. In June, 2010 a settlement was reached with the attorneys for the class representative for an amount that will not materially affect our consolidated financial position or results of operations. The settlement is subject to court approval which has not yet occurred.

### *Devore, et. al. v. Keystone Education and Youth Services, LLC:*

Alicante School in California was acquired by a subsidiary of ours in October, 2005. Prior to our acquisition, two former employees of the facility filed a false claim act qui tam action and a gender discrimination/whistleblower claim in a California state court. The plaintiffs allege that the Alicante School improperly billed subdivisions of the state of California based upon services provided at the school and that the plaintiffs were discriminated against based upon their gender and as a result of their objection to these practices. In June 2008, we entered into an agreement with the former owners of the facility whereby they agreed to defend the case, indemnify us and hold us harmless for any damages that may result from this case. The former owners of the facility have been funding the legal defense of this case since that time. While we may be required to initially fund any settlement or judgment resulting from this matter, we intend to pursue collection of any such amounts from the former owners of the facility pursuant to the June, 2008 indemnification agreement.

### *Other Matters*

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, there is no assurance that we will not be faced with sanctions, fines or penalties in connection with such inquiries or actions, including with respect to the investigations and other matters discussed herein. Even if we were to ultimately prevail, such inquiries and/or actions could have a material adverse effect on us.

### *Southwest Healthcare System:*

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS' conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

In April, 2010, SWHCS received notification from CMS that it intended to effectuate the termination of SWHCS's Medicare provider agreement effective June 1, 2010. At that time, SWHCS commenced discussions with officials from CMS regarding an agreement in an effort to resolve the provider agreement termination action. In May, 2010, SWHCS entered into an agreement with CMS which abated the termination action scheduled for June 1, 2010. The agreement is up to one year in duration and requires SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. At the conclusion of the agreement, CMS will conduct a full certification survey to determine if SWHCS has achieved substantial compliance with the Medicare conditions of participation. During the term of the agreement, SWHCS will remain eligible to receive reimbursements from Medicare for



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services rendered to Medicare beneficiaries.

Also in April, 2010, SWHCS received notification from the California Department of Public Health ( CDPH ) indicating that it planned to initiate a process to revoke SWHCS 's hospital license. In May, 2010, SWHCS received the formal document related to the revocation action. CDPH has previously indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements. SWHCS is currently engaged in pursuing a resolution of this action with CDPH, however, there can be no assurance it will be able to do so. Should SWHCS fail to reach an agreement with CDPH, SWHCS will appeal CDPH 's revocation action and SWHCS would remain operational during the appeal process.

Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters, although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009 and the six months ended June 30, 2010,

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after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% and 3%, respectively, of our income from operations after income attributable to noncontrolling interest.

**General:**

Currently, and from time to time, some of our other facilities are subjected to inquiries and/or actions and receive notices of potential non-compliance of laws and regulations from various federal and state agencies. If one of our facilities is found to have violated these laws and regulations, the facility may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We do not believe that, other than as described above, any such existing action would materially affect our consolidated financial position or results of operations.

In addition, various suits and claims arising against us in the ordinary course of business are pending. In the opinion of management, the outcome of such claims and litigation will not materially affect our consolidated financial position or results of operations.

**(6) Segment Reporting**

Our reportable operating segments consist of acute care hospital services and behavioral health care services. The Other column below includes centralized services including information services, purchasing, reimbursement, accounting, taxation, legal, advertising, design and construction and patient accounting as well as the operating results for our other operating entities including outpatient surgery and radiation centers. The chief operating decision making group for our acute care hospital services and behavioral health care services is comprised of the Chief Executive Officer, the President and the Presidents of each operating segment. The Presidents of each operating segment also manage the profitability of each respective segment's various facilities. The operating segments are managed separately because each operating segment represents a business unit that offers different types of healthcare services or operates in different healthcare environments. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2009.

	Three months ended June 30, 2010			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 2,624,502	\$ 554,141		\$ 3,178,643
Gross outpatient revenues	\$ 1,171,634	\$ 81,987	\$ 12,083	\$ 1,265,704
Total net revenues	\$ 974,010	\$ 357,008	\$ 7,297	\$ 1,338,315
Income/(loss) before income taxes	\$ 94,744	\$ 87,116	(\$ 64,388)	\$ 117,472
Total assets as of 6/30/10	\$ 2,760,944	\$ 1,002,427	\$ 226,386	\$ 3,989,757

	Six months ended June 30, 2010			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 5,407,933	\$ 1,098,922		\$ 6,506,855
Gross outpatient revenues	\$ 2,288,559	\$ 159,964	\$ 23,645	\$ 2,472,168
Total net revenues	\$ 1,963,321	\$ 706,190	\$ 15,957	\$ 2,685,468
Income/(loss) before income taxes	\$ 196,648	\$ 163,973	(\$ 114,978)	\$ 245,643
Total assets as of 6/30/10	\$ 2,760,944	\$ 1,002,427	\$ 226,386	\$ 3,989,757

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	Three months ended June 30, 2009			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 2,469,774	\$ 524,246		\$ 2,994,020
Gross outpatient revenues	\$ 1,047,095	\$ 72,513	\$ 16,470	\$ 1,136,078
Total net revenues	\$ 952,836	\$ 332,589	\$ 18,215	\$ 1,303,640
Income/(loss) before income taxes	\$ 125,775	\$ 76,133	(\$ 50,744)	\$ 151,164
Total assets as of 6/30/09	\$ 2,634,643	\$ 986,865	\$ 215,368	\$ 3,836,876

	Six months ended June 30, 2009			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 5,049,913	\$ 1,027,927		\$ 6,077,840
Gross outpatient revenues	\$ 2,042,794	\$ 140,641	\$ 32,383	\$ 2,215,818
Total net revenues	\$ 1,912,685	\$ 654,742	\$ 48,632	\$ 2,616,059
Income/(loss) before income taxes	\$ 239,488	\$ 142,297	(\$ 106,509)	\$ 275,276
Total assets as of 6/30/09	\$ 2,634,643	\$ 986,865	\$ 215,368	\$ 3,836,876

**(7) Earnings Per Share Data ( EPS ) and Stock Based Compensation**

Basic earnings per share are based on the weighted average number of common shares outstanding during the period. Diluted earnings per share are based on the weighted average number of common shares outstanding during the period adjusted to give effect to common stock equivalents.

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share data):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
(amounts in thousands)				
Basic and Diluted:				
Net income attributable to UHS	\$ 65,572	\$ 80,893	\$ 137,391	\$ 148,434
Less: Net income attributable to unvested restricted share grants	(278)	(381)	(593)	(695)
Net income attributable to UHS basic and diluted	\$ 65,294	\$ 80,512	\$ 136,798	\$ 147,739
Weighted average number of common shares basic	96,703	97,700	96,621	98,056
Net effect of dilutive stock options and grants based on the treasury stock method	1,351	404	1,131	202
Weighted average number of common shares and equivalents diluted	98,054	98,104	97,752	98,258
Earnings per basic share attributable to UHS	\$ 0.68	\$ 0.82	\$ 1.42	\$ 1.51
Earnings per diluted share attributable to UHS	\$ 0.67	\$ 0.82	\$ 1.40	\$ 1.50

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**Stock-Based Compensation:** During the three-month periods ended June 30, 2010 and 2009, compensation cost of \$3.4 million (\$2.1 million after-tax) and \$2.4 million (\$1.5 million after-tax), respectively, was recognized related to outstanding stock options. During the six-month periods ended June 30, 2010 and 2009, compensation cost of \$6.8 million (\$4.2 million after-tax) and \$5.2 million (\$3.2 million after-tax), respectively, was recognized related to outstanding stock options. In addition, during the three-month periods ended June 30, 2010 and 2009, compensation cost of \$867,000 (\$538,000 after-tax) and \$786,000 (\$488,000 after-tax), respectively, was recognized related to restricted stock. During the six-month periods ended June 30, 2010 and 2009, compensation cost of \$1.6 million (\$971,000 after-tax) and \$1.4 million (\$888,000 after-tax) was recognized related to restricted stock. As of June 30, 2010 there was \$32.8 million of unrecognized compensation cost related to unvested options and restricted stock which is expected to be recognized over the remaining weighted average vesting period of 2.9 years. There were 94,000 stock options granted during the first six months of 2010 with a weighted-average grant date fair value of \$7.84 per share. There were 49,472 restricted stock shares granted during the first six months of 2010, with a weighted-average grant date fair value of \$30.32 per share.

**(8) Comprehensive Income**

Comprehensive income (loss) is comprised of net income, changes in unrealized gains or losses on derivative financial instruments and foreign currency translation adjustments.

(amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income attributable to UHS	\$ 65,572	\$ 80,893	\$ 137,391	\$ 148,434
Other comprehensive income (loss):				
Amortization of terminated hedge, net of taxes	(54)	(54)	(108)	(108)
Unrealized derivative gains on cash flow hedges, net of taxes	390	1,428	468	1,114
<b>Comprehensive income attributable to UHS</b>	<b>\$ 65,908</b>	<b>\$ 82,267</b>	<b>\$ 137,751</b>	<b>\$ 149,440</b>

During the three and six-month periods ended June 30, 2010 and 2009, none of the components of other comprehensive income related to noncontrolling interests.

**(9) Dispositions and acquisitions of assets and businesses and assets held for sale****Agreement to Acquire Psychiatric Solutions, Inc. ( PSI ):**

In May, 2010, we reached a definitive agreement whereby we will acquire PSI for a price of \$33.75 per share in cash, or approximately \$2.0 billion. Including the assumption of approximately \$1.1 billion in PSI net debt, the total transaction consideration is approximately \$3.1 billion. The transaction has fully committed debt financing to be provided by JPMorgan Chase Bank, N.A. and Deutsche Bank AG. We expect to complete the transaction in the fourth quarter of 2010, subject to customary closing conditions, including regulatory approvals and clearance under the Hart-Scott-Rodino Act, as well as approval by PSI's shareholders. During the second quarter of 2010, we incurred approximately \$18 million of acquisition related costs which are included in other operating expenses on our Condensed Consolidated Statements of Income.

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During the first quarter of 2010, we acquired substantially all of the assets of an outpatient surgery center located in Florida in which we previously held a 20% minority ownership interest. The purchase price consideration in connection with this transaction consisted of acquisition of the net assets less the assumption of the outstanding liabilities and third-party debt.

**Divestitures and assets held for sale:**

During the first six months of 2010, we received cash proceeds of \$5.0 million for sale of: (i) our minority ownership interest in a healthcare technology company (during the first quarter), and; (ii) for sale of a portion of our ownership interest in an outpatient surgery center located in Texas (during the second quarter).

In August 2005, our Methodist Hospital located in New Orleans, Louisiana, was severely damaged and closed as a result of Hurricane Katrina. Since that time, the facility has remained closed and non-operational. In July 2010, we executed a letter of intent, which is contingent upon certain conditions, to sell the real property of Methodist Hospital to the City of New Orleans for cash proceeds of \$16.25 million. We expect to complete this transaction during the third quarter of 2010. The assets of this facility are classified as assets held for sale in the accompanying Condensed Consolidated Balance Sheet as of June 30, 2010.

The pre-tax gain, net of losses, resulting from the above-mentioned transactions did not have a material impact on our financial statements for the three or six-month periods ended June 30, 2010.

***Six-month period ended June 30, 2009:*****Acquisitions:**

During the second quarter of 2009, we spent \$9 million to acquire a 72-bed behavioral health facility located in Louisville, Colorado.

**Divestitures:**

There were no divestitures during the first six months of 2009.

**(10) Dividends**

We declared and paid dividends of \$4.9 million, or \$.05 per share, during the second quarter of 2010 and \$3.9 million, or \$.04 per share, during the second quarter of 2009. During the six-month periods ended June 30, 2010 and 2009, we declared and paid dividends of \$9.7 million and \$7.9 million, respectively.

**(11) Pension Plan**

The following table shows the components of net periodic pension cost for our defined benefit pension plan for the three and six-month periods ended June 30, 2010 and 2009 (amounts in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Service cost	\$ 154	\$ 298	\$ 570	\$ 596
Interest cost	669	1,209	2,479	2,418
Expected return on assets	(695)	(982)	(2,576)	(1,964)
Recognized actuarial loss	342	1,169	1,269	2,338

Net periodic pension cost	\$ 470	\$ 1,694	\$ 1,742	\$ 3,388
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During the six months ended June 30, 2010, we made contributions totaling \$6.3 million to our pension plan.

#### **(12) Income Taxes**

As of January 1, 2010, our unrecognized tax benefits were approximately \$6 million. The amount, if recognized, that would affect the effective tax rate is approximately \$4 million. During the quarter ended June 30, 2010, changes to the estimated liabilities for uncertain tax positions (including accrued interest) relating to tax positions taken during prior and current periods did not have a material impact on our financial statements.

We recognize accrued interest and penalties associated with uncertain tax positions as part of the tax provision. As of June 30, 2010, we have approximately \$1 million of accrued interest and penalties. The U.S. federal statute of limitations remains open for the 2006 and subsequent years. Foreign and U.S. state and local jurisdictions have statutes of limitations generally ranging from 3 to 4 years. The statute of limitations on certain jurisdictions could expire within the next twelve months.

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We operate in multiple jurisdictions with varying tax laws. We are subject to audits by any of these taxing authorities. Our tax returns have been examined by the Internal Revenue Service ( IRS ) through the year ended December 31, 2006. We believe that adequate accruals have been provided for federal, foreign and state taxes.

**(13) Recent Accounting Standards**

**Transfers of Financial Assets:** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, this amendment eliminates the concept of a qualifying special-purpose entity ( QSPE ). This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

**Consolidation of Variable Interest Entities:** In June 2009, the FASB also issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities ( VIE s). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this amendment. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise's involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise's financial statements. Finally, an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

**(14) Stockholders' Equity**

The following schedule presents the reconciliation of the carrying amount of total equity, equity attributable to UHS Common Stockholders and equity attributable to the noncontrolling interests for the six-month period ended June 30, 2010 (in thousands):

	Universal Health Services, Inc. Common Stockholders' Equity									
	(Note 15)									
	Redeemable Noncontrolling	Classes of Common Stock				Cumulative Dividends	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	UHS Common Stockholders' Equity	Noncontrolling Interest (b)
	A	B	C	D						
Balance, January 1, 2010 (As Revised)	\$ 197,152	\$ 67	\$ 896	\$ 7	\$ (108,627)	\$ 1,879,981	\$ (21,253)	\$ 1,751,071	\$ 41,323	\$ 1,792,394
Common Stock (a)										
Issued/(converted) including tax benefits from exercise of stock options			2			1,448		1,450		1,450
Repurchased			(1)			(2,156)		(2,157)		(2,157)
Restricted share-based compensation expense						877		877		877
Dividends paid					(4,834)			(4,834)		(4,834)
Stock option expense						3,505		3,505		3,505
Profit distributions to noncontrolling interests	(775)								(3,844)	(3,844)
Comprehensive income:										
Net income	7,848					71,819		71,819	3,095	74,914
Amortization of terminated hedge (net of income tax effect of \$30)							(54)	(54)		(54)
Unrealized derivative losses on cash flow hedges (net of income tax effect of \$47)							78	78		78
Subtotal - comprehensive income	7,848						24	71,843	3,095	74,938

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Balance, March 31, 2010 (As Revised)	\$ 204,225	\$ 67	\$ 897	\$ 7	\$ (113,461)	\$ 1,955,474	\$ (21,229)	\$ 1,821,755	\$ 40,574	\$ 1,862,329
<b>Common Stock (a)</b>										
Issued/(converted) including tax benefits from exercise of stock options			2			2,186		2,188		2,188
Repurchased						(1,546)		(1,546)		(1,546)
Restricted share-based compensation expense						686		686		686
Dividends paid					(4,859)			(4,859)		(4,859)
Stock option expense						3,233		3,233		3,233
Profit distributions to noncontrolling interests	(6,276)								(1,441)	(1,441)
Capital contributions from noncontrolling interests									300	300
<b>Comprehensive income:</b>										
Net income	7,514					65,572		65,572	3,332	68,904
Amortization of terminated hedge (net of income tax effect of \$30)							(54)	(54)		(54)
Unrealized derivative losses on cash flow hedges (net of income tax effect of \$237)							390	390		390
<b>Subtotal - comprehensive income</b>	<b>7,514</b>						<b>336</b>	<b>65,908</b>	<b>3,332</b>	<b>69,240</b>
Balance, June 30, 2010	\$ 205,463	\$ 67	\$ 899	\$ 7	\$ (118,320)	\$ 2,025,605	\$ (20,893)	\$ 1,887,365	\$ 42,765	\$ 1,930,130

- (a) Authorized shares of Universal Health Services, Inc. consist of 12,000,000 shares of Class A Common Stock, 150,000,000 shares of Class B Common Stock, 1,200,000 shares of Class C Common Stock and 5,000,000 shares of Class D Common Stock.
- (b) See Note 15 for revision related to reclassification of noncontrolling interests to redeemable noncontrolling interests outside of permanent equity.

**(15) Revision of December 31, 2009 and 2008 Consolidated Balance Sheets and Statements of Changes in Equity and of Unaudited March 31, 2010 Consolidated Balance Sheet**

Generally accepted accounting principles require that noncontrolling interests be classified as equity and we have previously presented all noncontrolling interests in total equity. However, since certain of our noncontrolling interests have redemption rights outside of our control, those noncontrolling interests are classified outside of permanent equity. Accordingly, noncontrolling interests with an estimated redemption amount of \$186 million as of December 31, 2008, \$197 million as of December 31, 2009 and \$204 million as of March 31, 2010 have been reclassified from total equity to redeemable noncontrolling interests outside of permanent equity. These revisions did not affect stockholders equity attributable to UHS nor did they affect any previously reported percentages based upon equity (such as percentage of debt to total capitalization and return on average equity), since we have based those calculations on only stockholders equity attributable to UHS (as opposed to total equity).

We do not believe these revisions are material to the condensed consolidated financial statements as of March 31, 2010 or to any prior years consolidated financial statements. In each applicable future filing, we will revise the December 31, 2009 and 2008 Consolidated Balance Sheet and Consolidated Statements of Changes in Equity and the March 31, 2010 Condensed Consolidated Balance Sheet



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The applicable sections of our December 31, 2009 and 2008 Consolidated Balance Sheet, as reported and as revised, are as follows:

	<i>As Reported</i> December 31, 2009	<i>As Revised</i> December 31, 2009	<i>As Reported</i> December 31, 2008	<i>As Revised</i> December 31, 2008
Redeemable noncontrolling interest		\$ 197,152		\$ 186,097
<b>Equity:</b>				
Class A Common Stock	\$ 67	\$ 67	\$ 33	\$ 33
Class B Common Stock	896	896	458	458
Class C Common Stock	7	7	3	3
Class D Common Stock				
Cumulative dividends	(108,627)	(108,627)	(91,921)	(91,921)
Retained earnings	1,879,981	1,879,981	1,666,973	1,666,973
Accumulated other comprehensive loss	(21,253)	(21,253)	(31,696)	(31,696)
Universal Health Services, Inc. common stockholders equity	1,751,071	1,751,071	1,543,850	1,543,850
Noncontrolling interest	238,475	41,323	226,735	40,638
<b>Total Equity</b>	<b>\$ 1,989,546</b>	<b>\$ 1,792,394</b>	<b>\$ 1,770,585</b>	<b>\$ 1,584,488</b>

The applicable section of our March 31, 2010 Condensed Consolidated Balance Sheet, as reported and as revised, are as follows:

	<i>As Reported</i> March 31, 2010	<i>As Revised</i> March 31, 2010
Redeemable noncontrolling interest		\$ 204,225
UHS common stockholders equity	\$ 1,821,755	\$ 1,821,755
Noncontrolling interest	244,799	40,574
Total equity	\$ 2,066,554	\$ 1,862,329

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

**Overview**

Our principal business is owning and operating, through our subsidiaries, acute care hospitals, behavioral health centers, surgical hospitals, ambulatory surgery centers and radiation oncology centers. As of June 30, 2010, we owned and/or operated or had under construction, 25 acute care hospitals (excluding 1 new replacement facility currently being constructed) and 102 behavioral health centers located in 32 states, Washington, D.C. and Puerto Rico. As part of our ambulatory treatment centers division, we manage and/or own outright or in partnerships with physicians, 7 surgical hospitals and surgery and radiation oncology centers located in 5 states and Puerto Rico.

Net revenues from our acute care hospitals, surgical hospitals, surgery centers and radiation oncology centers accounted for 73% and 74% of our consolidated net revenues during three-month periods ended June 30, 2010 and 2009, respectively, and 74% during each of the six-month periods ended June 30, 2010 and 2009. Net revenues from our behavioral health care facilities accounted for 27% and 26% of our consolidated net revenues during the three-month periods ended June 30, 2010 and 2009, respectively, and 26% and 25% during the six-month periods ended June 30, 2010 and 2009, respectively. Approximately 1% of our consolidated net revenues during the six-month period ended June 30, 2009 were recorded in connection with a construction management contract pursuant to the terms of which we built a newly constructed acute care hospital for an unrelated party that was completed during the fourth quarter of 2009.

Services provided by our hospitals include general and specialty surgery, internal medicine, obstetrics, emergency room care, radiology, oncology, diagnostic care, coronary care, pediatric services, pharmacy services and behavioral health services. We provide capital resources as well as a variety of management services to our facilities, including central purchasing, information services, finance and control systems, facilities planning, physician recruitment services, administrative personnel management, marketing and public relations.

**Forward-Looking Statements and Risk Factors**

This Annual Report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, and other similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, such performance or results will be achieved. Forward-looking information is based on information available at the time and/or our good faith belief with respect to future events, and is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Such factors include, among other things, the following:

our ability to comply with the existing laws and government regulations, and/or changes in laws and government regulations;

an increasing number of legislative initiatives have recently been passed into law that may result in major changes in the health care delivery system on a national or state level. No assurances can be given that the implementation of these new laws will not have a material adverse effect on our business, financial condition or results of operations;

possible unfavorable changes in the levels and terms of reimbursement for our charges by third party payors or government programs, including Medicare or Medicaid;

an increase in the number of uninsured and self-pay patients treated at our acute care facilities that unfavorably impacts our ability to satisfactorily and timely collect our self-pay patient accounts;

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our ability to enter into managed care provider agreements on acceptable terms and the ability of our competitors to do the same, including contracts with United/Sierra Healthcare in Las Vegas, Nevada;

the outcome of known and unknown litigation, government investigations, and liabilities and other claims asserted against us, including matters as disclosed in *Item 1. Legal Proceedings*;

the potential unfavorable impact on our business of continued deterioration in national, regional and local economic and business conditions, including a continuation or worsening of unfavorable credit market conditions;

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competition from other healthcare providers, including physician owned facilities in certain markets, including McAllen/Edinburg, Texas, the site of one of our largest acute care facilities;

technological and pharmaceutical improvements that increase the cost of providing, or reduce the demand for healthcare;

our ability to attract and retain qualified personnel, nurses, physicians and other healthcare professionals and the impact on our labor expenses resulting from a shortage of nurses and other healthcare professionals;

demographic changes;

our agreement to acquire Psychiatric Solutions, Inc. ( PSI ): (i) will substantially increase our level of indebtedness which could, among other things, adversely affect our ability to raise additional capital to fund operations, limit our ability to react to changes in the economy or our industry and could potentially prevent us from meeting our obligations under the agreements related to our indebtedness; (ii) is subject to conditions which may affect the timing of our consummation of the acquisition which could affect our ability to realize all the benefits of the acquisitions, and; (iii) will require us to successfully integrate the operations of PSI with our operations and, even if such integration is accomplished, we may never realize the potential benefits of the acquisition. See Item 1A. *Risk Factors* for additional disclosure;

our ability to successfully integrate and improve our recent acquisitions and the availability of suitable acquisitions and divestiture opportunities;

a significant portion of our revenues is produced by facilities located in Nevada, Texas and California making us particularly sensitive to regulatory, economic, environmental and competitive changes in those states;

our ability to continue to obtain capital on acceptable terms, including borrowed funds, to fund the future growth of our business;

some of our acute care facilities continue to experience decreasing inpatient admission trends;

our financial statements reflect large amounts due from various commercial and private payors and there can be no assurance that failure of the payors to remit amounts due to us will not have a material adverse effect on our future results of operations;

the ability to obtain adequate levels of general and professional liability insurance on current terms;

changes in our business strategies or development plans;

fluctuations in the value of our common stock, and;

other factors referenced herein or in our other filings with the Securities and Exchange Commission.

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services

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( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

In April, 2010, SWHCS received notification from CMS that it intended to effectuate the termination of SWHCS's Medicare provider agreement effective June 1, 2010. At that time, SWHCS commenced discussions with officials from CMS regarding an agreement in an effort to resolve the provider agreement termination action. In May, 2010, SWHCS entered into an agreement with CMS which abated the termination action scheduled for June 1, 2010. The agreement is up to one year in duration and requires SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. At the conclusion of the agreement, CMS will conduct a full certification survey to determine if SWHCS has achieved substantial compliance with the Medicare conditions of participation. During the term of the agreement, SWHCS will remain eligible to receive reimbursements from Medicare for services rendered to Medicare beneficiaries.

Also in April, 2010, SWHCS received notification from the California Department of Public Health ( CDPH ) indicating that it planned to initiate a process to revoke SWHCS's hospital license. In May, 2010, SWHCS received the formal document related to the revocation action. CDPH has previously indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements. SWHCS is currently engaged in pursuing a resolution of this action with CDPH, however, there can be no assurance it will be able to do so. Should SWHCS fail to reach an agreement with CDPH, SWHCS will appeal CDPH's revocation action and SWHCS would remain operational during the appeal process.

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Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters, although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009 and the six months ended June 30, 2010, after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% and 3%, respectively, of our income from operations after income attributable to non-controlling interest.

Given these uncertainties, risks and assumptions, as outlined above, you are cautioned not to place undue reliance on such forward-looking statements. Our actual results and financial condition could differ materially from those expressed in, or implied by, the forward-looking statements. Forward-looking statements speak only as of the date the statements are made. We assume no obligation to publicly update any forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except as may be required by law. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement.

**Table of Contents****Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our consolidated financial statements. For a summary of our significant accounting policies, please see *Note 1 to the Consolidated Financial Statements* as included in our Form 10-K for the year ended December 31, 2009.

**Revenue recognition:** We record revenues and related receivables for health care services at the time the services are provided. Medicare and Medicaid revenues represented 37% and 38% of our net patient revenues during the three-month periods ended June 30, 2010 and 2009, respectively, and 38% and 39% during the six-month periods ended June 30, 2010 and 2009, respectively. Revenues from managed care entities, including health maintenance organizations and managed Medicare and Medicaid programs, accounted for 46% of our net patient revenues during each of the three and six-month periods ended June 30, 2010 and 2009.

**Provision for Doubtful Accounts:** On a consolidated basis, we monitor our total self-pay receivables to ensure that the total allowance for doubtful accounts provides adequate coverage based on historical collection experience. Our accounts receivable are recorded net of allowance for doubtful accounts of \$180 million at June 30, 2010 and \$169 million at December 31, 2009.

Patients that express an inability to pay are reviewed for write-off as potential charity care. Our accounts receivable are recorded net of established charity care reserves of \$75 million at June 30, 2010 and \$61 million as of December 31, 2009.

**Recent Accounting Standards:** For a summary of accounting standards, please see *Note 13 to the Consolidated Financial Statements*, as included herein.

**Results of Operations****Three-month periods ended June 30, 2010 and 2009:**

The following table summarizes our results of operations and is used in the discussion below for the three-month periods ended June 30, 2010 and 2009 (dollar amounts in thousands):

	Three months ended June 30, 2010		Three months ended June 30, 2009	
	Amount	% of Revenues	Amount	% of Revenues
Net revenues	\$ 1,338,315	100.0%	\$ 1,303,640	100.0%
Operating charges:				
Salaries, wages and benefits	563,552	42.1%	541,950	41.6%
Other operating expenses	249,114	18.6%	232,894	17.9%
Supplies expense	179,926	13.4%	176,411	13.5%
Provision for doubtful accounts	143,764	10.7%	120,670	9.3%
Depreciation and amortization	54,025	4.0%	51,085	3.9%
Lease and rental expense	18,185	1.4%	17,587	1.3%
Subtotal operating expenses	1,208,566	90.3%	1,140,597	87.5%
Income from operations	129,749	9.7%	163,043	12.5%
Interest expense, net	12,277	0.9%	11,879	0.9%
Income before income taxes	117,472	8.8%	151,164	11.6%
Provision for income taxes	41,057	3.1%	57,187	4.4%
Net income	76,415	5.7%	93,977	7.2%

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Less: Income attributable to noncontrolling interests	10,843	0.8%	13,084	1.0%
Net income attributable to UHS	\$ 65,572	4.9%	\$ 80,893	6.2%

Net revenues increased 3% or \$35 million to \$1.34 billion during the three-month period ended June 30, 2010 as compared to \$1.30 billion during the comparable prior year quarter. This increase was due primarily to a \$39 million or 3% increase in net revenues generated at acute care hospitals and behavioral health care facilities owned during both periods (which we refer to as same facility). Partially offsetting the increase in our same facility revenues was an \$8 million decrease resulting from the revenues earned during the second quarter of 2009 in connection with a construction management contract pursuant to the terms of which we built a newly constructed acute care hospital for an unrelated party that was completed during the fourth quarter of 2009.



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Income before income taxes (before deduction for income attributable to noncontrolling interests) decreased \$34 million to \$117 million during the three-month period ended June 30, 2010 as compared to \$151 million during the comparable quarter of the prior year. Included in our income before income taxes during the second quarter of 2010, as compared to the comparable prior year quarter, was the following:

a decrease of \$25 million at our acute care facilities as discussed below in Acute Care Hospital Services (excluding the favorable impact of the reduction to our professional and general liability self-insurance reserves, as discussed below);

an increase of \$12 million at our behavioral health care facilities, as discussed below in Behavioral Health Services (excluding the favorable impact of the reduction to our professional and general liability self-insurance reserves, as discussed below);

a decrease of \$18 million resulting from the transaction fees incurred during the second quarter of 2010 in connection with our previously announced agreement to acquire Psychiatric Solutions, Inc.;

a net decrease of \$7 million resulting from the favorable adjustments recorded during the second quarters of 2010 (\$16 million) and 2009 (\$23 million) to our professional and general liability self-insurance reserves relating to prior years (please see *Note 5 to the Consolidated Financial Statements*, as included herein), and;

an increase of \$4 million from other combined net favorable changes.

Net income attributable to UHS decreased \$15 million to \$66 million during the three-month period ended June 30, 2010 as compared to \$81 million during the comparable prior year quarter. The decrease during the second quarter of 2010, as compared to the comparable prior year quarter, consisted of:

a decrease of \$34 million in income from operations before income taxes, as discussed above;

an increase of \$2 million resulting from a decrease in income attributable to noncontrolling interests, and;

an increase of \$16 million resulting from a decrease in the income tax provision resulting from: (i) a decrease of approximately \$12 million resulting from the \$32 million net decrease in pre-tax income (\$34 million decrease in income from operations net of the \$2 million reduction to income attributable to noncontrolling interests), and; (ii) a decrease of \$4 million resulting from an unfavorable discrete tax item recorded during the second quarter of 2009 in connection with our reserves established in connection with the settlement of the investigation of our South Texas Health System affiliates.

**Six-month periods ended June 30, 2010 and 2009:**

The following table summarizes our results of operations and is used in the discussion below for the six-month periods ended June 30, 2010 and 2009 (dollar amounts in thousands):

	Six months ended June 30, 2010		Six months ended June 30, 2009	
	Amount	% of Revenues	Amount	% of Revenues
Net revenues	\$ 2,685,468	100.0%	\$ 2,616,059	100.0%

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Operating charges:				
Salaries, wages and benefits	1,142,478	42.5%	1,083,247	41.4%
Other operating expenses	496,142	18.5%	506,115	19.3%
Supplies expense	363,742	13.5%	350,378	13.4%
Provision for doubtful accounts	269,154	10.0%	239,648	9.2%
Depreciation and amortization	107,536	4.0%	102,219	3.9%
Lease and rental expense	36,119	1.3%	34,659	1.3%
<b>Subtotal operating expenses</b>	<b>2,415,171</b>	<b>89.9%</b>	<b>2,316,266</b>	<b>88.5%</b>
Income from operations	270,297	10.1%	299,793	11.5%
Interest expense, net	24,654	1.0%	24,517	1.0%
Income before income taxes	245,643	9.1%	275,276	10.5%
Provision for income taxes	86,466	3.2%	99,265	3.8%
Net income	159,177	5.9%	176,011	6.7%
Less: Income attributable to noncontrolling interests	21,786	0.8%	27,577	1.0%
Net income attributable to UHS	\$ 137,391	5.1%	\$ 148,434	5.7%

Net revenues increased 3% or \$69 million to \$2.69 billion during the six-month period ended June 30, 2010 as compared to \$2.62 billion during the comparable prior year period. This increase was due primarily to a \$91 million or 4% increase in net revenues

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generated at our acute care hospitals and behavioral health care facilities, on a same facility basis. Partially offsetting the increase in our same facility revenues was a \$28 million decrease resulting from the revenues earned during the first six months of 2009 in connection with the above-mentioned construction management contract.

Income before income taxes (before deduction for income attributable to minority interests) decreased \$30 million to \$246 million during the six-month period ended June 30, 2010 as compared to \$275 million during the comparable prior year period. Included in our income before income taxes during the first six months of 2010, as compared to the comparable prior year period, was the following:

a decrease of \$37 million at our acute care facilities as discussed below in Acute Care Hospital Services (excluding the favorable impact of the reduction to our professional and general liability self-insurance reserves, as discussed below);

an increase of \$23 million at our behavioral health care facilities, as discussed below in Behavioral Health Services (excluding the favorable impact of the reduction to our professional and general liability self-insurance reserves, as discussed below);

a decrease of \$18 million resulting from the transaction fees incurred during the second quarter of 2010 in connection with our previously announced agreement to acquire Psychiatric Solutions, Inc.;

a net decrease of \$7 million resulting from the favorable adjustments recorded during the second quarters of 2010 (\$16 million) and 2009 (\$23 million) to our professional and general liability self-insurance reserves relating to prior years (please see *Note 5 to the Consolidated Financial Statements*, as included herein), and;

an increase of \$9 million from other combined net favorable changes, including a \$2 million gain realized during the first quarter of 2010 on the sale of our minority ownership interest in a healthcare company and a \$3 million charge recorded during the first quarter of 2009 in connection with the settlement of the South Texas Health System affiliates investigation.

Net income attributable to UHS decreased \$11 million to \$137 million during the six-month period ended June 30, 2010 as compared to \$148 million during the comparable prior year period. The decrease during the first six months of 2010, as compared to the comparable prior year period, consisted of:

a decrease of \$30 million in income from operations before income taxes, as discussed above;

an increase of \$6 million resulting from a decrease in income attributable to noncontrolling interests, and;

an increase of \$13 million resulting from a decrease in the income tax provision resulting from: (i) a decrease of approximately \$9 million resulting from the \$24 million net decrease in pre-tax income (\$30 million decrease in income from operations net of the \$6 million reduction to income attributable to noncontrolling interests), and; (ii) a decrease of \$4 million resulting from an unfavorable discrete tax item recorded during the second quarter of 2009 in connection with our reserves established in connection with the settlement of the investigation of our South Texas Health System affiliates.

## **Acute Care Hospital Services**

### **Same Facility and All Acute Care Basis**

We believe that providing our results on a Same Facility basis, which includes the operating results for facilities owned in both the current year and prior year periods, is helpful to our investors as a measure of our operating performance. Our Same Facility results also neutralize the effect of items that are non-operational in nature including items such as, but not limited to, gains on sales of assets and businesses, reserves for

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settlements, legal judgments and lawsuits and other amounts that may be reflected in the current or prior year financial statements that relate to prior periods.

As mentioned above, our results for the three and six-month period ended June 30, 2010 and 2009 were favorably impacted by reductions to our professional and general liability self-insurance reserves relating to prior years amounting to \$16 million (recorded during the second quarter of 2010) and \$23 million (recorded during the second quarter of 2009). Although approximately \$15 million during the second quarter of 2010, and \$20 million during the second quarter of 2009, of the favorable impact applies to our acute care facilities, the favorable impact is not reflected in the acute care results shown on the table below since the reduction was related to prior years. After adjusting the below-reflected acute care results for the three and six-month periods ended June 30, 2010 and 2009, income before income taxes (before deduction for income attributable to minority interests) amounted to \$94.7 million and \$125.8 million during the three-month periods ended June 30, 2010 and 2009, respectively, and \$196.6 million and \$239.5 million during the six-month periods ended June 30, 2010 and 2009, respectively. There were no other differences between Same Facility and All Acute Care Basis during the three and six-month periods ended June 30, 2010 and 2009 as there were no acute care hospitals acquired or opened during the period of January 1, 2009 through June 30, 2010.

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The following table summarizes the results of operations for our acute care facilities, on a same facility and all acute care basis, and is used in the discussion below for the three and six-month periods ended June 30, 2010 and 2009 (dollar amounts in thousands):

	Three Months Ended				Six Months Ended			
	June 30,		June 30,		June 30,		June 30,	
	2010	%	2009	%	2010	%	2009	%
Net revenues	\$ 974,010	100.0	\$ 952,836	100.0	\$ 1,963,321	100.0	\$ 1,912,685	100.0
Salaries, wages and benefits	366,558	37.6	356,600	37.4	741,657	37.7	712,417	37.2
Other operating expenses	173,363	17.8	166,661	17.5	346,560	17.7	337,743	17.7
Supplies expense	160,038	16.4	155,949	16.4	324,162	16.5	310,069	16.2
Provision for doubtful accounts	135,455	13.9	112,900	11.8	252,637	12.9	223,065	11.7
Depreciation and amortization	44,085	4.5	41,333	4.3	87,563	4.5	82,680	4.3
Lease and rental	13,625	1.4	12,852	1.3	27,118	1.4	25,422	1.3
Subtotal operating expenses	893,124	91.7	846,295	88.8	1,779,697	90.6	1,691,396	88.4
Income from operations	80,886	8.3	106,541	11.2	183,624	9.4	221,289	11.6
Interest expense, net	748	0.1	1,058	0.1	1,582	0.1	2,093	0.1
Income before income taxes	\$ 80,138	8.2	\$ 105,483	11.1	\$ 182,042	9.3	\$ 219,196	11.5

**Three-month periods ended June 30, 2010 and 2009:**

During the three-month period ended June 30, 2010, as compared to the comparable prior year quarter, net revenues at our acute care hospitals increased \$21 million or 2%. Income before income taxes (and before income attributable to noncontrolling interests) decreased \$25 million or 24% to \$80 million or 8.2% of net revenues during the second quarter of 2010 as compared to \$105 million or 11.1% of net revenues during the comparable prior year quarter. The decrease in income from operations at our acute care hospitals during the second quarter of 2010, as compared to the comparable quarter of the prior year, was due primarily to net revenue pressures experienced throughout our acute care hospitals and, most notably, at our hospitals located in Las Vegas, Nevada. The revenue pressures were caused primarily by declining commercial payor utilization and an increase in the number of uninsured and underinsured patients treated at our facilities. Our acute care facilities located in Texas were also unfavorably impacted by reductions in Medicaid revenues. Also contributing to decline in income from operations at our acute care facilities were increases in salaries, wages and benefits expense and supplies expense which increased beyond the rate of increase of our acute care revenues.

Inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our acute care facilities increased 0.4% and 1.9%, respectively, during the three-month period ended June 30, 2010 as compared to the comparable period of the prior year. Patient days decreased 1.2% and adjusted patient days increased 0.3% during the three-month period ended June 30, 2010 as compared to the comparable prior year quarter. The average length of inpatient stay at these facilities was 4.3 days and 4.4 days during the three-month periods ended June 30, 2010 and 2009, respectively. The occupancy rate, based on the average available beds at these facilities, was 55% and 58% during the three-month periods ended June 30, 2010 and 2009, respectively. During the three-month period ended June 30, 2010, net revenue per adjusted admission increased 0.3% and net revenue per adjusted patient day increased 1.9%, as compared to the comparable quarter of the prior year.

**Six-month periods ended June 30, 2010 and 2009:**

During the six-month period ended June 30, 2010, as compared to the comparable prior year period, net revenues at our acute care hospitals increased \$51 million or 3%. Income before income taxes (and before income attributable to noncontrolling interests) decreased \$37 million or 17% to \$182 million or 9.3% of net revenues during the first six months of 2010 as compared to \$219 million or 11.5% of net revenues during the comparable prior year period. The decrease in income from operations at our acute care hospitals during the first six months of 2010, as compared to the comparable period of the prior year, was due primarily to net revenue and operating expense pressures mentioned above.

Inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our acute care facilities increased 0.5% and 1.8%, respectively, during the six-month period ended June 30, 2010 as compared to the comparable period of the prior year. Patient days decreased 0.8% and adjusted patient days increased 0.5% during the six-month period ended June 30, 2010 as compared to the comparable prior year period. The average length of inpatient stay at these facilities was 4.4 days during each of the six-month periods ended June 30, 2010 and 2009, respectively.

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The occupancy rate, based on the average available beds at these facilities, was 58% and 60% during the six-month periods ended June 30, 2010 and 2009, respectively. During the six-month period ended June 30, 2010, net revenue per adjusted admission increased 0.8% and net revenue per adjusted patient day increased 2.2%, as compared to the comparable six-month period of the prior year.

We continue to experience an increase in uninsured patients throughout our portfolio of acute care hospitals which, in part, has resulted from an increase in the number of patients who are employed but do not have health insurance or who have policies with relatively high deductibles. We provide care to patients who meet certain financial or economic criteria without charge or at amounts substantially less than our established rates. Because we do not pursue collection of amounts that qualify as charity care, they are not

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reported in net revenues or in accounts receivable, net. Our acute care hospitals provided charity care and uninsured discounts, based on charges at established rates, amounting to \$190 million and \$181 million during three-month periods ended June 30, 2010 and 2009, respectively, and \$366 million and \$340 million during the six-month periods ended June 30, 2010 and 2009, respectively. A continued increase in the level of uninsured patients to our facilities and the resulting adverse trends in the provision for doubtful accounts and charity care provided, could have a material unfavorable impact on our future operating results.

**Behavioral Health Services**

The following table summarizes the results of operations for our behavioral health care facilities, on a same facility basis, and is used in the discussion below for the three and six-month periods ended June 30, 2010 and 2009 (dollar amounts in thousands):

**Same Facility Behavioral Health**

	Three Months Ended				Six Months Ended			
	June 30,		June 30,		June 30,		June 30,	
	2010	%	2009	%	2010	%	2009	%
Net revenues	\$ 350,842	100.0	\$ 332,544	100.0	\$ 694,457	100.0	\$ 654,466	100.0
Salaries, wages and benefits	166,940	47.6	159,787	48.0	333,722	48.1	317,433	48.5
Other operating expenses	60,481	17.2	60,520	18.2	121,591	17.5	119,058	18.2
Supplies expense	18,280	5.2	18,397	5.5	36,150	5.2	36,316	5.5
Provision for doubtful accounts	7,403	2.1	7,835	2.4	15,679	2.3	16,482	2.5
Depreciation and amortization	7,841	2.2	7,924	2.4	15,710	2.3	15,953	2.4
Lease and rental	3,883	1.1	4,108	1.2	7,591	1.1	7,961	1.2
Subtotal operating expenses	264,828	75.5	258,571	77.8	530,443	76.4	513,203	78.4
Income from operations	86,014	24.5	73,973	22.2	164,014	23.6	141,263	21.6
Interest expense, net	3	0.0	51	0.0	6	0.0	102	0.0
Income before income taxes	\$ 86,011	24.5	\$ 73,922	22.2	\$ 164,008	23.6	\$ 141,161	21.6

**Three-month periods ended June 30, 2010 and 2009:**

On a same facility basis, during the second quarter of 2010 as compared to the second quarter of 2009, net revenues at our behavioral health care facilities increased 6% or \$18 million to \$351 million from \$333 million. Income before income taxes increased \$12 million or 16% to \$86 million or 24.5% of net revenues during the three-month period ended June 30, 2010, as compared to \$74 million or 22.2% of net revenues during the comparable prior year quarter. The increase in revenues and income before income taxes during the second quarter of 2010, as compared to the comparable quarter of 2009, was due primarily to the operating leverage realized from the relatively robust admission growth mentioned below.

On a same facility basis, inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our behavioral health facilities increased 4.4% and 4.7%, respectively, during the three-month period ended June 30, 2010 as compared to the comparable quarter of the prior year. Patient days and adjusted patient days increased 2.1% and 2.4%, respectively, during the three-month period ended June 30, 2010 as compared to the comparable prior year quarter. The average length of inpatient stay at these facilities was 15.1 days and 15.5 days during the three-month periods ended June 30, 2010 and 2009, respectively. The occupancy rate, based on the average available beds at these facilities, was 76% and 75% during the three-month periods ended June 30, 2010 and 2009, respectively. During the three-month period ended June 30, 2010, net revenue per adjusted admission increased 0.1% and net revenue per adjusted patient day increased 2.3%, as compared to the comparable quarter of the prior year.

**Table of Contents****Six-month periods ended June 30, 2010 and 2009:**

On a same facility basis, during the first six months of 2010 as compared to the comparable prior year period, net revenues at our behavioral health care facilities increased 6% or \$40 million to \$694 million from \$654 million. Income before income taxes increased \$23 million or 16% to \$164 million or 23.6% of net revenues during the six-month period ended June 30, 2010, as compared to \$141 million or 21.6% of net revenues during the comparable prior year period.

On a same facility basis, inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our behavioral health facilities each increased 4.2% during the six-month period ended June 30, 2010 as compared to the comparable period of the prior year. Patient days and adjusted patient days each increased 3.1% during the six-month period ended June 30, 2010 as compared to the comparable prior year period. The average length of inpatient stay at these facilities was 15.1 days and 15.2 days during the six-month periods ended June 30, 2010 and 2009, respectively. The occupancy rate, based on the average available beds at these facilities, was 76% and 75% during the six-month periods ended June 30, 2010 and 2009, respectively. During the six-month period ended June 30, 2010, net revenue per adjusted admission increased 1.4% and net revenue per adjusted patient day increased 2.5%, as compared to the comparable period of the prior year.

The following table summarizes the results of operations for our behavioral health care facilities for the three and six-month periods ended June 30, 2010 and 2009, including newly acquired or recently opened facilities and the portion of the above-mentioned reduction to our professional and general liability self-insurance reserves recorded during the second quarters of 2010 and 2009 that is applicable to our behavioral health care facilities (\$2 million of the \$16 million recorded in the second quarter of 2010 was applicable to our behavioral health care facilities and \$3 million of the \$23 million recorded during the second quarter of 2009 was applicable):

**All Behavioral Health Care Facilities (dollar amounts in thousands)**

	Three Months Ended				Six Months Ended			
	June 30,		June 30,		June 30,		June 30,	
	2010	%	2009	%	2010	%	2009	%
Net revenues	\$ 357,008	100.0	\$ 332,589	100.0	\$ 706,190	100.0	\$ 654,742	100.0
Salaries, wages and benefits	170,364	47.7	159,959	48.1	341,088	48.3	318,096	48.6
Other operating expenses	60,345	16.9	58,143	17.5	123,288	17.5	117,361	17.9
Supplies expense	18,653	5.2	18,396	5.5	36,977	5.2	36,393	5.6
Provision for doubtful accounts	8,252	2.3	7,842	2.4	16,393	2.3	16,491	2.5
Depreciation and amortization	8,208	2.3	7,954	2.4	16,511	2.3	16,014	2.4
Lease and rental	4,067	1.1	4,111	1.2	7,954	1.1	7,988	1.2
Subtotal operating expenses	269,889	75.6	256,405	77.1	542,211	76.8	512,343	78.3
Income from operations	87,119	24.4	76,184	22.9	163,979	23.2	142,399	21.7
Interest expense, net	3	0.0	51	0.0	6	0.0	102	0.0
Income before income taxes	\$ 87,116	24.4	\$ 76,133	22.9	\$ 163,973	23.2	\$ 142,297	21.7

During the second quarter of 2010, as compared to the comparable prior year quarter, net revenues at our behavioral health care facilities (including newly acquired or recently opened facilities), increased 7% or \$24 million. Income before income taxes increased \$11 million or 14% to \$87 million or 24.4% of net revenues during the second quarter of 2010, as compared to \$76 million or 22.9% of net revenues during the second quarter of 2009.

During the first six months of 2010, as compared to the comparable prior year period, net revenues at our behavioral health care facilities (including newly acquired or recently opened facilities), increased 8% or \$51 million. Income before income taxes increased \$22 million or 15% to \$164 million or 23.2% of net revenues during the first six months of 2010, as compared to \$142 million or 21.7% of net revenues during the comparable period of 2009.

**Sources of Revenue**



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**Overview:** We receive payments for services rendered from private insurers, including managed care plans, the federal government under the Medicare program, state governments under their respective Medicaid programs and directly from patients.

Hospital revenues depend upon inpatient occupancy levels, the medical and ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the charges or negotiated payment rates for such services. Charges and reimbursement rates for inpatient routine services vary depending on the type of services provided (e.g., medical/surgical, intensive care or behavioral health) and the geographic location of the hospital. Inpatient occupancy levels fluctuate for various reasons, many of which are beyond our control. The percentage of patient service revenue attributable to outpatient services has generally increased in recent years, primarily as a result of advances in medical technology that allow more services to be provided on an outpatient basis, as well as increased pressure from Medicare, Medicaid and private insurers to reduce hospital stays

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and provide services, where possible, on a less expensive outpatient basis. We believe that our experience with respect to our increased outpatient levels mirrors the general trend occurring in the health care industry and we are unable to predict the rate of growth and resulting impact on our future revenues.

Patients are generally not responsible for any difference between customary hospital charges and amounts reimbursed for such services under Medicare, Medicaid, some private insurance plans, and managed care plans, but are responsible for services not covered by such plans, exclusions, deductibles or co-insurance features of their coverage. The amount of such exclusions, deductibles and co-insurance has generally been increasing each year. Indications from recent federal and state legislation are that this trend will continue. Collection of amounts due from individuals is typically more difficult than from governmental or business payers and we continue to experience an increase in uninsured and self-pay patients which unfavorably impacts the collectability of our patient accounts thereby increasing our provision for doubtful accounts and charity care provided.

Since a significant portion of our revenues are derived from facilities located in Nevada and Texas, we are particularly sensitive to regulatory, economic, environmental and competition changes in those states. Any material change in the current payment programs or regulatory, economic, environmental or competitive conditions in those states could have a disproportionate effect on our overall business results.

**Overview:** We receive payments for services rendered from private insurers, including managed care plans, the federal government under the Medicare program, state governments under their respective Medicaid programs and directly from patients.

The following table shows the approximate percentages of net patient revenue for the three and six month periods ended June 30, 2010 and 2009 presented on: (i) a combined basis for both our acute care and behavioral health facilities; (ii) for our acute care facilities only, and; (iii) for our behavioral health facilities only:

Acute Care and Behavioral Health Facilities Combined	Percentage of Net Patient Revenues Three Months		Percentage of Net Patient Revenues Six Months Ended	
	Ended June 30,		June 30,	
	2010	2009	2010	2009
	Third Party Payors:			
Medicare	24%	24%	25%	25%
Medicaid	13%	14%	13%	14%
Managed Care (HMO and PPOs)	45%	46%	46%	46%
Other Sources	18%	16%	16%	15%
Total	100%	100%	100%	100%

Acute Care Facilities	Percentage of Net Patient Revenues Three Months		Percentage of Net Patient Revenues Six Months Ended	
	Ended June 30,		June 30,	
	2010	2009	2010	2009
	Third Party Payors:			
Medicare	27%	27%	27%	27%
Medicaid	9%	10%	9%	9%
Managed Care (HMO and PPOs)	46%	47%	46%	47%
Other Sources	18%	16%	18%	17%
Total	100%	100%	100%	100%

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Behavioral Health Facilities	Percentage of Net Patient Revenues Three Months Ended June 30,		Percentage of Net Patient Revenues Six Months Ended June 30,	
	2010	2009	2010	2009
	Third Party Payors:			
Medicare	17%	17%	17%	16%
Medicaid	24%	26%	24%	26%
Managed Care (HMO and PPOs)	45%	43%	45%	43%
Other Sources	14%	14%	14%	15%
Total	100%	100%	100%	100%

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**Medicare:** Medicare is a federal program that provides certain hospital and medical insurance benefits to persons aged 65 and over, some disabled persons and persons with end-stage renal disease. All of our acute care hospitals and many of our behavioral health centers are certified as providers of Medicare services by the appropriate governmental authorities. Amounts received under the Medicare program are generally significantly less than a hospital's customary charges for services provided. Since a substantial portion of our revenues will come from patients under the Medicare program, our ability to operate our business successfully in the future will depend in large measure on our ability to adapt to changes in this program.

Under the Medicare program, for inpatient services, our general acute care hospitals receive reimbursement under the inpatient prospective payment system ( IPPS ). Under the IPPS, hospitals are paid a predetermined fixed payment amount for each hospital discharge. The fixed payment amount is based upon each patient's Medicare severity diagnosis related group ( MS-DRG ). Every MS-DRG is assigned a payment rate based upon the estimated intensity of hospital resources necessary to treat the average patient with that particular diagnosis. The MS-DRG payment rates are based upon historical national average costs and do not consider the actual costs incurred by a hospital in providing care. This MS-DRG assignment also affects the predetermined capital rate paid with each MS-DRG. The MS-DRG and capital payment rates are adjusted annually by the predetermined geographic adjustment factor for the geographic region in which a particular hospital is located and are weighted based upon a statistically normal distribution of severity. While we generally will not receive payment from Medicare for inpatient services, other than the MS-DRG payment, a hospital may qualify for an outlier payment if a particular patient's treatment costs are extraordinarily high and exceed a specified threshold.

MS-DRG rates are adjusted by an update factor each federal fiscal year, which begins on October 1. The index used to adjust the MS-DRG rates, known as the hospital market basket index, gives consideration to the inflation experienced by hospitals in purchasing goods and services. Generally, however, the percentage increases in the MS-DRG payments have been lower than the projected increase in the cost of goods and services purchased by hospitals.

In July, 2009, CMS published the final IPPS 2010 payment rule which provided for a 2.1% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors and annual geographic wage index updates and the documenting and coding adjustments are considered, we estimate our overall increase from the final federal fiscal year 2010 rule will approximate 1.1%.

In July, 2010, CMS published its proposed IPPS 2011 payment rule which provided for a 2.6% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors and annual geographic wage index updates and the documenting and coding adjustments are considered, we estimate our overall decrease from the proposed federal fiscal year 2011 rule will approximate 1.1%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.25% in federal fiscal year 2011.

In September, 2007, the TMA, Abstinence Education, and QI Programs Extension Act of 2007 legislation took effect and scaled back cuts in hospital reimbursement that CMS was set to impose. In federal fiscal years 2010 to 2012, the new law requires CMS to make adjustments to the Medicare standardized amounts in these years to reflect the removal of actual aggregate payment increases or decreases for documentation and coding adjustments that occurred during federal fiscal years 2008 and 2009 as compared to the initial CMS estimates. In federal fiscal year 2010, CMS made its initial statutory mandated adjustment under this legislation and will continue to do so in subsequent fiscal years to ensure the implementation of MS-DRGs was budget neutral among all affected hospitals. In April, 2010, the IPPS 2011 proposed payment rule applied a 2.9% reduction to the 2011 market basket update and indicated another 2.9% reduction would also be applied in 2012 for documenting and coding. In this same rule, CMS indicated a remaining documenting and coding adjustment of 3.9% reduction is still required to be made to future IPPS updates. CMS did not indicate to which future federal fiscal year(s) this reduction would be applied.

On January 1, 2005, CMS implemented a new PPS ( Psych PPS ) for inpatient services furnished by psychiatric hospitals under the Medicare program. This system replaced the cost-based reimbursement guidelines with a per diem Psych PPS with adjustments to account for certain facility and patient characteristics. The Psych PPS also contained provisions for outlier payments and an

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adjustment to a psychiatric hospital's base payment if it maintains a full-service emergency department. According to the May, 2009 CMS notice, the market basket increase is 2.1% for the period of July 1, 2009 through June 30, 2010. According to the April, 2010 CMS notice, the market basket increase is 2.4% for the period of July 1, 2010 through June 30, 2011.

In October 2009, CMS published its annual final Medicare Outpatient Prospective Payment System (OPPS) rule for 2010. The final market basket increase to the OPPS base rate is 2.1%. When other statutorily required adjustments are considered the overall Medicare OPPS payment increase for 2010 is estimated to be 1.9%.

In July 2010, CMS published its annual proposed Medicare OPPS rule for 2011. The proposed market basket increase to the OPPS base rate is 2.4%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.25% in federal fiscal year 2011. When other statutorily required adjustments are considered the overall Medicare OPPS payment increase for 2011 is estimated to be 2.4%.

In July 2010, the Department of Health and Human Services (HHS) published final regulations implementing the health information technology (HIT) provisions of the American Recovery and Reinvestment Act (referred to as the HITECH Act). The final regulation defines the meaningful use of Electronic Health Records (EHR) and establishes the requirements for the Medicare and Medicaid EHR payment incentive programs. The final rule established an initial set of standards and certification criteria.

The implementation period for these new Medicare and Medicaid incentive payments starts in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. State Medicaid program participation in this federally funded incentive program is voluntary and we are unable to predict which states will choose to participate. We estimate that approximately 75% of the projected incentive payments will be paid by Medicare and 25% from state Medicaid programs. Our acute care hospitals may qualify for these EHR incentive payments upon implementation of the EHR application assuming they meet the meaningful use criteria. These Medicare and Medicaid incentive payments are intended to offset a portion of the cost incurred to qualify as a meaningful user of EHR. Our acute care facilities are scheduled to implement an EHR application, on a facility-by-facility basis, beginning in late 2011 and ending in late 2014. However, there can be no assurance that we will ultimately qualify for these incentive payments and, should we qualify, we are unable to quantify the amount of incentive payments we may receive since the amounts is dependent upon various factors including the implementation timing at each facility. Should we qualify for incentive payments, there may be timing differences in the recognition of the revenues and expenses recorded in connection with the implementation of the EHR application which may cause material period-to-period changes in our future results of operations. Hospitals that do not qualify as a meaningful user of EHR by 2015 are subject to a reduced market basket update to the IPPS standardized amount in 2015 and each subsequent fiscal year. Although we believe that our acute care hospitals will be in compliance with the EHR standards by 2015, there can be no assurance that all of our facilities will be in compliance and therefore not subject to the penalty provision of the HITECH Act.

**Medicaid:** Medicaid is a joint federal-state funded health care benefit program that is administered by the states to provide benefits to qualifying individuals who are unable to afford care. Most state Medicaid payments are made under a PPS-like system, or under programs that negotiate payment levels with individual hospitals. Amounts received under the Medicaid program are generally significantly less than a hospital's customary charges for services provided. In addition to revenues received pursuant to the Medicare program, we receive a large portion of our revenues either directly from Medicaid programs or from managed care companies managing Medicaid. All of our acute care hospitals and most of our behavioral health centers are certified as providers of Medicaid services by the appropriate governmental authorities.

We receive a large concentration of our Medicaid revenues from Texas and significant amounts from Nevada, Florida, California, Washington, D.C. and Illinois. The majority of these states, as well as most other states in which we operate, have reported significant budget deficits that have resulted in the reduction of Medicaid funding for 2009 and 2010. We can provide no assurance that reductions to Medicaid revenues, particularly in the above-mentioned states, will not have a material adverse effect on our future results of operations. Furthermore, many states are currently working to effectuate further significant reductions in the level of Medicaid funding due to significant state budget deficits also projected for 2010, which could adversely affect future levels of Medicaid reimbursement received by our hospitals. Conversely, on February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law and contained various Medicaid provisions that will impact our hospitals including the following: (i) temporary increases to Medicaid funding through enhanced federal matching assistance percentages (FMAPs) for a 27 month period retroactive to October 1, 2008 through December 31, 2010 with all states receiving a FMAP increase of 6.2% and also receiving a bonus FMAP increase contingent on the increased level of a state's unemployment rate; (ii) a temporary increase of 2.5% in the federal Medicaid disproportionate share hospital allotment for both federal fiscal years 2009 and 2010, and; (iii) states will be required to maintain effort on Medicaid eligibility consistent with requirements prior to passage of this law. Due to the indirect nature of the enhanced Medicaid federal funding contained within the American Recovery and Reinvestment Act of 2009, we are unable to determine the impact of these Medicaid changes on our future results of operations.

Certain of our acute care hospitals located in various counties of Texas (Hidalgo, Maverick, Potter and Webb) participate in CMS-approved private Medicaid supplemental payment (UPL) programs. These hospitals also have affiliation agreements with third-



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party hospitals to provide free hospital and physician care to qualifying indigent residents of these counties. Our hospitals receive both UPL payments from the Medicaid program and indigent care payments from third-party, affiliated hospitals. The UPL payments are contingent on the county or hospital district making an Inter-Governmental Transfer ( IGT ) to the state Medicaid program while the indigent care payment is contingent on a transfer of funds from the applicable affiliated hospitals. We received \$10 million and \$11 million during the three-month periods ended June 30, 2010 and 2009, respectively, and \$20 million and \$19 million during the six-month periods ended June 30, 2010 and 2009, respectively, of aggregate, net UPL and affiliated hospital indigent care payments. If during the remainder of 2010 the hospital district makes IGTs consistent with 2009, we believe we would be entitled to additional aggregate, net UPL and affiliated hospital indigent care payment revenues of approximately \$20 million during the remaining six months of 2010.

In July 2009, the Texas Health and Human Services Commission ( THHSC ) issued a final rule and will rebase during state fiscal year ( SFY ) 2010, on a statewide budget neutral basis, all acute care hospital inpatient Standard Dollar Amount ( SDA ) rates. In addition, the THHSC will also rebase all MS-DRG relative weights concurrent with this SDA rate change. The THHSC will use SFY2008 cost report cost data for the SDA and relative weight rebasing and will only make changes on a prospective basis regardless of when the rebased SDA rates and relative weights are implemented. The THHSC recently notified hospitals of their preliminary rebased SFY2011 SDA rates, preliminary statewide MS-DRG relative weights for SFY2011 and the estimated statewide budget neutrality adjustment. We estimate that these changes could potentially reduce our inpatient Medicaid reimbursement by up to \$5 million annually, effective September 1, 2010.

In addition, we were notified in May, 2009 by the THHSC that the statewide new hospital rate for our hospitals located in South Texas will be reduced. Consistent with our expectations, THHSC finalized the South Texas Medicaid inpatient rate retroactively to September 1, 2009 and our Texas Medicaid reimbursement was reduced by \$12 million annually. This rate change will be superseded on September 1, 2010 by the aforementioned THHSC rebased SDA rates required by the July, 2009 final rule.

**Managed Care:** A significant portion of our net patient revenues are generated from managed care companies, which include health maintenance organizations, preferred provider organizations and managed Medicare (referred to as Medicare Part C or Medicare Advantage) and Medicaid programs. In general, we expect the percentage of our business from managed care programs to continue to grow. The consequent growth in managed care networks and the resulting impact of these networks on the operating results of our facilities vary among the markets in which we operate. Typically, we receive lower payments per patient from managed care payors than we do from traditional indemnity insurers, however, during the past few years we have secured price increases from many of our commercial payors including managed care companies.

**Commercial Insurance:** Our hospitals also provide services to individuals covered by private health care insurance. Private insurance carriers typically make direct payments to hospitals or, in some cases, reimburse their policy holders, based upon the particular hospital's established charges and the particular coverage provided in the insurance policy. Private insurance reimbursement varies among payors and states and is generally based on contracts negotiated between the hospital and the payor.

Commercial insurers are continuing efforts to limit the payments for hospital services by adopting discounted payment mechanisms, including predetermined payment or DRG-based payment systems, for more inpatient and outpatient services. To the extent that such efforts are successful and reduce the insurers' reimbursement to hospitals and the costs of providing services to their beneficiaries, such reduced levels of reimbursement may have a negative impact on the operating results of our hospitals.

**Other Sources:** Our hospitals provide services to individuals that do not have any form of health care coverage. Such patients are evaluated, at the time of service or shortly thereafter, for their ability to pay based upon federal and state poverty guidelines, qualifications for Medicaid or other state assistance programs, as well as our local hospital's indigent and charity care policy. Patients without health care coverage who do not qualify for Medicaid or indigent care write-offs are offered substantial discounts in an effort to settle their outstanding account balances.

**State Medicaid Disproportionate Share Hospital Payments:** Hospitals that have an unusually large number of low-income patients (i.e., those with a Medicaid utilization rate of at least one standard deviation above the mean Medicaid utilization, or having a low income patient utilization rate exceeding 25%) are eligible to receive a disproportionate share hospital ( DSH ) adjustment. Congress established a national limit on DSH adjustments. Although this legislation and the resulting state broad-based provider taxes have affected the payments we receive under the Medicaid program, to date the net impact has not been materially adverse.

Upon meeting certain conditions and serving a disproportionately high share of Texas' and South Carolina's low income patients, five of our facilities located in Texas and one facility located in South Carolina received additional reimbursement from each state's DSH fund. The Texas and South Carolina programs have been renewed for each state's 2010 fiscal years (covering the period of October 1, 2009 through September 30, 2010 for each state). In connection with these DSH programs, included in our financial results was an aggregate of \$13 million and \$15 million during the three-month periods ended June 30, 2010 and 2009, respectively, and \$27 million during each of the six-month periods ended June 30, 2010 and 2009. Failure to renew these DSH programs beyond their scheduled termination dates, failure of our hospitals that currently receive DSH payments to qualify for future DSH funds under these programs, or reductions in reimbursements, could have a

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material adverse effect on our future results of operations. Assuming that the Texas and South Carolina programs are renewed for each state's 2011 fiscal years at amounts similar to the 2010 fiscal year amounts, we estimate our aggregate reimbursements pursuant to these programs to be approximately \$26 million during the remaining six months of 2010.



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**Sources of Revenues and Health Care Reform:** Given increasing budget deficits, the federal government and many states are currently considering additional ways to limit increases in levels of Medicare and Medicaid funding, which could also adversely affect future payments received by our hospitals. In addition, the uncertainty and fiscal pressures placed upon the federal government as a result of, among other things, the War on Terrorism, economic recovery stimulus packages, responses to natural disasters, the expansion of a Medicare drug benefit and the federal budget deficit in general may affect the availability of federal funds to provide additional relief in the future. We are unable to predict the effect of future policy changes on our operations.

In March, 2010, the Health Care and Education Reconciliation Act of 2010 (H.R. 4872, P.L. 111-152), (the Reconciliation Act ) and the Patient Protection and Affordable Care Act (P.L. 111-148), (the Affordable Care Act ), were enacted into law and created significant changes to health insurance coverage for U.S. citizens as well as material revisions to the federal Medicare and state Medicaid programs. Legislated Medicare changes that will take effect in 2010 are noted below followed by Medicare, Medicaid and other health care industry changes which are scheduled to be implemented at various times during this decade.

***Immediate Medicare Reductions:***

The Reconciliation Act reduces the market basket update for inpatient and outpatient hospitals and inpatient behavioral health facilities in 2010 and 2011 by 0.25% with the noted effective dates as follows:

Outpatient acute care	Retroactive to January 1, 2010
Inpatient acute care	April 1, 2010
Inpatient behavioral health	July 1, 2010

***Future Medicare Reductions:***

Future changes to the Medicare program include:

Market basket update reductions and productivity adjustments (effective 2011 and forward)

Reforms to Medicare Advantage payments (effective 2011 and forward)

Implement a hospital readmissions reduction program (effective 2012)

Implement a national pilot program on payment bundling (effective 2013)

Reduction to Medicare disproportionate share hospital ( DSH ) payments (effective 2014)

***Medicaid Revisions:***

Expanded Medicaid eligibility and related special federal payments (effective 2014)

Reduction to Medicaid DSH (effective 2014)

***Health Insurance Revisions:***

Large employer insurance reforms (effective 2014)

Individual insurance mandate and related federal subsidies (effective 2014)

Federally mandated insurance coverage reforms (2010 and forward)

Although we do not believe the above-mentioned Medicare market basket reductions scheduled to be implemented in 2010 will have a material impact on our 2010 or 2011 results of operations, we are unable to estimate the future impact of the other legislative changes as outlined above.

In addition to statutory and regulatory changes to the Medicare and each of the state Medicaid programs, our operations and reimbursement may be affected by administrative rulings, new or novel interpretations and determinations of existing laws and regulations, post-payment audits, requirements for utilization review and new governmental funding restrictions, all of which may materially increase or decrease program payments as well as affect the cost of providing services and the timing of payments to our facilities. The final determination of amounts we receive under the Medicare and Medicaid programs often takes many years, because of audits by the program representatives, providers' rights of appeal and the application of numerous technical reimbursement provisions. We believe that we have made adequate provisions for such potential adjustments. Nevertheless, until final adjustments are made, certain issues remain unresolved and previously determined allowances could become either inadequate or more than ultimately required.

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Finally, we expect continued third-party efforts to aggressively manage reimbursement levels and cost controls. Reductions in reimbursement amounts received from third-party payors could have a material adverse effect on our financial position and our results of operations.

**Other Operating Results**

Combined net revenues from our surgical hospitals, ambulatory surgery centers and radiation oncology centers were \$4 million and \$6 million during the three-month periods ended June 30, 2010 and 2009, respectively, and \$9 million and \$13 million during the six-month periods ended June 30, 2010 and 2009, respectively. In connection with a construction management contract pursuant to the terms of which we built an acute care hospital for an unrelated third party which was completed during the fourth quarter of 2009, we earned revenues of \$9 million and \$30 million during the three and six-month periods ended June 30, 2009. Combined income before income taxes earned in connection with the revenues mentioned above was not material to our results of operations during each of the three and six-month periods ended June 30, 2010 and 2009.

Interest expense was \$12 million during each of the three-month periods ended June 30, 2010 and 2009, and \$25 million during each of the six-month periods ended June 30, 2010 and 2009. Below is a schedule of our interest expense for the three and six-month periods ended June 30, 2010 and 2009 (amounts in thousands):

	<b>Three Months Ended June 30, 2010</b>	<b>Three Months Ended June 30, 2009</b>	<b>Six Months Ended June 30, 2010</b>	<b>Six Months Ended June 30, 2009</b>
Revolving credit & demand notes	\$ 614	\$ 1,116	\$ 1,364	\$ 2,481
\$200 million, 6.75% Senior Notes due 2011	3,378	3,378	6,756	6,756
7.125% Senior Notes due 2016	7,124	7,124	14,248	14,248
Accounts receivable securitization program	191	190	343	500
Other combined, including interest rate swap expense, net	2,934	2,710	5,586	5,124
Capitalized interest on major construction projects	(1,911)	(2,494)	(3,373)	(4,312)
Interest income	(53)	(145)	(270)	(280)
Interest expense, net	\$ 12,277	\$ 11,879	\$ 24,654	\$ 24,517

The effective tax rate, as calculated by dividing the provision for income taxes by income before income taxes, was 35.0% and 37.8% during the three-month periods ended June 30, 2010 and 2009, respectively, and 35.2% and 36.1% during the six-month periods ended June 30, 2010 and 2009, respectively. The effective tax rate, as calculated by dividing the provision for income taxes by the difference in income before income taxes minus income attributable to noncontrolling interests, was 38.5% and 41.4% during the three-month periods ended June 30, 2010 and 2009, respectively, and 38.6% and 40.1% during the six-month periods ended June 30, 2010 and 2009, respectively. The decreases in the effective rates during the three and six-month periods ended June 30, 2010, as compared to the comparable prior year periods, consisted primarily of the \$4 million unfavorable discrete tax item recorded during the second quarter of 2009 resulting from the nondeductible portion of the settlement reserve recorded in connection with the investigation of our South Texas Health System affiliates.

**Liquidity****Net cash provided by operating activities**

Net cash provided by operating activities was \$219 million during the six-month period ended June 30, 2010 and \$301 million during the comparable period of the prior year. The net decrease of \$82 million was primarily attributable to the following:

\$21 million of construction management receivables collected during the first six months of 2009 related to a new acute care facility built for a third-party that was completed during the fourth quarter of 2009;

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a \$21 million unfavorable change in accounts receivable;

a \$29 million unfavorable change in other working capital accounts (excluding the effect of \$15 million of accrued transaction costs at June 30, 2010 incurred in connection with our agreement to acquire Psychiatric Solutions, Inc.) due primarily to a deferred purchase price payment of \$10 million made during the first quarter of 2010 in connection with a prior year acquisition and the timing of accounts payable and accrued compensation payments;

an \$11 million unfavorable change in other assets and deferred charges, and;

Our days sales outstanding ( DSO ) are calculated by dividing our net revenue by the number of days in the six-month period. The result is divided into the accounts receivable balance at June 30<sup>th</sup> of each year to obtain the DSO. Our DSO were 42 days at June 30<sup>th</sup> of 2010 and 2009.

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### **Net cash used in investing activities**

During the first six months of 2010, we used \$117 million of net cash in investing activities as follows:

spent \$122 million to finance capital expenditures related to the following: (i) construction costs related to the newly constructed Palmdale Regional Medical Center, a 171-bed acute care hospital in Palmdale, California that is scheduled to be completed and opened in late 2010; (ii) construction costs related to multiple projects in process to add capacity to our busiest behavioral health facilities, and; (iii) capital expenditures for equipment, renovations and new projects at various existing facilities, and;

received \$5 million of combined proceeds in connection with the divestiture of our minority ownership interest in a healthcare technology company and sale of a portion of our ownership interest in an outpatient surgery center.

During the first six months of 2009, we used \$192 million of net cash in investing activities as follows:

spent \$183 million to finance capital expenditures related to the following: (i) construction costs related to Palmdale Regional Medical Center; (ii) construction costs related to a major expansion of the emergency, imaging and women's services at our Southwest Healthcare System hospitals located in Riverside County, California; (iii) construction costs related to a newly constructed 220-bed replacement acute care hospital in Denison, Texas that opened in late December, 2009; (iv) construction costs related to a new patient tower at Summerlin Hospital Medical Center located in Las Vegas, Nevada that opened in December, 2009; (v) construction costs related to multiple projects in process to add capacity to our busiest behavioral health facilities, and; (vi) capital expenditures for equipment, renovations and new projects at various existing facilities, and;

spent \$9 million to acquire a 72-bed behavioral health facility located in Louisville, Colorado.

### **Net cash used in financing activities**

During the first six months of 2010, we used \$100 million of net cash provided by financing activities as follows:

spent \$78 million on net repayments of debt due primarily to repayments pursuant to our \$800 million revolving credit facility partially offset by increased borrowings pursuant to our \$200 million accounts receivable securitization program;

spent \$12 million to pay profit distributions related to noncontrolling interests in majority owned businesses;

spent \$4 million to repurchase 103,000 shares of our Class B Common Stock;

spent \$10 million to pay quarterly cash dividends of \$.05 per share, and;

generated \$4 million from the issuance of shares of our Class B Common Stock pursuant to the terms of employee stock purchase plans.

During the first six months of 2009, we used \$103 million of net cash provided by financing activities as follows:

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spent \$77 million on net of repayments of debt due primarily to repayments pursuant to our \$800 million revolving credit facility and our \$200 million accounts receivable securitization program;

spent \$15 million to repurchase 452,000 shares of our Class B Common Stock;

spent \$4 million to pay profit distributions related to noncontrolling interests in majority owned businesses;

spent \$8 million to pay quarterly cash dividends of \$.08 per share, and;

generated \$1 million from the issuance of shares of our Class B Common Stock pursuant to the terms of employee stock purchase plans.

### ***2010 Expected Capital Expenditures:***

During the remaining six months of 2010, we expect to spend approximately \$130 million to \$150 million on capital expenditures. We believe that our capital expenditure program is adequate to expand, improve and equip our existing hospitals. We expect to finance all capital expenditures and acquisitions with internally generated funds and/or additional funds, as discussed below.

### **Capital Resources**

#### **Credit Facilities and Outstanding Debt Securities**

We have an \$800 million, unsecured non-amortizing revolving credit agreement, as amended ( *Credit Agreement* ) which is scheduled to expire in July, 2011. The *Credit Agreement* includes a \$100 million sub-limit for letters of credit. The interest rate on the borrowings is determined, at our option, as either: (i) the one, two, three or six month London Inter-Bank Offer Rate ( *LIBOR* ) plus a spread of 0.33% to 0.575%; (ii) at the higher of the Agent's prime rate or the federal funds rate plus 0.50%, or; (iii) a competitive bid rate. A facility fee ranging from 0.07% to 0.175% is required on the total commitment. The applicable margins over *LIBOR* and the

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facility fee are based upon our credit ratings from Standard & Poor's Ratings Services and Moody's Investors Service, Inc. At June 30, 2010, the applicable margin over the LIBOR rate was 0.50% and the facility fee was 0.125%. There are no compensating balance requirements. As of June 30, 2010, we had \$166 million of borrowings outstanding under our revolving credit agreement and \$571 million of available borrowing capacity, net of \$63 million of outstanding letters of credit.

In August, 2007, we entered into a \$200 million accounts receivable securitization program ( "Securitization" ) with a group of conduit lenders and liquidity banks. The patient-related accounts receivable ( "Receivables" ) for substantially all of our acute care hospitals serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of .35%. The initial term of this Securitization was 364 days and the term can be extended for incremental 364 day periods upon mutual agreement of the parties. The facility was extended for a third 364-day term in August, 2009 and will mature in August, 2010. We have accounted for this Securitization as borrowings. We maintain effective control over the Receivables since, pursuant to the terms of the Securitization, the Receivables are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The wholly-owned special purpose entities use the Receivables to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. As of June 30, 2010, we had \$100 million of borrowings outstanding pursuant to this program and \$100 million of available borrowing capacity. The outstanding borrowings pursuant to the Securitization program are classified as long-term on our balance sheet since they can be refinanced through available borrowings under the terms of our Credit Agreement, which is scheduled to expire in July of 2011.

In June, 2006, we issued \$250 million of senior notes (the "Notes" ) which have a 7.125% coupon rate and mature on June 30, 2016. Interest on the Notes is payable semiannually in arrears on June 30 and December 30 of each year. In June, 2008, we issued an additional \$150 million of Notes which formed a single series with the original Notes issued in June, 2006. Other than their date of issuance and initial price to the public, the terms of the Notes issued in June, 2008 are identical to, and trade interchangeably with, the Notes which were originally issued in June, 2006.

During 2001, we issued \$200 million of senior notes which have a 6.75% coupon rate and which mature on November 15, 2011. The interest on the senior notes is paid semiannually in arrears on May 15 and November 15 of each year. The senior notes can be redeemed in whole at any time and in part from time to time.

The carrying amount and fair value of our long-term debt was \$881 million and \$901 million at June 30, 2010, respectively. The fair value of our debt was computed based upon quotes received from financial institutions.

Our revolving credit agreement includes a material adverse change clause that must be represented at each draw. The facility also requires compliance with maximum debt to capitalization and minimum fixed charge coverage ratios. We are in compliance with all required covenants as of June 30, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

Our \$200 million Securitization facility, under which we had \$100 million of outstanding borrowings at June 30, 2010, matures in August, 2010. Upon maturity, or shortly thereafter, we plan to replace the existing Securitization with a new \$250 million accounts receivable securitization program. Our existing \$800 million Credit Agreement, under which we had \$166 million of outstanding borrowings at June 30, 2010, matures on July 28, 2011. In May, 2010, we announced our intent to acquire, through a merger, Psychiatric Solutions, Inc. ( "Merger" ). In association with the Merger, we have obtained a debt financing commitment for a total of \$3.45 billion consisting of an \$800 million revolving credit agreement, a \$1.05 billion term loan A and a \$1.6 billion term loan B (collectively "The Credit Facilities" ). The Credit Facilities will become effective upon closing of the Merger which is expected to occur in the fourth quarter of 2010. Should the Merger be completed and the Credit Facilities become effective, our existing \$800 million Credit Agreement, which is scheduled to mature on July 28, 2011, will be replaced by The Credit Facilities. We also have \$200 million of 6.75% senior notes which are scheduled to mature November 15, 2011. Although our refinancing plans for these bonds have not yet been determined, we believe we will have sufficient capacity under The Credit Facilities to repay the \$200 million of 6.75% senior notes upon their maturity in November, 2011.

We expect to finance all capital expenditures and acquisitions, pay dividends and potentially repurchase shares of our common stock utilizing internally generated and additional funds. Additional funds may be obtained through: (i) the issuance of equity; (ii) borrowings under our existing revolving credit facility or through refinancing the existing revolving credit agreement, and/or; (iii) the issuance of other long-term debt. There can be no assurance that such additional funds will be available in the preferred amounts or from the preferred sources.

**Off-Balance Sheet Arrangements**

During the six months ended June 30, 2010, there have been no material changes in the off-balance sheet arrangements consisting of operating leases and standby letters of credit and surety bonds. Reference is made to *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Contractual Obligations and Off-Balance Sheet Arrangements*, in our Annual Report on Form 10-K for

the year ended December 31, 2009.



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We have various obligations under operating leases or master leases for real property and under operating leases for equipment. The real property master leases are leases for buildings on or near hospital property for which we guarantee a certain level of rental income. We sublease space in these buildings and any amounts received from these subleases are offset against the expense. In addition, we lease four hospital facilities from the Trust with terms scheduled to expire in 2011 and 2014. These leases contain up to four, 5-year renewal options.

As of June 30, 2010 we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds. Our outstanding letters of credit and surety bonds as of June 30, 2010 totaled \$80 million consisting of: (i) \$64 million related to our self-insurance programs; (ii) \$14 million related primarily to pending appeals of legal judgments (including judgments related to professional and generally liability claims), and; (iii) \$2 million of other debt guarantees related to public utilities and entities in which we own a minority interest.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in the quantitative and qualitative disclosures during the six months ended June 30, 2010. Reference is made to *Item 7A. Quantitative and Qualitative Disclosures about Market Risk* in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

As of June 30, 2010, under the supervision and with the participation of our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), we performed an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the 1934 Act ). Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

### **Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting or in other factors during the second quarter of 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are subject to claims and suits in the ordinary course of business, including those arising from care and treatment afforded by our hospitals and are party to litigation, as outlined below.

*False Claims Act Case Against Virginia Behavioral Health Facilities:*

In late 2007 and again on July 3, 2008 and January 27, 2009, the Office of Inspector General for the Department of Health and Human Services (OIG) issued subpoenas to two of our facilities, Marion Youth Center and Mountain Youth Academy, seeking documents related to the treatment of Medicaid beneficiaries at the facilities. It was our understanding at that time that the OIG was investigating whether claims for reimbursement submitted by those facilities to the Virginia Medicaid program were supported by adequate documentation of the services provided which could be considered to be a basis for a false claims act violation. On August 4, 2008, the Office of the Attorney General for the Commonwealth of Virginia issued a subpoena to Keystone Newport News, another of our facilities. It was our understanding at that time that the Office of Attorney General was investigating whether Keystone Newport News complied with various Virginia laws and regulations, including documentation requirements.

In response to these subpoenas, we produced the requested documents on a rolling basis and we cooperated with the investigations in all respects. We also met with representatives of the OIG, the Virginia Attorney General, the United States Attorney for the Western District of Virginia, and the United States Department of Justice Civil Division on several occasions to discuss a possible resolution of this matter. However, the parties were not able to reach a resolution.

Consequently, on November 4, 2009, the United States Department of Justice and the Virginia Attorney General intervened in a qui tam case that had been filed under seal in 2007 against Universal Health Services, Inc. (UHS), and Keystone Marion, LLC and Keystone Education and Youth Center (Keystone). The Department of Justice and the Commonwealth of Virginia filed and served their complaint which, at present, relates solely to the Marion Youth Center. The complaint alleges causes of action pursuant to the federal and state false claims acts, Virginia fraud, and unjust enrichment. The former employees filed a separate amended complaint, alleging employment and retaliation claims as well as false claim act violations. On April 30, 2010, UHS and Keystone filed separate motions to dismiss the government's claims in their entirety. Keystone also filed a separate motion to dismiss the relators' employment claims. The court recently ruled on the motions granting them in part and denying them in part. The court has allowed the government's False Claim Act case to proceed and parts of the relators' employment related claims. We have established a reserve in connection with this matter which did not have a material impact on our financial statements. We will continue to defend ourselves vigorously against the government's and former employees' allegations. There can be no assurance that we will prevail in the litigation or that the case will be limited to the Marion Youth Center.

*Ethridge v. Universal Health Services et. al:*

In June, 2008, we and one of our acute care facilities, Lancaster Community Hospital, were named as defendants in a wage and hour lawsuit in Los Angeles County Superior Court. This is a purported class action lawsuit alleging that the hospital failed to provide sufficient meal and break periods to certain employees. In June, 2010 a settlement was reached with the attorneys for the class representative for an amount that will not materially affect our consolidated financial position or results of operations. The settlement is subject to court approval which has not yet occurred.

*Devore, et. al. v. Keystone Education and Youth Services, LLC:*

Alicante School in California was acquired by a subsidiary of ours in October, 2005. Prior to our acquisition, two former employees of the facility filed a false claim act qui tam action and a gender discrimination/whistleblower claim in a California state court. The plaintiffs allege that the Alicante School improperly billed subdivisions of the state of California based upon services provided at the school and that the plaintiffs were discriminated against based upon their gender and as a result of their objection to these practices. In June 2008, we entered into an agreement with the former owners of the facility whereby they agreed to defend the case, indemnify us and hold us harmless for any damages that may result from this case. The former owners of the facility have been funding the legal defense of this case since that time. While we may be required to initially fund any settlement or judgment resulting from this matter, we intend to pursue collection of any such amounts from the former owners of the facility pursuant to the June, 2008 indemnification agreement.



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**Table of Contents*****Other Matters***

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, there is no assurance that we will not be faced with sanctions, fines or penalties in connection with such inquiries or actions, including with respect to the investigations and other matters discussed herein. Even if we were to ultimately prevail, such inquiries and/or actions could have a material adverse effect on us.

***Southwest Healthcare System:***

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

In April, 2010, SWHCS received notification from CMS that it intended to effectuate the termination of SWHCS's Medicare provider agreement effective June 1, 2010. At that time, SWHCS commenced discussions with officials from CMS regarding an agreement in an effort to resolve the provider agreement termination action. In May, 2010, SWHCS entered into an agreement with CMS which abated the termination action scheduled for June 1, 2010. The agreement is up to one year in duration and requires SWHCS to engage independent experts in various disciplines to analyze and develop implementation plans for SWHCS to meet the Medicare conditions of participation. At the conclusion of the agreement, CMS will conduct a full certification survey to determine if SWHCS has achieved substantial compliance with the Medicare conditions of participation. During the term of the agreement, SWHCS will remain eligible to receive reimbursements from Medicare for services rendered to Medicare beneficiaries.

Also in April, 2010, SWHCS received notification from the California Department of Public Health ( CDPH ) indicating that it planned to initiate a process to revoke SWHCS's hospital license. In May, 2010, SWHCS received the formal document related to the revocation action. CDPH has previously indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements. SWHCS is currently engaged in pursuing a resolution of this action with CDPH, however, there can be no assurance it will be able to do so. Should SWHCS fail to reach an agreement with CDPH, SWHCS will appeal CDPH's revocation action and SWHCS would remain operational during the appeal process.

Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters, although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009 and the six months ended June 30, 2010, after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% and 3%, respectively, of our income from operations after income attributable to noncontrolling interest.

***General:***

Currently, and from time to time, some of our other facilities are subjected to inquiries and/or actions and receive notices of potential non-compliance of laws and regulations from various federal and state agencies. If one of our facilities is found to have violated these laws and regulations, the facility may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We do not believe that, other than as described above, any such existing action would materially affect our consolidated financial position or results of operations.

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In addition, various suits and claims arising against us in the ordinary course of business are pending. In the opinion of management, the outcome of such claims and litigation will not materially affect our consolidated financial position or results of operations.

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**Item 1A. Risk Factors**

Our Annual Report on Form 10-K for 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 include a listing of risk factors to be considered by investors in our securities. Other than developments related to our Southwest Healthcare System, as disclosed in Note 5 to the Financial Statements included in Part 1 of this Report and incorporated herein by reference, and additional risks related to our acquisition of Psychiatric Solutions Inc., there have been no material changes in our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2009 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010.

***Our proposed acquisition of Psychiatric Solutions, Inc. ( PSI ) is subject to conditions which may affect the timing of or consummation of the acquisition***

Our agreement to acquire PSI contains several customary conditions to closing including regulatory approvals and the approval of the stockholders of PSI. There is no assurance when or if the conditions will be satisfied. We have received a second request from the Federal Trade Commission ( FTC ) for information under the Hart Scott Rodino Act of 1976 which will require us and PSI to produce additional information which can cause delays in working to integrate the companies. The FTC may require divestures or other actions in order to allow the acquisition to proceed which could affect our ability to realize all the benefits of the acquisition. We have devoted substantial time and financial resources toward proceeding with the acquisition which could have adverse effects on operations and income.

***We may not be able to successfully integrate our proposed acquisition of PSI or realize the potential benefits of the acquisition, which could cause an adverse effect on us***

We may not be able to combine successfully the operations of PSI with our operations and, even if such integration is accomplished, we may never realize the potential benefits of the acquisition. The integration of PSI with our operations requires significant attention from management and may impose substantial demands on our operations or other projects. The integration of PSI also involves a significant capital commitment, and the return that we achieve on any capital invested may be less than the return that we would achieve on our other projects or investments. Any of these factors could cause delays or increased costs of combining PSI with us; and could adversely affect our operations, financial results and liquidity.

***Our level of indebtedness that we will incur in connection with the proposed acquisition of PSI could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry and prevent us from meeting our obligations under the agreements relating to our indebtedness.***

Our level of indebtedness that we will incur to complete the acquisition of PSI could adversely affect our ability to raise additional capital to fund our operations, limit our ability to react to changes in the economy or our industry and could potentially prevent us from meeting our obligations under the agreements relating to our indebtedness.

In connection with the consummation of our potential acquisition of PSI, we obtained a debt financing commitment of \$3.45 billion consisting of an \$800 million revolving credit agreement, a \$1.05 billion term loan A and a \$1.6 billion term loan B (collectively The Credit Facilities ). The Credit Facilities will become effective upon closing of the proposed acquisition of PSI which is expected to occur in the fourth quarter of 2010. The indebtedness under The Credit Facilities will be senior obligations of ours and will be guaranteed by substantially all of our material domestic subsidiaries. We will use the net proceeds from The Credit Facilities to pay the consideration under the merger agreement with PSI, to refinance certain of our existing indebtedness and the indebtedness of PSI, to pay certain costs and expenses of the transactions and for general corporate uses.

The Credit Facilities will contain various covenants that may limit our ability to take certain actions, including our ability to:

incur, assume or guarantee additional indebtedness; create liens; make restricted payments, including paying dividends and making investments;

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 substantially all our assets;

enter into transactions with affiliates; and;

guarantee certain obligations.

In addition, The Credit Facilities will contain 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 The Credit Facilities. If we were to suffer a an event of default under The Credit Facilities, all amounts outstanding under The Credit Facilities may become due and payable and all commitments under The Credit Facilities to extend further credit may be terminated.

Our leverage could result in unfavorable impact on us, including the following:

it may limit our ability to obtain additional debt or equity financing for working capital, capital expenditures, debt service requirements, acquisitions and general corporate or other purposes;

a substantial portion of our cash flows from operations will be dedicated to the payment of principal and interest on our indebtedness and will not be available for other purposes, including our operations, capital expenditures and future business opportunities;

some of our borrowings, including borrowings under The Credit Facilities, are at variable rates of interest, exposing us to the risk of increased interest rates;

it may limit our ability to adjust to changing market conditions and place us at a competitive disadvantage compared to our competitors that have less debt; and;

we may be vulnerable in a downturn in general economic conditions or in our business, or we may be unable to carry out capital spending that is important to our operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During 2007, our Board of Directors authorized us to repurchase additional shares on the open market under our stock repurchase programs. Pursuant to the terms of our program, we purchased 37,588 shares at an average price of \$41.13 per share or \$1.5 million in the aggregate during the second quarter of 2010 and 103,102 shares at an average price of \$35.91 per share or approximately \$3.7 million in the aggregate during the first six months of 2010. As of June 30, 2010, the number of shares available for purchase was 2,049,237 shares. There is no expiration date for our stock repurchase program.

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<b>2010 period</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share for forfeited restricted shares</b>	<b>Total number of shares purchased as part of publicly announced programs</b>	<b>Average price paid per share for shares purchased as part of publicly announced program</b>	<b>Aggregate purchase price paid</b>	<b>Maximum number of shares that may yet be purchased under the program</b>
April, 2010	8,041	N/A	8,041	\$ 37.55	\$ 301,949	2,078,784
May, 2010	19,408	N/A	19,408	41.64	808,235	2,059,376
June, 2010	10,139	N/A	10,139	42.97	435,659	2,049,237
Total April through June	37,588	N/A	37,588	\$ 41.13	\$ 1,545,843	2,049,237

**Dividends**

During the quarter ended June 30, 2010, we declared and paid dividends of \$.05 per share.

**Item 6. Exhibits**

(a) Exhibits:

- 11. Statement re computation of per share earnings is set forth in Note 7 of the Notes to Condensed Consolidated Financial Statements.
- 31.1 Certification of the Company's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
- 31.2 Certification of the Company's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS\*\* XBRL Instance Document
- 101.SCH\*\* XBRL Taxonomy Extension Schema Document
- 101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.





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**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES**

**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.

Date: August 9, 2010

Universal Health Services, Inc.  
(Registrant)

/s/ Alan B. Miller  
Alan B. Miller, Chairman of the Board  
and Chief Executive Officer  
(Principal Executive Officer)

/s/ Steve Filton  
Steve Filton, Senior Vice President,  
Chief Financial Officer  
(Principal Financial Officer)

**Table of Contents****EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
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