

COMMUNITY HEALTH SYSTEMS INC

Form 10-Q

August 05, 2008

**Table of Contents**

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

**Form 10-Q**

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

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

**Commission file number 001-15925**

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

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

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

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

**37067**  
*(Zip Code)*

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

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

As of July 25, 2008, there were outstanding 95,884,621 shares of the Registrant's Common Stock, \$.01 par value.

---

**Community Health Systems, Inc.**

**Form 10-Q**

**For the Three and Six Months Ended June 30, 2008**

**Page**

**PART I. FINANCIAL INFORMATION**

<b><u>Item 1.</u></b>	<b><u>Financial Statements:</u></b>	
	<u>Condensed Consolidated Balance Sheets June 30, 2008 and December 31, 2007 (Unaudited)</u>	2
	<u>Condensed Consolidated Statements of Income Three and Six Months Ended June 30, 2008 and June 30, 2007 (Unaudited)</u>	3
	<u>Condensed Consolidated Statements of Cash Flows Six Months Ended June 30, 2008 and June 30, 2007 (Unaudited)</u>	4
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	5
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition And Results of Operations</u></b>	37
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>	53
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>	54

**PART II. OTHER INFORMATION**

<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>	54
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>	58
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	58
<b><u>Item 3.</u></b>	<b><u>Defaults Upon Senior Securities</u></b>	58
<b><u>Item 4.</u></b>	<b><u>Submission of Matters to a Vote of Security Holders</u></b>	59
<b><u>Item 5.</u></b>	<b><u>Other Information</u></b>	59
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>	59
<b><u>Signatures</u></b>		60
<b><u>Index to Exhibits</u></b>		61
<b><u>31.1</u></b>	<b><u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></b>	62
<b><u>31.2</u></b>	<b><u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></b>	63
<b><u>32.1</u></b>	<b><u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></b>	64
<b><u>32.2</u></b>	<b><u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></b>	65
	<u>EX-31.1 Section 302 Certification of the CEO</u>	
	<u>EX-31.2 Section 302 Certification of the CFO</u>	
	<u>EX-32.1 Section 906 Certification of the CEO</u>	
	<u>EX-32.2 Section 906 Certification of the CFO</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except share data)</b>	
<b>ASSETS</b>		
<i>Current assets</i>		
Cash and cash equivalents	\$ 264,072	\$ 132,874
Patient accounts receivable, net of allowance for doubtful accounts of \$1,052,811 and \$1,033,516 at June 30, 2008, and December 31, 2007, respectively	1,603,702	1,533,798
Supplies	266,403	262,903
Prepaid income taxes		99,417
Deferred income taxes	88,531	113,741
Prepaid expenses and taxes	89,724	70,339
Other current assets	191,226	339,826
Total current assets	2,503,658	2,552,898
<i>Property and equipment</i>		
Property and equipment, net	6,639,690	6,310,240
Less accumulated depreciation and amortization	(1,017,936)	(797,666)
Property and equipment, net	5,621,754	5,512,574
<i>Goodwill</i>	4,165,041	4,247,714
<i>Other assets, net</i>	1,069,055	1,180,457
<i>Total assets</i>	\$ 13,359,508	\$ 13,493,643

**LIABILITIES AND STOCKHOLDERS EQUITY**

<i>Current liabilities</i>		
Current maturities of long-term debt	\$ 24,279	\$ 20,710
Accounts payable	438,518	492,693
Current income taxes payable	12,224	
Accrued interest	147,451	153,832
Accrued liabilities	691,406	780,700

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Total current liabilities	1,313,878	1,447,935
<i>Long-term debt</i>	8,889,915	9,077,367
<i>Deferred income taxes</i>	429,934	407,947
<i>Other long-term liabilities</i>	571,085	483,459
<i>Minority interests in equity of consolidated subsidiaries</i>	320,587	366,131
<i>Stockholders' equity</i>		
Preferred stock, \$.01 par value per share, 100,000,000 shares authorized, none issued		
Common stock, \$.01 par value per share, 300,000,000 shares authorized; 96,944,770 shares issued and 95,969,221 shares outstanding at June 30, 2008, and 96,611,085 shares issued and 95,635,536 shares outstanding at December 31, 2007	969	966
Additional paid-in capital	1,251,746	1,240,308
Treasury stock, at cost, 975,549 shares at June 30, 2008 and December 31, 2007	(6,678)	(6,678)
Accumulated other comprehensive income	(77,893)	(81,737)
Retained earnings	665,965	557,945
Total stockholders' equity	1,834,109	1,710,804
<i>Total liabilities and stockholders' equity</i>	\$ 13,359,508	\$ 13,493,643

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>			
	<b>(In thousands, except share and per share data)</b>			
<i>Net operating revenues</i>	\$ 2,690,600	\$ 1,197,865	\$ 5,418,154	\$ 2,352,143
<i>Operating costs and expenses:</i>				
Salaries and benefits	1,079,376	472,846	2,167,146	935,611
Provision for bad debts	291,045	141,820	588,125	269,874
Supplies	377,586	140,348	763,995	274,642
Other operating expenses	526,098	246,980	1,052,265	481,145
Rent	58,479	26,966	118,336	51,722
Depreciation and amortization	124,942	51,982	247,657	100,479
<b>Total operating costs and expenses</b>	<b>2,457,526</b>	<b>1,080,942</b>	<b>4,937,524</b>	<b>2,113,473</b>
<i>Income from operations</i>	233,074	116,923	480,630	238,670
<i>Interest expense, net</i>	154,361	29,184	320,063	57,617
<i>Loss from early extinguishment of debt</i>			1,328	
<i>Minority interest in earnings</i>	8,317	625	17,999	818
<i>Equity in earnings of unconsolidated affiliates</i>	(10,508)		(23,392)	
<i>Income from continuing operations before income taxes</i>	80,904	87,114	164,632	180,235
<i>Provision for income taxes</i>	31,148	33,556	63,383	69,388
<i>Income from continuing operations</i>	49,756	53,558	101,249	110,847
<i>Discontinued operations, net of taxes:</i>				
Income (loss) from operations of hospitals sold and hospital held for sale	(1,854)	205	(2,837)	(2,760)
Gain (loss) on sale of hospitals, net	(9)		9,608	
<i>Income (loss) on discontinued operations</i>	(1,863)	205	6,771	(2,760)
<i>Net income</i>	\$ 47,893	\$ 53,763	\$ 108,020	\$ 108,087
<i>Income from continuing operations per common share:</i>				
Basic	\$ 0.53	\$ 0.57	\$ 1.08	\$ 1.19

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Diluted	\$	0.52	\$	0.57	\$	1.06	\$	1.17
<i>Net income per common share:</i>								
Basic	\$	0.51	\$	0.57	\$	1.15	\$	1.16
Diluted	\$	0.50	\$	0.57	\$	1.14	\$	1.14
<i>Weighted-average number of shares outstanding:</i>								
Basic		94,192,295		93,518,991		94,017,435		93,373,357
Diluted		95,513,127		94,647,870		95,127,523		94,422,000

See accompanying notes to the condensed consolidated financial statements.



**Table of Contents**

**COMMUNITY HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<i>Cash flows from operating activities</i>		
Net income	\$ 108,020	\$ 108,087
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	247,426	104,619
Minority interest in earnings	17,999	818
Stock-based compensation expense	26,681	14,295
Gain on sale of hospitals, net	(13,211)	
Excess tax benefits relating to stock-based compensation	947	(2,295)
Loss on early extinguishment of debt	1,328	
Other non-cash expenses (gains), net	2,041	(1,542)
Changes in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Patient accounts receivable	(74,786)	(47,415)
Supplies, prepaid expenses and other current assets	13,570	(13,458)
Accounts payable, accrued liabilities and income taxes	83,868	46,353
Other	2,900	6,526
Net cash provided by operating activities	416,783	215,988
<i>Cash flows from investing activities</i>		
Acquisitions of facilities and other related equipment	(6,646)	(187,955)
Purchases of property and equipment	(275,605)	(108,849)
Proceeds from disposition of hospitals and other ancillary operations	365,913	12,662
Proceeds from sale of property and equipment	12,889	234
Increase in other assets	(144,380)	(25,362)
Net cash used in investing activities	(47,829)	(309,270)
<i>Cash flows from financing activities</i>		
Proceeds from exercise of stock options	1,357	6,693
Excess tax benefits relating to stock-based compensation	(947)	2,295
Stock buy-back	(10,194)	
Deferred financing costs	(2,444)	(367)
Proceeds from minority investors in joint ventures	11,214	1,105
Redemption of minority investments in joint ventures	(53,485)	(1,369)
Distributions to minority investors in joint ventures	(14,916)	(1,705)
Borrowings under credit agreement	22,657	132,000
Repayments of long-term indebtedness	(190,998)	(64,579)

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Net cash (used in) provided by financing activities	(237,756)	74,073
<i>Net change in cash and cash equivalents</i>	131,198	(19,209)
<i>Cash and cash equivalents at beginning of period</i>	132,874	40,566
<i>Cash and cash equivalents at end of period</i>	\$ 264,072	\$ 21,357

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents**

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

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

**1. BASIS OF PRESENTATION**

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

The presentation of gross property and equipment and accumulated depreciation and amortization at December 31, 2007 has been corrected to reflect certain assets acquired from Triad Hospitals, Inc. (Triad). This correction increased both gross property and equipment and accumulated depreciation and amortization by the same amount and did not impact the net balance of property and equipment as previously presented on the balance sheet.

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

Stock-based compensation awards are granted under the Community Health Systems, Inc. Amended and Restated 2000 Stock Option and Award Plan (the 2000 Plan). The 2000 Plan allows for the grant of incentive stock options intended to qualify under Section 422 of the Internal Revenue Code, as well as stock options which do not so qualify, stock appreciation rights, restricted stock, performance units and performance shares, phantom stock awards and share awards. Persons eligible to receive grants under the 2000 Plan include the Company's directors, officers, employees and consultants. To date, the options granted under the 2000 Plan have all been nonqualified stock options for tax purposes. Generally, vesting of these granted options occurs in one-third increments on each of the first three anniversaries of the award date. Options granted prior to 2005 have a 10 year contractual term, options granted in 2005 through 2007 have an 8 year contractual term and options granted in 2008 have a 10 year contractual term. The exercise price of all options granted to employees under the 2000 Plan is equal to the fair value of the Company's common stock on the option grant date. As of June 30, 2008, 3,529,664 shares of unissued common stock remain reserved for future grants under the 2000 Plan.

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

restricted stock by the Company for any reason other than for cause or change in control of the Company. Restricted stock awards subject to

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

performance standards are not considered outstanding for purposes of determining earnings per share until the performance objectives have been satisfied.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Effect on income from continuing operations before income taxes	\$ (13,435)	\$ (7,965)	\$ (26,681)	\$ (14,295)
Effect on net income	\$ (8,162)	\$ (4,839)	\$ (16,209)	\$ (8,684)
Effect on net income per share-diluted	\$ (0.09)	\$ (0.05)	\$ (0.17)	\$ (0.09)

At June 30, 2008, \$84.2 million of unrecognized stock-based compensation expense from all outstanding unvested stock options and restricted stock is expected to be recognized over a weighted-average period of 19 months.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Expected volatility	24.5%	24.6%	24.1%	25.5%
Expected dividends	0	0	0	0
Expected term	4 years	4 years	4 years	4 years
Risk-free interest rate	2.80%	4.77%	2.59%	4.50%

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

The expected volatility rate was estimated based on historical volatility. In determining expected volatility, the Company also reviewed the market-based implied volatility of actively traded options of its common stock and

determined that historical volatility did not differ significantly from the implied volatility.

The expected life computation is based on historical exercise and cancellation patterns and forward looking factors, where present, for each population identified. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The pre-vesting forfeiture rate is based on historical rates and forward looking factors for each population identified. The Company adjusts the estimated forfeiture rate to its actual experience.

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

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

	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value as of June 30, 2008
Outstanding at December 31, 2007	8,439,015	\$ 30.90		
Granted	996,500	32.28		
Exercised	(11,666)	23.26		
Forfeited and cancelled	(172,600)	35.02		
Outstanding at March 31, 2008	9,251,249	30.98		
Granted	95,500	35.75		
Exercised	(36,998)	29.69		
Forfeited and cancelled	(142,836)	33.98		
Outstanding at June 30, 2008	9,166,915	\$ 30.99	6.1 years	\$ 40,150
Exercisable at June 30, 2008	4,794,980	\$ 25.68	5.2 years	\$ 39,446

The weighted-average grant date fair value of stock options granted during the six months ended June 30, 2008 and 2007, was \$7.64 and \$10.36, respectively. The aggregate intrinsic value (the number of in-the-money stock options multiplied by the difference between the Company's closing stock price on the last trading day of the reporting period (\$32.98) and the exercise price of the respective stock options) in the table above represents the amount that would have been received by the option holders had all option holders exercised their options on June 30, 2008. This amount changes based on the market value of the Company's common stock. The aggregate intrinsic value of options exercised during the three months ended June 30, 2008 and 2007 was \$0.3 million and \$1.5 million, respectively, and the aggregate intrinsic value of options exercised during the six months ended June 30, 2008 and 2007 was \$0.4 million and \$2.9 million, respectively. The aggregate intrinsic value of options vested and expected to vest approximates that of the outstanding options.

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

**Weighted-**

	<b>Shares</b>	<b>Average Fair Value</b>
Unvested at December 31, 2007	1,956,543	\$ 38.04
Granted	748,500	32.38
Vested	(592,505)	36.09
Forfeited	(3,000)	37.20
Unvested at March 31, 2008	2,109,538	36.58
Granted	25,000	35.33
Vested	(17,832)	38.81
Forfeited	(3,500)	32.88
Unvested at June 30, 2008	2,113,206	36.55



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

As of June 30, 2008, there was \$55.8 million of unrecognized stock-based compensation expense related to unvested restricted stock expected to be recognized over a weighted-average period of 18 months.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Directors' fees earned and deferred into plan	\$ 17,000	\$ 29,375	\$ 57,875	\$ 65,250
Equivalent units	515.464	726.205	1,733.069	1,743.936

At June 30, 2008, there are a total of 15,141.601 units deferred in the plan with an aggregate fair value of \$0.5 million, based on the closing market price of the Company's common stock on the last trading day of the reporting period of \$32.98.

**3. COST OF REVENUE**

The majority of the Company's operating costs and expenses are cost of revenue items. Operating costs that could be classified as general and administrative by the Company would include the Company's corporate office costs at the Company's Franklin, Tennessee office, which were \$43.0 million and \$23.9 million for the three months ended June 30, 2008 and 2007, respectively, and \$81.1 million and \$47.0 million for the six months ended June 30, 2008 and 2007, respectively. Included in these amounts is stock-based compensation expense of \$13.4 million and \$8.0 million for the three months ended June 30, 2008 and 2007, respectively, and \$26.7 million and \$14.3 million for the six months ended June 30, 2008 and 2007, respectively.

**4. USE OF ESTIMATES**

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

**5. ACQUISITIONS AND DIVESTITURES**

***Triad Acquisition***

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

**Table of Contents**

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

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

acquisition of Triad. The Company acquired Triad for approximately \$6.857 billion, including the assumption of \$1.686 billion of existing indebtedness.

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

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

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

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

many support functions will be centralized; and

duplicate corporate functions will be eliminated.

The allocation process requires the analysis of acquired fixed assets, contracts, contractual commitments, and legal contingencies to identify and record the fair value of all assets acquired and liabilities assumed. The values of certain assets and liabilities are based on preliminary valuations and are subject to adjustment as additional information is obtained. Such additional information includes, but is not limited to, valuations of property and equipment, valuation of equity investments, valuation of contractual commitments, and review of open cost report settlement periods. The Company is also negotiating the termination of certain assumed contracts it deems unfavorable, such as various physician and service contracts. Under GAAP, the Company has up to twelve months from the closing of the acquisition to complete its valuations and complete contract terminations in order for these terminations to be considered in the allocation process. The Company expects to complete the allocation of the total cost of the Triad acquisition in the third quarter of 2008. Material adjustments to goodwill may result upon the completion of these matters.

***Other Acquisitions***

Effective April 1, 2007, the Company completed its acquisition of Lincoln General Hospital (157 licensed beds), located in Ruston, Louisiana. The total consideration for this hospital was approximately \$49.4 million, of which \$44.7 million was paid in cash and \$4.7 million was assumed in liabilities. On May 1, 2007, the Company completed

its acquisition of Porter Health (301 licensed beds), located in Valparaiso, Indiana, with a satellite campus in Portage, Indiana and outpatient medical campuses located in Chesterton, Demotte, and Hebron, Indiana. As part of this acquisition, the Company has agreed to construct a 225-bed replacement facility for the Valparaiso hospital no later than April 2011. The total consideration for Porter Health was approximately \$113.2 million, of which \$88.9 million was paid in cash and \$24.3 million was assumed in

**Table of Contents**

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

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

liabilities. The Company's purchase price allocation relating to these acquisitions resulted in approximately \$8.1 million of goodwill being recorded.

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

***Discontinued Operations***

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

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

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

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

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

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

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

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

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

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net operating revenues	\$ 18,485	\$ 51,263	\$ 125,118	\$ 100,982
Income (loss) from operations of hospitals sold or held for sale before income taxes	(3,422)	306	(4,211)	(4,483)
Gain (loss) on sale of hospitals, net	(9)		17,715	
Income (loss) from discontinued operations, before taxes	(3,431)	306	13,504	(4,483)
Income tax expense (benefit)	1,568	(101)	(6,733)	1,723
Income (loss) from discontinued operations, net of tax	\$ (1,863)	\$ 205	\$ 6,771	\$ (2,760)

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

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

The assets and liabilities of one hospital held for sale as of June 30, 2008 are included in the accompanying condensed consolidated balance sheet as follows: current assets of \$17.1 million, included in other current assets; net property and equipment of \$33.9 million and other long-term assets of \$0.1 million, included in other assets; and current liabilities of \$22.1 million, included in other accrued liabilities.

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

**6. INCOME TAXES**

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007. The total amount of unrecognized benefit that would affect the effective tax rate, if recognized, is approximately \$6.2 million as of June 30, 2008. It is the Company's policy to recognize interest and

penalties accrued related to unrecognized benefits in its condensed consolidated statements of income as income tax expense. During the three months ended June 30, 2008, the Company recorded approximately \$0.2 million in interest and penalties related to prior state income tax returns through its income tax provision from continuing operations and which are included in its FIN 48 liability at June 30, 2008. A total of approximately \$2.2 million of interest and penalties is included in the amount of FIN 48 liability at June 30, 2008.

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



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

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

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

Cash paid for income taxes, net of refunds received, resulted in a net cash refund of \$46.5 million and \$49.3 million for the three and six months ended June 30, 2008, respectively, and net cash paid of \$16.2 million and \$29.4 million for the three and six months ended June 30, 2007, respectively.

**7. GOODWILL AND OTHER INTANGIBLE ASSETS**

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

Balance as of December 31, 2007	\$ 4,247,714
Goodwill acquired as part of acquisitions during 2008	4,109
Consideration adjustments and purchase price allocation adjustments for acquisitions in 2007	(75,441)
Goodwill written-off as part of disposals	(11,341)
Balance as of June 30, 2008	\$ 4,165,041

Goodwill related to the former Triad hospitals of \$2.825 billion has not been allocated to the reporting unit level (hospital operations, home health and management services) as of June 30, 2008 because the final purchase price allocation has not been completed (see Note 5).

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

The gross carrying amount of the Company's other intangible assets was \$207.9 million at June 30, 2008 and \$194.6 million at December 31, 2007, and the net carrying amount was \$195.4 million at June 30, 2008 and \$181.0 million at December 31, 2007. Other intangible assets are included in other assets, net on the Company's condensed consolidated balance sheets.

The weighted-average amortization period for the intangible assets subject to amortization is approximately ten years. There are no expected residual values related to these intangible assets. Amortization expense on these intangible assets during the three months ended June 30, 2008 and 2007 was \$0.8 million and \$0.5 million, respectively. Amortization expense on these intangible assets during the six months ended June 30, 2008 and 2007 was \$3.2 million.

and \$1.0 million, respectively. Amortization expense on intangible assets is estimated to be \$5.4 million for the remainder of 2008, \$14.0 million in 2009, \$12.2 million in 2010, \$7.0 million in 2011, \$6.6 million in 2012, and \$22.7 million in 2013 and thereafter.

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

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Numerator:				
Numerator for basic earnings per share				
Income from continuing operations available to common stockholders basic	\$ 49,756	\$ 53,558	\$ 101,249	\$ 110,847
Numerator for diluted earnings per share				
Income from continuing operations available to common stockholders diluted	\$ 49,756	\$ 53,558	\$ 101,249	\$ 110,847
Denominator:				
Weighted-average number of shares outstanding basic	94,192,295	93,518,991	94,017,435	93,373,357
Effect of dilutive securities:				
Non-employee director options				5,913
Restricted stock awards	399,975	181,183	871,373	111,539
Employee options	920,857	947,696	238,715	931,191
Weighted-average number of shares outstanding diluted	95,513,127	94,647,870	95,127,523	94,422,000
Dilutive securities outstanding not included in the computation of earning per share because their effect is antidilutive:				
Employee options	3,540,068	1,032,071	3,950,600	1,479,319

**9. STOCKHOLDERS EQUITY**

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

On January 14, 2006, the Company commenced an open market repurchase program for up to 5,000,000 shares of the Company's common stock, not to exceed \$200 million in repurchases. Under this program, the Company repurchased the entire 5,000,000 shares at a weighted-average price of \$35.23. This program concluded on November 8, 2006 when the maximum number of shares had been repurchased. This repurchase plan followed a prior repurchase plan for up to 5,000,000 shares which concluded on January 13, 2006. The Company repurchased 3,029,700 shares at a weighted-average price of \$31.20 per share under this program.

On December 13, 2006, the Company commenced another open market repurchase program for up to 5,000,000 shares of the Company's common stock, not to exceed \$200 million in repurchases. This program will conclude at the earlier of three years or when the maximum number of shares has been repurchased.

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

During the period from June 1, 2008 to June 30, 2008, the Company repurchased 305,400 shares at a weighted-average price of \$33.34 per share under this program.

**10. COMPREHENSIVE INCOME**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net income	\$ 47,893	\$ 53,763	\$ 108,020	\$ 108,087
Net change in fair value of interest rate swaps	109,368	13,670	4,814	9,800
Net change in fair value of available for sale securities	(105)	237	(858)	24
Amortization of unrecognized pension components	880		(112)	
Comprehensive income	\$ 158,036	\$ 67,670	\$ 111,864	\$ 117,911

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

**11. EQUITY INVESTMENTS**

The Company owns equity interests of 27.5% in four hospitals in Las Vegas, Nevada, and 26.1% in one hospital in Las Vegas, Nevada in which Universal Health Systems, Inc. owns the majority interest; an equity interest of 38.0% in three hospitals in Macon, Georgia in which HCA, Inc. owns the majority interest; and an equity interest of 50.0% in a hospital in El Dorado, Arkansas in which the SHARE Foundation, a not-for-profit foundation, owns the remaining 50.0%. These equity investments were acquired as part of the acquisition of Triad. The Company uses the equity method of accounting for its investments in these entities. During the three months ended June 30, 2008, the Company adjusted the carrying amount of these equity investments based on the preliminary Triad asset valuations. The difference between the fair value of these equity investments and the estimated underlying equity in net assets is approximately \$128.1 million and represents goodwill under the equity method of accounting. The Company's investment in unconsolidated affiliates is \$419.2 million and \$267.8 million at June 30, 2008 and December 31, 2007, respectively, and is included in other assets in the accompanying condensed consolidated balance sheets. The Company's investment in unconsolidated affiliates at December 31, 2007 has been corrected from amounts previously disclosed to eliminate amounts related to discontinued operations; the correction did not affect the amounts reported in

other assets in the accompanying condensed consolidated balance sheet. Included in the Company's results of operations for the three and six months ended June 30, 2008, is \$10.5 million and \$23.4 million, respectively, representing the Company's equity in pre-tax earnings from investments in unconsolidated affiliates.

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

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

	<b>For the Three Months Ended June 30, 2008</b>	<b>For the Six Months Ended June 30, 2008</b>
Revenues	\$ 359,695	\$ 723,362
Operating costs and expenses	322,151	641,914
Net income	37,578	88,277

**12. LONG-TERM DEBT***Terminated Credit Facility and Notes*

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

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

*New Credit Facility and Notes*

On July 25, 2007, the New Credit Facility was entered into with a syndicate of financial institutions led by Credit Suisse, as administrative agent and collateral agent. The New Credit Facility consists of a \$6.065 billion funded term loan facility with a maturity of seven years, a \$400 million delayed draw term loan facility with a maturity of seven years and a \$750 million revolving credit facility with a maturity of six years. As of December 31, 2007, the \$400 million delayed draw term loan had been reduced to \$300 million at the



**Table of Contents**

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

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

request of the Company. The revolving credit facility also includes a subfacility for letters of credit and a swingline subfacility. As previously disclosed, in connection with the consummation of the acquisition of Triad, the Company used a portion of the net proceeds from its New Credit Facility and the Notes offering to repay its outstanding debt under the Terminated Credit Facility, the 6.50% Notes and certain of Triad's existing indebtedness. During the third quarter of 2007, the Company recorded a pre-tax write-off of approximately \$13.9 million in deferred loan costs relative to the early extinguishment of the debt under the Terminated Credit Facility and incurred tender and solicitation fees of approximately \$13.4 million on the early repayment of the Company's \$300 million aggregate principal amount of 6.50% Senior Subordinated Notes due 2012 through a cash tender offer and consent solicitation.

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

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

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

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

CHS has agreed to pay letter of credit fees equal to the applicable percentage then in effect with respect to Eurodollar rate loans under the revolving credit facility times the maximum aggregate amount available to be drawn under all letters of credit outstanding under the subfacility for letters of credit. The issuer of any letter of credit issued under the

subfacility for letters of credit will also receive a customary fronting fee and other customary processing charges. CHS is initially obligated to pay commitment fees of 0.50% per annum (subject to reduction based upon the Company's leverage ratio) on the unused portion of the revolving credit facility. For purposes of this calculation, swingline loans are not treated as usage of the revolving credit facility. CHS is also obligated to pay commitment fees of 0.50% per annum for the first six months after the

**Table of Contents**

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

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

closing of the New Credit Facility, 0.75% per annum for the next three months thereafter and 1.0% per annum thereafter, in each case on the unused amount of the delayed draw term loan facility. The Company paid arrangement fees on the closing of the New Credit Facility and will pay an annual administrative agent fee.

The New Credit Facility contains customary representations and warranties, subject to limitations and exceptions, and customary covenants restricting, subject to certain exceptions, the Company's and its subsidiaries' ability to, among other things (1) declare dividends, make distributions or redeem or repurchase capital stock, (2) prepay, redeem or repurchase other debt, (3) incur liens or grant negative pledges, (4) make loans and investments and enter into acquisitions and joint ventures, (5) incur additional indebtedness or provide certain guarantees, (6) make capital expenditures, (7) engage in mergers, acquisitions and asset sales, (8) conduct transactions with affiliates, (9) alter the nature of the Company's businesses, (10) grant certain guarantees with respect to physician practices, (11) engage in sale and leaseback transactions or (12) change the Company's fiscal year. The Company is also required to comply with specified financial covenants (consisting of a leverage ratio and an interest coverage ratio) and various affirmative covenants.

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

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

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

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

<b>Period</b>	<b>Redemption Price</b>
2011	104.438%
2012	102.219%

2013 and thereafter

100.000%

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

**Table of Contents**

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

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

Company, a portion of the Net Cash Proceeds thereof equal to the amount required to redeem any such Notes is contributed to the equity capital of CHS); provided, however, that:

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

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

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

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

As of June 30, 2008, the availability for additional borrowings under the New Credit Facility was \$1.050 billion (consisting of a \$750 million revolving credit facility and a \$300 million delayed draw term loan facility), of which \$78.8 million was set aside for outstanding letters of credit. CHS also has the ability to add up to \$300 million of borrowing capacity from receivable transactions (including securitizations) under the New Credit Facility which has not yet been accessed. CHS also has the ability to amend the New Credit Facility to provide for one or more tranches of term loans in an aggregate principal amount of \$600 million, which CHS has not yet accessed. As of June 30, 2008, the weighted-average interest rate under the New Credit Facility was 5.2%.

Cash paid for interest, net of interest income, was \$97.4 million and \$34.6 million during the three months ended June 30, 2008 and 2007, respectively, and \$326.4 million and \$60.3 million during the six months ended June 30, 2008 and 2007, respectively.

**13. RECENT ACCOUNTING PRONOUNCEMENTS**

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

changes in the fair value, whether realized or unrealized, recognized in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 159 as of January 1, 2008 and did not elect to re-measure any assets or liabilities. The adoption of this statement has not had a material effect on the Company's consolidated results of operations or consolidated financial position.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) replaces SFAS No. 141 and addresses the recognition and accounting for identifiable assets

**Table of Contents**

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

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

acquired, liabilities assumed, and noncontrolling interests in business combinations. This standard will require more assets and liabilities to be recorded at fair value and will require expense recognition (rather than capitalization) of certain pre-acquisition costs. This standard also will require any adjustments to acquired deferred tax assets and liabilities occurring after the related allocation period to be made through earnings. Furthermore, this standard requires this treatment of acquired deferred tax assets and liabilities also be applied to acquisitions occurring prior to the effective date of this standard. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and is required to be adopted prospectively with no early adoption permitted. SFAS No. 141(R) will be adopted by the Company in the first quarter of 2009. The Company is currently assessing the potential impact that SFAS No. 141(R) will have on its consolidated results of operations and consolidated financial position.

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

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

**14. SEGMENT INFORMATION**

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

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

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Revenues:				
Hospital operations	\$ 2,630,281	\$ 1,153,583	\$ 5,294,297	\$ 2,283,790
Corporate and all other	60,319	44,282	123,857	68,353
	\$ 2,690,600	\$ 1,197,865	\$ 5,418,154	\$ 2,352,143
Income from continuing operations before income taxes:				
Hospital operations	\$ 118,572	\$ 105,824	\$ 236,464	\$ 219,354
Corporate and all other	(37,668)	(18,710)	(71,832)	(39,119)
	\$ 80,904	\$ 87,114	\$ 164,632	\$ 180,235

**15. FAIR VALUE**

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

In February 2008, the FASB issued FASB Statement of Position No. 157-2, Effective Date of FASB Statement No. 157, ( FSP 157-2 ). FSP 157-2 deferred the effective date of the provisions of SFAS No. 157 for all non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008, and will be adopted by the Company in the first quarter of 2009. The Company is currently assessing the potential impact of SFAS No. 157 for non-financial assets and non-financial liabilities on its consolidated statements of financial position and consolidated results of operations.

***Fair Value Hierarchy***

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

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



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

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

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

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

	<b>June 30,</b>			<b>Level</b>
	<b>2008</b>	<b>Level 1</b>	<b>Level 2</b>	<b>3</b>
Available-for-sale securities	\$ 8,081	\$ 8,081	\$	\$
Trading securities	32,317	32,317		
Total assets	\$ 40,398	\$ 40,398	\$	\$
Fair value of interest rate swap agreements	\$ 121,598	\$	\$ 121,598	\$
Total liabilities	\$ 121,598	\$	\$ 121,598	\$

Available-for-sale securities and trading securities classified as Level 1 are measured using quoted market prices. The fair value of the Company's interest rate swap agreements are classified as Level 2, and are estimated using an income approach based on the LIBOR swap rate, which is observable at commonly quoted intervals for the full term of the swap.

**16. CONTINGENCIES**

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

In a letter dated October 4, 2007, the Civil Division of the Department of Justice notified the Company that, as a result of an investigation into the way in which different state Medicaid programs apply to the federal government for matching or supplemental funds that are ultimately used to pay for a small portion of the services provided to Medicaid and indigent patients, it believes the Company and three of its New Mexico hospitals have caused the State of New Mexico to submit improper claims for federal funds in violation of the federal False Claims Act. In a letter dated January 22, 2008, the Civil Division notified the Company that based on its investigation, it has calculated that these three hospitals received ineligible federal participation payments from August 2000 to June 2006 of approximately \$27.5 million. The Civil Division also advised the Company that were it to proceed to trial, it would seek treble damages plus an appropriate penalty for each of the violations of the False Claims Act. On May 28, 2008, the Company received a letter from the Office of the U.S. Attorney for the State of New Mexico requesting additional

information. The Company is in the process of providing the requested information. The Company continues to believe that it has not violated the False Claims Act, and is continuing discussions with the Civil Division in an effort to resolve this matter.

#### **17. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

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

The Notes are fully and unconditionally guaranteed on a joint and several basis. The following condensed consolidating financial statements present the Company (as parent guarantor), CHS (as the issuer), the

**Table of Contents**

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

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

subsidiary guarantors, the subsidiary non-guarantors and eliminations. These supplemental condensed consolidating financial statements have been prepared and presented in accordance with SEC Regulation S-X Rule 3-10 Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered .

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

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

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

Income tax expense is allocated from the parent guarantor to the income producing operations (other guarantors and non-guarantors) and the Issuer through shareholders equity; income tax expense was previously allocated entirely to the Parent Guarantor, which is the tax paying entity. As this approach represents an allocation, the income tax expense allocation is considered non-cash for statement of cash flow purposes.

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

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

The tables on pages 23 to 28 disclose the impact of these corrections on each of the respective line items of the supplemental condensed consolidating financial statements as of and for the periods ending March 31, 2008, June 30, 2007, and December 31, 2007, 2006 and 2005 (in thousands).

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Condensed Consolidating Balance Sheet As of March 31, 2008						
<b>As reported</b>						
Prepaid expenses and taxes	\$	\$ 58	\$ 180,024	\$ 13,930	\$	\$ 194,012
Total current assets	113,741	448	1,709,370	832,359	(49,526)	2,606,392
Intercompany receivables (non-current)						
Goodwill	21,126		2,435,773	1,918,394		4,375,293
Net investment in subsidiaries	1,506,013	1,234,270	3,680,406		(6,420,689)	
Total Assets	1,640,880	1,420,794	11,656,624	5,084,266	(6,470,215)	13,332,349
Long-term debt	4	4,325,296	4,509,849	51,206		8,886,355
Intercompany payables (non-current)	(438,836)	(4,698,000)	4,841,662	4,101,680	(3,806,506)	
Additional paid-in capital	1,247,241					1,247,241
Retained earnings	618,072	1,694,047	1,232,700	(118,796)	(2,807,951)	618,072
Total stockholders equity	1,671,570	1,506,010	1,226,967	(118,794)	(2,614,183)	1,671,570
Total liabilities and stockholders equity	1,640,880	1,420,794	11,656,624	5,084,266	(6,470,215)	13,332,349
<b>As adjusted</b>						
Prepaid expenses and taxes	110,160	58	69,864	13,930		194,012
Total current assets	223,901	448	1,599,210	832,359	(49,526)	2,606,392
Intercompany receivables (non-current)	928,673	9,198,002	10,361,699	1,937,602	(22,425,976)	
Goodwill			2,456,899	1,918,394		4,375,293
	1,473,779	4,194,870	2,380,982		(8,049,631)	

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Net investment in subsidiaries						
Total Assets	2,626,352	13,579,396	20,629,866	7,021,868	(30,525,133)	13,332,349
Long-term debt	4	8,825,296	54,667	6,388		8,886,355
Intercompany payables (non-current)	546,636	2,992,839	18,370,619	6,084,099	(27,994,193)	
Additional paid-in capital	1,247,241	639,797	435,885		(1,075,682)	1,247,241
Retained earnings	618,072	1,022,014	696,282	(118,796)	(1,599,500)	618,072
Total stockholders equity	1,671,570	1,473,774	1,126,434	(118,794)	(2,481,414)	1,671,570
Total liabilities and stockholders equity	2,626,352	13,579,396	20,629,866	7,021,868	(30,525,133)	13,332,349

Condensed Consolidating Statement of Cash Flows  
For the three months ended March 31, 2008

**As reported**

Net cash provided by (used in) operating activities	853	164,026	321,361	(427,836)	(49,526)	8,878
Changes in intercompany balances with affiliates, net						
Net cash provided by (used in) financing activities	(853)	(164,026)	(123,280)	126,688		(161,471)

**As adjusted**

Net cash provided by (used in) operating activities	(45,719)	(102,699)	319,923	(113,101)	(49,526)	8,878
Changes in intercompany balances with affiliates, net	46,572	266,725	(43,381)	(269,916)		
Net cash provided by (used in) financing activities	45,719	102,699	(121,843)	(188,046)		(161,471)

Condensed  
Consolidating  
Statement of  
Income  
For the three  
months ended  
March 31, 2008

**As reported**

Interest expense, net		72,577	75,937	17,188		165,702
Equity in earnings of unconsolidated affiliates	(92,362)	(166,267)	(20,967)		266,712	(12,884)
Income (loss) from continuing operations before income taxes	92,362	92,362	166,029	(313)	(266,712)	83,728
Provision for income taxes	32,235					32,235
Income (loss) from continuing operations	60,127	92,362	166,029	(313)	(266,712)	51,493
Net income	60,127	92,362	166,029	8,321	(266,712)	60,127

**As adjusted**

Interest expense, net		12,924	135,590	17,188		165,702
Equity in earnings of unconsolidated affiliates	(60,127)	(65,733)	(21,088)		134,064	(12,884)
Income (loss) from continuing operations before income taxes	60,127	51,481	106,496	(312)	(134,064)	83,728
Provision for income taxes		(8,646)	41,001	(120)		32,235
Income (loss) from continuing operations	60,127	60,127	65,495	(192)	(134,064)	51,493
Net income	\$ 60,127	\$ 60,127	\$ 65,495	\$ 8,442	\$ (134,064)	\$ 60,127

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Condensed Consolidating Balance Sheet As of June 30, 2007						
<b>As reported</b>						
Prepaid expenses and taxes	\$	\$	\$ 44,099	\$ (7,812)	\$	\$ 36,287
Total current assets	13,249	1,000	875,500	242,564		1,132,313
Intercompany receivables (non-current)						
Goodwill			1,184,171	160,785		1,344,956
Net investment in subsidiaries	1,265,254	1,242,139	415,423		(2,922,816)	
Total Assets	1,278,503	1,279,256	4,356,882	801,286	(2,922,816)	4,793,111
Income taxes payable			49,010			49,010
Total current liabilities	867	22,971	486,955	100,231		611,024
Long-term debt	300,000	1,626,000	47,886	354		1,974,240
Intercompany payables (non-current)	(1,024,803)	(1,634,966)	2,420,325	722,874	(483,430)	
Additional paid-in capital	1,215,321					1,215,321
Retained earnings	635,743	1,249,629	1,244,075	(62,450)	(2,431,254)	635,743
Total stockholders equity	1,860,967	1,265,251	1,236,583	(62,448)	(2,439,386)	1,860,967
Total liabilities and stockholders equity	1,278,503	1,279,256	4,356,882	801,286	(2,922,816)	4,793,111
<b>As adjusted(1)</b>						
Prepaid expenses and taxes			32,150	4,137		36,287
Total current assets	13,249	1,000	821,752	296,311		1,132,312



Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Intercompany receivables (non-current)	1,235,247	2,165,424	3,654,627	291,969	(7,347,267)	
Goodwill			1,165,653	179,303		1,344,956
Net investment in subsidiaries	1,197,054	1,790,793	469,040		(3,456,887)	
Total Assets	2,445,550	3,993,334	7,904,544	1,253,837	(10,804,154)	4,793,111
Income taxes payable	49,010					49,010
Total current liabilities	49,877	23,322	416,758	121,067		611,024
Long-term debt	300,000	1,627,000	22,937	24,303		1,974,240
Intercompany payables (non-current)	88,494	1,145,962	6,129,544	1,131,143	(8,495,143)	
Additional paid-in capital	1,215,321	452,487	451,060		(903,547)	1,215,321
Retained earnings	640,484	728,941	726,642	(62,993)	(1,397,331)	635,743
Total stockholders equity	1,865,708	1,197,050	1,170,211	(62,991)	(2,309,011)	1,860,967
Total liabilities and stockholders equity	2,445,550	3,993,334	7,904,544	1,253,837	(10,804,154)	4,793,111
<b>Condensed Consolidating Statement of Cash Flows</b>						
For the six months ended June 30, 2007						
<b>As reported</b>						
Net cash provided by (used in) operating activities	(9,039)	(71,000)	188,772	107,255		215,988
Changes in intercompany balances with affiliates, net						
Net cash provided by (used in) financing activities	9,039	71,000	(2,628)	(3,338)		74,073
<b>As adjusted(1)</b>						
Net cash provided by (used in) operating activities	(31,955)	(4,182)	269,777	(17,652)		215,988
	22,916	(57,951)	(83,304)	118,339		

Changes in intercompany balances with affiliates, net							
Net cash provided by (used in) financing activities	31,955	11,682	(86,449)	116,885		74,073	
<b>Condensed Consolidating Statement of Income</b>							
For the six months ended June 30, 2007							
<b>As reported</b>							
Interest expense, net			51,995	9,564		61,559	
Equity in earnings of unconsolidated affiliates	(175,752)	(175,752)	3,955		347,549		
Income (loss) from continuing operations before income taxes	175,752	175,752	174,939	(3,142)	(347,549)	175,752	
Provision for income taxes	67,665					67,665	
Income (loss) from continuing operations	108,087	175,752	174,939	(3,142)	(347,549)	108,087	
Net income	108,087	175,752	174,939	(3,142)	(347,549)	108,087	
<b>As adjusted(1)</b>							
Interest expense, net		3,774	40,410	13,433		57,617	
Equity in earnings of unconsolidated affiliates	(108,087)	(114,657)	10,138		212,606		
Income (loss) from continuing operations before income taxes	108,087	110,883	184,511	(10,640)	(212,606)	180,235	
Provision for income taxes		2,795	70,668	(4,075)		69,388	
Income (loss) from continuing operations	108,087	108,088	113,843	(6,565)	(212,606)	110,847	
Net income	\$ 108,087	\$ 108,088	\$ 113,843	\$ (9,325)	\$ (212,606)	\$ 108,087	

(1)

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

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Condensed Consolidating Balance Sheet As of December 31, 2007 <b>As reported</b>						
Prepaid expenses and taxes	\$	\$ 102	\$ 156,733	\$ 12,921	\$	\$ 169,756
Total current assets	113,741	102	1,518,022	921,033		2,552,898
Intercompany receivables (non-current)						
Goodwill	96,671		2,162,601	1,988,442		4,247,714
Net investment in subsidiaries	1,519,952	1,464,944	4,968,905		(7,953,801)	
Total Assets	1,730,364	1,654,186	12,593,604	5,469,290	(7,953,801)	13,493,643
Long-term debt	4	4,487,090	4,633,801	(43,528)		9,077,367
Intercompany payables (non-current)	(385,872)	(4,627,439)	5,956,358	4,562,215	(5,505,262)	
Other long-term liabilities	(2,519)	121,482	188,316	176,180		483,459
Additional paid-in capital	1,240,308					1,240,308
Retained earnings	557,945	1,601,686	1,066,671	(134,094)	(2,534,263)	557,945
Total stockholders equity	1,710,804	1,519,949	1,062,682	(134,092)	(2,448,539)	1,710,804
Total liabilities and stockholders equity	1,730,364	1,654,186	12,593,604	5,469,290	(7,953,801)	13,493,643
<b>As adjusted</b>						
Prepaid expenses and taxes	99,417	102	57,316	12,921		169,756
Total current assets	213,158	102	1,418,605	921,033		2,552,898
Intercompany receivables	1,085,684	9,129,859	18,854,467	884,296	(29,954,306)	

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

(non-current)						
Goodwill			2,259,113	1,988,601		4,247,714
Net investment in subsidiaries	957,750	4,168,316	2,485,035		(7,611,101)	
Total Assets	2,256,592	13,487,417	28,961,296	6,353,745	(37,565,407)	13,493,643
Long-term debt	4	8,987,090	62,792	27,481		9,077,367
Intercompany payables (non-current)	137,837	3,267,993	27,008,767	5,378,021	(35,792,618)	
Other long-term liabilities		121,482	188,316	173,661		483,459
Additional paid-in capital	1,240,308	434,505	398,338		(832,843)	1,240,308
Retained earnings	557,945	604,980	554,624	(133,935)	(1,025,669)	557,945
Total stockholders equity	1,710,804	957,748	948,974	(133,933)	(1,772,789)	1,710,804
Total liabilities and stockholders equity	2,256,592	13,487,417	28,961,296	6,353,745	(37,565,407)	13,493,643
Condensed Consolidating Statement of Cash Flows						
For the year ended December 31, 2007						
<b>As reported</b>						
Net cash provided by (used in) operating activities	290,438	(326,264)	707,127	16,437		687,738
Changes in intercompany balances with affiliates, net						
Net cash provided by (used in) financing activities	(290,438)	7,196,560	(137,159)	134,465		6,903,428
<b>As adjusted</b>						
Net cash provided by (used in) operating activities	(85,881)	141,137	417,930	214,552		687,738
Changes in intercompany balances with affiliates, net	376,319	(468,160)	360,206	(268,365)		
Net cash provided by (used in)	85,881	6,728,400	152,038	(62,891)		6,903,428

financing  
activities

Condensed  
Consolidating  
Statement of  
Income  
For the year ended  
December 31,  
2007

**As reported**

Interest expense, net		(160,144)	455,541	69,136		364,533
Equity in earnings of unconsolidated affiliates	(73,292)	59,464	74,773		(86,077)	(25,132)
Income (loss) from continuing operations before income taxes	73,292	73,292	(59,464)	(70,297)	86,077	102,900
Provision for income taxes	43,003					43,003
Income (loss) from continuing operations	30,289	73,292	(59,464)	(70,297)	86,077	59,897
Net income	\$ 30,289	\$ 73,292	\$ (59,464)	\$ (99,905)	\$ 86,077	\$ 30,289

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>As adjusted</b>						
Interest expense, net	\$	\$ 67,495	\$ 227,902	\$ 69,136	\$	\$ 364,533
Equity in earnings of unconsolidated affiliates	(30,289)	(114,008)	43,066		76,099	(25,132)
Income (loss) from continuing operations before income taxes	30,289	19,125	199,880	(70,295)	(76,099)	102,900
Provision for income taxes		(11,164)	83,550	(29,383)		43,003
Income (loss) from continuing operations	30,289	30,289	116,330	(40,912)	(76,099)	59,897
Net income	\$ 30,289	\$ 30,289	\$ 116,330	\$ (70,520)	\$ (76,099)	\$ 30,289

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Condensed Consolidating Balance Sheet As of December 31, 2006 <b>As reported</b>						
Intercompany receivables (non-current)	\$	\$	\$	\$	\$	\$
Net investment in subsidiaries	1,085,218	1,071,903	420,246		(2,577,367)	
Total Assets	1,098,467	1,092,707	4,064,626	828,146	(2,577,367)	4,506,579
Current income taxes payable			7,626			7,626
Total current liabilities	867	21,866	443,751	108,799		575,283
Long-term debt	300,000	1,556,000	24,942	24,839		1,905,781
Intercompany payables (non-current)	(1,067,545)	(1,570,373)	2,403,385	709,118	(474,585)	
Additional paid-in capital	1,195,947					1,195,947
Retained earnings	527,656	1,079,416	1,074,675	(49,594)	(2,104,497)	527,656
Total stockholders equity	1,723,673	1,085,214	1,067,160	(49,592)	(2,102,782)	1,723,673
Total liabilities and stockholders equity	1,098,467	1,092,707	4,064,626	828,146	(2,577,367)	4,506,579
<b>As adjusted</b>						
Intercompany receivables (non-current)	1,360,530	5,620,834	5,590,489	275,417	(12,847,270)	
Net investment in subsidiaries	975,063	1,650,140	415,506		(3,040,709)	
Total Assets	2,348,842	7,291,778	9,650,375	1,103,563	(15,887,979)	4,506,579
Current income taxes payable	7,626					7,626
	8,493	21,866	436,125	108,799		575,283



Total current liabilities						
Long-term debt	300,000	1,556,000	24,942	24,839		1,905,781
Intercompany payables (non-current)	175,204	4,738,853	8,083,418	984,535	(13,982,010)	
Additional paid-in capital	1,195,947	371,227	375,072		(746,299)	1,195,947
Retained earnings	527,656	598,034	612,946	(49,594)	(1,161,386)	527,656
Total stockholders equity	1,723,673	975,059	980,502	(49,592)	(1,905,969)	1,723,673
Total liabilities and stockholders equity	2,348,842	7,291,778	9,650,375	1,103,563	(15,887,979)	4,506,579

Condensed  
Consolidating  
Statement of Cash  
Flows  
For the year ended  
December 31,  
2006

**As reported**

Net cash provided by (used in) operating activities	155,052	(387,000)	487,607	94,596		350,255
Changes in intercompany balances with affiliates, net						
Net cash provided by (used in) financing activities	(155,052)	387,000	(5,734)	246		226,460

**As adjusted**

Net cash provided by (used in) operating activities	(151,205)	(20,514)	522,332	(358)		350,255
Changes in intercompany balances with affiliates, net	306,257	(366,486)	(34,727)	94,956		
Net cash provided by (used in) financing activities	151,205	20,514	(40,460)	95,201		226,460

Condensed  
Consolidating

Statement of  
Income  
For the year ended  
December 31,  
2006

**As reported**

Interest expense, net			71,797	22,618		94,415
Equity in earnings of unconsolidated affiliates	(278,415)	(278,415)	53,778		503,052	
Income (loss) from continuing operations before income taxes	278,415	278,415	273,103	(39,034)	(503,052)	287,847
Provision for income taxes	110,152					110,152
Income (loss) from continuing operations	168,263	278,415	273,103	(39,034)	(503,052)	177,695
Net income	168,263	278,415	273,103	(48,466)	(503,052)	168,263

**As adjusted**

Interest expense, net		14,130	57,667	22,618		94,415
Equity in earnings of unconsolidated affiliates	(168,263)	(191,759)	38,829		321,193	
Income (loss) from continuing operations before income taxes	168,263	177,629	302,182	(39,034)	(321,193)	287,847
Provision for income taxes		9,366	115,736	(14,950)		110,152
Income (loss) from continuing operations	168,263	168,263	186,446	(24,084)	(321,193)	177,695
Net income	\$ 168,263	\$ 168,263	\$ 186,446	\$ (33,516)	\$ (321,193)	\$ 168,263

27

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Condensed Consolidating Statement of Cash Flows For the year ended December 31, 2005						
<b>As reported</b>						
Net cash provided by (used in) operating activities	\$ 30,571	\$ 12,000	\$ 333,376	\$ 35,102	\$	\$ 411,049
Changes in intercompany balances with affiliates, net						
Net cash provided by (used in) financing activities	(30,571)	(12,000)	(13,122)	(6,474)		(62,167)
<b>As adjusted</b>						
Net cash provided by (used in) operating activities	(67,739)	(38,924)	469,028	48,684		411,049
Changes in intercompany balances with affiliates, net	98,309	50,924	(135,653)	(13,580)		
Net cash provided by (used in) financing activities	67,739	38,924	(148,774)	(20,056)		(62,167)
Condensed Consolidating Statement of Income For the year ended December 31, 2005						
<b>As reported</b>						
Interest expense, net		(9)	67,927	19,267		87,185
Equity in earnings of unconsolidated affiliates	(287,348)	(287,499)	15,315		559,532	
Income (loss) from continuing operations before income taxes	287,348	287,508	287,499	5,351	(559,532)	308,174
Provision for income taxes	119,804					119,804
Income (loss) from continuing operations	167,544	287,508	287,499	5,351	(559,532)	188,370

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Net income	167,544	287,508	287,499	(15,475)	(559,532)	167,544
<b>As adjusted</b>						
Interest expense, net		34,930	32,988	19,267		87,185
Equity in earnings of unconsolidated affiliates	(167,544)	(195,805)	17,143		346,206	
Income (loss) from continuing operations before income taxes	167,544	160,875	320,610	5,351	(346,206)	308,174
Provision for income taxes		(6,669)	124,397	2,076		119,804
Income (loss) from continuing operations	167,544	167,544	196,213	3,275	(346,206)	188,370
Net income	\$ 167,544	\$ 167,544	\$ 196,213	\$ (17,551)	\$ (346,206)	\$ 167,544

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors (In thousands, except share data)</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>						
Current assets						
Cash and cash equivalents	\$	\$	\$ 264,514	\$	\$ (442)	\$ 264,072
Patient accounts receivable, net of allowance for doubtful accounts			1,005,103	598,599		1,603,702
Supplies			164,395	102,008		266,403
Deferred income taxes	88,531					88,531
Prepaid expenses and taxes		15	106,088	(16,379)		89,724
Other current assets		610	115,069	75,547		191,226
Total current assets	88,531	625	1,655,169	759,775	(442)	2,503,658
Intercompany receivable	903,283	9,533,225	11,486,044	2,777,775	(24,700,327)	
Property and equipment, net			3,509,232	2,112,522		5,621,754
Goodwill			2,633,866	1,531,175		4,165,041
Other assets, net		183,525	102,849	782,681		1,069,055
Net investment in subsidiaries	1,631,815	4,567,686	2,435,096		(8,634,597)	
Total assets	\$ 2,623,629	\$ 14,285,061	\$ 21,822,256	\$ 7,963,928	\$ (33,335,366)	\$ 13,359,508
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>						
Current liabilities	\$	\$	\$ 20,856	\$ 3,423	\$	\$ 24,279

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Current maturities of long-term debt						
Accounts payable	92	349,822	88,162	442	438,518	
Current income taxes payable	12,224				12,224	
Accrued liabilities	12,126	417,221	262,059		691,406	
Interest payable (receivable)	146,644	1,984	(1,177)		147,451	
Total current liabilities	24,350	146,736	789,883	352,467	442	1,313,878
Long-term debt payable	4	8,825,296	54,969	9,646		8,889,915
Intercompany payable	334,140	3,567,256	19,505,014	7,235,026	(30,641,436)	
Deferred income taxes	429,934					429,934
Other long-term liabilities	1,092	113,960	279,640	176,393		571,085
Minority interests in equity of consolidated subsidiaries			7,067	313,520		320,587
Stockholders equity						
Preferred stock						
Common stock	969		1	2	(3)	969
Additional paid-in capital	1,251,746	658,237	458,396		(1,116,633)	1,251,746
Treasury stock, at cost, 975,549 shares	(6,678)					(6,678)
Accumulated other comprehensive income (loss)	(77,893)	(77,893)	(4,959)		82,852	(77,893)
Retained earnings	665,965	1,051,469	732,245	(123,126)	(1,660,588)	665,965
Total stockholders equity	1,834,109	1,631,813	1,185,683	(123,124)	(2,694,372)	1,834,109
Total liabilities and stockholders equity	\$ 2,623,629	\$ 14,285,061	\$ 21,822,256	\$ 7,963,928	\$ (33,335,366)	\$ 13,359,508

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

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

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Accounts payable		19	276,503	216,171		492,693
Current income taxes payable						
Deferred income taxes current						
Accrued liabilities			437,808	342,892		780,700
Interest payable (receivable)		153,085	8,042	(7,295)		153,832
Total current liabilities		153,104	738,956	555,875		1,447,935
Long-term debt payable (receivable)	4	8,987,090	62,792	27,481		9,077,367
Intercompany payable	137,837	3,267,993	27,008,767	5,378,021	(35,792,618)	
Deferred income taxes	407,947					407,947
Other long-term liabilities		121,482	188,316	173,661		483,459
Minority interests in equity of consolidated subsidiaries			13,491	352,640		366,131
Stockholders' equity						
Preferred stock						
Common stock	966		1	2	(3)	966
Additional paid-in capital	1,240,308	434,505	398,338		(832,843)	1,240,308
Treasury stock, at cost, 975,549 shares	(6,678)					(6,678)
Accumulated other comprehensive income (loss)	(81,737)	(81,737)	(3,989)		85,726	(81,737)
Retained earnings	557,945	604,980	554,624	(133,935)	(1,025,669)	557,945
Total stockholders' equity	1,710,804	957,748	948,974	(133,933)	(1,772,789)	1,710,804
Total liabilities and stockholders' equity	\$ 2,256,592	\$ 13,487,417	\$ 28,961,296	\$ 6,353,745	\$ (37,565,407)	\$ 13,493,643



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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>(In thousands)</b>					
Net operating revenues	\$	\$	\$ 1,658,492	\$ 1,032,108	\$	\$ 2,690,600
Operating costs and expenses:						
Salaries and benefits			623,124	456,252		1,079,376
Provision for bad debts			184,372	106,673		291,045
Supplies			222,385	155,201		377,586
Other operating expenses			300,853	225,245		526,098
Rent			29,859	28,620		58,479
Depreciation and amortization			77,112	47,830		124,942
			1,437,705	1,019,821		2,457,526
Income from operations			220,787	12,287		233,074
Interest expense, net		14,598	146,962	(7,199)		154,361
Loss from early extinguishment of debt						
Minority interest in earnings			(491)	8,808		8,317
Equity in earnings of subsidiary	(47,893)	(59,313)	(4,164)		100,862	(10,508)
Income (loss) from continuing operations before income taxes	47,893	44,715	78,480	10,678	(100,862)	80,904
Provision for income taxes		(3,178)	30,215	4,111		31,148
Income (loss) from continuing operations	47,893	47,893	48,265	6,567	(100,862)	49,756
Discontinued operations, net of taxes:				(1,854)		(1,854)

Income (loss) from operations of hospitals sold and held for sale							
Gain (loss) on sale of hospitals, net					(9)		(9)
Income (loss) on discontinued operations					(1,863)		(1,863)
Net income	\$ 47,893	\$ 47,893	\$ 48,265	\$ 4,704	\$ (100,862)	\$	47,893

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors (In thousands)</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net operating revenues	\$	\$	\$ 931,026	\$ 266,839	\$	\$ 1,197,865
Operating costs and expenses:						
Salaries and benefits			347,753	125,093		472,846
Provision for bad debts			113,264	28,556		141,820
Supplies			107,429	32,919		140,348
Other operating expenses			185,496	61,484		246,980
Rent			18,008	8,958		26,966
Depreciation and amortization			41,837	10,145		51,982
			813,787	267,155		1,080,942
Income from operations			117,239	(316)		116,923
Interest expense, net		3,774	18,729	6,681		29,184
Loss from early extinguishment of debt						
Minority interest in earnings				625		625
Equity in earnings of subsidiary	(53,763)	(65,367)	4,795		114,335	
Income (loss) from continuing operations before income taxes	53,763	61,593	93,715	(7,622)	(114,335)	87,114
Provision for income taxes		582	35,893	(2,919)		33,556
Income (loss) from continuing operations	53,763	61,011	57,822	(4,703)	(114,335)	53,558
Discontinued operations, net of taxes:						
Income (loss) from operations of hospitals sold and held for sale				205		205

Gain (loss) on sale of  
hospitals, net

Income (loss) on  
discontinued operations

Net income	\$ 53,763	\$ 61,011	\$ 57,822	\$ (4,498)	\$ (114,335)	\$ 53,763
------------	-----------	-----------	-----------	------------	--------------	-----------

205

205

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors (In thousands)</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net operating revenues	\$	\$	\$ 3,347,235	\$ 2,070,919	\$	\$ 5,418,154
Operating costs and expenses:						
Salaries and benefits			1,261,764	905,382		2,167,146
Provision for bad debts			378,262	209,863		588,125
Supplies			448,515	315,480		763,995
Other operating expenses			601,045	451,220		1,052,265
Rent			61,159	57,177		118,336
Depreciation and amortization			154,897	92,760		247,657
			2,905,642	2,031,882		4,937,524
Income from operations			441,593	39,037		480,630
Interest expense, net		27,522	267,683	24,858		320,063
Loss from early extinguishment of debt		1,328				1,328
Minority interest in earnings			(685)	18,684		17,999
Equity in earnings of subsidiary	(108,020)	(124,379)	(26,986)		235,993	(23,392)
Income (loss) from continuing operations before income taxes	108,020	95,529	201,581	(4,505)	(235,993)	164,632
Provision for income taxes		(12,491)	77,608	(1,734)		63,383
Income (loss) from continuing operations	108,020	108,020	123,973	(2,771)	(235,993)	101,249

Discontinued operations, net of taxes:							
Income (loss) from operations of hospitals sold and held for sale				(2,837)			(2,837)
Gain (loss) on sale of hospitals, net				9,608			9,608
Income (loss) on discontinued operations				6,771			6,771
Net income	\$ 108,020	\$ 108,020	\$ 123,973	\$ 4,000	\$ (235,993)	\$	108,020

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors (In thousands)</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net operating revenues	\$	\$	\$ 1,852,257	\$ 499,886	\$	\$ 2,352,143
Operating costs and expenses:						
Salaries and benefits			700,235	235,376		935,611
Provision for bad debts			218,804	51,070		269,874
Supplies			214,545	60,097		274,642
Other operating expenses			365,498	115,647		481,145
Rent			35,687	16,035		51,722
Depreciation and amortization			82,429	18,050		100,479
			1,617,198	496,275		2,113,473
Income from operations			235,059	3,611		238,670
Interest expense, net		3,774	40,410	13,433		57,617
Loss from early extinguishment of debt						
Minority interest in earnings				818		818
Equity in earnings of subsidiary	(108,087)	(114,657)	10,138		212,606	
Income (loss) from continuing operations before income taxes	108,087	110,883	184,511	(10,640)	(212,606)	180,235
Provision for income taxes		2,795	70,668	(4,075)		69,388
Income (loss) from continuing operations	108,087	108,088	113,843	(6,565)	(212,606)	110,847
Discontinued operations, net of taxes:						

Income (loss) from operations of hospitals sold and held for sale					(2,760)		(2,760)
Gain (loss) on sale of hospitals, net							
Income (loss) on discontinued operations					(2,760)		(2,760)
Net income	\$ 108,087	\$ 108,088	\$ 113,843	\$ (9,325)	\$ (212,606)	\$	108,087



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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
	<b>(In thousands)</b>					
Cash flows from operating activities:						
Net cash provided by(used in) operating activities	\$ 58,738	\$ (31,359)	\$ 621,921	\$ (232,517)	\$	\$ 416,783
Cash flows from investing activities:						
Acquisitions of facilities and other related equipment			(6,464)	(182)		(6,646)
Purchases of property and equipment			(180,745)	(94,860)		(275,605)
Proceeds from disposition of hospitals and other ancillary services			10,693	355,220		365,913
Proceeds from sale of property and equipment			1,094	11,795		12,889
Investment in other assets			(110,380)	(34,000)		(144,380)
Net cash provided by (used in) investing activities			(285,802)	237,973		(47,829)
Cash flows from financing activities:						
Proceeds from exercise of stock options	1,357					1,357
Deferred financing costs		(2,444)				(2,444)
Excess tax benefits relating to stock-based compensation	(947)					(947)
Stock buy-back	(10,194)					(10,194)
Proceeds from minority investors in joint ventures				11,214		11,214
Redemption of minority investments in joint ventures				(53,485)		(53,485)
Distributions to minority investors in joint ventures				(14,916)		(14,916)

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

Changes in intercompany balances with affiliates, net	(48,954)	195,597	(100,769)	(45,432)	(442)	
Borrowings under credit agreement		25,000	44,818	(47,161)		22,657
(Repayments) borrowings of long-term indebtedness		(186,794)	(129,729)	125,525		(190,998)
Net cash provided by (used in) financing activities	(58,738)	31,359	(185,680)	(24,255)	(442)	(237,756)
Net change in cash and cash equivalents			150,439	(18,799)	(442)	131,198
Cash and cash equivalents at beginning of period			114,075	18,799		132,874
Cash and cash equivalents at end of period	\$	\$	\$ 264,514	\$	\$ (442)	\$ 264,072

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

	<b>Parent Guarantor</b>	<b>Issuer</b>	<b>Other Guarantors</b>	<b>Non- Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
	(In thousands)					
Cash flows from operating activities:						
Net cash provided by (used in) operating activities	\$ (31,955)	\$ (4,182)	\$ 269,777	\$ (17,652)	\$	\$ 215,988
Cash flows from investing activities:						
Acquisitions of facilities and other related equipment			(100,525)	(87,430)		(187,955)
Purchases of property and equipment			(91,443)	(17,406)		(108,849)
Proceeds from disposition of hospitals and other ancillary services				12,662		12,662
Proceeds from sale of property and equipment			167	67		234
Investment in other assets		(7,500)	(16,563)	(1,299)		(25,362)
Net cash provided by (used in) investing activities		(7,500)	(208,364)	(93,406)		(309,270)
Cash flows from financing activities:						
Proceeds from exercise of stock options	6,693					6,693
Deferred financing costs		(367)				(367)
Excess tax benefits relating to stock-based compensation	2,295					2,295
Proceeds from minority investors in joint ventures	51			1,054		1,105
Redemption of minority investments in joint ventures				(1,369)		(1,369)
Distributions to minority investors in joint ventures				(1,705)		(1,705)
	22,916	(57,951)	(83,304)	118,339		

Changes in intercompany balances with affiliates, net						
Borrowings under credit agreement		132,000				132,000
(Repayments) borrowings of long-term indebtedness		(62,000)	(3,145)	566		(64,579)
Net cash provided by (used in) financing activities	31,955	11,682	(86,449)	116,885		74,073
Net change in cash and cash equivalents			(25,036)	5,827		(19,209)
Cash and cash equivalents at beginning of period			28,560	12,006		40,566
Cash and cash equivalents at end of period	\$	\$	\$ 3,524	\$ 17,833	\$	\$ 21,357

## **Table of Contents**

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

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

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

#### **Executive Overview**

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

Effective July 25, 2007, we completed our acquisition of Triad Hospitals, Inc., or Triad, for an aggregate consideration of \$6.857 billion, including \$1.686 billion of assumed indebtedness. In connection with this acquisition, one of our subsidiaries issued \$3.021 billion principal amount of 8.875% senior notes due 2015 (the Notes ) and we entered into a new \$7.215 billion credit facility (the New Credit Facility ) consisting of a \$6.065 billion term loan, a \$750 million revolving credit facility and a \$400 million delayed draw term loan facility. The delayed draw term loan facility was reduced in the fourth quarter of 2007, per our request, from \$400 million to \$300 million. The proceeds of these financings were used to pay the cash consideration under the merger agreement and to refinance substantially all of both the assumed indebtedness and our existing indebtedness and to pay related fees and expenses. The revolving credit facility and the delayed draw term loan facility remain available to us for future acquisitions, working capital, and general corporate purposes. We believe the acquisition of Triad will benefit us since it has expanded the number of markets we serve, expanded our operations into five states where we previously did not operate, and reduced our concentration of credit risk in any one state. We also believe that synergies obtained from eliminating duplicate corporate functions and centralizing many support functions will allow us to improve Triad's margins. During the three and six months ended June 30, 2008, we have realized approximately \$42 million and \$77 million, respectively, of our estimated synergies related to the Triad acquisition. We continue to believe our integration is on track and we anticipate recognizing all of the anticipated synergies.

As of December 31, 2007, two of the former Triad hospitals had been sold and six other hospitals formerly owned by Triad along with six hospitals owned by us had been identified as available for sale. During the three months ended March 31, 2008, we completed the sale of eleven of these hospitals that were available for sale as of December 31, 2007. Accordingly, these hospitals have been classified in discontinued operations in the condensed consolidated statements of income for the three and six months ended June 30, 2008 and three and six months ended June 30, 2007 to the extent that the hospitals were owned by us during the respective periods. Additionally, effective June 30, 2008, we acquired the 35% minority interest in Affinity Health Systems, LLC which indirectly owns and operates Trinity Medical Center (560 licensed beds) located in Birmingham, Alabama, from Baptist Health Systems, Inc. of Birmingham, Alabama ( Baptist ), giving us 100% ownership of that facility. The purchase price for this minority interest was \$51.5 million in cash and the cancellation of a promissory note issued by Baptist and held by Affinity Health Systems, LLC in the original principal amount of \$32.8 million. The Company, prior to the acquisition of the 35% minority interest, consolidated all the operations of Affinity Health Systems, LLC as the majority owner of 65% of the equity.

With the exception of the previously announced definitive agreement to acquire a two hospital system in Spokane, Washington, our focus has remained on the integration of the former Triad hospitals. The acquisition of the two hospital system in Spokane is pending governmental approval and is expected to be completed in

**Table of Contents**

the fourth quarter of 2008. We do not anticipate any further acquisition activity in 2008; however, we intend to begin considering additional acquisitions in 2009.

In the quarter ended June 30, 2008, we were informed that we would not receive the full amount of previously estimated reimbursements under certain Indiana Medicaid programs. These reductions are due partly to the state not receiving a federal waiver for one of its programs and partly as a result of changes to its disproportionate share program which were different from what had previously been communicated to us. This represents an approximate \$8.0 million reduction in expected payments from these programs on an annual basis.

For the three months ended June 30, 2008, we generated \$2.691 billion in net operating revenues, a growth of 124.6% over the three months ended June 30, 2007, and \$47.9 million of net income, a decrease of 10.9% over the three months ended June 30, 2007. For the three months ended June 30, 2008, consolidated admissions increased 101.3% and adjusted admissions increased 93.4% over the three months ended June 30, 2007. The increases in net operating revenue and volume reflect both our acquisition of the former Triad hospitals as well as the benefit from the strong flu season.

For the six months ended June 30, 2008, we generated \$5.418 billion in net operating revenues, a growth of 130.3% over the six months ended June 30, 2007, and \$108.0 million of net income, consistent with the six months ended June 30, 2007. For the six months ended June 30, 2008, consolidated admissions increased 106.3% and adjusted admissions increased 97.6% over the six months ended June 30, 2007. The increases in net operating revenue and volume reflect both our acquisition of the former Triad hospitals as well as the benefit from the strong flu season.

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

**Sources of Consolidated Net Operating Revenue**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Medicare	27.5%	29.4%	28.0%	30.1%
Medicaid	8.7%	11.5%	8.5%	10.9%
Managed Care and other third party payors	52.8%	46.8%	52.7%	46.6%
Self-pay	11.0%	12.3%	10.8%	12.4%
Total	100.0%	100.0%	100.0%	100.0%

Net operating revenues include amounts estimated by management to be reimbursable by Medicare and Medicaid under prospective payment systems and provisions of cost-based reimbursement and other payment methods. In addition, we are reimbursed by non-governmental payors using a variety of payment methodologies. Amounts we receive for treatment of patients covered by these programs are generally less than the standard billing rates. We

account for the differences between the estimated program reimbursement rates and the standard billing rates as contractual allowance adjustments, which we deduct from gross revenues to arrive at net operating revenues. Final settlements under some of these programs are subject to adjustment based on administrative review and audit by third parties. We account for adjustments to previous program reimbursement estimates as contractual allowance adjustments and report them in the periods that such adjustments become known. Adjustments related to final settlements that increased revenue were insignificant to both net operating revenue and net income in each of the three and six months ended June 30, 2008 and 2007. In the future, we expect the percentage of revenues received from the Medicare program to increase due to the general aging of the population.



**Table of Contents**

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

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

**Results of Operations**

Our hospitals offer a variety of services involving a broad range of inpatient and outpatient medical and surgical services. These include orthopedics, cardiology, occupational medicine, diagnostic services, emergency services, rehabilitation treatment, home health and skilled nursing. The strongest demand for hospital services generally occurs during January through April and the weakest demand for these services occurs during the summer months. Accordingly, eliminating the effect of new acquisitions, our net operating revenues and earnings are historically highest during the first quarter and lowest during the third quarter.

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Consolidated(a)				
Net operating revenues	100.0%	100.0%	100.0%	100.0%
Operating expenses(b)	(86.7)	(85.9)	(86.5)	(85.6)
Depreciation and amortization	(4.6)	(4.3)	(4.6)	(4.3)
Income from operations	8.7	9.8	8.9	10.1
Interest expense, net	(5.8)	(2.5)	(5.9)	(2.4)
Minority interest in earnings	(0.3)		(0.4)	
Equity in earnings of unconsolidated affiliates	0.4		0.4	
Income from continuing operations before income taxes	3.0	7.3	3.0	7.7
Provision for income taxes	(1.2)	(2.8)	(1.1)	(3.0)
Income from continuing operations	1.8	4.5	1.9	4.7
Income (loss) on discontinued operations			0.1	(0.1)
Net income	1.8%	4.5%	2.0%	4.6%
			<b>Three Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2008</b>

Percentage increase (decrease) from same period prior year(a):		
Net operating revenues	124.6%	130.3%
Admissions	101.3	106.3
Adjusted admissions(c)	93.4	97.6
Average length of stay	2.4	4.9
Net income(d)	(10.9)	0.0
Same-store percentage increase from same period prior year(a)(e):		
Net operating revenues	4.9%	5.3%
Admissions	2.3	3.1
Adjusted admissions(c)	2.4	3.1

(a) Pursuant to Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we have restated our prior period financial statements and

**Table of Contents**

statistical results to reflect as discontinued operations the seven hospitals that were in discontinued operations during the three and six months ended June 30, 2008, which were also owned or leased during the three months ended June 30, 2007.

- (b) Operating expenses include salaries and benefits, provision for bad debts, supplies, rent and other operating expenses.
- (c) Adjusted admissions is a general measure of combined inpatient and outpatient volume. We computed adjusted admissions by multiplying admissions by gross patient revenues and then dividing that number by gross inpatient revenues.
- (d) Includes loss from operations of discontinued hospitals and gain on sale of discontinued hospitals.
- (e) Includes former Triad hospitals during the comparable periods and other acquired hospitals to the extent we operated them in both years.

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

Net operating revenues increased \$1.493 billion to \$2.691 billion for the three months ended June 30, 2008, from \$1.198 billion for the three months ended June 30, 2007. On a combined basis, the hospitals acquired in the Triad acquisition and growth from those hospitals owned throughout both periods contributed \$1.460 billion of that increase and \$32.6 million was contributed by other hospitals acquired in 2007. On a same-store basis, including the former Triad hospitals during the comparable periods, this represents an increase in same-store net revenue of 4.9%. The increase from hospitals that we owned throughout both periods was attributable to volume increases, primarily from flu and respiratory cases, rate increases, payor mix and the acuity level of services provided.

On a consolidated basis, inpatient admissions increased by 101.3% and adjusted admissions increased by 93.4%. With respect to the increase in consolidated admissions, approximately 50.6% of the admissions were contributed from newly acquired hospitals, including those hospitals acquired from Triad, and 49.4% of the admissions were contributed by hospitals we owned throughout both periods. On a same-store basis, which includes the hospitals acquired from Triad, as if we owned them during both periods, admissions increased by 2.3% during the three months ended June 30, 2008.

Operating expenses, excluding depreciation and amortization, as a percentage of net operating revenues, increased to 86.7% for the three months ended June 30, 2008 compared to 85.9% for the three months ended June 30, 2007. Salaries and benefits, as a percentage of net operating revenues, increased 0.6% to 40.1% for the three months ended June 30, 2008, compared to 39.5% for the three months ended June 30, 2007. This increase is primarily the result of an increase in the number of employed physicians as well as certain IT employees who were previously treated as leased employees with related expense previously being included in other operating expense. These increases have offset improvements realized at our other hospitals owned throughout both periods. Provision for bad debts, as a percentage of net operating revenues, decreased 1.0% to 10.8% for the three months ended June 30, 2008 compared to 11.8% for the three months ended June 30, 2007. This decrease is primarily the result of the former Triad hospitals having a self-pay discount program and historically lower provision for bad debts, as well as our phasing in of a discounting program at those hospitals where one previously did not exist. Supplies, as a percentage of net operating revenues, increased 2.3% to 14.0% for the three months ended June 30, 2008, as compared to 11.7% for the three months ended June 30, 2007. This increase is primarily the result of the acquisition of the former Triad hospitals whose higher acuity of services resulted in higher supply costs than our other hospitals taken collectively, offsetting improvements from greater utilization of and improved pricing under our purchasing program. Rent and other operating expenses, as a percentage of net operating revenues, decreased from 22.9% for the three months ended

June 30, 2007, to 21.8% for the three months ended June 30, 2008. As part of our acquisition of Triad, we acquired minority investments in certain joint ventures. These investments provided earnings of 0.4% of net operating revenues. Prior to the Triad acquisition, we did not have any material investments in unconsolidated subsidiaries.

Depreciation and amortization increased from 4.3% of net operating revenues for the three months ended June 30, 2007 to 4.6% of net operating revenues for the three months ended June 30, 2008. The increase in

**Table of Contents**

depreciation and amortization as a percentage of net operating revenue is primarily due to the acquisition of the former Triad hospitals which, as a result of a higher level of capital spending, had a higher fair market valuation in relation to their respective revenue than that of our other hospitals in the comparable period.

Interest expense, net, increased by \$125.2 million from \$29.2 million for the three months ended June 30, 2007 to \$154.4 million for the three months ended June 30, 2008. An increase in interest rates during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, accounted for \$4.7 million of this increase, while an increase in our average outstanding debt during the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, accounted for the remaining \$120.5 million.

Income from continuing operations margin decreased from 4.5% for the three months ended June 30, 2007 to 1.8% for the three months ended June 30, 2008. Net income margin decreased from 4.5% for the three months ended June 30, 2007 to 1.8% for the three months ended June 30, 2008. The decrease in income from continuing operations margin and net income margin are reflective of the net increases in operating expenses, depreciation expense and interest expense, as discussed above.

The net results of the above mentioned changes resulted in income from continuing operations before income taxes decreasing \$6.2 million from \$87.1 million for the three months ended June 30, 2007 to \$80.9 million for the three months ended June 30, 2008.

Provision for income taxes decreased from \$33.6 million for the three months ended June 30, 2007 to \$31.1 million for the three months ended June 30, 2008, due primarily to a reduction in taxable income in the comparable period which was the result of higher operating expenses.

Net income was \$47.9 million for the three months ended June 30, 2008 compared to \$53.8 million for the three months ended June 30, 2007, a decrease of 10.9%.

**Six months Ended June 30, 2008 Compared to Six months Ended June 30, 2007**

Net operating revenues increased \$3.066 billion to \$5.418 billion for the six months ended June 30, 2008, from \$2.352 billion for the six months ended June 30, 2007. On a combined basis, the hospitals acquired in the Triad acquisition and growth from those hospitals owned throughout both periods contributed \$2.945 billion of that increase and \$120.8 million was contributed by other hospitals acquired in 2007. On a same-store basis, including the former Triad hospitals during the comparable periods, this represents an increase in same-store net revenue of 5.3%. The increase from hospitals that we owned throughout both periods was attributable to volume increases, primarily from flu and respiratory cases, rate increases, payor mix and the acuity level of services provided. Our revenue and volume increases were benefited by one additional business day because the current year is a leap year.

On a consolidated basis, inpatient admissions increased by 106.3% and adjusted admissions increased by 97.6%. With respect to the increase in consolidated admissions, approximately 51.6% of the admissions were contributed from newly acquired hospitals, including those hospitals acquired from Triad, and 48.4% of the admissions were contributed by hospitals we owned throughout both periods. On a same-store basis, which includes the hospitals acquired from Triad, as if we owned them during both periods, admissions increased by 3.1% during the six months ended June 30, 2008.

Operating expenses, excluding depreciation and amortization, as a percentage of net operating revenues, increased to 86.5% for the six months ended June 30, 2008 compared to 85.6% for the six months ended June 30, 2007. Salaries and benefits, as a percentage of net operating revenues, increased 0.2% to 40.0% for the six months ended June 30, 2008, compared to 39.8% for the six months ended June 30, 2007. This increase is primarily the result of an increase

in the number of employed physicians as well as certain IT employees who were previously treated as leased employees with related expense previously being included in other operating expense. These increases have offset improvements realized at our other hospitals owned throughout both periods. Provision for bad debts, as a percentage of net operating revenues, decreased 0.6% to 10.9% for the six months ended June 30, 2008 compared to 11.5% for the six months ended June 30, 2007. This decrease is primarily the result of the former Triad hospitals having a self-pay discount program and

## **Table of Contents**

historically lower provision for bad debts, as well as our phasing in of a discounting program at those hospitals where one previously did not exist. Supplies, as a percentage of net operating revenues, increased 2.4% to 14.1% for the six months ended June 30, 2008, as compared to 11.7% for the six months ended June 30, 2007. This increase is primarily the result of the acquisition of the former Triad hospitals whose higher acuity of services resulted in higher supply costs than our other hospitals taken collectively, offsetting improvements from greater utilization of and improved pricing under our purchasing program. Rent and other operating expenses, as a percentage of net operating revenues, decreased from 22.6% for the six months ended June 30, 2007 to 21.5% for the six months ended June 30, 2008. As part of our acquisition of Triad, we acquired minority investments in certain joint ventures. These investments provided earnings of 0.4% of net operating revenues. Prior to the Triad acquisition, we did not have any material investments in unconsolidated subsidiaries.

Depreciation and amortization increased from 4.3% of net operating revenues for the six months ended June 30, 2007 to 4.6% of net operating revenues for the six months ended June 30, 2008. The increase in depreciation and amortization as a percentage of net operating revenue is primarily due to the acquisition of the former Triad hospitals which, as a result of a higher level of capital spending, had a higher fair market valuation in relation to their respective revenue than that of our other hospitals in the comparable period.

Interest expense, net, increased by \$262.4 million from \$57.6 million for the six months ended June 30, 2007 to \$320.1 million for the six months ended June 30, 2008. Since the current year is a leap year, one additional day in the six months resulted in \$0.3 million of the increase in interest expense. An increase in interest rates during the six months ended June 30, 2008, as compared to the six months ended June 30, 2007, accounted for \$11.3 million of this increase, while an increase in our average outstanding debt during the six months ended June 30, 2008, as compared to the six months ended June 30, 2007, accounted for the remaining \$250.8 million.

Income from continuing operations margin decreased from 4.7% for the six months ended June 30, 2007 to 1.9% for the six months ended June 30, 2008. Net income margin decreased from 4.6% for the six months ended June 30, 2007 to 2.0% for the six months ended June 30, 2008. The decrease in income from continuing operations margin and net income margin are reflective of the net increases in operating expenses, depreciation expense and interest expense, as discussed above.

The net results of the above mentioned changes resulted in income from continuing operations before income taxes decreasing \$15.6 million from \$180.2 million for the six months ended June 30, 2007 to \$164.6 million for the six months ended June 30, 2008.

Provision for income taxes decreased from \$69.4 million for the six months ended June 30, 2007 to \$63.4 million for the six months ended June 30, 2008, due primarily to a reduction in taxable income in the comparable period which was the result of higher operating expenses.

Net income was \$108.0 million for the six months ended June 30, 2008 compared to \$108.1 million for the six months ended June 30, 2007.

## **Liquidity and Capital Resources**

Net cash provided by operating activities increased \$200.8 million from \$216.0 million for the six months ended June 30, 2007 to \$416.8 million for the six months ended June 30, 2008. The increase in cash flow, in comparison to the prior year period, is from a net cash inflow from accounts payable, accrued liabilities and income taxes of \$33.5 million and supplies, prepaid expenses and other assets of \$27.0 million. Additionally, there was an increase in cash flow in comparison to the prior year period resulting from an increase in non-cash depreciation expense of \$142.8 million and an increase of other non-cash expenses of \$34.2 million. These changes in cash were offset by a

decrease in cash from the net activity of all other assets and liabilities of \$9.3 million and a net cash outflow from accounts receivable of \$27.4 million, reflecting the growth in net operating revenues and volume, as compared to the same prior year period. As much of this growth occurred in the latter part of the quarter ended June 30, 2008, the collections of the related cash has not yet occurred as of June 30, 2008. The cash used in investing activities was \$47.8 million for the six months ended June 30,



## **Table of Contents**

2008 compared to \$309.3 million for the six months ended June 30, 2007. This decrease in cash used in investing activities was due to the sale of 11 hospitals, as well as not completing any hospital acquisitions during the six months ended June 30, 2008, offset by an increase in capital expenditures compared to the six months ended June 30, 2007. Increase in other assets used in investing activities includes \$40.1 million of proceeds received from the sale of hospitals and land that has been deposited in escrow accounts to be used for the acquisition of like-kind property.

### ***Capital Expenditures***

Cash expenditures related to purchases of facilities were \$6.6 million for the six months ended June 30, 2008, compared to \$188.0 million for the six months ended June 30, 2007. These expenditures during the six months ended June 30, 2008 were for the acquisition of ten physician practices and a clinic. The expenditures during the six months ended June 30, 2007, included \$45.5 million related to the acquisition of Triad and \$137.1 million for the acquisition of two hospitals, the contingent settlements of working capital items from acquisitions in the prior year and the acquisition of five physician practices and \$5.4 million for the purchase of information systems and other equipment to integrate recently acquired hospitals.

Excluding the cost to construct replacement hospitals, our capital expenditures for the six months ended June 30, 2008, totaled \$172.2 million, compared to \$71.0 million for the six months ended June 30, 2007. Costs to construct replacement hospitals totaled \$103.4 million during the six months ended June 30, 2008 compared to \$37.8 million during the six months ended June 30, 2007.

Pursuant to hospital purchase agreements in effect as of June 30, 2008, where required certificate of need approval has been obtained, we are required to build replacement facilities in Petersburg, Virginia, by August 2008, Valparaiso, Indiana, by April 2011 and Birmingham, Alabama within three years of receiving a certificate of need. Two previously required replacement hospitals recently opened, one in Clarksville, Tennessee (June 2008) and one in Shelbyville, Tennessee (July 2008). Also, as required by an amendment to a lease agreement entered into in 2005, we agreed to build a replacement hospital at our Barstow, California location. Estimated construction costs, including equipment, are approximately \$864.2 million for these six replacement hospitals of which approximately \$368.5 million has been incurred to date, including costs incurred by Triad prior to our acquisition. The certificate of need for the hospital in Birmingham, Alabama was received in June, 2008, however, the decision to issue the certificate of need is being appealed.

### ***Capital Resources***

Net working capital was \$1.190 billion at June 30, 2008, compared to \$1.105 billion at December 31, 2007. The \$85 million increase was attributable primarily to an increase in cash and accounts receivable and a decrease in accounts payable, which reflects the timing of our cash collections and payments.

In connection with the consummation of the Triad acquisition in July 2007, we obtained \$7.215 billion of senior secured financing under a New Credit Facility with a syndicate of financial institutions led by Credit Suisse, as administrative agent and collateral agent. The New Credit Facility consists of a \$6.065 billion funded term loan facility with a maturity of seven years, a \$300 million delayed draw term loan facility, (reduced from \$400 million) with a maturity of seven years and a \$750 million revolving credit facility with a maturity of six years. The revolving credit facility also includes a subfacility for letters of credit and a swingline subfacility. The New Credit Facility requires us to make quarterly amortization payments of each term loan facility equal to 0.25% of the initial outstanding amount of the term loans, if any, with the outstanding principal balance of each term loan facility payable on July 25, 2014.

The term loan facility must be prepaid in an amount equal to (1) 100% of the net cash proceeds of certain asset sales and dispositions by us and our subsidiaries, subject to certain exceptions and reinvestment rights, (2) 100% of the net cash proceeds of issuances of certain debt obligations or receivables based financing by us and our subsidiaries, subject to certain exceptions, and (3) 50%, subject to reduction to a lower percentage based on our leverage ratio (as defined in the New Credit Facility generally as the ratio of total debt on the date of determination to our EBITDA, as defined, for the four quarters most recently ended prior to such date), of excess cash flow (as defined) for any year, commencing in 2008, subject to certain

## **Table of Contents**

exceptions. Voluntary prepayments and commitment reductions are permitted in whole or in part, without premium or penalty, subject to minimum prepayment or reduction requirements.

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

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

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

The New Credit Facility contains customary representations and warranties, subject to limitations and exceptions, and customary covenants restricting our and our subsidiaries' ability to, among other things and subject to various exceptions, (1) declare dividends, make distributions or redeem or repurchase capital stock, (2) prepay, redeem or repurchase other debt, (3) incur liens or grant negative pledges, (4) make loans and investments and enter into acquisitions and joint ventures, (5) incur additional indebtedness or provide certain guarantees, (6) make capital expenditures, (7) engage in mergers, acquisitions and asset sales, (8) conduct transactions with affiliates, (9) alter the nature of our businesses, (10) grant certain guarantees with respect to physician practices, (11) engage in sale and leaseback transactions or (12) change our fiscal year. We and our subsidiaries are also required to comply with specified financial covenants (consisting of a leverage ratio and an interest coverage ratio) and various affirmative covenants.

Events of default under the New Credit Facility include, but are not limited to, (1) our failure to pay principal, interest, fees or other amounts under the credit agreement when due (taking into account any applicable grace period), (2) any representation or warranty proving to have been materially incorrect when made, (3) covenant defaults subject, with respect to certain covenants, to a grace period, (4) bankruptcy events, (5) a cross default to certain other debt, (6) certain undischarged judgments (not paid within an applicable grace period), (7) a change of control, (8) certain

ERISA-related defaults and (9) the invalidity or impairment of specified security interests, guarantees or subordination provisions in favor of the administrative agent or lenders under the New Credit Facility.

As of June 30, 2008, there was approximately \$1.050 billion of available borrowing capacity under our New Credit Facility, of which \$78.8 million was set aside for outstanding letters of credit. We believe that

**Table of Contents**

these funds, along with internally generated cash and continued access to the bank credit and capital markets, will be sufficient to finance future acquisitions, capital expenditures and working capital requirements through the next 12 months and into the foreseeable future.

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

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

Swap #	Notional Amount (In 000 s)	Fixed Interest Rate	Termination Date
1	100,000	3.5860%	August 29, 2008
2	100,000	3.9350%	June 6, 2009
3	100,000	4.3375%	November 30, 2009
4	100,000	4.9360%	October 4, 2010
5	100,000	4.7090%	January 24, 2011
6	300,000	5.1140%	August 8, 2011
7	100,000	4.7185%	August 19, 2011
8	100,000	4.7040%	August 19, 2011
9	100,000	4.6250%	August 19, 2011
10	200,000	4.9300%	August 30, 2011
11	200,000	4.4815%	October 26, 2011
12	200,000	4.0840%	December 3, 2011
13	100,000	3.8470%	January 4, 2012
14	100,000	3.8510%	January 4, 2012
15	100,000	3.8560%	January 4, 2012
16	200,000	3.7260%	January 8, 2012
17	200,000	3.5065%	January 16, 2012
18	250,000	5.0185%	May 30, 2012
19	150,000	5.0250%	May 30, 2012
20	200,000	4.6845%	September 11, 2012
21	125,000	4.3745%	November 23, 2012
22	75,000	4.3800%	November 23, 2012
23	150,000	5.0200%	November 30, 2012
24	100,000	5.0230%	May 30, 2013
25	300,000	5.2420%	August 6, 2013
26	100,000	5.0380%	August 30, 2013
27	100,000	5.0500%	November 30, 2013(1)
28	100,000	5.2310%	July 25, 2014
29	100,000	5.2310%	July 25, 2014
30	200,000	5.1600%	July 25, 2014

Edgar Filing: COMMUNITY HEALTH SYSTEMS INC - Form 10-Q

31	75,000	5.0405%	July 25, 2014
32	125,000	5.0215%	July 25, 2014

(1) This swap agreement becomes effective September 2, 2008, after the termination of agreement #1 listed above.

**Table of Contents**

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

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

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

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

**Off-balance sheet arrangements**

Excluding the hospitals whose leases terminated in conjunction with our sale of interests in the partnerships holding the leases and whose operating results are included in discontinued operations, our consolidated operating results for the six months ended June 30, 2008 and 2007, included \$139.0 million and \$136.4 million, respectively, of net operating revenue and \$7.4 million and \$9.9 million, respectively, of income from operations generated from six hospitals operated by us under operating lease arrangements. In accordance with accounting principles generally

accepted in the United States of America, or GAAP, the respective assets and the future lease obligations under these arrangements are not recorded on our condensed consolidated balance sheet. Lease payments under these arrangements are included in rent expense when paid and totaled approximately \$8.2 million for the six months ended June 30, 2008, compared to \$7.4 million for the six months ended June 30, 2007. The current terms of these operating leases expire between June 2010 and December 2019, not including lease extension options. If we allow these leases to expire, we would no longer generate revenue nor incur expenses from these hospitals.

In the past, we have utilized operating leases as a financing tool for obtaining the operations of specified hospitals without acquiring, through ownership, the related assets of the hospital and without a significant outlay of cash at the front end of the lease. We utilize the same management and operating strategies to



## **Table of Contents**

improve operations at those hospitals held under operating leases as we do at those hospitals that we own. We have not entered into any operating leases for hospital operations since December 2000.

## **Joint Ventures**

We have sold minority interests in certain of our subsidiaries or acquired subsidiaries with existing minority interest ownership positions. Triad implemented this strategy to a greater extent than we did. In conjunction with the acquisition of Triad, we acquired 19 hospitals containing minority ownership interests ranging from less than 1% to 35%. As of June 30, 2008, 20 of our hospitals were owned by physician joint ventures, of which two also had non-profit entities as partners. In addition, five other hospitals had non-profit entities as partners. Effective June 30, 2008, we acquired the 35% minority interest in Affinity Health Systems, LLC which indirectly owns and operates Trinity Medical Center (560 licensed beds) in Birmingham, Alabama, from Baptist, giving us 100% ownership of that facility. The purchase price for this minority interest was \$51.5 million in cash and the cancellation of a promissory note issued by Baptist and held by Affinity Health Systems, LLC in the original principal amount of \$32.8 million. Minority interests in equity of consolidated subsidiaries was \$320.6 million and \$366.1 million as of June 30, 2008 and December 31, 2007, respectively, and the amount of minority interest in earnings was \$8.3 million and \$0.6 million for the three months ended June 30, 2008 and 2007, respectively, and \$18.0 million and \$0.8 million for the six months ended June 30, 2008 and 2007, respectively.

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

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

## **Inflation**

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

## **Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our condensed consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

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

**Table of Contents*****Third Party Reimbursement***

Net operating revenues include amounts estimated by management to be reimbursable by Medicare and Medicaid under prospective payment systems and provisions of cost-reimbursement and other payment methods. In addition, we are reimbursed by non-governmental payors using a variety of payment methodologies. Amounts we receive for treatment of patients covered by these programs are generally less than the standard billing rates. Excluding the former Triad hospitals, contractual allowances are automatically calculated and recorded through our internally developed automated contractual allowance system. Within the automated system, actual Medicare DRG data, coupled with all payors' historical paid claims data, is utilized to calculate the contractual allowances. This data is automatically updated on a monthly basis. For the former Triad hospitals, contractual allowances are determined through a manual process wherein contractual allowance adjustments, regardless of payor or method of calculation, are reviewed and compared to actual payment experience. The methodology used is similar to the methodology used within our automated contractual allowance system. The former Triad hospitals are being phased into the automated contractual allowance system. All hospital contractual allowance calculations are subjected to monthly review by management to ensure reasonableness and accuracy. We account for the differences between the estimated program reimbursement rates and the standard billing rates as contractual allowance adjustments, which we deduct from gross revenues to arrive at net operating revenues. Determining payor classification, proper DRG and other coding of services performed and the relevance of historical paid claims data are the key assumptions in determining the estimate of expected reimbursement. Assuming the aforementioned assumptions changed our estimate of expected reimbursement by 1% of gross accounts receivable, a change in net accounts receivable of approximately \$38.8 million and an impact on net income of approximately \$23.9 million would have occurred as of and for the six months ended June 30, 2008. However, due to the complexities involved in these estimates, actual payments we receive could be different from the amounts we estimate and record. Final settlements under some of these programs are subject to adjustment based on administrative review and audit by third parties. We account for adjustments to previous program reimbursement estimates as contractual allowance adjustments and report them in the periods that such adjustments become known. Contractual allowance adjustments related to final settlements increased net operating revenue and net income by an insignificant amount in each of the three and six months ended June 30, 2008 and June 30, 2007.

***Allowance for Doubtful Accounts***

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

We estimate the allowance for doubtful accounts by reserving a percentage of all self-pay accounts receivable without regard to aging category, based on collection history, adjusted for expected recoveries and, if present, anticipated changes in trends. For all other payor categories we reserve 100% of all accounts aging over 365 days from the date of discharge. The percentage used to reserve for all self-pay accounts is based on our collection history. We believe that we collect substantially all of our third-party insured receivables which include receivables from governmental agencies. During the quarter ended December 31, 2007, in conjunction with our ongoing process of monitoring the net realizable value of our accounts receivable, as well as integrating the methodologies, data and assumptions used by the former Triad management, we performed various analyses including updating a review of historical cash collections. As a result of these analyses, we noted deterioration in certain key cash collection indicators. The acquisition of Triad

also provided additional data and a comparative and larger population on which to base our estimates. As a result of the lower estimated collectability indicated by the updated analyses, we revised our estimate of contractual allowances for estimated amounts of self-pay accounts receivable that will ultimately qualify as charity care, or that will

**Table of Contents**

ultimately qualify for Medicaid, indigent care or other specific governmental reimbursement resulting in an increase to our contractual reserves of \$96.3 million. Previous estimates of uncollectible amounts for such receivables were included in our bad debt reserves for each period. We also recorded an increase to our allowance for doubtful accounts of approximately \$70.1 million as of December 31, 2007. The resulting impact, net of taxes, for the year ended December 31, 2007 was a decrease to income from continuing operations of \$105.4 million. We believe this lower collectability was primarily the result of an increase in the number of patients qualifying for charity care, reduced enrollment in certain state Medicaid programs and an increase in the number of indigent non-resident aliens. Collections are impacted by the economic ability of patients to pay and the effectiveness of our collection efforts. Significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental healthcare coverage could affect our collection of accounts receivable. Assuming the aforementioned factors resulted in a hypothetical 1% change in the allowance for doubtful accounts as a percentage of self-pay receivables, a change in net accounts receivable of approximately \$17.1 million and net income of approximately \$10.5 million would have occurred as of and for the six months ended June 30, 2008. We also continually review our overall reserve adequacy by monitoring historical cash collections as a percentage of trailing net revenue less provision for bad debts, as well as by analyzing current period net revenue and admissions by payor classification, aged accounts receivable by payor, days revenue outstanding, and the impact of recent acquisitions and dispositions.

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

Patient accounts receivable from our hospital segment represent approximately 96% of our total consolidated accounts receivable. All of the following information represents that derived from our hospital segment.

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

Total gross accounts receivable (prior to allowance for contractual adjustments and doubtful accounts) was approximately \$5.335 billion as of June 30, 2008 and approximately \$4.544 billion as of December 31, 2007. The approximate percentage of total gross accounts receivable (prior to allowance for contractual adjustments and doubtful accounts) summarized by aging categories is as follows:

	<b>June 30, 2008</b>	<b>As of December 31, 2007</b>
0 to 60 days	64.2%	62.7%
61 to 150 days	17.4%	18.4%
151 to 360 days	14.4%	14.6%
Over 360 days	4.0%	4.3%
Total	100.0%	100.0%



**Table of Contents**

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

	<b>June 30, 2008</b>	<b>As of December 31, 2007</b>
Insured receivables	69.1%	69.7%
Self-pay receivables	30.9%	30.3%
Total	100.0%	100.0%

On a combined basis, as a percentage of gross self-pay receivables, the combined total allowance for doubtful accounts and related allowances for other self-pay discounts and contractals, was approximately 80% at June 30, 2008 and 82% at December 31, 2007.

***Goodwill and Other Intangibles***

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

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

The SFAS No. 142 goodwill impairment model requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. We estimated the fair values of the related operations using both a debt free discounted cash flow model as well as an adjusted EBITDA multiple model. These models are both based on our best estimate of future revenues and operating costs and are reconciled to our consolidated market capitalization. The cash flow forecasts are adjusted by an appropriate discount rate based on our weighted-average cost of capital. We performed our initial evaluation, as required by SFAS No. 142, during the first quarter of 2002 and the annual evaluation as of each succeeding September 30. No impairment has been indicated by these evaluations. Estimates used to conduct the impairment review, including revenue and profitability projections or fair values, could cause our analysis to indicate that our goodwill is impaired in subsequent periods and result in a write-off of a portion or all of our goodwill.

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

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

***Professional Liability Insurance Claims***

We accrue for estimated losses resulting from professional liability claims. The accrual, which includes an estimate for incurred but not reported claims, is based on historical loss patterns and actuarially determined projections and is discounted to its net present value using a weighted-average risk-free discount rate of 4.1% and 4.6% in 2007 and 2006, respectively. To the extent that subsequent claims information varies from management's estimates, the liability is adjusted currently. Our insurance is underwritten on a claims-made basis. Prior to June 1, 2002, substantially all of our professional and general liability risks were subject to a \$0.5 million per occurrence deductible; for claims reported from June 1, 2002 through June 1, 2003, these deductibles were \$2.0 million per occurrence. Additional coverage above these deductibles was purchased



## **Table of Contents**

through captive insurance companies in which we had a 7.5% minority ownership interest in each and to which the premiums paid by us represented less than 8% of the total premium revenues of each captive insurance company. With the formation of our own wholly-owned captive insurance company in June 2003, we terminated our minority interest relationships in those entities. Substantially all claims reported after June 1, 2003 and before June 1, 2005 are self-insured up to \$4 million per claim. Substantially all claims reported on or after June 1, 2005 are self-insured up to \$5 million per claim. Management on occasion has selectively increased the insured risk at certain hospitals based upon insurance pricing and other factors and may continue that practice in the future. Excess insurance for all hospitals was purchased through commercial insurance companies and generally covers us for liabilities in excess of the self-insured amount and up to \$100 million per occurrence for claims reported on or after June 1, 2003.

Effective January 1, 2008, the former Triad Hospitals are insured on a claims-made basis through a policy purchased through our wholly-owned captive insurance company and commercial insurance companies as described above for substantially all claims occurring on or after January 1, 2007 and reported on or after January 1, 2008. Substantially all losses for the former Triad hospitals in periods prior to May 1999 were insured through a wholly-owned insurance subsidiary of HCA, Inc., or HCA, Triad's owner prior to that time, and excess loss policies maintained by HCA. HCA has agreed to indemnify the former Triad hospitals in respect of claims covered by such insurance policies arising prior to May 1999. After May 1999 through December 31, 2006, the former Triad hospitals obtained insurance coverage on a claims incurred basis from HCA's wholly-owned insurance subsidiary with excess coverage obtained from other carriers that is subject to certain deductibles. Effective for claims incurred after December 31, 2006, Triad began insuring its claims from \$1 million to \$5 million through its wholly-owned captive insurance company, replacing the coverage provided by HCA. Substantially all claims reported during 2007 were self-insured up to \$10 million per claim.

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

## ***Income Taxes***

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

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). The total amount of unrecognized benefit that would affect the effective tax rate, if recognized, is approximately \$6.2 million as of June 30, 2008. It is our policy to recognize interest and penalties accrued related to unrecognized benefits in our condensed consolidated statements of income as income tax expense. During the three months ended June 30, 2008, we recorded approximately \$0.2 million in interest and penalties related to prior state income tax returns through our income tax provision from continuing operations and which are included in our FIN 48 liability at June 30, 2008. A total of approximately \$2.2 million of interest and penalties is included in the amount of FIN 48 liability at June 30, 2008.

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

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

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

## **Table of Contents**

### ***Recent Accounting Pronouncements***

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

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ( SFAS No. 141(R) ). SFAS No. 141(R) replaces SFAS No. 141 and addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. This standard will require more assets and liabilities be recorded at fair value and will require expense recognition (rather than capitalization) of certain pre-acquisition costs. This standard will also require any adjustments to acquired deferred tax assets and liabilities occurring after the related allocation period to be made through earnings. Furthermore, this standard requires this treatment of acquired deferred tax assets and liabilities also be applied to acquisitions occurring prior to the effective date of this standard. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and is required to be adopted prospectively with no early adoption permitted. We will begin applying SFAS No. 141(R) in the first quarter of 2009. We are currently assessing the potential impact that SFAS No. 141(R) will have on our consolidated results of operations and consolidated financial position.

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

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

### **FORWARD-LOOKING STATEMENTS**

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

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

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

**Table of Contents**

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

demographic changes;

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

legislative proposals for healthcare reform;

potential adverse impact of known and unknown government investigations;

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

changes in inpatient or outpatient Medicare and Medicaid payment levels;

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

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

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

competition;

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

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

changes in medical or other technology;

changes in GAAP;

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

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

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

timeliness of reimbursement payments received under government programs.

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

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

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

A 1% change in interest rates on variable rate debt in excess of that amount covered by interest rate swaps would have resulted in interest expense fluctuating approximately \$3.5 million for the three months ended June 30, 2008 and \$7.3 million for the six months ended June 30, 2008.

## **Table of Contents**

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

Our Chief Executive Officer and Chief Financial Officer, with the participation of other members of management, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended), as of the end of the period covered by this quarterly report. Based on such evaluations, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective (at the reasonable assurance level) to ensure that the information required to be included in this report has been recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms and to ensure that the information required to be included in this report was accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As a result of the completion of the acquisition of Triad on July 25, 2007, our internal controls over financial reporting have changed. Since the Triad acquisition, we have started to analyze the systems of disclosure controls and procedures and internal controls over financial reporting of the former Triad hospitals and other operations acquired in the Triad acquisition and integrate them within our broader framework of controls. The Securities and Exchange Commission's rules require us to complete this process by the first anniversary of the acquisition. We plan to complete this evaluation and integration within the required time frame and report any changes in internal controls in our first annual report in which our assessment of the former Triad hospitals and other operations is to be included. Although we have not yet identified any material weaknesses in our disclosure controls and procedures or internal control over financial reporting as a result of this acquisition, there can be no assurance that a material weakness will not be identified in the course of this review.

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

## **PART II OTHER INFORMATION**

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

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

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

In May 1999, we were served with a complaint in *U.S. ex rel. Bledsoe v. Community Health Systems, Inc.*, subsequently moved to the Middle District of Tennessee, Case No. 2-00-0083. This qui tam action sought treble damages and penalties under the False Claims Act against us. The Department of Justice did not intervene in this action. The allegations in the amended complaint were extremely general, but involved Medicare billing at our White County Community Hospital in Sparta, Tennessee. By order entered on September 19, 2001, the U.S. District Court granted our motion for judgment on the pleadings and dismissed the case, with prejudice. The qui tam whistleblower

(also referred to as a relator ) appealed the district court's ruling to the U.S. Court of Appeals for the Sixth Circuit. On September 10, 2003, the Sixth Circuit



**Table of Contents**

Court of Appeals rendered its decision in this case, affirming in part and reversing in part the district court's decision to dismiss the case with prejudice. The court affirmed the lower court's dismissal of certain of plaintiff's claims on the grounds that his allegations had been previously publicly disclosed. In addition, the appeals court agreed that, as to all other allegations, the relator had failed to include enough information to meet the special pleading requirements for fraud under the False Claims Act and the Federal Rules of Civil Procedure. However, the case was returned to the district court to allow the relator another opportunity to amend his complaint in an attempt to plead his fraud allegations with particularity. In May 2004, the relator in *U.S. ex rel. Bledsoe* filed an amended complaint alleging fraud involving Medicare billing at White County Community Hospital. We then filed a renewed motion to dismiss the amended complaint. On January 6, 2005, the District Court dismissed with prejudice the bulk of the relator's allegations. The only remaining allegations involve a small number of 1997-98 charges at White County. After further motion practice between the relator and the United States Government regarding the relator's right to participate in a previous settlement with the Company, the District Court again dismissed all claims in the case on December 13, 2005. On January 9, 2006, the relator filed a notice of appeal to the U.S. Court of Appeals for the Sixth Circuit and on September 6, 2007, the Court of Appeals issued its 25 page opinion affirming in part, reversing in part (and in doing so, reinstating a number of the allegations claimed by the relator), and remanding the case to the District Court for further proceedings. The relator has filed a motion for rehearing. That motion for rehearing was denied. The relator has amended his complaint to conform to the decision of the Court of Appeals and we have filed an answer. A case management conference is set for August 18, 2008. We will continue to vigorously defend this case.

In August 2004, we were served a complaint in *Arleana Lawrence and Robert Hollins v. Lakeview Community Hospital and Community Health Systems, Inc. (now styled Arleana Lawrence and Lisa Nichols vs. Eufaula Community Hospital, Community Health Systems, Inc., South Baldwin Regional Medical Center and Community Health Systems Professional Services Corporation)* in the Circuit Court of Barbour County, Alabama (Eufaula Division). This alleged class action was brought by the plaintiffs on behalf of themselves and as the representatives of similarly situated uninsured individuals who were treated at our Lakeview Hospital or any of our other Alabama hospitals. The plaintiffs allege that uninsured patients who do not qualify for Medicaid, Medicare or charity care are charged unreasonably high rates for services and materials and that we use unconscionable methods to collect bills. The plaintiffs seek restitution of overpayment, compensatory and other allowable damages and injunctive relief. In October 2005, the complaint was amended to eliminate one of the named plaintiffs and to add our management company subsidiary as a defendant. In November 2005, the complaint was again amended to add another plaintiff, Lisa Nichols and another defendant, our hospital in Foley, Alabama, South Baldwin Regional Medical Center. After a hearing held on June 13, 2007, on October 29, 2007 the Circuit Court ruled in favor of the plaintiffs' class action certification request. On summary judgment, the Circuit Court dismissed the case against Community Health Systems, Inc. only. All other parties remain. We disagree with the certification ruling and have pursued our automatic right of appeal to the Alabama Supreme Court. We are vigorously defending this case.

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



**Table of Contents**

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

On February 10, 2006, we received a letter from the Civil Division of the Department of Justice requesting documents in an investigation they are conducting involving the Company. The inquiry relates to the way in which different state Medicaid programs apply to the federal government for matching or supplemental funds that are ultimately used to pay for a small portion of the services provided to Medicaid and indigent patients. These programs are referred to by different names, including intergovernmental payments, upper payment limit programs, and Medicaid disproportionate share hospital payments. The February 10th letter focused on our hospitals in 3 states: Arkansas, New Mexico, and South Carolina. On August 31, 2006, we received a follow up letter from the Department of Justice requesting additional documents relating to the programs in New Mexico and the payments to the Company's three hospitals in that state. We have provided the Department of Justice with the requested documents. In a letter dated October 4, 2007, the Civil Division notified us that, based on its investigation to date, it preliminarily believes that we and these three New Mexico hospitals have caused the State of New Mexico to submit improper claims for federal funds, in violation of the Civil False Claims Act. The DOJ asserted that these allegedly improper claims and payments began in 2000 and may be ongoing, but provided no information about the amount of any improper claims or the possible damages or penalties it may seek. After a meeting between us and the DOJ held in November 2007, by letter dated January 22, 2008, the Civil Division notified us that they continued to believe that the False Claims Act had been violated and had calculated that the three hospitals received ineligible federal participation payments from August 2000 to June 2006 of approximately \$27.5 million. The Civil Division advised us that if they proceeded to trial, they would seek treble damages plus an appropriate penalty for each of the violations of the False Claims Act. Discussions are continuing with the Civil Division in an effort to resolve this matter. On May 28, 2008, we received a letter from the Office of the U.S. Attorney for the state of New Mexico requesting additional information. We are providing the requested information. We continue to believe that we have not violated the Federal False Claims Act in the manner described in the government's letter of January 22, 2008.

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

On August 28, 2007, Texas Health Resources of Arlington, Texas, or THR, notified us of its decision to exercise a call right to acquire our 80% interest in the limited partnership that owns Presbyterian Hospital of Denton, Texas, together with certain land and buildings that we own in Denton (including rights under a lease for such land and buildings). We acquired these interests in connection with the Triad acquisition. This call right became exercisable under the terms of the limited partnership agreement by reasons of our acquisition of Triad. Shortly after we initiated efforts to set the

purchase price, which is determined by various formulas set forth in the limited partnership agreement and related documents, THR filed suit in Texas state court seeking

## **Table of Contents**

injunctive and declaratory relief to extend the 90-day closing date and to set the purchase price. We removed the case to Federal District Court and proceedings are underway in that court with respect to THR's renewed motions for relief. Pursuant to the limited partnership agreement, the closing was to occur on or before November 26, 2007. The closing did not occur on November 26, 2007, as THR failed to properly tender adequate closing consideration. The case will proceed and the pre-trial and trial scheduling conference is set for January 5, 2009.

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

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

Triad, and its subsidiary, Quorum Health Resources, Inc. are defendants in a *qui tam* case styled *U.S. ex rel. Whitten vs. Quorum Health Resources, Inc. et al.*, which is pending in the Southern District of Georgia, Brunswick Division. Whitten, a long-term employee of a two hospital system in Brunswick and Camden, Georgia sued both his employer and Quorum Health Resources, Inc. and its predecessors, which had managed the facility from 1989 through September 2000; upon his termination of employment, Whitten signed a release and was paid \$124,000. Whitten's original *qui tam* complaint was filed under seal in November 2002 and the case was unsealed in 2004. Whitten alleges various charging and billing infractions, including charging for routine equipment supplies and services not separately billable, billing for observation services that were not medically necessary or for which there was no physician order, billing labor and delivery patients for durable medical equipment that was not separately billable, inappropriate preparation of patients' histories and physicals, billing for cardiac rehabilitation services without physician supervision, performing outpatient dialysis without Medicare certification, and performing mental health services without the proper staff assignments. In October 2005, the district court granted Quorum's motion for summary judgment on the grounds that his claims were precluded under his severance agreement with the hospital, without reaching two other arguments made by Quorum, which included that a prior settlement agreement between the hospital and the federal government precluded the claims brought by Whitten as well as the doctrine of prior public disclosure. On appeal to the 11th Circuit Court of Appeals, the court reversed the findings of the district court regarding the severance agreement, but remanded the case to the district court for findings on Quorum's other two defenses. Limited discovery has been conducted and renewed motions by Quorum to dismiss the action and to stay further discovery were filed in September 2007. We await the district court's ruling on our motion to dismiss. We continue to believe that the relator's claims are without merit and will continue to vigorously defend this case.

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

continue to vigorously defend it.

**Table of Contents**

On January 14, 2004, Relator Mark E. Thompson filed a Qui Tam Complaint under seal, styled *U.S. ex rel. Mark E. Thompson v. Quorum Health Resources, LLC and Triad Hospitals, Inc.*, which is pending in the United States District Court, Western District of Kentucky, Bowling Green Division. The Complaint alleges Quorum Health Resources, LLC ( Quorum ) and Triad Hospitals, Inc. (collectively, the Defendants ) filed or caused to be filed false claims against the United States of America. Relator was the CEO of Monroe County Medical Center ( MCMC ) in Tompkinsville, Kentucky and served as the CEO of MCMC pursuant to a contractual arrangement between MCMC and Quorum. Plaintiff alleges certain activities of Defendants relating to: (1) MCMC s participation in HealthTrust Purchasing Group, a group purchasing organization (GPO) in which Triad Hospital, Inc. maintained a 20% ownership interest; (2) agreements with strategic service partners (SSPs) acting as vendors of supplies, services and equipment; and (3) encouraging hospitals to employ American Healthcare Facilities Development, LLC (a subsidiary of Quorum) for capital project management services violated the Federal Antikickback Statute. Plaintiff alleges Quorum received certain administrative fees from these arrangements and that Quorum, directly and indirectly, manipulated and/or coerced MCMC to participate in these relationships. The Defendants cooperated with the government s investigation and on May 5, 2008, the United States of America declined to intervene in the case and the complaint was subsequently unsealed by the Court by order dated May 20, 2008. The Defendants have yet to be served with the complaint. The Defendants will vigorously defend these allegations. In 2006, Plaintiff also filed a wrongful discharge case styled, *Mark Thompson v. Quorum Health Resources, LLC and Triad Hospitals, Inc.* in the same court, alleging he was wrongfully suspended and subsequently terminated because of his actions regarding his False Claims Act filing. We are vigorously defending these allegations as well.

**Item 1A. Risk Factors**

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

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

On December 13, 2006, we commenced an open market repurchase program for up to 5,000,000 shares of our common stock not to exceed \$200 million in purchases. This purchase program will conclude at the earlier of three years or when the maximum number of shares have been repurchased. During the period from June 1, 2008 to June 30, 2008, the Company repurchased 305,400 shares at a weighted-average price of \$33.34 per share under this program.

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

**Item 3. Defaults Upon Senior Securities**

None

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

(a) The annual meeting of the stockholders of Community Health Systems, Inc., was held in New York, New York on May 20, 2008, for the purpose of voting on the proposals described below.

(b) Proxies for the meeting were solicited pursuant to Section 14(a) of the Securities and Exchange Act of 1934 and there was no solicitation in opposition to the Governance and Nominating Committee's nominees for directors. All of the Governance and Nominating Committee's nominees for directors were elected as set forth in clause (c) below. In addition, the terms of office as a director of Wayne T. Smith, W. Larry Cash, John A. Clerico, Julia B. North, Harvey Klein, M.D. and H. Mitchell Watson, Jr. continued after the meeting.

(c) Two proposals were submitted to a vote of security holders as follows:

(1) The stockholders approved the election of the following persons as directors of the Company:

<b>Name</b>	<b>For</b>	<b>Withheld</b>	<b>Abstain</b>
John A. Fry	81,112,899	734,059	7,715
William Norris Jennings, M.D.	81,406,293	440,875	7,505

(2) The Board of Directors appointment of Deloitte & Touche, LLP, as the Company's independent accountants for 2008 was ratified by the affirmative votes of stockholders:

<b>For</b>	<b>Against</b>	<b>Abstain</b>
81,606,154	238,672	9,847

**Item 5. Other Information**

None

**Item 6. Exhibits**

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



**Table of Contents**

**SIGNATURES**

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

COMMUNITY HEALTH SYSTEMS, INC.

(Registrant)

By: /s/ Wayne T. Smith

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

By: /s/ W. Larry Cash

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

By: /s/ T. Mark Buford

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

Date: August 1, 2008

**Table of Contents**

**Index to Exhibits**

<b>No.</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.