UNIVERSAL HEALTH SERVICES INC
Form 10-Q
November 08, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from ______ to ______

Commission file number 1-10765

UNIVERSAL HEALTH SERVICES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**23-2077891**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA 19406

(Address of principal executive offices) (Zip Code)

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

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. Common shares outstanding, as of October 31, 2007:

Class A	3,328,404
Class B	50,007,970
Class C	335,800
Class D	23,890

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UNIVERSAL HEALTH SERVICES, INC.

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PART I. FINANCIAL INFORMATION

UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net revenues	$ 1,180,217	$ 1,043,457	$ 3,556,794	$ 3,125,419
Operating charges:				
Salaries, wages and benefits	510,917	459,099	1,520,489	1,336,087
Other operating expenses	265,534	211,875	748,979	708,932
Supplies expense	162,342	146,944	506,946	400,271
Provision for doubtful accounts	110,451	97,901	312,583	260,090
Depreciation and amortization	46,548	40,961	135,417	120,360
Lease and rental expense	17,920	16,184	50,701	48,247
Hurricane related expenses	82	4,172	707	14,432
Hurricane insurance recoveries		(4,172)		(14,432)
	1,113,794	972,964	3,275,822	2,873,987
Income before interest expense, hurricane insurance recoveries in excess of expenses, minority interests and income taxes	66,423	70,493	280,972	251,432
Interest expense, net	12,881	6,140	38,643	23,362
Hurricane insurance recoveries in excess of expenses		(130,328)		(167,359)
Minority interests in earnings of consolidated entities	9,784	14,948	32,651	37,617
Income before income taxes	43,758	179,733	209,678	357,812
Provision for income taxes	14,756	65,704	79,062	132,420
Income from continuing operations	29,002	114,029	130,616	225,392
Loss from discontinued operations, net of income taxes	(148)	(84)	(183)	(104)
Net income	$ 28,854	$ 113,945	$ 130,433	$ 225,288
Basic earnings per share:				
From continuing operations	$ 0.54	$ 2.01	$ 2.44	$ 4.11
From discontinued operations	0.00	0.00	0.00	0.00
Total basic earnings per share	$ 0.54	$ 2.01	$ 2.44	$ 4.11
Diluted earnings per share:				
From continuing operations	$ 0.54	$ 2.00	$ 2.43	$ 3.89
From discontinued operations	0.00	0.00	0.00	0.00
Total diluted earnings per share	$ 0.54	$ 2.00	$ 2.43	$ 3.89

Weighted average number of common shares basic	53,481	56,794	53,491	54,764
Add: Shares for conversion of convertible debentures				4,168
Other share equivalents	148	207	190	227
Weighted average number of common shares and equivalents diluted	53,629	57,001	53,681	59,159

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

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UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollar amounts in thousands)

(unaudited)

	September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 13,574	$ 14,939
Accounts receivable, net	631,527	595,009
Supplies	70,874	64,532
Other current assets	30,172	19,113
Deferred and prepaid income taxes	60,733	34,913
Total current assets	806,880	728,506
Property and equipment	2,971,787	2,665,209
Less: accumulated depreciation	(1,077,280)	(980,124)
	1,894,507	1,685,085
Other assets:		
Goodwill	753,846	719,991
Deferred charges	6,824	7,262
Other	136,871	136,198
	$ 3,598,928	$ 3,277,042
Liabilities and Stockholders Equity		
Current liabilities:		
Current maturities of long-term debt	$ 3,329	$ 1,938
Accounts payable and accrued liabilities	554,582	491,309
Federal and state taxes		9,204
Total current liabilities	557,911	502,451
Other noncurrent liabilities	353,328	340,815
Minority interests	203,412	174,061
Long-term debt	900,628	821,363
Deferred income taxes	48,810	35,888
Commitments and contingencies		
Common stockholders' equity	1,534,839	1,402,464
	$ 3,598,928	$ 3,277,042

See accompanying notes to these condensed consolidated financial statements.

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UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

(unaudited)

	Nine Months Ended September 30, 2007	2006
Cash Flows from Operating Activities:		
Net income	$ 130,433	$ 225,288
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation & amortization	135,417	120,360
Accretion of discount on convertible debentures		6,364
Gain on sale of assets	(2,200)	
Hurricane insurance recoveries		(137,862)
Hurricane related expenses		4,894
Changes in assets & liabilities, net of effects from acquisitions and dispositions:		
Accounts receivable	(17,359)	(85,132)
Accrued interest	9,055	7,519
Accrued and deferred income taxes	(6,374)	36,745
Other working capital accounts	47,558	8,157
Other assets and deferred charges	37	6,943
Other	4,923	11,413
Minority interest in earnings of consolidated entities, net of distributions	9,041	15,223
Accrued insurance expense, net of commercial premiums paid	45,275	61,378
Payments made in settlement of self-insurance claims	(33,025)	(31,270)
Net cash provided by operating activities	322,781	250,020
Cash Flows from Investing Activities:		
Property and equipment additions, net of disposals	(263,366)	(233,008)
Acquisition of property and businesses	(103,159)	(45,654)
Hurricane insurance recoveries received		144,571
Proceeds received from sales of assets	5,268	
Purchase of minority ownership interest in majority owned business	(14,762)	
Net cash used in investing activities	(376,019)	(134,091)
Cash Flows from Financing Activities:		
Reduction of long-term debt	(103,846)	(141,804)
Additional borrowings	170,000	248,645
Issuance of common stock	1,041	4,205
Repurchase of common shares	(14,386)	(220,343)
Dividends paid	(12,917)	(13,090)
Financing costs	(148)	(2,020)
Net cash received for termination of derivatives		3,393
Capital contributions from minority member	12,129	11,939
Net cash provided by (used in) financing activities	51,873	(109,075)
(Decrease) Increase in cash and cash equivalents	(1,365)	6,854

Cash and cash equivalents, beginning of period	14,939	7,963
Cash and cash equivalents, end of period	$ 13,574	$ 14,817
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 35,991	$ 18,073
Income taxes paid, net of refunds	$ 83,894	$ 95,412

See accompanying notes to these condensed consolidated financial statements.

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UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) General

This Report on Form 10-Q is for the Quarterly period ended September 30, 2007. In this Quarterly Report, we, us, our and the Company refer t Universal Health Services, Inc. and its subsidiaries.

You should carefully review the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, expects, plans, anticipates, believes, estimates, potential, or continue or the negative of those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks related to healthcare industry trends and those detailed in our filings with the Securities and Exchange Commission including those set forth in our Annual Report on Form 10-K for the year ended December 31, 2006 in Item 1A-Risk Factors and in Item 7-Forward Looking Statements and Risk Factors. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

The condensed consolidated financial statements include the accounts of our majority-owned subsidiaries and partnerships and limited liability companies controlled by us, or our subsidiaries, as managing general partner or managing member. The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. The balance sheet at December 31, 2006 has been derived from the audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements, significant accounting policies and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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

Relationship with Universal Health Realty Income Trust:

At September 30, 2007, we held approximately 6.7% of the outstanding shares of Universal Health Realty Income Trust (the Trust). We serve as Advisor to the Trust under an annually renewable advisory agreement pursuant to the terms of which, we conduct the Trust s day-to-day affairs, provide administrative services and present investment opportunities. In addition, certain of our officers and directors are also officers and/or directors of the Trust. Management believes that it has the ability to exercise significant influence over the Trust, therefore we account for our investment in the Trust using the equity method of accounting. We earned an advisory fee from the Trust, which is included in net revenues in the accompanying condensed consolidated statements of income, of approximately $355,000 and $364,000 during the three month periods ended September 30, 2007 and 2006, respectively, and approximately $1.1 million during each of the nine month periods ended September 30, 2007 and 2006. Our pre-tax share of income from the Trust was $299,000 and $1.3 million during the three month periods ended September 30, 2007 and 2006, respectively, and $1.2 million and $2.1 million during the nine month periods ended September 30, 2007 and 2006, respectively. The carrying value of this investment was $10.0 million at September 30, 2007 and $10.2 million at December 31, 2006, and is included in other assets in the accompanying condensed consolidated balance sheets. The market value of this investment was $28.0 million at September 30, 2007 and $30.7 million at December 31, 2006.

Total rent expense under the operating leases on the hospital facilities with the Trust was $3.9 million during each of the three month periods ended September 30, 2007 and 2006 and $12.0 million and $11.9 million during the nine month periods ended September 30, 2007 and 2006, respectively. In addition, certain of our subsidiaries are tenants in several medical office buildings owned by limited liability companies in which the Trust holds non-controlling ownership interests.

The Trust commenced operations in 1986 by purchasing certain properties from us and immediately leasing the properties back to our respective subsidiaries. Most of the leases were entered into at the time the Trust commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. Each lease also provided for additional or bonus rental, as discussed below. In 1998, the lease for

McAllen Medical Center was amended to provide that the last two renewal terms would also be fixed at the initial agreed upon rental. This lease amendment was in connection with certain concessions granted by us with respect to the renewal of other leases. The base rents are paid monthly and the bonus rents are computed and paid on a quarterly basis, based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. The leases with our subsidiaries are unconditionally guaranteed by us and are cross-defaulted with one another.

Pursuant to the terms of the leases with the Trust, we have the option to renew the leases at the lease terms described above by providing notice to the Trust at least 90 days prior to the termination of the then current term. In addition, we have rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer. We also have the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, during 2006, as part of the overall exchange and substitution transaction relating to Chalmette Medical Center, which was completed during the third quarter of 2006, as well as the early five year lease renewals on Southwest Healthcare System-Inland Valley Campus (Inland Valley), Wellington Regional Medical Center, McAllen Medical Center and The Bridgeway, the Trust agreed to amend the Master Lease to include a change of control provision. The change of control provision grants us the right, upon one month s notice should a change of control of the Trust occur, to purchase any or all of the four leased hospital properties at their appraised fair market value purchase price.

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

Hospital Name	Type of Facility	Annual Minimum Rent	End of Lease Term	Renewal Term (years)
McAllen Medical Center	Acute Care	$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	$ 2,597,000(d)	December, 2011	20(b)
The Bridgeway	Behavioral Health	$ 930,000	December, 2014	10(c)

(a) We have four 5-year renewal options at existing lease rates (through 2031).

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

(c) We have two 5-year renewal options at fair market value lease rates (2015 through 2024).

(d) Excludes incremental rent on the additional real property assets in excess of $11.0 million, being constructed at Inland Valley that were transferred to the Trust as part of the asset exchange and substitution transaction completed during the third quarter of 2006.

Other Related Party Transactions:

Our Chairman of the Board of Directors and Chief Executive Officer (CEO) is a member of the Board of Directors of Broadlane, Inc. (Broadlane). Broadlane provides contracting and other supply chain services to us and various other healthcare organizations. Our contract with Broadlane is scheduled to expire on December 31, 2007. In addition, we along with certain of our Board of Directors and members of our executive management team, own approximately 6% of the outstanding shares of Broadlane. The carrying value of our investment in Broadlane is approximately $12 million as of September 30, 2007.

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

We invested $3.3 million for a 25% ownership interest in an information technology company that provides laboratory information system and order management technology to many of our acute care hospitals. We also committed to pay this company a license fee which has a remaining commitment of $4.5 million as of September 30, 2007.

(3) Other Noncurrent and Minority Interest Liabilities

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

As of September 30, 2007 and December 31, 2006, the minority interest liability of $203.4 million and $174.1 million, respectively, consists primarily of: (i) an outside ownership interest of approximately 28% in four acute care facilities located in Las Vegas, Nevada that are in operation and a fifth that is currently under construction and expected to be completed and opened in early 2008; (ii) a 20% outside ownership in an acute care facility located in Washington D.C., and; (iii) an outside ownership interest of approximately 10% in an acute care facility located in Laredo, Texas.

In connection with the five acute care facilities located in Las Vegas, Nevada, the outside owners have certain put rights that may require the respective limited liabilities companies (LLCs) to purchase the minority member s interests upon the occurrence of: (i) certain specified financial conditions falling below established thresholds; (ii) breach of the management contract by the managing member (a subsidiary of ours), or; (iii) if the minority member s ownership percentage is reduced to less than certain thresholds.

(4) Long-term debt

We have an $800 million, unsecured non-amortizing revolving credit agreement, as amended, (Credit Agreement) which is scheduled to expire on July 28, 2011. In April, 2007, the Credit Agreement was amended to increase commitments from $650 million to $800 million. The Credit Agreement includes a $100 million sub-limit for letters of credit. The interest rate on the borrowings is determined, at our option, as either: (i) the one, two, three or six month London Inter-Bank Offer Rate (LIBOR) plus a spread of 0.33% to 0.575%; (ii) at the higher of the Agent s prime rate or the federal funds rate plus 0.50%, or; (iii) a competitive bid rate. A facility fee ranging from 0.07% to 0.175% is required on the total commitment. The applicable margins over LIBOR and the facility fee are based upon our credit ratings from Standard & Poor s Ratings Services and Moody s Investors Service, Inc. At September 30, 2007, the applicable margin over the LIBOR rate was .50% and the commitment fee was .125%**.** There are no compensating balance requirements. As of September 30, 2007, we had $253 million of borrowings outstanding under our revolving credit agreement and $47 million of outstanding letters of credit. As of September 30, 2007, we had $500 million of available borrowing capacity pursuant to the terms of our Credit Agreement.

In August of 2007, we entered into a $200 million accounts receivable securitization program (Securitization) with a group of conduit lenders and liquidity banks. The patient accounts receivable for substantially all of our acute care hospitals serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of .25%. The initial term of this Securitization is 364 days and the term can be extended for incremental 364 day periods upon mutual agreement of the parties. The Securitization has a term-out feature that can be exercised by us if the banks do not extend the Securitization which would extend the maturity date to June 30, 2010. Under the terms of the term-out provision, the borrowing rate would be the same as our Credit Agreement rate. Outstanding borrowings which can be refinanced through available borrowings under the terms of our Credit Agreement are classified as long-term on our condensed consolidated balance sheet. As of September 30, 2007, there were $170 million of borrowings outstanding pursuant to this program.

On June 30, 2006, we issued $250 million of senior notes (the Notes) which have a 7.125% coupon rate and mature on June 30, 2016. Interest on the Notes is payable semiannually in arrears on June 30 and December 30 of each year.

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

(5) Commitments and Contingencies

Professional and General Liability Claims and Property Insurance

As of September 30, 2007, the total accrual for our professional and general liability claims was $259 million ($257 million net of expected recoveries), of which $32 million is included in current liabilities. As of December 31, 2006, the total accrual for our professional and general liability claims was $248 million ($245 million net of expected recoveries), of which $32 million is included in current liabilities. Included in other assets was $2 million as of September 30, 2007 and $3 million as of December 31, 2006, related to estimated expected recoveries from various state guaranty funds in connection with professional and general liability claims payments related to a former commercial insurer which was placed in receivership during 2002. During the second quarter of 2007, based upon the results of a third-party actuarial analysis, we recorded an $18 million reduction to our prior year reserves for professional and general liability self-insured claims. This favorable change in our estimated future claims payments was partially due to the favorable impact of medical malpractice tort reform experienced in several states in which we operate as well as a decrease in obstetrical-related claims due to a company-wide patient safety initiative in this high-risk specialty.

Effective April 1, 2007, we have commercial property insurance policies covering catastrophic losses resulting from windstorm damage up to $100 million per occurrence. Losses resulting from non-named windstorms are subject to a $250,000 deductible. Losses resulting from named windstorms are subject to a 5% deductible based upon the declared value of the property. In addition, we have commercial property insurance policies covering catastrophic losses resulting from earthquake and flood damage, each subject to annual aggregate limitations of $100 million. Earthquake losses are subject to a $250,000 deductible for our facilities located in all states except California, Alaska and Puerto Rico. Earthquake losses sustained at facilities located in California, Alaska and Puerto Rico are subject to a 5% deductible based upon the declared value of the property. Flood losses have a $250,000 deductible except in FEMA designated flood zones A and V (which are located in certain sections of Florida, Oklahoma and Texas) in which case the losses are subject to a $500,000 deductible. Due to a sharp increase in property losses experienced nationwide in recent years, the cost of commercial property insurance

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has increased significantly. As a result, catastrophic coverage for earthquake and flood has been limited to annual aggregate losses (as opposed to per occurrence losses). Given these insurance market conditions, there can be no assurance that a continuation of these unfavorable trends, or a sharp increase in uninsured property losses sustained by us, will not have a material adverse effect on our future results of operations.

As of September 30, 2007, we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds. Our outstanding letters of credit and surety bonds as of September 30, 2007 totaled $79 million consisting of: (i) $74 million related to our self-insurance programs; (ii) $4 million consisting primarily of collateral for outstanding bonds of an unaffiliated third-party and public utility, and; (iii) $1 million of debt guarantees related to entities in which we own a minority interest.

We have a long-term contract with a third party that expires in 2012, to provide certain data processing services for our acute care and behavioral health facilities.

Legal Proceedings

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

Investigation of South Texas Health System affiliates:

We and our South Texas Health System affiliates, which operate McAllen Medical Center, McAllen Heart Hospital, Edinburg Regional Medical Center and certain other affiliates, were served with a subpoena dated November 21, 2005, issued by the Office of Inspector General of the Department of Health and Human Services (OIG). At that time, the Civil Division of the U.S. Attorney s office in Houston, Texas indicated that the subpoena was part of an investigation under the False Claims Act of compliance with Medicare and Medicaid rules and regulations pertaining to the employment of physicians and the solicitation of patient referrals from physicians from January 1, 1999 to the date of the subpoena related to the South Texas Health System. On March 9, 2007, an additional subpoena was served upon us by the OIG requesting documents concerning the Medicare cost reports for the South Texas Health System affiliates. On February 16, 2007, our South Texas Health System affiliates were served with a search warrant in connection with what we have been advised is a related criminal Grand Jury investigation concerning the production of documents. At that time, the government obtained various documents and other property related to the facilities. Follow-up Grand Jury subpoenas for documents and witnesses and other requests for information were subsequently served on South Texas Health System facilities and certain employees.

Over the last several weeks, at our request, our legal representatives have met with representatives of the civil and criminal divisions of the United States Attorney s Office for the Southern District of Texas to discuss the status of these matters. Our representatives have been advised that the government is continuing its investigations. We believe that, based on those discussions and its investigations to date, the government is focused on certain arrangements entered into by the South Texas Health System affiliates which the government believes may have violated Medicare and Medicaid rules and regulations pertaining to payments to physicians and the solicitation of patient referrals from physicians and other matters relating to payments to various individuals which may have constituted improper or illegal payments. We believe that the government is also focusing its investigation to determine whether the South Texas Health System affiliates and certain individuals illegally failed to fully comply with the original OIG subpoena. We are in the process of investigating these matters and are cooperating with the investigations and intend to respond to the matters raised with us. We are unable to evaluate the existence or extent of any potential financial exposure in connection with this matter at this time.

We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, no assurance can be given that we will not be subjected to further inquiries or actions, or that we will not be faced with sanctions, fines or penalties in connection with the investigation of our South Texas Health System affiliates. Even if we were to ultimately prevail, the government s inquiry and/or action in connection with this matter could have a material adverse effect on our future operating results.

Lasko-Hoellinger, et al, v. UHS of Delaware, Inc. et al, and other related matter:

On November 1, 2005, our management company and several of our facilities located in California, including Inland Valley Medical Center, Rancho Springs Medical Center, Del Amo Hospital and Corona Regional Medical Center (Hospitals) were named as defendants in a wage and hour lawsuit filed in Los Angeles Superior Court under the caption *Lasko-Hoellinger, et al v. UHS of Delaware, Inc., et al.* Del Amo Hospital was subsequently dismissed from the case. While two of the four original plaintiffs in that case voluntarily requested that they be dismissed as plaintiffs from that lawsuit, the remaining two

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plaintiffs sought to have the matter certified as a class action. The remaining plaintiffs alleged, among other things, that they were entitled to recover damages from the Hospitals for missed breaks and other alleged violations of various California Labor Code sections and applicable wage orders for a period of at least one year prior to the filing of the case. During 2006, we recorded an estimated $10 million pre-tax provision in connection with this and another related matter ($2 million during the first quarter of 2006 and $8 million during the fourth quarter of 2006). During the third quarter of 2007, this case and the related matter were settled for a combined total of $10.4 million.

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from government for previously billed patient services. Although we believe our policies, procedures and practices comply with governmental regulations, no assurance can be given that we will not be subjected to governmental inquiries or actions. Even if we were to ultimately prevail, the government s inquiries and/or actions could have a material adverse effect on our future operating results.

(6) Segment Reporting

Our reportable operating segments consist of acute care hospital services and behavioral health care services. The Other segment column below includes centralized services including information services, purchasing, reimbursement, accounting, taxation, legal, advertising, design and construction, and patient accounting as well as the operating results for our other operating entities including outpatient surgery and radiation centers. The chief operating decision making group for our acute care hospital services and behavioral health care services is comprised of the President and Chief Executive Officer, and the lead executives of each operating segment. The lead executives for each operating segment also manage the profitability of each respective segment s various facilities. The operating segments are managed separately because each operating segment represents a business unit that offers different types of healthcare services or operates in different healthcare environments. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2006.

	Three Months ended September 30, 2007			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Dollar amounts in thousands)			
Gross inpatient revenues	$ 2,095,327	$ 452,223		$ 2,547,550
Gross outpatient revenues	$ 900,787	$ 54,470	$ 20,648	$ 975,905
Total net revenues	$ 863,206	$ 285,013	$ 31,998	$ 1,180,217
Income/(loss) before income taxes	$ 37,040	$ 50,670	$ (43,952)	$ 43,758
Total assets as of 9/30/07	$ 2,333,690	$ 935,194	$ 330,044	$ 3,598,928
Licensed beds	5,417	7,485		12,902
Available beds	5,110	7,453		12,563
Patient days	290,968	506,466		797,434
Admissions	64,817	30,156		94,973
Average length of stay	4.5	16.8		8.4

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	Nine Months ended September 30, 2007			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Dollar amounts in thousands)			
Gross inpatient revenues	$ 6,458,535	$ 1,339,098		$ 7,797,633
Gross outpatient revenues	$ 2,666,277	$ 173,558	$ 60,965	$ 2,900,800
Total net revenues	$ 2,609,743	$ 847,578	$ 99,473	$ 3,556,794
Income/(loss) before income taxes	$ 177,773	$ 163,003	$ (131,098)	$ 209,678
Total assets as of 9/30/07	$ 2,333,690	$ 935,194	$ 330,044	$ 3,598,928
Licensed beds	5,417	7,269		12,686
Available beds	5,110	7,229		12,339
Patient days	886,844	1,489,301		2,376,145
Admissions	197,722	89,182		286,904
Average length of stay	4.5	16.7		8.3

	Three Months ended September 30, 2006			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Dollar amounts in thousands)			
Gross inpatient revenues	$ 1,813,162	$ 416,515		$ 2,229,677
Gross outpatient revenues	$ 717,752	$ 47,809	$ 21,906	$ 787,467
Total net revenues	$ 777,632	$ 254,170	$ 11,655	$ 1,043,457
Income/(loss) before income taxes	$ 171,694	$ 47,475	$ (39,436)	$ 179,733
Total assets as of 9/30/06	$ 2,126,231	$ 765,102	$ 257,694	$ 3,149,027
Licensed beds	5,139	6,640		11,779
Available beds	4,858	6,582		11,440
Patient days	268,537	467,860		736,397
Admissions	60,656	28,100		88,756
Average length of stay	4.4	16.6		8.3

	Nine Months ended September 30, 2006			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Dollar amounts in thousands)			
Gross inpatient revenues	$ 5,607,700	$ 1,244,739		$ 6,852,439
Gross outpatient revenues	$ 2,147,156	$ 154,605	$ 63,571	$ 2,365,332
Total net revenues	$ 2,323,560	$ 767,416	$ 34,443	$ 3,125,419
Income/(loss) before income taxes	$ 322,820	$ 152,577	$ (117,585)	$ 357,812
Total assets as of 9/30/06	$ 2,126,231	$ 765,102	$ 257,694	$ 3,149,027
Licensed beds	5,047	6,492		11,539
Available beds	4,756	6,434		11,190
Patient days	819,711	1,386,299		2,206,010
Admissions	184,374	84,100		268,474
Average length of stay	4.4	16.5		8.2

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

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

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	(amounts in thousands)			
	2007	2006	2007	2006
Basic:				
Income from continuing operations	$ 29,002	$ 114,029	$ 130,616	$ 225,392
Less: Dividends on unvested restricted stock, net of taxes	(18)	(20)	(62)	(63)
Income from continuing operations basic	$ 28,984	$ 114,009	$ 130,554	$ 225,329
Loss from discontinued operations	(148)	(84)	(183)	(104)
Net income basic	$ 28,836	$ 113,925	$ 130,371	$ 225,225
Diluted:				
Income from continuing operations	$ 29,002	$ 114,029	$ 130,616	$ 225,392
Less: Dividends on unvested restricted stock, net of taxes	(18)	(20)	(62)	(63)
Add: Debenture interest, net of taxes				4,902
Income from continuing operations diluted	$ 28,984	$ 114,009	$ 130,554	$ 230,231
Loss from discontinued operations	(148)	(84)	(183)	(104)
Net income diluted	$ 28,836	$ 113,925	$ 130,371	$ 230,127
Weighted average number of common shares	53,481			