

UNIVERSAL HEALTH SERVICES INC

Form 10-Q

November 08, 2012

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

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended September 30, 2012

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)

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

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

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

**KING OF PRUSSIA, PENNSYLVANIA 19406**

(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding, as of October 31, 2012:

Class A	6,625,708
Class B	89,884,317
Class C	664,000
Class D	31,948

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In this Report on Form 10-Q for the quarterly period ended September 30, 2012, we, us, our and the Company refer to Universal Health Services, Inc. and its subsidiaries. UHS is a registered trademark of UHS of Delaware, Inc., the management company for, and a wholly-owned subsidiary of Universal Health Services, Inc. Universal Health Services, Inc. is a holding company and operates through its subsidiaries including its management company, UHS of Delaware, Inc. All healthcare and management operations are conducted by subsidiaries of Universal Health Services, Inc. To the extent any reference to UHS or UHS facilities in this report including letters, narratives or other forms contained herein relates to our healthcare or management operations it is referring to Universal Health Services, Inc.'s subsidiaries including UHS of Delaware, Inc. Further, the terms we, us, our or the Company in such context similarly refer to the operations of Universal Health Services Inc.'s subsidiaries including UHS of Delaware, Inc. Any reference to employees or employment contained herein refers to employment with or employees of the subsidiaries of Universal Health Services, Inc. including UHS of Delaware, Inc.

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

(amounts in thousands, except per share amounts)

(unaudited)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net revenues before provision for doubtful accounts	\$ 1,869,263	\$ 1,814,686	\$ 5,718,676	\$ 5,553,268
Less: Provision for doubtful accounts	188,910	152,011	522,203	456,042
<b>Net revenues</b>	<b>1,680,353</b>	<b>1,662,675</b>	<b>5,196,473</b>	<b>5,097,226</b>
Operating charges:				
Salaries, wages and benefits	838,075	828,606	2,565,052	2,492,570
Other operating expenses	362,687	343,873	1,059,048	1,030,492
Supplies expense	191,747	198,794	594,924	603,657
EHR incentive income	(10,551)		(12,506)	
Depreciation and amortization	77,032	73,170	221,807	213,828
Lease and rental expense	23,481	22,704	70,906	68,501
Costs related to extinguishment of debt	29,170		29,170	
	1,511,641	1,467,147	4,528,401	4,409,048
<b>Income from operations</b>	<b>168,712</b>	<b>195,528</b>	<b>668,072</b>	<b>688,178</b>
Interest expense, net	45,207	48,452	137,805	154,677
<b>Income before income taxes</b>	<b>123,505</b>	<b>147,076</b>	<b>530,267</b>	<b>533,501</b>
Provision for income taxes	42,132	52,234	188,880	192,638
<b>Net income</b>	<b>81,373</b>	<b>94,842</b>	<b>341,387</b>	<b>340,863</b>
Less: Income attributable to noncontrolling interests	9,556	9,788	33,402	37,967
<b>Net income attributable to UHS</b>	<b>\$ 71,817</b>	<b>\$ 85,054</b>	<b>\$ 307,985</b>	<b>\$ 302,896</b>
Basic earnings per share attributable to UHS	\$ 0.74	\$ 0.87	\$ 3.18	\$ 3.10
Diluted earnings per share attributable to UHS	\$ 0.73	\$ 0.86	\$ 3.15	\$ 3.06
Weighted average number of common shares - basic	96,817	97,397	96,701	97,447
Add: Other share equivalents	794	1,201	1,010	1,461
Weighted average number of common shares and equivalents - diluted	97,611	98,598	97,711	98,908

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



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

(amounts in thousands, unaudited)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net income	\$ 81,373	\$ 94,842	\$ 341,387	\$ 340,863
Other comprehensive income (loss):				
Unrealized derivative gains (losses) on cash flow hedges	(45)	(21,360)	1,782	(39,636)
Amortization of terminated hedge	(84)	(84)	(252)	(252)
Other comprehensive income (loss) before tax	(129)	(21,444)	1,530	(39,888)
Income tax (benefit) expense related to items of other comprehensive income	(47)	(8,214)	585	(15,270)
Total other comprehensive income (loss), net of tax	(82)	(13,230)	945	(24,618)
Comprehensive income	81,291	81,612	342,332	316,245
Less: Comprehensive income attributable to noncontrolling interests	9,556	9,788	33,402	37,967
Comprehensive income attributable to UHS	\$ 71,735	\$ 71,824	\$ 308,930	\$ 278,278

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

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

(amounts in thousands, unaudited)

	September 30, 2012	December 31, 2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 25,652	\$ 41,229
Accounts receivable, net	1,042,535	969,802
Supplies	97,013	96,775
Other current assets	93,022	99,859
Deferred income taxes	123,131	108,324
Current assets held for sale	107,071	48,916
<b>Total current assets</b>	<b>1,488,424</b>	<b>1,364,905</b>
Property and equipment	5,240,909	5,106,160
Less: accumulated depreciation	(1,924,833)	(1,818,180)
	3,316,076	3,287,980
Other assets:		
Goodwill	2,594,740	2,627,602
Deferred charges	87,092	111,780
Other	294,734	272,978
	<b>\$ 7,781,066</b>	<b>\$ 7,665,245</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 2,499	\$ 2,479
Accounts payable and accrued liabilities	810,963	832,125
Current liabilities held for sale	18,112	2,329
Federal and state taxes	6,774	0
<b>Total current liabilities</b>	<b>838,348</b>	<b>836,933</b>
Other noncurrent liabilities	408,535	401,908
Long-term debt	3,440,962	3,651,428
Deferred income taxes	195,692	209,592
Redeemable noncontrolling interests	234,056	218,266
UHS common stockholders' equity	2,608,782	2,296,352
Noncontrolling interest	54,691	50,766
<b>Total equity</b>	<b>2,663,473</b>	<b>2,347,118</b>
	<b>\$ 7,781,066</b>	<b>\$ 7,665,245</b>

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





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

(amounts in thousands, unaudited)

	Nine months ended September 30,	
	2012	2011
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 341,387	\$ 340,863
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation & amortization	227,641	220,208
(Gain) loss on sale of assets	(945)	164
Stock-based compensation expense	16,189	13,434
Costs related to extinguishment of debt	29,170	
<i>Changes in assets &amp; liabilities, net of effects from acquisitions and dispositions:</i>		
Accounts receivable	(86,821)	(103,700)
Accrued interest	11,901	13,143
Accrued and deferred income taxes	(260)	102,949
Other working capital accounts	(42,916)	(74,342)
Other assets and deferred charges	25,959	20,215
Other	5,833	4,146
Accrued insurance expense, net of commercial premiums paid	66,752	71,186
Payments made in settlement of self-insurance claims	(58,884)	(45,764)
Net cash provided by operating activities	535,006	562,502
<b>Cash Flows from Investing Activities:</b>		
Property and equipment additions, net of disposals	(282,191)	(195,404)
Proceeds received from sale of assets and businesses	56,194	23,682
Acquisition of property and businesses	(25,092)	(8,599)
Costs incurred for purchase and implementation of electronic health records application	(41,854)	(27,874)
Return of deposit on terminated purchase agreement	6,500	
Net cash used in investing activities	(286,443)	(208,195)
<b>Cash Flows from Financing Activities:</b>		
Reduction of long-term debt	(1,127,829)	(267,539)
Additional borrowings	906,000	36,000
Financing costs	(8,257)	(23,559)
Repurchase of common shares	(9,676)	(44,532)
Dividends paid	(14,519)	(14,638)
Issuance of common stock	3,828	3,596
Profit distributions to noncontrolling interests	(13,687)	(33,962)
Net cash used in financing activities	(264,140)	(344,634)
(Decrease) increase in cash and cash equivalents	(15,577)	9,673
Cash and cash equivalents, beginning of period	41,229	29,474
Cash and cash equivalents, end of period	\$ 25,652	\$ 39,147

**Supplemental Disclosures of Cash Flow Information:**

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Interest paid	\$ 104,560	\$ 120,712
Income taxes paid, net of refunds	\$ 187,899	\$ 89,268

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

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(1) General**

This Quarterly Report on Form 10-Q is for the quarterly period ended September 30, 2012. In this Quarterly Report, we, us, our and the Company refer to Universal Health Services, Inc. and its subsidiaries.

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 ( SEC ) and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly state results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should 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, 2011.

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

At September 30, 2012, we held approximately 6.2% 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 \$540,000 and \$525,000 during the three-month periods ended September 30, 2012 and 2011, respectively and \$1.6 million and \$1.5 million during the nine-month periods ended September 30, 2012 and 2011, respectively. Our pre-tax share of income from the Trust was \$31,000 and \$133,000 for the three-month periods ended September 30, 2012 and 2011, respectively, and \$922,000 and \$693,000 for the nine-month periods ended September 30, 2012 and 2011, respectively. The carrying value of this investment was \$9.5 million and \$10.0 million at September 30, 2012 and December 31, 2011, respectively, and is included in other assets in the accompanying condensed consolidated balance sheets. The market value of this investment, based on the closing price of the Trust's stock on the respective dates, was \$36.2 million at September 30, 2012 and \$30.7 million at December 31, 2011.

Total rent expense under the operating leases on the hospital facilities with the Trust was \$4.1 million during each of the three-month periods ended September 30, 2012 and 2011, respectively, and \$12.2 million and \$12.4 million for the nine-month periods ended September 30, 2012 and 2011, respectively. In addition, certain of our subsidiaries are tenants in several medical office buildings owned by limited liability companies in which the Trust holds either 100% ownership interests or non-controlling majority ownership interests.

The table below details the renewal options and terms for each of our four hospital facilities leased from the Trust, giving effect to the above-mentioned renewals:

Hospital Name	Type of Facility	Annual Minimum Rent	End of Lease Term	Renewal Term (years)
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2016	15(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2016	15(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,648,000	December, 2016	15(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

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

### ***Other Related Party Transactions:***

In December, 2010, our Board of Directors approved the Company's entering into supplemental life insurance plans and agreements on the lives of our chief executive officer and his wife. As a result of these agreements, based on actuarial tables and other assumptions, during the life expectancies of the insureds, we would pay approximately \$25 million in premiums and certain trusts, owned by our chief executive officer, would pay approximately \$8 million in premiums. Based on the projected premiums mentioned above, and assuming the policies remain in effect until the death of the insureds, we will be entitled to receive death benefit proceeds of no less than \$33 million representing the \$25 million of aggregate premiums paid by us as well as the \$8 million of aggregate premiums paid by the trusts. These agreements did not have a material effect on our consolidated financial statements or results of operations during 2011 or the first nine months of 2012.

In connection with the commencement of Marvin G. Pember's employment with us in August, 2011 as Senior Vice President and President of our Acute Care division, we agreed to purchase his former personal residence located in Indiana if it remained unsold to a third-party for longer than 180 days after commencement of his employment. Since the property remained unsold, the purchase occurred in June, 2012 for approximately \$1 million which represents the fair-market value as derived by third-party appraisals. We are actively marketing the property for sale to a third-party buyer.

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

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

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

Outside owners hold noncontrolling, minority ownership interests of: (i) approximately 28% in our five acute care facilities located in Las Vegas, Nevada; (ii) 20% in an acute care facility located in Washington, D.C.; (iii) approximately 11% in an acute care facility located in Laredo, Texas, and; (iv) 20% in a behavioral health care facility located in Philadelphia, Pennsylvania. The redeemable noncontrolling interest balances of \$234 million and \$218 million as of September 30, 2012 and December 31, 2011, respectively, and the noncontrolling interest balances of \$55 million and \$51 million at September 30, 2012 and December 31, 2011, respectively, consist primarily of the third-party ownership interests in these hospitals.

In connection with the five acute care facilities located in Las Vegas, Nevada, the minority ownership interests of which are reflected as redeemable noncontrolling interests on our Consolidated Balance Sheet, the outside owners have certain put rights, that are currently exercisable, that if exercised, require us to purchase the minority member's interests at fair market value. The put rights are exercisable upon the occurrence of: (i) certain specified financial conditions falling below established thresholds; (ii) breach of the management contract by the managing member (a subsidiary of ours), or; (iii) if the minority member's ownership percentage is reduced to less than certain thresholds. In connection with the behavioral health care facility located in Philadelphia, Pennsylvania, the minority ownership interest of which is also reflected as redeemable noncontrolling interests on our Consolidated Balance Sheet, the outside owner has a put option to put its entire ownership interest to us at any time. If exercised, the put option requires us to purchase the minority member's interest at fair market value. As of September 30, 2012, we believe the fair market value of the minority ownership interests in these facilities approximates the book value of the redeemable noncontrolling interests.

**(4) Long-term debt and cash flow hedges***Debt:*

On September 21, 2012, we entered into a second amendment to our credit agreement, dated as of November 15, 2010, as amended on March 15, 2011, with several banks and other financial institutions ( Credit Agreement ). The second amendment, which was effective on September 21, 2012, provides for a new \$900 million Term Loan-A ( Term Loan A2 ) with a final maturity date of August 15, 2016 and extended the maturity date on approximately \$777 million of our existing \$800 million revolving credit facility, and \$943 million of our existing Term Loan-A facility, by nine months to mature on August 15, 2016. Approximately \$23 million of our revolving credit facility commitment and \$45 million of our existing Term Loan-A was not extended and is scheduled to mature on November 15, 2015. The second amendment also provides for increased flexibility for refinancing and certain other modifications but substantially all other terms of the Credit Agreement, dated as of November 15, 2010 and as previously amended in March, 2011, including interest rates, remain unchanged.

On September 21, 2012, we used \$700 million of the proceeds from the new Term Loan-A2 to extinguish a portion of our higher priced, existing Term Loan-B facility. Current pricing under the new Term Loan-A2 is 100 basis points lower than the Term Loan-B facility and does not include a LIBOR floor whereas the Term Loan-B facility has a 1% LIBOR floor. The remainder of the new Term Loan-A2 was used to pay transaction related fees and expenses and to repay other floating rate debt. During the third quarter of 2012, in connection with the extinguishment of a portion of our Term Loan-B facility, we recorded a pre-tax charge of \$29 million to write-off the related portion of the Term Loan-B deferred financing costs.

The Credit Agreement, as amended on September 21, 2012, is a senior secured facility which provides for an aggregate commitment amount of \$3.43 billion, comprised of a \$800 million revolving credit facility, a \$988 million Term Loan-A facility, a \$746 million Term Loan-B facility and a \$900 million Term Loan-A2 facility. The revolving credit facility includes a \$125 million sub-limit for letters of credit. The Credit Agreement is secured by substantially all of the assets of the Company and our material subsidiaries and guaranteed by our material subsidiaries.

Borrowings under the Credit Agreement bear interest at the ABR rate which is defined as the rate per annum equal to, at our election (1) the greatest of (a) the lender's prime rate, (b) the weighted average of the federal funds rate, plus 0.5% and (c) one month Eurodollar rate plus 1%, in each case, plus an applicable margin based upon our consolidated leverage ratio at the end of each quarter ranging from 0.50% to 1.25% for revolving credit and Term Loan-A borrowings and 1.75% to 2.00% for Term Loan B borrowings or (2) the one, two, three or six month

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Eurodollar rate (at our election), plus an applicable margin based upon our consolidated leverage ratio at the end of each quarter ranging from 1.50% to 2.25% for revolving credit and Term Loan-A borrowings and ranging from 2.75% to 3.00% for Term Loan-B borrowings. The current applicable margins are 0.75% for ABR-based loans, 1.75% for Eurodollar-based loans under the revolving credit and Term Loan-A and Term Loan-A2 facilities and 2.75% under the Term Loan-B facility. The minimum Eurodollar rate for the Term Loan-B facility is 1.00%.

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As of September 30, 2012, we had \$678 million of available borrowing capacity pursuant to the terms of our \$800 million revolving credit facility, net of \$59 million of outstanding borrowings (including borrowings outstanding pursuant to a short-term, on-demand credit facility) and \$63 million of outstanding letters of credit. As of September 30, 2012, we had \$15 million of outstanding borrowings under a short-term, on-demand credit facility. Outstanding borrowings pursuant to this facility are classified as long-term debt on our Consolidated Balance Sheet since we have the intent and ability to refinance through available borrowings under the terms of our Credit Agreement.

In October, 2010, we amended our accounts receivable securitization program ( *Securitization* ) with a group of conduit lenders and liquidity banks. We increased the size of the *Securitization* to \$240 million (the *Commitments* ), from \$200 million, and extended the maturity date to October 25, 2013. In May, 2012, we further increased the size of the securitization by \$35 million to \$275 million. Substantially all of the patient-related accounts receivable of our acute care hospitals ( *Receivables* ) serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of 0.475% and there is a facility fee of 0.375% required on 102% on the *Commitments*. We have accounted for this *Securitization* as borrowings. We maintain effective control over the *Receivables* since, pursuant to the terms of the *Securitization*, the *Receivables* are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The *Receivables*, however, are owned by the special purpose entities, can be used only to satisfy the debts of the wholly-owned special purpose entities, and thus are not available to us except through our ownership interest in the special purpose entities. The wholly-owned special purpose entities use the *Receivables* to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. At September 30, 2012, we had \$60 million of outstanding borrowings and \$215 million of additional capacity pursuant to the terms of our accounts receivable securitization program.

On September 29, 2010, we issued \$250 million of 7.00% senior unsecured notes (the *Unsecured Notes* ) which are scheduled to mature on October 1, 2018. The *Unsecured Notes* were registered in April, 2011. Interest on the *Unsecured Notes* is payable semiannually in arrears on April 1st and October 1st of each year. The *Unsecured Notes* can be redeemed in whole at anytime subject to a make-whole call at treasury rate plus 50 basis points prior to October 1, 2014. They are also redeemable in whole or in part at a price of: (i) 103.5% on or after October 1, 2014; (ii) 101.75% on or after October 1, 2015, and; (iii) 100% on or after October 1, 2016. These *Unsecured Notes* are guaranteed by a group of subsidiaries (each of which is a 100% directly owned subsidiary of Universal Health Services, Inc.) which fully and unconditionally guarantee the *Unsecured Notes* on a joint and several basis, subject to certain customary automatic release provisions.

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

In connection with the entering into of the Credit Agreement on November 15, 2010, and in accordance with the Indenture dated January 20, 2000 governing the rights of our existing notes, we entered into a supplemental indenture pursuant to which our *7.125% Notes* (due in 2016) were equally and ratably secured with the lenders under the Credit Agreement with respect to the collateral for so long as the lenders under the Credit Agreement are so secured.

Our Credit Agreement includes a material adverse change clause that must be represented at each draw. The Credit Agreement contains covenants that include a limitation on sales of assets, mergers, change of ownership, liens and indebtedness, transactions with affiliates and dividends; and requires compliance with financial covenants including maximum leverage and minimum interest coverage ratios. We are in compliance with all required covenants as of September 30, 2012.

The carrying amount and fair value of our debt was \$3.44 billion and \$3.53 billion at September 30, 2012, respectively. The fair value of our debt was computed based upon quotes received from financial institutions and we consider these to be level 2 in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with debt instruments.

*Cash Flow Hedges:*

We manage our ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this risk in a cost-effective manner, we, from time to time, enter into interest rate swap agreements in which we agree to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts. We account for our





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derivative and hedging activities using the Financial Accounting Standard Board's (FASB) guidance which requires all derivative instruments, including certain derivative instruments embedded in other contracts, to be carried at fair value on the balance sheet. For derivative transactions designated as hedges, we formally document all relationships between the hedging instrument and the related hedged item, as well as its risk-management objective and strategy for undertaking each hedge transaction.

Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Cash flow hedges are accounted for by recording the fair value of the derivative instrument on the balance sheet as either an asset or liability, with a corresponding amount recorded in accumulated other comprehensive income (AOCI) within stockholders' equity. Amounts are reclassified from AOCI to the income statement in the period or periods in which the hedged transaction affects earnings. We use interest rate derivatives in our cash flow hedge transactions. Such derivatives are designed to be highly effective in offsetting changes in the cash flows related to the hedged liability. For derivative instruments designated as cash flow hedges, the ineffective portion of the changes in expected cash flows of the hedged item are recognized currently in the income statement.

For hedge transactions that do not qualify for the short-cut method, at the hedge's inception and on a regular basis thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instruments have been highly effective in offsetting changes in cash flows of the hedged items and whether they are expected to be highly effective in the future.

The fair value of interest rate swap agreements approximates the amount at which they could be settled, based on estimates obtained from the counterparties. We assess the effectiveness and consideration of nonperformance risk of our hedge instruments on a quarterly basis. We performed periodic assessments of the cash flow hedge instruments during 2011 and the first nine months of 2012 and determined the hedges to be highly effective. We also determined that no significant portion of the hedges is ineffective as of September 30, 2012. The counterparties to the interest rate swap agreements expose us to credit risk in the event of nonperformance. We do not anticipate nonperformance by our counterparties. At September 30, 2012, each swap agreement entered into by us was in a net liability position which would require us to make the net settlement payments to the counterparties. We do not hold or issue derivative financial instruments for trading purposes.

During the first quarter of 2011, we entered into a forward starting interest rate cap on a total notional amount of \$450 million from December, 2011 to December, 2012 reducing to \$400 million from December, 2012 to December, 2013 whereby we paid a premium of \$740,000 in exchange for the counterparty agreeing to pay the difference between 7.00% and three-month LIBOR if the three-month LIBOR rate rises above 7.00% during the term of the cap. If the three-month LIBOR does not reach 7.00% during the term of the cap, no payment is made to us.

We also entered into six forward starting interest rate swaps in the first quarter of 2011 whereby we pay a fixed rate on a total notional amount of \$425 million and receive three-month LIBOR. Three of these swaps with a total notional amount of \$225 million became effective in March, 2011 and will mature in May, 2015. The average fixed rate payable on these swaps is 1.91%. The three remaining interest rate swaps with total notional amounts of \$100 million, \$25 million and \$75 million became effective in December, 2011 and have fixed rates of 2.50%, 1.96% and 1.32%, and maturity dates in December, 2014, December, 2013 and December, 2012, respectively.

During the fourth quarter of 2010, we entered into four forward starting interest rate swaps whereby we pay a fixed rate on a total notional amount of \$600 million and receive three-month LIBOR. Each of the four swaps became effective in December, 2011 and will mature in May, 2015. The average fixed rate payable on these swaps is 2.38%.

During the fourth quarter of 2007, we entered into an interest rate swap whereby we paid a fixed rate on a total notional principal amount of \$75 million and receive three-month LIBOR. The fixed rate payable was 4.76% and it matured in October, 2012.

We measure our interest rate swaps at fair value on a recurring basis. The fair value of our interest rate swaps is based primarily on quotes from banks. We consider those inputs to be level 2 in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with derivative instruments and hedging activities. The fair value of our interest rate swaps was a liability of \$46 million at September 30, 2012, substantially all of which is included in other noncurrent liabilities on the accompanying balance sheet.

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

Effective January 1, 2008, most of our subsidiaries became self-insured for professional and general liability exposure up to \$10 million per occurrence. Prior to our acquisition of Psychiatric Solutions, Inc. (PSI) in November, 2010, our subsidiaries purchased several excess policies

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through commercial insurance carriers which provide for coverage in excess of \$10 million up to \$200 million per occurrence and in the aggregate. However, we are liable for 10% of the claims paid pursuant to the commercially insured coverage in excess of \$10 million up to \$60 million per occurrence and in the aggregate.

Prior to our acquisition in November, 2010, the PSI subsidiaries were commercially insured for professional and general liability insurance claims in excess of a \$3 million self-insured retention to a limit of \$75 million. PSI utilized its captive insurance company and that captive insurance company remains in place after our acquisition of PSI to manage the self-insured retention for all former PSI subsidiaries for claims incurred prior to January 1, 2011. The captive insurance company also continues to manage the applicable self-insured retention for all professional and general liability claims, regardless of date incurred, for the former PSI subsidiaries located in Florida and Puerto Rico.

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Since our acquisition of PSI on November 15, 2010, the former PSI subsidiaries are self-insured for professional and general liability exposure up to \$3 million per occurrence and our legacy subsidiaries (which are not former PSI subsidiaries) are self-insured for professional and general liability exposure up to \$10 million per occurrence. Effective November, 2010, our subsidiaries (including the former PSI subsidiaries) were provided with several excess policies through commercial insurance carriers which provide for coverage in excess of the applicable per occurrence self-insured retention (either \$3 million or \$10 million) up to \$200 million per occurrence and in the aggregate. We remain liable for 10% of the claims paid pursuant to the commercially insured coverage in excess of \$10 million up to \$60 million per occurrence and in the aggregate.

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

As of September 30, 2012 and December 31, 2011, the total accrual for our professional and general liability claims, including the estimated claims related to the facilities acquired from PSI, was \$300 million and \$292 million, respectively, of which \$60 million is included in current liabilities as of each date.

### *Property Insurance*

We have commercial property insurance policies covering catastrophic losses, including windstorm damage, up to a \$1 billion policy limit per occurrence, subject to a \$250,000 deductible for the majority of our properties (the properties acquired from Psychiatric Solutions, Inc. are subject to a \$50,000 deductible). Losses resulting from named windstorms are subject to deductibles between 3% and 5% of the declared total insurable value of the property. In addition, we have commercial property insurance policies covering catastrophic losses resulting from earthquake and flood damage, each subject to aggregated loss limits (as opposed to per occurrence losses). Our earthquake limit is \$250 million, subject to a deductible of \$250,000, except for facilities located within documented fault zones. Earthquake losses that affect facilities located in fault zones within the United States are subject to a \$100 million limit and will have applied deductibles ranging from 1% to 5% of the declared total insurable value of the property. The earthquake limit in Puerto Rico is \$25 million. Flood losses have either a \$250,000 or \$500,000 deductible, based upon the location of the facility.

### *Other*

As of September 30, 2012 and December 31, 2011, our accounts receivable includes approximately \$76 million and \$54 million, respectively, due from Illinois. Collection of these receivables continues to be delayed due to state budgetary and funding pressures. Approximately \$55 million as of September 30, 2012, and \$41 million as of December 31, 2011, of the receivables due from Illinois have been outstanding in excess of 60 days, as of each respective date, and a large portion will likely remain outstanding for the foreseeable future. Since we expect to eventually collect all amounts due to us, no related reserves have been established in our consolidated financial statements. However, we can provide no assurance that we will eventually collect all amounts due to us from Illinois. Failure to ultimately collect all outstanding amounts due from Illinois would have an adverse impact on our future consolidated results of operations and cash flows.

As of September 30, 2012, we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds which totaled \$81 million consisting of: (i) \$66 million related to our self-insurance programs, and; (ii) \$15 million of other debt and public utility guarantees.

### *Legal Proceedings*

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

#### *Department of Justice ICD Investigation:*

In September, 2010, we, along with many other companies in the healthcare industry, received a letter from the United States Department of Justice ( DOJ ) advising of a False Claim Act investigation being conducted in connection with the implantation of implantable cardioverter defibrillators ( ICDs ) from 2003 to the present at several of our acute care facilities. The DOJ alleges that ICDs were implanted and billed by our

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facilities in contravention of a National Claims Determination regarding these devices. We have established a reserve in connection with this matter which did not have a material impact on our consolidated financial statements.

### *Two Rivers Psychiatric Hospital:*

In April, 2011, the Centers for Medicare and Medicaid Services ( CMS ) issued notice of its decision terminating Two Rivers Psychiatric Hospital ( Two Rivers ) in Kansas City, Missouri from participation in the Medicare and Medicaid program. The termination notice was issued

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as a result of surveys conducted which allegedly found Two Rivers to be out of compliance with the conditions of participation required for participation in the Medicare program and for Two Rivers alleged failure to alleviate an immediate jeopardy situation. Two Rivers filed an administrative appeal with the U.S. Department of Health and Human Services, Departmental Appeal Board, Civil Remedies Division, seeking review and reversal of that decision. In addition, Two Rivers filed a complaint in the U.S. District Court for the Western District of Missouri seeking a temporary restraining order and preliminary injunction against CMS rescinding the termination action. Later in April, 2011, the District Court issued a temporary restraining order abating the termination action pending a preliminary injunction hearing or an agreement with CMS. In May, 2011, Two Rivers and CMS entered into a settlement agreement which resulted in the rescission of the termination notice and actions by CMS. Pursuant to the terms of the agreement, Two Rivers was required to submit an acceptable plan of correction relative to the immediate jeopardy citation and engage independent experts in various disciplines to analyze and develop implementation plans for Two Rivers to meet the applicable Medicare conditions of participation. Both of these actions have occurred. Pursuant to the agreement, CMS conducted an initial survey of Two Rivers in April 2012 to determine if the Medicare conditions of participation, which formed the basis of the termination action in April 2011, have been met. In late April, 2012, CMS advised Two Rivers that it has successfully passed this initial survey. Pursuant to the terms of the agreement, a second survey will be conducted either late 2012 or early 2013 to further confirm that Two Rivers is in compliance with all Medicare/Medicaid Conditions of Participation. During the term of this agreement, Two Rivers remains eligible to receive reimbursements for services rendered to Medicare and Medicaid beneficiaries. Two Rivers remains fully committed to providing high-quality healthcare to their patients and the community it serves. We therefore intend to work expeditiously and collaboratively with CMS in an effort to resolve these matters. We can provide no assurance that Two Rivers will not ultimately lose its Medicare certification. The operating results of Two Rivers did not have a material impact on our consolidated results of operations or financial condition for the nine-month period ended September 30, 2012 or the year ended December 31, 2011.

*Office of Inspector General Investigation of Peachford Hospital:*

In July, 2012, one of our subsidiaries, Peachford Behavioral Health System of Atlanta located in Atlanta, Georgia, received a subpoena from the Office of the Inspector General for the Department of Health and Human Services requesting various documents from 2004 to the present. We are in the process of securing and collecting the requested documents for production. At present, we are uncertain as to the focus, scope or extent of the investigation, liability of the facility and/or potential financial exposure, if any, in connection with this matter.

*Matters Relating to PSI:*

The following matters pertain to PSI or former PSI facilities (owned by subsidiaries of Psychiatric Solutions, Inc.) for which we have assumed the defense as a result of our acquisition of PSI which was completed in November, 2010:

*Garden City Employees Retirement System v. PSI:*

This is a purported shareholder class action lawsuit filed in the United States District Court for the Middle District of Tennessee against PSI and the former directors in 2009 alleging violations of federal securities laws. We intend to defend the case vigorously. Should we be deemed liable in this matter, we believe we would be entitled to commercial insurance recoveries for amounts paid by us, subject to certain limitations and deductibles. Included in our consolidated balance sheets as of September 30, 2012 and December 31, 2011, is an estimated reserve (current liability) and corresponding commercial insurance recovery (current asset) which did not have a material impact on our financial statements. Although we believe the commercial insurance recoveries are adequate to satisfy potential liability and related legal fees in connection with this matter, we can provide no assurance that the ultimate liability will not exceed the commercial insurance recoveries which would make us liable for the excess.

*Department of Justice Investigation of Friends Hospital:*

In October, 2010, Friends Hospital in Philadelphia, Pennsylvania, received a subpoena from the DOJ requesting certain documents from the facility. The requested documents have been collected and provided to the DOJ for review and examination. Another subpoena was issued to the facility in July 2011 requesting additional documents, a portion of which have been collected and delivered to the DOJ, pursuant to their request. At present, we are uncertain as to the focus, scope or extent of the investigation, liability of the facility and/or potential financial exposure, if any, in connection with this matter.

*Department of Justice Investigation of Riveredge Hospital:*

In 2008, Riveredge Hospital in Chicago, Illinois received a subpoena from the DOJ requesting certain information from the facility. Additional requests for documents were also received from the DOJ in 2009 and 2010. The requested documents have been provided to the DOJ and we continue to cooperate with the DOJ with respect to this investigation. At present, we are uncertain as to the focus, scope or extent of the

investigation, liability of the facility and/or potential financial exposure, if any, in connection with this matter.

*Virginia Department of Medical Assistance Services Recoupment Claims:*

The Virginia Department of Medical Assistance Services ( DMAS ) has conducted audits at seven former PSI Residential Treatment Centers operated in the Commonwealth of Virginia to confirm compliance with provider rules under the state s Medicaid Provider Services Manual ( Manual ). As a result of those audits, DMAS claims the facilities failed to comply with the requirements of the Manual and has requested repayment of Medicaid payments to those facilities. PSI had previously filed appeals to repayment demands at each facility which are currently pending. We have recently reached a preliminary settlement of this matter which requires finalization of a definitive agreement and approval of Virginia state officials. The aggregate refund of Medicaid payments made to those facilities, as requested by DMAS, and the settlement amount is not material to our consolidated financial position or results of operations.

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The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure, certifications, 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. Currently, and from time to time, some of our facilities are subjected to inquiries and/or actions and receive notices of potential non-compliance of laws and regulations from various federal and state agencies. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to potential licensure, certification, and/or accreditation revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, there is no assurance that we will not be faced with sanctions, fines or penalties in connection with such inquiries or actions, including with respect to the investigations and other matters discussed herein. Even if we were to ultimately prevail, such inquiries and/or actions could have a material adverse effect on us.

The outcome of any current or future litigation or governmental or internal investigations, including the matters described above, cannot be accurately predicted, nor can we predict any resulting penalties, fines or other sanctions that may be imposed at the discretion of federal or state regulatory authorities. We record accruals for such contingencies to the extent that we conclude it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. No estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made at this time regarding the matters specifically described above because the inherently unpredictable nature of legal proceedings may be exacerbated by various factors, including, but not limited to: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) there are significant facts in dispute; (vi) there are a large number of parties, or; (vii) there is a wide range of potential outcomes. It is possible that the outcome of these matters could have a material adverse impact on our future results of operations, financial position, cash flows and, potentially, our reputation.

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

**(6) Segment Reporting**

Our reportable operating segments consist of acute care hospital services and behavioral health care services. The Other 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 Chief Executive Officer, the President and the Presidents of each operating segment. The Presidents of each operating segment also manage the profitability of each respective segment's various facilities. The operating segments are managed separately because each operating segment represents a business unit that offers different types of healthcare services or operates in different healthcare environments. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2011. The corporate overhead allocations, as reflected below, are utilized for internal reporting purposes and are comprised of each period's projected corporate-level operating expenses (excluding interest expense). The overhead expenses are captured and allocated directly to each segment, to the extent possible, with the non-directly allocated overhead expenses allocated based upon each segment's respective percentage of total facility-based operating expenses.

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	Three months ended September 30, 2012			Total Consolidated
	Acute Care Hospital Services	Behavioral Health Services	Other	
	(Amounts in thousands)			
Gross inpatient revenues	\$ 3,013,482	\$ 1,410,170		\$ 4,423,652
Gross outpatient revenues	\$ 1,517,261	\$ 151,788	\$ 14,475	\$ 1,683,524
Total net revenues	\$ 828,399	\$ 841,669	\$ 10,285	\$ 1,680,353
Income/(loss) before allocation of corporate overhead and income taxes	\$ 48,925	\$ 200,711	(\$ 126,131)	\$ 123,505
Allocation of corporate overhead	(\$ 39,360)	(\$ 20,533)	\$ 59,893	0
Income/(loss) after allocation of corporate overhead and before income taxes	\$ 9,565	\$ 180,178	(\$ 66,238)	\$ 123,505
Total assets as of 9/30/12	\$ 2,987,293	\$ 4,459,030	\$ 334,743	\$ 7,781,066

	Nine months ended September 30, 2012			Total Consolidated
	Acute Care Hospital Services	Behavioral Health Services	Other	
	(Amounts in thousands)			
Gross inpatient revenues	\$ 9,326,344	\$ 4,242,528		\$ 13,568,872
Gross outpatient revenues	\$ 4,606,680	\$ 474,623	\$ 39,468	\$ 5,120,771
Total net revenues	\$ 2,598,527	\$ 2,572,256	\$ 25,690	\$ 5,196,473
Income/(loss) before allocation of corporate overhead and income taxes	\$ 240,375	\$ 628,170	(\$ 338,278)	\$ 530,267
Allocation of corporate overhead	(\$ 118,082)	(\$ 62,665)	\$ 180,747	0
Income/(loss) after allocation of corporate overhead and before income taxes	\$ 122,293	\$ 565,505	(\$ 157,531)	\$ 530,267
Total assets as of 9/30/12	\$ 2,987,293	\$ 4,459,030	\$ 334,743	\$ 7,781,066

	Three months ended September 30, 2011			Total Consolidated
	Acute Care Hospital Services	Behavioral Health Services	Other	
	(Amounts in thousands)			
Gross inpatient revenues	\$ 2,827,617	\$ 1,368,405		\$ 4,196,022
Gross outpatient revenues	\$ 1,384,084	\$ 146,836	\$ 13,542	\$ 1,544,462
Total net revenues	\$ 831,775	\$ 825,825	\$ 5,075	\$ 1,662,675
Income/(loss) before allocation of corporate overhead and income taxes	\$ 57,027	\$ 184,304	(\$ 94,255)	\$ 147,076
Allocation of corporate overhead	(\$ 35,094)	(\$ 15,438)	\$ 50,532	0
Income/(loss) after allocation of corporate overhead and before income taxes	\$ 21,933	\$ 168,866	(\$ 43,723)	\$ 147,076
Total assets as of 9/30/11	\$ 2,797,029	\$ 4,421,040	\$ 387,862	\$ 7,605,931

	Nine months ended September 30, 2011			Total Consolidated
	Acute Care Hospital Services	Behavioral Health Services	Other	
	(Amounts in thousands)			
Gross inpatient revenues	\$ 8,934,701	\$ 4,154,117		\$ 13,088,818
Gross outpatient revenues	\$ 4,068,566	\$ 453,652	\$ 41,082	\$ 4,563,300
Total net revenues	\$ 2,587,070	\$ 2,493,336	\$ 16,820	\$ 5,097,226
Income/(loss) before allocation of corporate overhead and income taxes	\$ 275,156	\$ 559,681	(\$ 301,336)	\$ 533,501
Allocation of corporate overhead	(\$ 98,418)	(\$ 46,854)	\$ 145,272	0
Income/(loss) after allocation of corporate overhead and before income taxes	\$ 176,738	\$ 512,827	(\$ 156,064)	\$ 533,501



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Total assets as of 9/30/11	\$ 2,797,029	\$ 4,421,040	\$ 387,862	\$ 7,605,931
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**Table of Contents****(7) Earnings Per Share Data ( EPS ) and Stock Based Compensation**

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

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

	Three months ended September 30, (amounts in thousands)		Nine months ended September 30,	
	2012	2011	2012	2011
<b>Basic and Diluted:</b>				
Net income attributable to UHS	\$ 71,817	\$ 85,054	\$ 307,985	\$ 302,896
Less: Net income attributable to unvested restricted share grants	(85)	(165)	(379)	(440)
Net income attributable to UHS basic and diluted	\$ 71,732	\$ 84,889	\$ 307,606	\$ 302,456
<b>Weighted average number of common shares basic</b>				
Net effect of dilutive stock options and grants based on the treasury stock method	794	1,201	1,010	1,461
<b>Weighted average number of common shares and equivalents diluted</b>				
	97,611	98,598	97,711	98,908
Earnings per basic share attributable to UHS:	\$ 0.74	\$ 0.87	\$ 3.18	\$ 3.10
Earnings per diluted share attributable to UHS:	\$ 0.73	\$ 0.86	\$ 3.15	\$ 3.06

The Net effect of dilutive stock options and grants based on the treasury stock method, for all periods presented above, excludes certain outstanding stock options applicable to each period since the effect would have been anti-dilutive. The excluded weighted-average stock options totaled 2.6 million for each of the three and nine-month periods ended September 30, 2012. The excluded weighted-average stock options totaled 2.7 million for the three-month period ended September 30, 2011 and 922,000 for the nine-month period ended September 30, 2011. All classes of our common stock have the same dividend rights.

**Stock-Based Compensation:** During the three-month periods ended September 30, 2012 and 2011, compensation cost of \$4.8 million (\$3.0 million after-tax) and \$4.3 million (\$2.6 million after-tax), respectively, was recognized related to outstanding stock options. During the nine-month periods ended September 30, 2012 and 2011, compensation cost of \$14.4 million (\$8.9 million after-tax) and \$12.0 million (\$7.4 million after-tax), respectively, was recognized related to outstanding stock options. In addition, during the three-month periods ended September 30, 2012 and 2011, compensation cost of approximately \$567,000 (\$352,000 after-tax) and \$544,000 (\$336,000 after-tax), respectively, was recognized related to restricted stock. During the nine-month periods ended September 30, 2012 and 2011, compensation cost of approximately \$1.7 million (\$1.1 million after-tax) and \$1.4 million (\$894,000 after-tax), respectively, was recognized related to restricted stock. As of September 30, 2012 there was \$40.0 million of unrecognized compensation cost related to unvested options and restricted stock which is expected to be recognized over the remaining weighted average vesting period of 2.7 years. There were 2,794,250 stock options granted (net of cancellations) during the first nine months of 2012 with a weighted-average grant date fair value of \$10.72 per share. There were 54,127 restricted stock shares granted during the first nine months of 2012, with a weighted-average grant date fair value of \$36.95 per share.

**(8) Dispositions and acquisitions**

*Nine-month period ended September 30, 2012:*

**Acquisitions:**

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In October of 2012, we completed the acquisition of Ascend Health Corporation ( Ascend ) for \$500 million in cash. Prior to the acquisition, Ascend was the largest private psychiatric hospital provider with 9 owned or leased freestanding psychiatric inpatient facilities located in 5 states including Texas, Arizona, Utah, Oregon and Washington. In connection with the receipt of antitrust

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clearance from the Federal Trade Commission in connection with our acquisition of Ascend, we have agreed to certain conditions, including the divestiture, within approximately six months, of Peak Behavioral Health Services ( Peak ), a 104-bed behavioral health care facility located in Santa Teresa, New Mexico. The revenues of Peak were approximately \$14 million during each of the nine-month period ended September 30, 2012, and the twelve month period ended December 31, 2011.

During the first nine months of 2012, we spent \$25 million in connection with the acquisition of physician practices and various real properties.

As a result of the third-party seller's inability to obtain the removal of the deed restriction on its hospital, we provided the seller with a notice of termination of the previously executed purchase agreement in connection with our planned acquisition of the Knapp Medical Center located in Weslaco, Texas. In connection with this termination, our \$6.5 million deposit was refunded to us in March, 2012.

### **Divestitures:**

In October of 2012, we completed the divestiture of Auburn Regional Medical Center ( Auburn ), a 159-bed acute care hospital located in Auburn, Washington, for total cash proceeds of approximately \$93 million including estimated working capital. This divestiture is expected to result in a substantial pre-tax gain which will be recorded in our consolidated financial statements during the fourth quarter of 2012.

During the first nine months of 2012, we received aggregate cash proceeds of approximately \$56 million for the divestiture of: (i) the Hospital San Juan Capestrano, a 108-bed behavioral health care facility located in Rio Piedras, Puerto Rico, that was sold in January, 2012 pursuant to our agreement with the Federal Trade Commission in connection with our acquisition of Psychiatric Solutions, Inc., and; (ii) the real property of two non-operating behavioral health care facilities. The pre-tax net gain on these divestitures did not have a material impact on our consolidated results of operations during the first nine months of 2012.

The operating results for Auburn and Peak are reflected as discontinued operations for each of the periods presented herein. Since the aggregate income from discontinued operations before income tax expense for these facilities is not material to our consolidated financial statements, it is included as a reduction to other operating expenses. The assets and liabilities for Auburn and Peak are reflected as held for sale on our Consolidated Balance Sheet as of September 30, 2012, and the assets and liabilities for the Hospital San Juan Capestrano were reflected as held for sale on our Consolidated Balance Sheet as of December 31, 2011.

### ***Nine-month period ended September 30, 2011:***

#### **Acquisitions:**

During the third quarter of 2011, we paid approximately \$9 million to acquire administrative office buildings located in Pennsylvania and Tennessee.

#### **Divestitures:**

During the first nine months of 2011, we received cash proceeds of approximately \$24 million for: (i) sale of the real property of a closed acute care hospital (during the first quarter); (ii) installment payment for our ownership interest in an outpatient surgery center (during the second quarter); (iii) sale of MeadowWood Behavioral Health System which is located in Delaware (this third quarter sale was pursuant to our agreement with the Federal Trade Commission in connection with our acquisition of PSI), and; (iv) sale of our majority ownership interest in a radiation oncology center located in Nevada (during the third quarter). The pre-tax loss, net of gains, did not have a material impact on our consolidated financial statements for the three or nine-month periods ended September 30, 2011.

### **(9) Dividends**

We declared and paid dividends of \$4.8 million, or \$.05 per share, during the third quarter of 2012 and \$4.8 million, or \$.05 per share, during the third quarter of 2011. We declared and paid dividends of \$14.5 million and \$14.6 million during the nine-month periods ended September 30, 2012 and 2011, respectively.

### **(10) Pension Plan**

The following table shows the components of net periodic pension cost for our defined benefit pension plan as of September 30, 2012 and 2011 (amounts in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Service cost	\$ 286	\$ 290	\$ 858	\$ 871
Interest cost	1,165	1,262	3,495	3,785
Expected return on assets	(1,825)	(1,642)	(5,476)	(4,925)
Recognized actuarial loss	1,055	607	3,165	1,821
Net periodic pension cost	\$ 681	\$ 517	\$ 2,042	\$ 1,552

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During the nine months ended September 30, 2012, we made contributions totaling \$7.1 million to our pension plan.

### **(11) Income Taxes**

As of January 1, 2012, our unrecognized tax benefits were approximately \$7 million. The amount, if recognized, that would affect the effective tax rate is approximately \$5 million. During the quarter ended September 30, 2012, changes to the estimated liabilities for uncertain tax positions (including accrued interest) relating to tax positions taken during prior and current periods did not have a material impact on our financial statements.

We recognize accrued interest and penalties associated with uncertain tax positions as part of the tax provision. As of September 30, 2012, we have approximately \$2 million of accrued interest and penalties. The U.S. federal statute of limitations remains open for the 2009 and subsequent years. Foreign and U.S. state and local jurisdictions have statutes of limitations generally ranging from 3 to 4 years. The statute of limitations on certain jurisdictions could expire within the next twelve months.

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

### **(12) Supplemental Condensed Consolidating Financial Information**

Certain of our senior notes are guaranteed by a group of subsidiaries (the Guarantors ). The Guarantors, each of which is a 100% directly owned subsidiary of Universal Health Services, Inc., fully and unconditionally guarantee the senior notes on a joint and several basis, subject to certain customary release provisions.

The following financial statements present condensed consolidating financial data for (i) Universal Health Services, Inc. (on a parent company only basis), (ii) the combined Guarantors, (iii) the combined non guarantor subsidiaries (all other subsidiaries), (iv) an elimination column for adjustments to arrive at the information for the parent company, Guarantors, and non guarantors on a consolidated basis, and (v) the parent company and our subsidiaries on a consolidated basis.

Investments in subsidiaries are accounted for by the parent company and the Guarantors using the equity method for this presentation. Results of operations of subsidiaries are therefore classified in the parent company s and Guarantors investment in subsidiaries accounts. The elimination entries set forth in the following condensed consolidating financial statements eliminate distributed and undistributed income of subsidiaries, investments in subsidiaries, and intercompany balances and transactions between the parent, Guarantors, and non guarantors.

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net revenues before provision for doubtful accounts	\$ 0	\$ 1,269,429	\$ 605,991	\$ (6,157)	\$ 1,869,263
Less: Provision for doubtful accounts	0	110,187	78,723	0	188,910
Net revenues	0	1,159,242	527,268	(6,157)	1,680,353
Operating charges:					
Salaries, wages and benefits	0	595,752	242,323	0	838,075
Other operating expenses	0	236,012	132,737	(6,062)	362,687
Supplies expense	0	118,357	73,390	0	191,747
EHR incentive income	0	(3,109)	(7,442)	0	(10,551)
Depreciation and amortization	0	52,986	24,046	0	77,032
Lease and rental expense	0	14,884	8,692	(95)	23,481
Costs related to extinguishment of debt	29,170	0	0	0	29,170
	29,170	1,014,882	473,746	(6,157)	1,511,641
Income from operations	(29,170)	144,360	53,522	0	168,712
Interest expense	43,649	886	672	0	45,207
Interest (income) expense, affiliate	0	22,782	(22,782)	0	0
Equity in net income of consolidated affiliates	(116,764)	(25,037)	0	141,801	0
Income before income taxes	43,945	145,729	75,632	(141,801)	123,505
Provision for income taxes	(27,872)	50,012	19,992	0	42,132
Net income	71,817	95,717	55,640	(141,801)	81,373
Less: Income attributable to noncontrolling interests	0	0	9,556	0	9,556
Net income attributable to UHS	\$ 71,817	\$ 95,717	\$ 46,084	\$ (141,801)	\$ 71,817

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF INCOME****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net revenues before provision for doubtful accounts	\$ 0	\$ 3,896,741	\$ 1,840,971	\$ (19,036)	\$ 5,718,676
Less: Provision for doubtful accounts	0	304,955	217,248	0	522,203
Net revenues	0	3,591,786	1,623,723	(19,036)	5,196,473
Operating charges:					
Salaries, wages and benefits	0	1,825,547	739,505	0	2,565,052
Other operating expenses	0	695,599	382,201	(18,752)	1,059,048
Supplies expense	0	369,190	225,734	0	594,924
EHR incentive income	0	(5,064)	(7,442)	0	(12,506)
Depreciation and amortization	0	155,242	66,565	0	221,807
Lease and rental expense	0	44,122	27,068	(284)	70,906
Costs related to extinguishment of debt	29,170	0	0	0	29,170
	29,170	3,084,636	1,433,631	(19,036)	4,528,401
Income from operations	(29,170)	507,150	190,092	0	668,072
Interest expense	133,101	2,511	2,193	0	137,805
Interest (income) expense, affiliate	0	68,347	(68,347)	0	0
Equity in net income of consolidated affiliates	(408,146)	(94,662)	0	502,808	0
Income before income taxes	245,875	530,954	256,246	(502,808)	530,267
Provision for income taxes	(62,110)	186,641	64,349	0	188,880
Net income	307,985	344,313	191,897	(502,808)	341,387
Less: Income attributable to noncontrolling interests	0	0	33,402	0	33,402
Net income attributable to UHS	\$ 307,985	\$ 344,313	\$ 158,495	\$ (502,808)	\$ 307,985



**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net revenues before provision for doubtful accounts	\$ 0	\$ 1,237,210	\$ 583,581	\$ (6,105)	\$ 1,814,686
Less: Provision for doubtful accounts	0	90,046	61,965	0	152,011
Net revenues	0	1,147,164	521,616	(6,105)	1,662,675
Operating charges:					
Salaries, wages and benefits	0	587,621	240,985	0	828,606
Other operating expenses	0	232,667	117,216	(6,010)	343,873
Supplies expense	0	123,204	75,590	0	198,794
Depreciation and amortization	0	53,218	19,952	0	73,170
Lease and rental expense	0	14,949	7,850	(95)	22,704
	0	1,011,659	461,593	(6,105)	1,467,147
Income from operations	0	135,505	60,023	0	195,528
Interest expense, net	47,113	810	529	0	48,452
Interest (income) expense, affiliate	0	15,904	(15,904)	0	0
Equity in net income of consolidated affiliates	(113,314)	(29,851)	0	143,165	0
Income before income taxes	66,201	148,642	75,398	(143,165)	147,076
Provision for income taxes	(18,853)	51,165	19,922	0	52,234
Net income	85,054	97,477	55,476	(143,165)	94,842
Less: Income attributable to noncontrolling interests	0	0	9,788	0	9,788
Net income attributable to UHS	\$ 85,054	\$ 97,477	\$ 45,688	\$ (143,165)	\$ 85,054

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF INCOME****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net revenues before provision for doubtful accounts	\$ 0	\$ 3,781,885	\$ 1,790,141	\$ (18,758)	\$ 5,553,268
Less: Provision for doubtful accounts	0	260,713	195,329	0	456,042
Net revenues	0	3,521,172	1,594,812	(18,758)	5,097,226
Operating charges:					
Salaries, wages and benefits	0	1,775,194	717,376	0	2,492,570
Other operating expenses	0	697,527	351,438	(18,473)	1,030,492
Supplies expense	0	376,674	226,983	0	603,657
Depreciation and amortization	0	154,788	59,040	0	213,828
Lease and rental expense	0	45,888	22,898	(285)	68,501
	0	3,050,071	1,377,735	(18,758)	4,409,048
Income from operations	0	471,101	217,077	0	688,178
Interest expense, net	150,369	2,412	1,896	0	154,677
Interest (income) expense, affiliate	0	47,712	(47,712)	0	0
Equity in net income of consolidated affiliates	(394,754)	(118,102)	0	512,856	0
Income before income taxes	244,385	539,079	262,893	(512,856)	533,501
Provision for income taxes	(58,511)	191,297	59,852	0	192,638
Net income	302,896	347,782	203,041	(512,856)	340,863
Less: Income attributable to noncontrolling interests	0	0	37,967	0	37,967
Net income attributable to UHS	\$ 302,896	\$ 347,782	\$ 165,074	\$ (512,856)	\$ 302,896

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net income	\$ 71,817	\$ 95,717	\$ 55,640	\$ (141,801)	\$ 81,373
Other comprehensive income (loss):					
Unrealized derivative gains on cash flow hedges	(45)	0	0	0	(45)
Amortization of terminated hedge	(84)	0	0	0	(84)
Other comprehensive income before tax	(129)	0	0	0	(129)
Income tax expense related to items of other comprehensive income	(47)	0	0	0	(47)
Total other comprehensive income, net of tax	(82)	0	0	0	(82)
Comprehensive income	71,735	95,717	55,640	(141,801)	81,291
Less: Comprehensive income attributable to noncontrolling interests	0	0	9,556	0	9,556
Comprehensive income attributable to UHS	\$ 71,735	\$ 95,717	\$ 46,084	\$ (141,801)	\$ 71,735

**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
Net income	\$ 307,985	\$ 344,313	\$ 191,897	\$ (502,808)	\$ 341,387
Other comprehensive income (loss):					
Unrealized derivative gains on cash flow hedges	1,782	0	0	0	1,782
Amortization of terminated hedge	(252)	0	0	0	(252)
Other comprehensive income before tax	1,530	0	0	0	1,530
Income tax expense related to items of other comprehensive income	585	0	0	0	585
Total other comprehensive income, net of tax	945	0	0	0	945

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Comprehensive income	308,930	344,313	191,897	(502,808)	342,332
Less: Comprehensive income attributable to noncontrolling interests	0	0	33,402	0	33,402
Comprehensive income attributable to UHS	\$ 308,930	\$ 344,313	\$ 158,495	\$ (502,808)	\$ 308,930

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME****FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011**

(amounts in thousands)

	<b>Parent</b>	<b>Guarantors</b>	<b>Non Guarantors</b>	<b>Consolidating Adjustments</b>	<b>Total Consolidated Amounts</b>
Net income	\$ 85,054	\$ 97,477	\$ 55,476	\$ (143,165)	\$ 94,842
Other comprehensive income (loss):					
Unrealized derivative losses on cash flow hedges	(21,360)	0	0	0	(21,360)
Amortization of terminated hedge	(84)	0	0	0	(84)
Other comprehensive income before tax	(21,444)	0	0	0	(21,444)
Income tax expense related to items of other comprehensive income	(8,214)	0	0	0	(8,214)
Total other comprehensive income, net of tax	(13,230)	0	0	0	(13,230)
Comprehensive income	71,824	97,477	55,476	(143,165)	81,612
Less: Comprehensive income attributable to noncontrolling interests	0	0	9,788	0	9,788
Comprehensive income attributable to UHS	\$ 71,824	\$ 97,477	\$ 45,688	\$ (143,165)	\$ 71,824

**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011**

(amounts in thousands)

	<b>Parent</b>	<b>Guarantors</b>	<b>Non Guarantors</b>	<b>Consolidating Adjustments</b>	<b>Total Consolidated Amounts</b>
Net income	\$ 302,896	\$ 347,782	\$ 203,041	\$ (512,856)	\$ 340,863
Other comprehensive income (loss):					
Unrealized derivative losses on cash flow hedges	(39,636)	0	0	0	(39,636)
Amortization of terminated hedge	(252)	0	0	0	(252)
Other comprehensive income before tax	(39,888)	0	0	0	(39,888)
Income tax expense related to items of other comprehensive income	(15,270)	0	0	0	(15,270)
Total other comprehensive income, net of tax	(24,618)	0	0	0	(24,618)

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Comprehensive income	278,278	347,782	203,041	(512,856)	316,245
Less: Comprehensive income attributable to noncontrolling interests	0	0	37,967	0	37,967
Comprehensive income attributable to UHS	\$ 278,278	\$ 347,782	\$ 165,074	\$ (512,856)	\$ 278,278

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING BALANCE SHEET****AS OF SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$ 0	\$ 18,487	\$ 7,165	\$ 0	\$ 25,652
Accounts receivable, net	3,314	732,142	307,079	0	1,042,535
Supplies	0	59,561	37,452	0	97,013
Other current assets	8,065	73,270	11,687	0	93,022
Deferred income taxes	81,894	41,237	322	(322)	123,131
Current assets held for sale	0	107,071	0	0	107,071
<b>Total current assets</b>	<b>93,273</b>	<b>1,031,768</b>	<b>363,705</b>	<b>(322)</b>	<b>1,488,424</b>
Investments in subsidiaries	5,621,719	1,276,511	0	(6,898,230)	0
Intercompany receivable	422,241	0	175,909	(598,150)	0
Intercompany note receivable	0	0	1,142,539	(1,142,539)	0
Property and equipment	0	3,748,468	1,492,441	0	5,240,909
Less: accumulated depreciation	0	(1,243,819)	(681,014)	0	(1,924,833)
	0	2,504,649	811,427	0	3,316,076
<b>Other assets:</b>					
Goodwill	820	2,101,345	492,575	0	2,594,740
Deferred charges	72,388	5,928	8,776	0	87,092
Other	8,971	202,818	82,945	0	294,734
	\$ 6,219,412	\$ 7,123,019	\$ 3,077,876	\$ (8,639,241)	\$ 7,781,066
<b>Liabilities and Stockholders Equity</b>					
<b>Current liabilities:</b>					
Current maturities of long-term debt	\$ 0	\$ 1,029	\$ 1,470	\$ 0	\$ 2,499
Accounts payable and accrued liabilities	22,582	604,201	184,180	0	810,963
Current liabilities held for sale	0	18,112	0	0	18,112
Federal and state taxes	5,966	188	620	0	6,774
<b>Total current liabilities</b>	<b>28,548</b>	<b>623,530</b>	<b>186,270</b>	<b>0</b>	<b>838,348</b>
Intercompany payable	0	598,150	0	(598,150)	0
Other noncurrent liabilities	51,880	250,752	105,903	0	408,535
Long-term debt	3,388,425	1,153	51,384	0	3,440,962
Intercompany note payable	0	1,142,539	0	(1,142,539)	0
Deferred income taxes	141,777	54,237	0	(322)	195,692
Redeemable noncontrolling interests	0	0	234,056	0	234,056

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UHS common stockholders equity	2,608,782	4,452,658	2,445,572	(6,898,230)	2,608,782
Noncontrolling interest	0	0	54,691	0	54,691
Total equity	2,608,782	4,452,658	2,500,263	(6,898,230)	2,663,473
	\$ 6,219,412	\$ 7,123,019	\$ 3,077,876	\$ (8,639,241)	\$ 7,781,066



**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING BALANCE SHEET****AS OF DECEMBER 31, 2011**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$ 0	\$ 33,221	\$ 8,008	\$ 0	\$ 41,229
Accounts receivable, net	8,891	663,593	297,318	0	969,802
Supplies	0	59,467	37,308	0	96,775
Other current assets	33,057	56,864	9,938	0	99,859
Deferred income taxes	67,189	41,755	322	(942)	108,324
Current assets held for sale	0	48,916	0	0	48,916
<b>Total current assets</b>	<b>109,137</b>	<b>903,816</b>	<b>352,894</b>	<b>(942)</b>	<b>1,364,905</b>
Investments in subsidiaries	5,213,573	1,181,849	0	(6,395,422)	0
Intercompany receivable	669,112	0	74,155	(743,267)	0
Intercompany note receivable	0	0	1,148,839	(1,148,839)	0
Property and equipment	0	3,650,025	1,456,135	0	5,106,160
Less: accumulated depreciation	0	(1,184,283)	(633,897)	0	(1,818,180)
	0	2,465,742	822,238	0	3,287,980
<b>Other assets:</b>					
Goodwill	820	2,132,103	494,679	0	2,627,602
Deferred charges	103,434	5,972	2,374	0	111,780
Other	10,412	241,107	21,459	0	272,978
	\$ 6,106,488	\$ 6,930,589	\$ 2,916,638	\$ (8,288,470)	\$ 7,665,245
<b>Liabilities and Stockholders Equity</b>					
<b>Current liabilities:</b>					
Current maturities of long-term debt	\$ 0	\$ 1,133	\$ 1,346	\$ 0	\$ 2,479
Accounts payable and accrued liabilities	14,201	616,026	201,898	0	832,125
Current liabilities held for sale	0	2,329	0	0	2,329
Federal and state taxes	0	0	620	(620)	0
<b>Total current liabilities</b>	<b>14,201</b>	<b>619,488</b>	<b>203,864</b>	<b>(620)</b>	<b>836,933</b>
Intercompany payable	0	743,267	0	(743,267)	0
Other noncurrent liabilities	49,840	249,033	103,035	0	401,908
Long-term debt	3,594,182	3,616	53,630	0	3,651,428
Intercompany note payable	0	1,148,839	0	(1,148,839)	0
Deferred income taxes	151,913	58,001	0	(322)	209,592
Redeemable noncontrolling interests	0	0	218,266	0	218,266

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UHS common stockholders equity	2,296,352	4,108,345	2,287,077	(6,395,422)	2,296,352
Noncontrolling interest	0	0	50,766	0	50,766
Total equity	2,296,352	4,108,345	2,337,843	(6,395,422)	2,347,118
	\$ 6,106,488	\$ 6,930,589	\$ 2,916,638	\$ (8,288,470)	\$ 7,665,245

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2012**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
<b>Net cash provided by operating activities</b>	\$ (7,607)	\$ 379,574	\$ 163,039	\$ 0	\$ 535,006
<b>Cash Flows from Investing Activities:</b>					
Property and equipment additions, net of disposals	0	(236,978)	(45,213)	0	(282,191)
Proceeds received from sale of assets and businesses	0	49,984	6,210	0	56,194
Acquisition of property and businesses	0	(11,476)	(13,616)	0	(25,092)
Costs incurred for purchase and development of electronic health records application	0	(41,854)	0	0	(41,854)
Return of deposit on terminated purchase agreement	6,500	0	0	0	6,500
<b>Net cash used in investing activities</b>	<b>6,500</b>	<b>(240,324)</b>	<b>(52,619)</b>	<b>0</b>	<b>(286,443)</b>
<b>Cash Flows from Financing Activities:</b>					
Reduction of long-term debt	(1,123,140)	(2,567)	(2,122)	0	(1,127,829)
Additional borrowings	906,000	0	0	0	906,000
Financing costs	(8,257)	0	0	0	(8,257)
Repurchase of common shares	(9,676)	0	0	0	(9,676)
Dividends paid	(14,519)	0	0	0	(14,519)
Issuance of common stock	3,828	0	0	0	3,828
Profit distributions to noncontrolling interests	0	0	(13,687)	0	(13,687)
Changes in intercompany balances with affiliates, net	246,871	(151,417)	(95,454)	0	0
<b>Net cash (used in) provided by financing activities</b>	<b>1,107</b>	<b>(153,984)</b>	<b>(111,263)</b>	<b>0</b>	<b>(264,140)</b>
Increase (decrease) in cash and cash equivalents	0	(14,734)	(843)	0	(15,577)
Cash and cash equivalents, beginning of period	0	33,221	8,008	0	41,229
Cash and cash equivalents, end of period	\$ 0	\$ 18,487	\$ 7,165	\$ 0	\$ 25,652

**Table of Contents****UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011**

(amounts in thousands)

	Parent	Guarantors	Non Guarantors	Consolidating Adjustments	Total Consolidated Amounts
<b>Net cash provided by operating activities</b>	<b>\$ 60,800</b>	<b>\$ 388,838</b>	<b>112,864</b>	<b>\$ 0</b>	<b>\$ 562,502</b>
<b>Cash Flows from Investing Activities:</b>					
Property and equipment additions, net of disposals	0	(143,953)	(51,451)	0	(195,404)
Proceeds received from sale of assets and businesses	0	0	23,682	0	23,682
Acquisition of property and businesses	0	0	(8,599)	0	(8,599)
Costs incurred for purchase and development of electronic health records application	0	(27,874)	0	0	(27,874)
<b>Net cash used in investing activities</b>	<b>0</b>	<b>(171,827)</b>	<b>(36,368)</b>	<b>0</b>	<b>(208,195)</b>
<b>Cash Flows from Financing Activities:</b>					
Reduction of long-term debt	(252,289)	(1,156)	(14,094)	0	(267,539)
Additional borrowings	36,000	0	0	0	36,000
Financing costs	(23,559)	0	0	0	(23,559)
Repurchase of common shares	(44,532)	0	0	0	(44,532)
Dividends paid	(14,638)	0	0	0	(14,638)
Issuance of common stock	3,596	0	0	0	3,596
Profit distributions to noncontrolling interests	0	0	(33,962)	0	(33,962)
Changes in intercompany balances with affiliates, net	234,622	(205,164)	(29,458)		0
<b>Net cash (used in) provided by financing activities</b>	<b>(60,800)</b>	<b>(206,320)</b>	<b>(77,514)</b>	<b>0</b>	<b>(344,634)</b>
Increase (decrease) in cash and cash equivalents	0	10,691	(1,018)	0	9,673
Cash and cash equivalents, beginning of period	0	21,385	8,089	0	29,474
Cash and cash equivalents, end of period	\$ 0	\$ 32,076	\$ 7,071	\$ 0	\$ 39,147

**(13) Recent Accounting Standards**

**Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities:** During the first quarter of 2012, we adopted the Financial Accounting Standards Board's Accounting Standards Update (ASU) No. 2011-07, Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities, which required certain health care entities to change the presentation in their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). As a result, the provision for doubtful accounts for our acute care and behavioral health care facilities is reflected as a deduction from net revenues in the accompanying consolidated statements of income for the three and nine-month periods ended September 30, 2012 and 2011. The adoption of this standard had no impact on our financial position or overall results of operations.

**Presentation of Comprehensive Income:** In June 2011, the FASB amended its guidance governing the presentation of comprehensive income. The amended guidance eliminates the option to report other comprehensive income and its components in the statement of changes in equity.

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Under the new guidance, an entity can elect to present items of net income and other comprehensive income in one continuous statement referred to as the statement of comprehensive income or in two separate, but consecutive, statements. While the options for presenting other comprehensive income change under the guidance, other portions of the current guidance will not change. For public entities, these changes are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of this standard did not have an impact on our consolidated financial position or results of operations.

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

Our principal business is owning and operating, through our subsidiaries, acute care hospitals, behavioral health centers, surgical hospitals, ambulatory surgery centers and radiation oncology centers. As of October 31, 2012, we owned and/or operated 24 acute care hospitals (excluding Auburn Regional Medical Center that was divested in October, 2012) and 197 behavioral health centers (including 9 facilities acquired from Ascend Health Corporation in October, 2012) located in 36 states, Washington, D.C., Puerto Rico and the U.S. Virgin Islands. As part of our ambulatory treatment centers division, we manage and/or own outright or in partnerships with physicians, 6 surgical hospitals and surgery and radiation oncology centers located in 4 states and Puerto Rico.

During the first quarter of 2012, we adopted the Financial Accounting Standards Board's Accounting Standards Update (ASU) No. 2011-07, Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities, which required certain health care entities to change the presentation in their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). As a result, the provision for doubtful accounts for our acute care and behavioral health care facilities is reflected as a deduction from net revenues in the accompanying consolidated statements of income for the three and nine-month periods ended September 30, 2012 and 2011. The adoption of this standard had no impact on our financial position or overall results of operations.

As a percentage of our consolidated net revenues, net revenues from our acute care hospitals, surgical hospitals, surgery centers and radiation oncology centers accounted for 50% during each of the three-month periods ended September 30, 2012 and 2011, respectively, and 50% and 51% during the nine-month periods ended September 30, 2012 and 2011, respectively. Net revenues from our behavioral health care facilities accounted for 50% during each of the three-month periods ended September 30, 2012 and 2011, respectively, and 50% and 49% during the nine-month periods ended September 30, 2012 and 2011, respectively.

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

**Forward-Looking Statements and Risk Factors**

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. This Quarterly Report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, appears, projects and similar statements in future tense, identify forward-looking statements. In evaluating those statements, you should specifically consider various factors, including the risks related to healthcare industry trends and those detailed in our filings with the SEC including those set forth herein and in our Annual Report on Form 10-K for the year ended December 31, 2011 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements and Risk Factors*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

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

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

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

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

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

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

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

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

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

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

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

demographic changes;

our level of indebtedness has increased substantially as a result of our 2010 acquisition of PSI, and increased more as a result of our acquisition of Ascend Health Corporation in October, 2012 (as discussed herein), which could, among other things, adversely affect our ability to raise additional capital to fund operations, limit our ability to react to changes in the economy or our industry and could potentially prevent us from meeting our obligations under the agreements related to our indebtedness;

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

we receive Medicaid revenues in excess of \$90 million annually from each of Texas, Pennsylvania, Washington, D.C., Illinois, Massachusetts and Virginia, making us particularly sensitive to reductions in Medicaid and other state based revenue programs (which have been implemented in various forms with respect to our areas of operation in the respective 2013 state fiscal years) as well as regulatory, economic, environmental and competitive changes in those states. In the states in which we operate, based upon the state budgets for the 2012 fiscal year (which generally began at various times during the second half of 2011), we estimate that, on a blended basis, our aggregate Medicaid rates have been reduced by approximately 3% to 4% (or approximately \$45 million to \$55 million annually) from the average rates in effect during the states' 2011 fiscal years (which generally ended during the third quarter of 2011). Our consolidated results of operations for the three and nine-month periods ended September 30, 2012 include the pro rata portion of these Medicaid rate reductions. Based upon the state budgets for the 2013 fiscal year (which generally begin at various times during the second half of 2012), we estimate that, on a blended basis, our aggregate Medicaid rates will be reduced by approximately 1% (or approximately \$15 million annually) from the average rates in effect during the states' 2012 fiscal years (which generally end during the third quarter of 2012). We can provide no assurance that further reductions to Medicaid revenues, particularly in the above-mentioned states, will not have a material adverse effect on our future results of operations;

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

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



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

the Department of Health and Human Services ( HHS ) published final regulations in July, 2010 implementing the health information technology ( HIT ) provisions of the American Recovery and Reinvestment Act (referred to as the HITECH Act ). The final regulation defines the meaningful use of Electronic Health Records ( EHR ) and establishes the requirements for the Medicare and Medicaid EHR payment incentive programs. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. Our acute care hospitals may qualify for these EHR incentive payments upon implementation of the EHR application assuming they meet the meaningful use criteria . Certain of our acute care hospitals implemented EHR applications in 2011 and 2012 and we plan to continue the implementation at each of our acute care hospitals, on a facility-by-facility basis, until completion which is expected to occur in mid-2013. However, there can be no assurance that we (our acute care hospitals) will ultimately qualify for these incentive payments and, should we qualify, we are unable to quantify the amount of incentive payments we may receive since the amounts are dependent upon various factors including the implementation timing at each hospital. Should we qualify for incentive payments, there may be timing differences in the recognition of the incentive income and expenses recorded in connection with the implementation of the EHR application which may cause material period-to-period changes in our future results of operations. Hospitals that do not qualify as a meaningful user of EHR by 2015 are subject to a reduced market basket update to the inpatient prospective payment system ( IPPS ) standardized amount in 2015 and each subsequent fiscal year. Although we believe that our acute care hospitals will be in compliance with the EHR standards by 2015, there can be no assurance that all of our facilities will be in compliance and therefore not subject to the penalty provision of the HITECH Act;

in August, 2011, the Budget Control Act of 2011 (the 2011 Act ) was enacted into law. The 2011 Act imposed annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Select Committee on Deficit Reduction (the Joint Committee ), which was tasked with making recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented which, if triggered, would result in Medicare payment reductions of up to 2% per fiscal year with a uniform percentage reduction across all Medicare programs starting in 2013 (approximately \$32 million annual reduction to our Medicare net revenues). We cannot predict whether Congress will attempt to suspend or restructure the automatic budget cuts or what other deficit reduction initiatives may be proposed by Congress;

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as of September 30, 2012 and December 31, 2011, our accounts receivable includes approximately \$76 million and \$54 million, respectively, due from Illinois. Collection of these receivables continues to be delayed due to state budgetary and funding pressures. Approximately \$55 million as of September 30, 2012, and \$41 million as of December 31, 2011, of the receivables due from Illinois have been outstanding in excess of 60 days, as of each respective date, and a large portion will likely remain outstanding for the foreseeable future. Since we expect to eventually collect all amounts due to us, no related reserves have been established in our consolidated financial statements. However, we can provide no assurance that we will eventually collect all amounts due to us from Illinois. Failure to ultimately collect all outstanding amounts due from Illinois would have an adverse impact on our future consolidated results of operations and cash flows.

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

changes in our business strategies or development plans;

fluctuations in the value of our common stock, and;

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

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

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our consolidated financial statements. For a summary of our significant accounting policies, please see *Note 1 to the Consolidated Financial Statements* as included in our Annual Report on Form 10-K for the year ended December 31, 2011.

**Revenue recognition:** We record revenues and related receivables for health care services at the time the services are provided. Medicare and Medicaid revenues represented 39% of our net patient revenues during each of the three and nine-month periods ended September 30, 2012 and 41% of net patient revenues during each of the three and nine-month periods ended September 30, 2011. Revenues from managed care entities, including health maintenance organizations and managed Medicare and Medicaid programs, accounted for 50% and 46% of our net patient revenues during the three-month periods ended September 30, 2012 and 2011, respectively, and 49% and 46% of our net patient revenues during the nine-month periods ended September 30, 2012 and 2011, respectively.

**Provision for Doubtful Accounts:** On a consolidated basis, we monitor our total self-pay receivables to ensure that the total allowance for doubtful accounts provides adequate coverage based on historical collection experience. Our accounts receivable are recorded net of allowance for doubtful accounts of \$339 million at September 30, 2012 and \$253 million at December 31, 2011.

As of September 30, 2012 and December 31, 2011, our accounts receivable includes approximately \$76 million and \$54 million, respectively, due from Illinois. Collection of these receivables continues to be delayed due to state budgetary and funding pressures. Although approximately \$55 million of the receivables due from Illinois as of September 30, 2012 have been outstanding in excess of 60 days, and a large portion will likely remain outstanding for the foreseeable future, we expect to eventually collect all amounts due to us and therefore no related reserves have been established in our consolidated financial statements. However, we can provide no assurance that we will eventually collect all amounts due to us from Illinois. Failure to ultimately collect all outstanding amounts due from Illinois would have an adverse impact on our future consolidated results of operations and cash flows.

**Accounting for Medicare and Medicaid Electronic Health Records Incentive Payments:** In July 2010, the Department of Health and Human Services published final regulations implementing the health information technology provisions of the American Recovery and Reinvestment Act. The regulation defines the meaningful use of Electronic Health Records ( EHR ) and established the requirements for the Medicare and Medicaid EHR payment incentive programs. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. We recognize income related to Medicare and Medicaid incentive payments using a gain contingency model that is based upon when our eligible hospitals have demonstrated meaningful use of certified EHR technology for the applicable period and the cost report information for the full cost report year that will determine the final calculation of the incentive payment is available.

**Medicare EHR incentive payments:** Federal regulations require that Medicare EHR incentive payments be computed based on the Medicare cost report that begins in the federal fiscal period in which a hospital meets the applicable meaningful use requirements. Since the annual Medicare cost report periods for each of our acute care hospitals ends on December 31<sup>st</sup>, we will recognize Medicare EHR incentive income for each hospital during the fourth quarter of the year in which the facility meets the meaningful use criteria and during the fourth quarter of each applicable subsequent year.

**Medicaid EHR incentive payments:** Medicaid EHR incentive payments are determined based upon prior period cost report information available at the time our hospitals meet the meaningful use criteria. Therefore, the majority of the Medicaid EHR incentive income recognition occurs in the period in which the applicable hospitals are deemed to have met initial meaningful use criteria. Upon meeting subsequent fiscal year meaningful use criteria, our hospitals may become entitled to additional Medicaid EHR incentive payments which will be recognized as incentive income in future periods. Medicaid EHR incentive payments received prior to our hospitals meeting the meaningful use criteria are included in other current liabilities (as deferred EHR incentive income) in our consolidated balance sheet.

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

**Table of Contents****Results of Operations*****Three-month periods ended September 30, 2012 and 2011:***

The following table summarizes our results of operations and is used in the discussion below for the three-month periods ended September 30, 2012 and 2011 (dollar amounts in thousands):

	Three months ended September 30, 2012		Three months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 1,869,263		\$ 1,814,686	
Less: Provision for doubtful accounts	188,910		152,011	
<b>Net revenues</b>	<b>1,680,353</b>	<b>100.0%</b>	<b>1,662,675</b>	<b>100.0%</b>
Operating charges:				
Salaries, wages and benefits	838,075	49.9%	828,606	49.8%
Other operating expenses	362,687	21.6%	343,873	20.7%
Supplies expense	191,747	11.4%	198,794	12.0%
EHR incentive income	(10,551)	-0.6%	0	0.0%
Depreciation and amortization	77,032	4.6%	73,170	4.4%
Lease and rental expense	23,481	1.4%	22,704	1.4%
Costs related to extinguishment of debt	29,170	1.7%	0	0.0%
<b>Subtotal-operating expenses</b>	<b>1,511,641</b>	<b>90.0%</b>	<b>1,467,147</b>	<b>88.2%</b>
<b>Income from operations</b>	<b>168,712</b>	<b>10.0%</b>	<b>195,528</b>	<b>11.8%</b>
Interest expense, net	45,207	2.7%	48,452	2.9%
<b>Income before income taxes</b>	<b>123,505</b>	<b>7.3%</b>	<b>147,076</b>	<b>8.8%</b>
Provision for income taxes	42,132	2.5%	52,234	3.1%
<b>Net income</b>	<b>81,373</b>	<b>4.8%</b>	<b>94,842</b>	<b>5.7%</b>
Less: Income attributable to noncontrolling interests	9,556	0.6%	9,788	0.6%
<b>Net income attributable to UHS</b>	<b>\$ 71,817</b>	<b>4.3%</b>	<b>\$ 85,054</b>	<b>5.1%</b>

Net revenues increased 1% or \$18 million to \$1.68 billion during the three-month period ended September 30, 2012 as compared to \$1.66 billion during the comparable quarter of the prior year. The increase was attributable to a \$24 million or 2% increase in net revenues generated at our acute care hospitals and behavioral health care facilities owned during both periods (which we refer to as same facility), partially offset by \$6 million of other combined net decreases in revenues resulting primarily from the divestiture of a behavioral health care facility in January, 2012 (San Juan Capestrano).

Income before income taxes (before deduction for income attributable to noncontrolling interests) decreased \$24 million to \$124 million during the three-month period ended September 30, 2012 as compared to \$147 million during the comparable quarter of the prior year. Included in our income before income taxes during the third quarter of 2012, as compared to the comparable prior year quarter, was the following:

- a. a decrease of \$11 million at our acute care facilities as discussed below in Acute Care Hospital Services, excluding impact of the implementation of electronic health records ( EHR ) applications at our acute care hospitals, as mentioned in e. below;

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- b. an increase of \$16 million at our behavioral health care facilities, as discussed below in Behavioral Health Services, excluding the impact of the item mentioned in c. below;
  
- c. a decrease of \$29 million resulting from the write-off of deferred financing costs related to the portion of our Term Loan B credit facility that was extinguished during the third quarter of 2012;

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- d. an increase of \$3 million due to a decrease in interest expense resulting primarily from a decrease in our average borrowings outstanding;
  - e. an increase of \$3 million related to the incentive income, net of expenses, recorded in connection with the implementation of EHR applications at our acute care hospitals, and;
  - f. \$6 million of other combined net decreases including increased corporate overhead expenses.
- Net income attributable to UHS decreased \$13 million to \$72 million during the three-month period ended September 30, 2012 as compared to \$85 million during the comparable prior year quarter. The decrease during the third quarter of 2012, as compared to the comparable prior year quarter, consisted of:

a decrease of \$24 million in income before income taxes, as discussed above, and;

an increase of \$10 million resulting primarily from a decrease in the provision for income taxes resulting from the income tax benefit recorded on the \$24 million decrease in pre-tax income and a favorable income tax adjustment of approximately \$2 million recorded during the third quarter of 2012.

**Nine-month periods ended September 30, 2012 and 2011:**

The following table summarizes our results of operations and is used in the discussion below for the nine-month periods ended September 30, 2012 and 2011 (dollar amounts in thousands):

	Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 5,718,676		\$ 5,553,268	
Less: Provision for doubtful accounts	522,203		456,042	
<b>Net revenues</b>	<b>5,196,473</b>	<b>100.0%</b>	<b>5,097,226</b>	<b>100.0%</b>
Operating charges:				
Salaries, wages and benefits	2,565,052	49.4%	2,492,570	48.9%
Other operating expenses	1,059,048	20.4%	1,030,492	20.2%
Supplies expense	594,924	11.4%	603,657	11.8%
EHR incentive income	(12,506)	-0.2%	0	0.0%
Depreciation and amortization	221,807	4.3%	213,828	4.2%
Lease and rental expense	70,906	1.4%	68,501	1.3%
Costs related to extinguishment of debt	29,170	0.6%	0	0.0%
<b>Subtotal-operating expenses</b>	<b>4,528,401</b>	<b>87.1%</b>	<b>4,409,048</b>	<b>86.5%</b>
<b>Income from operations</b>	<b>668,072</b>	<b>12.9%</b>	<b>688,178</b>	<b>13.5%</b>
Interest expense, net	137,805	2.7%	154,677	3.0%
<b>Income before income taxes</b>	<b>530,267</b>	<b>10.2%</b>	<b>533,501</b>	<b>10.5%</b>
Provision for income taxes	188,880	3.6%	192,638	3.8%
<b>Net income</b>	<b>341,387</b>	<b>6.6%</b>	<b>340,863</b>	<b>6.7%</b>

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Less: Income attributable to noncontrolling interests	33,402	0.6%	37,967	0.7%
Net income attributable to UHS	\$ 307,985	5.9%	\$ 302,896	5.9%



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Net revenues increased 2% or \$99 million to \$5.20 billion during the nine-month period ended September 30, 2012 as compared to \$5.10 billion during the comparable period of the prior year. The increase was attributable to:

a \$90 million or 2% increase in net revenues generated at our acute care hospitals and behavioral health care facilities, on a same facility basis;

\$36 million of revenues resulting from an agreement, which was part of an industry-wide settlement related to underpayments of Medicare inpatient prospective payments during a number of prior years, entered into during the first quarter of 2012 with the United States Department of Health and Human Services, the Secretary of Health and Human Services, and the Centers for Medicare and Medicaid Services, and;

\$27 million of other combined net decreases in revenues resulting primarily from the divestiture of a behavioral health care facility in January, 2012 (San Juan Capestrano) and the temporary closure of a behavioral health care facility that was closed during the third quarter of 2011 from flood damage (the facility re-opened in March, 2012), partially offset by the 2011 portion of Medicaid revenues recorded during the first nine months of 2012 related to new supplemental revenue programs initiated in Oklahoma, Ohio and Indiana.

Income before income taxes (before deduction for income attributable to noncontrolling interests) decreased \$3 million to \$530 million during the nine-month period ended September 30, 2012 as compared to \$534 million during the comparable period of the prior year. Included in our income before income taxes during the first nine months of 2012, as compared to the comparable prior year period, was the following:

- a. a decrease of \$44 million at our acute care facilities as discussed below in Acute Care Hospital Services, excluding the impact of the applicable items mentioned in c., f. and h. below;
- b. an increase of \$49 million at our behavioral health care facilities, as discussed below in Behavioral Health Services, excluding the impact of the applicable items mentioned in e. and f. below;
- c. an increase of \$33 million (net of related expenses) resulting from an agreement, which was part of an industry-wide settlement related to underpayments of Medicare inpatient prospective payments during a number of prior years, entered into with the United States Department of Health and Human Services, the Secretary of Health and Human Services, and the Centers for Medicare and Medicaid Services;
- d. a decrease of \$29 million resulting from the write-off of deferred financing costs related to the portion of our Term Loan B credit facility that was extinguished during the third quarter of 2012;
- e. an increase of \$7 million representing the 2011 portion of the net Medicaid supplemental reimbursements earned pursuant to the Oklahoma Supplemental Hospital Offset Payment Program ( SHOPP ) which is expected to provide annual aggregate net reimbursements of \$14 million to our facilities located in the state during the state's fiscal years of 2012 and 2013, retroactive to July 1, 2011;
- f. a net aggregate decrease of \$5 million resulting from: (i) the revised Supplemental Security Income ratios utilized for calculating Medicare disproportionate share hospital reimbursements for federal fiscal years 2006 through 2009 (\$7 million unfavorable impact); (ii) the write-off of receivables related to revenues recorded during 2011 at two of our acute care hospitals located in Florida resulting from reductions in certain county reimbursements due to reductions in federal matching Inter-Governmental Transfer funds

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(\$4 million unfavorable impact), and; (iii) the 2011 portion of net Medicaid supplemental revenues recorded during the first nine months of 2012 related to new programs initiated in certain states in which we operate behavioral health care facilities (\$6 million favorable impact);

- g. an increase of \$17 million due to a decrease in interest expense resulting primarily from a decrease in our average outstanding borrowings and a decrease in our average effective interest rate (due primarily to an amendment to our credit agreement in March of 2011 which, among other things, provided for reductions in the rates payable for borrowings outstanding under our Term Loan A, Term Loan B and revolving credit facility);
- h. a decrease of \$6 million related to the expenses, net of incentive income, recorded in connection with the implementation of EHR applications at our acute care hospitals, and;
- i. \$25 million of other combined net decreases including increased corporate overhead expenses.

Net income attributable to UHS increased \$5 million to \$308 million during the nine-month period ended September 30, 2012 as compared to \$303 million during the comparable prior year period. The increase during the first nine months of 2012, as compared to the comparable prior year period, consisted of:

a decrease of \$3 million in income before income taxes, as discussed above;

an increase of \$5 million resulting from a decrease in income attributable to noncontrolling interests, and;

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an increase of \$4 million resulting from a decrease in the provision for income taxes resulting primarily from a favorable income tax adjustment of approximately \$2 million recorded during the third quarter of 2012.

**Acute Care Hospital Services****Same Facility Basis Acute Care Hospitals**

We believe that providing our results on a Same Facility basis, which includes the operating results for facilities owned in both the current year and prior year periods, is helpful to our investors as a measure of our operating performance. Our Same Facility results also neutralize the impact of the EHR applications and the effect of items that are non-operational in nature including items such as, but not limited to, gains on sales of assets and businesses, impacts of settlements, legal judgments and lawsuits and other amounts that may be reflected in the current or prior year financial statements that relate to prior periods.

The following table summarizes the results of operations for our acute care facilities, on a same facility and all acute care basis, and is used in the discussion below for the three and nine-month periods ended September 30, 2012 and 2011 (dollar amounts in thousands):

	Three months ended September 30, 2012		Three months ended September 30, 2011		Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 994,969		\$ 966,119		\$ 3,031,053		\$ 2,985,515	
Less: Provision for doubtful accounts	166,570		134,344		456,078		398,445	
Net revenues	828,399	100.0%	831,775	100.0%	2,574,975	100.0%	2,587,070	100.0%
Operating charges:								
Salaries, wages and benefits	381,266	46.0%	379,287	45.6%	1,156,914	44.9%	1,130,541	43.7%
Other operating expenses	186,254	22.5%	177,692	21.4%	535,470	20.8%	531,022	20.5%
Supplies expense	150,097	18.1%	152,093	18.3%	464,552	18.0%	465,166	18.0%
Depreciation and amortization	47,028	5.7%	49,068	5.9%	139,609	5.4%	142,556	5.5%
Lease and rental expense	14,313	1.7%	13,093	1.6%	43,523	1.7%	39,539	1.5%
Subtotal-operating expenses	778,958	94.0%	771,233	92.7%	2,340,068	90.9%	2,308,824	89.2%
Income from operations	49,441	6.0%	60,542	7.3%	234,907	9.1%	278,246	10.8%
Interest expense, net	1,129	0.1%	957	0.1%	3,511	0.1%	2,946	0.1%
Income before income taxes	48,312	5.8%	59,585	7.2%	231,396	9.0%	275,300	10.6%

**Three-month periods ended September 30, 2012 and 2011:**

During the three-month period ended September 30, 2012, as compared to the comparable prior year quarter, net revenues at our acute care hospitals, on a same facility basis, decreased \$3 million or less than 1%. Income before income taxes (and before income attributable to noncontrolling interests) decreased \$11 million or 19% to \$48 million or 5.8% of net revenues during the third quarter of 2012 as compared to \$60 million or 7.2% of net revenues during the comparable prior year quarter.

During the three-month period ended September 30, 2012, as compared to the comparable prior year quarter, inpatient admissions to our acute care facilities decreased 2.6% and adjusted admissions (adjusted for outpatient activity) decreased 1.7%. Patient days at these facilities decreased 2.0% during the third quarter of 2012 and adjusted patient days decreased 1.7% during the three-month period ended September 30, 2012 as compared to the comparable prior year quarter. The average length of inpatient stay at these facilities was 4.4 days during each of the three-month periods ended September 30, 2012 and 2011, respectively. The occupancy rate, based on the average available beds at these facilities, was 54% and 56% during the three-month periods ended September 30, 2012 and 2011, respectively. During the three-month period ended September 30, 2012, net revenue per adjusted admission increased 1.3% and net revenue per adjusted patient day increased 0.6%, as

compared to the comparable quarter of the prior year.

**Nine-month periods ended September 30, 2012 and 2011:**

During the nine-month period ended September 30, 2012, as compared to the comparable prior year period, net revenues at our acute care hospitals, on a same facility basis, decreased \$12 million or approximately 1%. Income before income taxes (and before income attributable to noncontrolling interests) decreased \$44 million or 16% to \$231 million or 9.0% of net revenues during the first nine months of 2012 as compared to \$275 million or 10.6% of net revenues during the comparable prior year period.

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During the nine-month period ended September 30, 2012, as compared to the comparable prior year period, inpatient admissions to our acute care facilities decreased 2.9% and adjusted admissions decreased 0.3%. Patient days at these facilities decreased 2.4% during the first nine months of 2012 and adjusted patient days increased 0.3% during the nine-month period ended September 30, 2012 as compared to the comparable prior year period. The average length of inpatient stay at these facilities was 4.5 days during each of the nine-month periods ended September 30, 2012 and 2011. The occupancy rate, based on the average available beds at these facilities, was 57% and 59% during the nine-month periods ended September 30, 2012 and 2011, respectively. During the nine-month period ended September 30, 2012, net revenue per adjusted admission decreased 0.2% and net revenue per adjusted patient day decreased 0.7%, as compared to the comparable period of the prior year.

The decreases in income from operations, net revenues and net revenue per adjusted admission and adjusted patient day experienced at our acute care hospitals during the three and nine-month periods ended September 30, 2012, as compared to the comparable periods of the prior year, were largely due a decline in organic revenue growth caused by the continuing trends of weak demand and deteriorating payor mix

**Charity care and uninsured discounts:**

A significant portion of the patients treated throughout our portfolio of acute care hospitals are uninsured patients which, in part, has resulted from an increase in the number of patients who are employed but do not have health insurance or who have policies with relatively high deductibles. Patients treated at our hospitals for non-elective services, who have gross income less than 400% of the federal poverty guidelines, are deemed eligible for charity care. The federal poverty guidelines are established by the federal government and are based on income and family size. Because we do not pursue collection of amounts that qualify as charity care, they are not reported in our net revenues or in our accounts receivable, net. We also provide discounts to uninsured patients (included in uninsured discounts amounts below) who do not qualify for Medicaid or charity care. Because we do not pursue collection of amounts classified as uninsured discounts, they are not reported in our net revenues or in our accounts receivable, net. In implementing the discount policy, we first attempt to qualify uninsured patients for governmental programs, charity care or any other discount program. If an uninsured patient does not qualify for these programs, the uninsured discount is applied.

The following tables show the amounts recorded at our acute care hospitals for charity care and uninsured discounts, based on charges at established rates, for the three and nine-month periods ended September 30, 2012 and 2011:

**Uncompensated care (in millions):**

	Three Months Ended Sept. 30, 2012	%	Three Months Ended Sept. 30, 2011	%
Charity care	\$ 185	71%	\$ 212	86%
Uninsured discounts	74	29%	34	14%
<b>Total uncompensated care</b>	<b>\$ 259</b>	<b>100%</b>	<b>\$ 246</b>	<b>100%</b>

	Nine Months Ended Sept. 30, 2012	%	Nine Months Ended Sept. 30, 2011	%
Charity care	\$ 643	77%	\$ 591	83%
Uninsured discounts	197	23%	117	17%
<b>Total uncompensated care</b>	<b>\$ 840</b>	<b>100%</b>	<b>\$ 708</b>	<b>100%</b>

The estimated costs of providing uncompensated care as reflected below were based on a calculation which multiplied the percentage of operating expenses for our acute care hospitals to gross charges for those hospitals by the above-mentioned total uncompensated care amounts. The percentage of cost to gross charges is calculated based on the total operating expenses for our acute care facilities (excluding provision for doubtful accounts) divided by gross patient service revenue for those facilities. An increase in the level of uninsured patients to our facilities and the resulting adverse trends in the provision for doubtful accounts and uncompensated care provided could have a material unfavorable impact

on our future operating results.

**Estimated cost of providing uncompensated care (in millions):**

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2012	Sept. 30, 2011	Sept. 30, 2012	Sept. 30, 2011
Estimated cost of providing charity care	\$ 32	\$ 38	\$ 108	\$ 105
Estimated cost of providing uninsured discounts related care	13	7	33	21
Estimated cost of providing uncompensated care	\$ 45	\$ 45	\$ 141	\$ 126

**Table of Contents****All Acute Care Hospitals**

The following table summarizes the results of operations for our acute care hospitals for the three and nine-month periods ended September 30, 2012 and 2011.

**Three-month periods ended September 30, 2012 and 2011:**

Included in the financial results below for the three-month periods ended September 30, 2012 and 2011, in addition to our acute care hospitals same facility basis financial results as discussed above, were certain other items consisting of the net favorable impact of \$3 million recorded during the third quarter of 2012 related to the incentive income (\$11 million) and expenses (\$8 million) recorded in connection with the implementation of electronic health records ( EHR ) applications at our acute care hospitals (see *HITECH Act* in *Sources of Revenue* below for additional disclosure), and a net charge of \$3 million from other amounts.

**Nine-month periods ended September 30, 2012 and 2011:**

Included in the financial results below for the nine-month periods ended September 30, 2012 and 2011, in addition to our acute care hospitals same facility basis financial results as discussed above, were the following items:

a net favorable impact of \$33 million (\$36 million of net revenues and \$3 million of related operating expenses) resulting from an agreement, which was part of an industry-wide settlement related to underpayments of Medicare inpatient prospective payments during a number of prior years, entered into with the United States Department of Health and Human Services, the Secretary of Health and Human Services, and the Centers for Medicare and Medicaid Services;

an aggregate unfavorable impact of \$11 million resulting from a \$7 million reduction to net revenues from the revised Supplemental Security Income ratios utilized for calculating Medicare disproportionate share hospital reimbursements for federal fiscal years 2006 through 2009 and a \$4 million reduction to net revenues resulting from the write-off of receivables related to revenues recorded during 2011 at two of our acute care hospitals located in Florida resulting from reductions in certain county reimbursements due to reductions in federal matching Inter-Governmental Transfer funds;

a net charge of \$7 million recorded during the first nine months of 2012 related to the incentive income (\$13 million) and expenses (\$20 million) recorded in connection with the implementation of EHR applications at our acute care hospitals, and;

other combined amounts aggregating to a net charge \$7 million during the nine-month period ended September 30, 2012 and a net charge of \$1 million recorded during the nine-month period ended September 30, 2011.

	Three months ended September 30, 2012		Three months ended September 30, 2011		Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 994,969		\$ 966,119		\$ 3,054,605		\$ 2,985,515	
Less: Provision for doubtful accounts	166,570		134,344		456,078		398,445	
Net revenues	828,399	100.0%	831,775	100.0%	2,598,527	100.0%	2,587,070	100.0%
Operating charges:								
Salaries, wages and benefits	384,045	46.4%	379,287	45.6%	1,167,636	44.9%	1,130,541	43.7%
Other operating expenses	188,838	22.8%	180,250	21.7%	543,725	20.9%	531,166	20.5%

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Supplies expense	150,097	18.1%	152,093	18.3%	464,552	17.9%	465,166	18.0%
Depreciation and amortization	51,603	6.2%	49,068	5.9%	147,711	5.7%	142,556	5.5%
Lease and rental expense	14,313	1.7%	13,093	1.6%	43,523	1.7%	39,539	1.5%
EHR incentive income	(10,551)	-1.3%	0	0.0%	(12,506)	-0.5%	0	0.0%
Subtotal-operating expenses	778,345	94.0%	773,791	93.0%	2,354,641	91.4%	2,308,968	89.3%
Income from operations	50,054	6.0%	57,984	7.0%	243,886	9.4%	278,102	10.7%
Interest expense, net	1,129	0.1%	957	0.1%	3,511	0.1%	2,946	0.1%
Income before income taxes	48,925	5.9%	57,027	6.9%	240,375	9.3%	275,156	10.6%



**Table of Contents****Behavioral Health Services**

The following table summarizes the results of operations for our behavioral health care facilities, on a same facility basis, and is used in the discussion below for the three and nine-month periods ended September 30, 2012 and 2011 (dollar amounts in thousands):

**Same Facility Behavioral Health**

	Three months ended September 30, 2012		Three months ended September 30, 2011		Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 856,258		\$ 824,579		\$ 2,606,091		\$ 2,495,450	
Less: Provision for doubtful accounts	21,854		17,430		65,244		56,402	
<b>Net revenues</b>	<b>834,404</b>	<b>100.0%</b>	<b>807,149</b>	<b>100.0%</b>	<b>2,540,847</b>	<b>100.0%</b>	<b>2,439,048</b>	<b>100.0%</b>
Operating charges:								
Salaries, wages and benefits	413,637	49.6%	402,866	49.9%	1,261,549	49.7%	1,221,074	50.1%
Other operating expenses	148,891	17.8%	145,901	18.1%	448,568	17.7%	435,839	17.9%
Supplies expense	40,061	4.8%	44,236	5.5%	125,611	4.9%	131,201	5.4%
Depreciation and amortization	23,292	2.8%	21,341	2.6%	68,035	2.7%	63,300	2.6%
Lease and rental expense	8,345	1.0%	8,218	1.0%	25,212	1.0%	24,742	1.0%
<b>Subtotal-operating expenses</b>	<b>634,226</b>	<b>76.0%</b>	<b>622,562</b>	<b>77.1%</b>	<b>1,928,975</b>	<b>75.9%</b>	<b>1,876,156</b>	<b>76.9%</b>
<b>Income from operations</b>	<b>200,178</b>	<b>24.0%</b>	<b>184,587</b>	<b>22.9%</b>	<b>611,872</b>	<b>24.1%</b>	<b>562,892</b>	<b>23.1%</b>
Interest expense, net	431	0.1%	377	0.0%	1,192	0.0%	1,350	0.1%
<b>Income before income taxes</b>	<b>199,747</b>	<b>23.9%</b>	<b>184,210</b>	<b>22.8%</b>	<b>610,680</b>	<b>24.0%</b>	<b>561,542</b>	<b>23.0%</b>

**Three-month periods ended September 30, 2012 and 2011:**

On a same facility basis, during the third quarter of 2012, as compared to the third quarter of 2011, net revenues at our behavioral health care facilities increased 3% or \$27 million to \$834 million from \$807 million. Income before income taxes increased \$16 million or 8% to \$200 million or 23.9% of net revenues during the three-month period ended September 30, 2012, as compared to \$184 million or 22.8% of net revenues during the comparable prior year quarter.

On a same facility basis, inpatient admissions and adjusted admissions to our behavioral health facilities increased 2.8% and 2.6%, respectively, during the three-month period ended September 30, 2012 as compared to the comparable quarter of the prior year. Patient days and adjusted patient days increased 0.9% and 0.7%, respectively, during the three-month period ended September 30, 2012 as compared to the comparable prior year quarter. The average length of inpatient stay at these facilities was 14.1 days and 14.4 days during the three-month periods ended September 30, 2012 and 2011, respectively. The occupancy rate, based on the average available beds at these facilities, was 73% during each of the three-month periods ended September 30, 2012 and 2011. During the three-month period ended September 30, 2012, net revenue per adjusted admission increased 0.7% and net revenue per adjusted patient day increased 2.6%, as compared to the comparable quarter of the prior year.

**Nine-month periods ended September 30, 2012 and 2011:**

On a same facility basis, during the first nine months of 2012, as compared to the comparable period of 2011, net revenues at our behavioral health care facilities increased 4% or \$102 million to \$2.54 billion from \$2.44 billion. Income before income taxes increased \$49 million or 9% to \$611 million or 24.0% of net revenues during the nine-month period ended September 30, 2012, as compared to \$562 million or 23.0% of net

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revenues during the comparable period of 2011.

On a same facility basis, inpatient admissions and adjusted admissions to our behavioral health facilities increased 4.8% and 5.0%, respectively, during the nine-month period ended September 30, 2012 as compared to the comparable period of 2011. Patient days and adjusted patient days increased 1.0% and 1.2%, respectively, during the nine-month period ended September 30, 2012 as compared to the comparable period of 2011. The average length of inpatient stay at these facilities was 14.0 days and 14.5 days during the nine-month periods ended September 30, 2012 and 2011, respectively. The occupancy rate, based on the average available beds at these facilities, was 75% and 74% during each of the nine-month periods ended September 30, 2012 and 2011. During the nine-month period ended September 30, 2012, net revenue per adjusted admission decreased 0.7% and net revenue per adjusted patient day increased 2.9%, as compared to the comparable period of 2011.

**Table of Contents****All Behavioral Health Care Facilities**

The following table summarizes the results of operations for our behavioral health care facilities for the three and nine-month periods ended September 30, 2012 and 2011.

**Three-month periods ended September 30, 2012 and 2011:**

Included in the financial results below for the three-month period ended September 30, 2012, in addition to our behavioral health care facilities same facility basis financial results as discussed above, were various other items that combined to a net favorable aggregate of approximately \$1 million.

**Nine-month periods ended September 30, 2012 and 2011:**

Included in the financial results below for the nine-month period ended September 30, 2012, in addition to our behavioral health care facilities same facility basis financial results as discussed above, were the following items:

\$7 million of net revenues recorded during the first quarter of 2012 representing the 2011 portion of the net Medicaid supplemental reimbursements earned pursuant to the Oklahoma Supplemental Hospital Offset Payment Program;

\$7 million of net revenues recorded during the second quarter of 2012 representing the 2011 portion of the net Medicaid supplemental reimbursements earned primarily from new programs approved in Indiana and Ohio which were retroactive to July 1, 2011, and;

an other combined net favorable aggregate of \$3 million during the first nine months of 2012 and an other combined net unfavorable aggregate of \$2 million during the first nine months of 2011.

	Three months ended September 30, 2012		Three months ended September 30, 2011		Nine months ended September 30, 2012		Nine months ended September 30, 2011	
	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues	Amount	% of Net Revenues
Net revenues before provision for doubtful accounts	\$ 863,995		\$ 843,535		\$ 2,638,400		\$ 2,550,833	
Less: Provision for doubtful accounts	22,326		17,710		66,144		57,497	
<b>Net revenues</b>	<b>841,669</b>	<b>100.0%</b>	<b>825,825</b>	<b>100.0%</b>	<b>2,572,256</b>	<b>100.0%</b>	<b>2,493,336</b>	<b>100.0%</b>
Operating charges:								
Salaries, wages and benefits	417,794	49.6%	414,014	50.1%	1,276,741	49.6%	1,252,040	50.2%
Other operating expenses	149,845	17.8%	150,752	18.3%	444,522	17.3%	454,314	18.2%
Supplies expense	40,414	4.8%	45,349	5.5%	126,686	4.9%	134,477	5.4%
Depreciation and amortization	23,809	2.8%	22,141	2.7%	69,214	2.7%	65,241	2.6%
Lease and rental expense	8,665	1.0%	8,887	1.1%	25,731	1.0%	26,231	1.1%
<b>Subtotal-operating expenses</b>	<b>640,527</b>	<b>76.1%</b>	<b>641,143</b>	<b>77.6%</b>	<b>1,942,894</b>	<b>75.5%</b>	<b>1,932,303</b>	<b>77.5%</b>
<b>Income from operations</b>	<b>201,142</b>	<b>23.9%</b>	<b>184,682</b>	<b>22.4%</b>	<b>629,362</b>	<b>24.5%</b>	<b>561,033</b>	<b>22.5%</b>
Interest expense, net	431	0.1%	378	0.0%	1,192	0.0%	1,352	0.1%
<b>Income before income taxes</b>	<b>200,711</b>	<b>23.8%</b>	<b>184,304</b>	<b>22.3%</b>	<b>628,170</b>	<b>24.4%</b>	<b>559,681</b>	<b>22.4%</b>

**Sources of Revenue**

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

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The following table shows the approximate percentages of net patient revenue for the three and nine-month periods ended September 30, 2012 and 2011 presented: (i) on a combined basis for both our acute care and behavioral health facilities; (ii) for our acute care facilities only, and; (iii) for our behavioral health facilities only:

Acute Care and Behavioral Health Facilities Combined	Percentage of Net Patient Revenues Three Months Ended September 30,		Percentage of Net Patient Revenues Nine Months Ended September 30,	
	2012	2011	2012	2011
	Third Party Payors:			
Medicare	24%	24%	24%	24%
Medicaid	15%	17%	15%	17%
Managed Care (HMO and PPOs)	50%	46%	49%	46%
Other Sources	11%	13%	12%	13%
Total	100%	100%	100%	100%

  

Acute Care Facilities	Percentage of Net Patient Revenues Three Months Ended September 30,		Percentage of Net Patient Revenues Nine Months Ended September 30,	
	2012	2011	2012	2011
	Third Party Payors:			
Medicare	28%	28%	29%	29%
Medicaid	7%	9%	7%	9%
Managed Care (HMO and PPOs)	59%	52%	57%	53%
Other Sources	6%	11%	7%	9%
Total	100%	100%	100%	100%

  

Behavioral Health Facilities	Percentage of Net Patient Revenues Three Months Ended September 30,		Percentage of Net Patient Revenues Nine Months Ended September 30,	
	2012	2011	2012	2011
	Third Party Payors:			
Medicare	21%	19%	19%	18%
Medicaid	23%	24%	23%	25%
Managed Care (HMO and PPOs)	40%	40%	40%	39%
Other Sources	16%	17%	18%	18%
Total	100%	100%	100%	100%

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

Under the Medicare program, for inpatient services, our general acute care hospitals receive reimbursement under the inpatient prospective payment system ( IPPS ). Under the IPPS, hospitals are paid a predetermined fixed payment amount for each hospital discharge. The fixed payment amount is based upon each patient's Medicare severity diagnosis related group ( MS-DRG ). Every MS-DRG is assigned a payment rate

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

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

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

In August, 2011, CMS published its final IPPS 2012 payment rule which provided for a 3.0% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors, annual geographic wage index updates, documenting and coding adjustments and Health Care Reform productivity adjustments are considered, we estimate our overall increase from the final federal fiscal year 2012 rule will approximate 0.6%. CMS also includes a 2.0% market basket reduction related to prior year documentation and coding adjustments as well as a 1.1% increase related to the correction of a prior year wage index budget neutrality adjustment. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS was also required by federal law to reduce the update factor by 0.10% in federal fiscal year 2012. The projected impact from this IPPS rule noted above reflects all of the adjustments described in this paragraph.

In August, 2012, CMS published its final IPPS 2013 payment rule which provided for a 2.6% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors, annual geographic wage index updates, documenting and coding adjustments and Health Care Reform mandated adjustments are considered, we estimate our overall increase from the final federal fiscal year 2013 rule (covering the period of October 1, 2012 through September 30, 2013) will approximate 1.8%. This projected impact from the IPPS 2013 final rule reflects all of the adjustments described in this paragraph, however, it excludes the impact of potential reductions related to the Budget Control Act of 2011, as discussed below.

In September, 2007, the TMA, Abstinence Education, and QI Programs Extension Act of 2007 legislation took effect and scaled back cuts in hospital reimbursement that CMS was set to impose. In federal fiscal years 2010 to 2012, the new law requires CMS to make adjustments to the Medicare standardized amounts in these years to reflect the removal of actual aggregate payment increases or decreases for documentation and coding adjustments that occurred during federal fiscal years 2008 and 2009 as compared to the initial CMS estimates. In federal fiscal year 2010, CMS made its initial statutory mandated adjustment under this legislation and will continue to do so in subsequent fiscal years to ensure the implementation of MS-DRGs was budget neutral among all affected hospitals. In July, 2010, the IPPS 2011 proposed payment rule applied a 2.9% reduction to the 2011 market basket update and indicated another 2.9% reduction would also be applied in 2012 for documenting and coding. In this same rule, CMS indicated a remaining documenting and coding adjustment of 3.9% reduction is still required to be made to future IPPS updates. In the 2012 IPPS final rule, CMS offset 2.0% of this remaining reduction and has proposed to offset the remaining 1.9% in the IPPS 2013 payment rule described above.

On January 1, 2005, CMS implemented a new Psychiatric Prospective Payment System ( Psych PPS ) for inpatient services furnished by psychiatric hospitals under the Medicare program. This system replaced the cost-based reimbursement guidelines with a per diem Psych PPS with adjustments to account for certain facility and patient characteristics. The Psych PPS also contained provisions for outlier payments and an adjustment to a psychiatric hospital's base payment if it maintains a full-service emergency department. According to the April, 2010 CMS notice, the market basket increase was 2.4% for the period of July 1, 2010 through June 30, 2011. In April, 2011 CMS published its final Psych PPS rule for the fifteen month period July 1, 2011 to September 30, 2012. The market basket increase for this time period is 2.95%, which includes a 0.25% reduction required by the federal Health Care Reform legislation enacted in 2010. In August, 2012 CMS published the federal year 2013 Psych PPS rate notice. The market basket increase for this period is 2.7% less required Health Care Reform legislation reductions totaling 0.8% for a net market basket increase of 1.9%.

In November 2010, CMS published its annual final Medicare Outpatient Prospective Payment System ( OPPTS ) rule for 2011. The final market basket increase to the OPPTS base rate is 2.46%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.25% in federal fiscal year 2011. When other statutorily required adjustments and hospital patient service mix are considered, the overall Medicare OPPTS payment increase for 2011 is estimated to be 3.2%.

In November, 2011, CMS published its annual final Medicare OPPTS rule for 2012. The market basket increase to the OPPTS base rate is 3.0%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.1% in federal fiscal year 2012 and to reduce the annual update by a productivity adjustment which is 1.1%. In the final rule, CMS is also implementing a significant decrease in the 2012 Medicare rates for both hospital-based and community mental health center (CMHC) partial hospitalization programs. When other statutorily required adjustments, hospital patient service mix and the aforementioned partial hospitalization rates are considered, our overall Medicare OPPTS payment decrease for 2012 is estimated to be 0.7%. Excluding the behavioral health division partial hospitalization rate impact, our Medicare OPPTS payment increase for 2012 is estimated to be 2.1%.

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In November, 2012, CMS published its annual final Medicare OPPS rule for 2013. The market basket increase to the OPPS base rate is 2.6%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.1% in federal fiscal year 2013 and to reduce the annual update by a productivity adjustment which is 0.7%. In the final rule, CMS is also implementing a significant increase in the 2013 Medicare rates for both hospital-based and community mental health center partial hospitalization programs. When other statutorily required adjustments, hospital patient service mix and the aforementioned partial hospitalization rates are considered, our overall Medicare OPPS payment increase for 2013 is estimated to be 3.5%. Excluding the behavioral health division partial hospitalization rate impact, our Medicare OPPS payment increase for 2013 is estimated to be 1.7%.



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In August, 2011, the Budget Control Act of 2011 (the 2011 Act ) was enacted into law. Included in this law are the imposition of annual spending limits for most federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. Among its other provisions, the law established a bipartisan Congressional committee, known as the Joint Committee, which was responsible for developing recommendations aimed at reducing future federal budget deficits by an additional \$1.5 trillion over 10 years. The Joint Committee was unable to reach an agreement by the November 23, 2011 deadline and, as a result, across-the-board cuts to discretionary, national defense and Medicare spending were implemented which, if triggered, would result in Medicare payment reductions of up to 2% per fiscal year with a uniform percentage reduction across all Medicare programs starting in 2013 (approximately \$32 million annual reduction to our Medicare net revenues). We cannot predict whether Congress will attempt to suspend or restructure the automatic budget cuts or what other deficit reduction initiatives may be proposed by Congress.

We entered into an agreement in April, 2012 with the United States Department of Health and Human Services, the Secretary of Health and Human Services, and the Centers for Medicare and Medicaid Services (referred to collectively as HHS ) that resulted in an aggregate cash payment to us of approximately \$36 million, the majority of which was received by June 30, 2012. After reductions for estimated related expenses and the portion attributable to third-party non-controlling ownership interests, this settlement favorably impacted our pre-tax consolidated financial results during the three-month period ended March 31, 2012 by approximately \$30 million. This agreement was part of an industry-wide settlement with HHS related to litigation that was pending for several years contending that acute care hospitals in the U.S. were underpaid from the Medicare inpatient prospective payment system during a number of prior years. The underpayments resulted from calculations related to rural floor budget neutrality adjustments that were implemented in connection with the Balanced Budget Act of 1997.

During March, 2012, CMS issued new Supplemental Security Income ( SSI ) ratios utilized for calculating Medicare Disproportionate Share Hospital reimbursements ( Medicare DSH ) for federal fiscal years 2006 through 2009. As a result of these new SSI ratios, acute care hospitals are required to recalculate their Medicare DSH for the affected years and record adjustments for differences in estimated reimbursements. In addition, two of our acute care hospitals located in Florida were notified that the respective counties in which they operate were no longer funding the hospitals with certain reimbursements resulting from reductions in federal matching Inter-Governmental Transfer funds. As a result of the unfavorable adjustments required from the revised SSI ratios, and the write-off of receivables from certain counties located in Florida, our pre-tax consolidated financial results during the nine-month period ended September 30, 2012 were unfavorably impacted by an aggregate of approximately \$8 million (net of the portion attributable to third-party non-controlling ownership interests).

**HITECH Act:** In July 2010, the Department of Health and Human Services ( HHS ) published final regulations implementing the health information technology ( HIT ) provisions of the American Recovery and Reinvestment Act (referred to as the HITECH Act ). The final regulation defines the meaningful use of Electronic Health Records ( EHR ) and establishes the requirements for the Medicare and Medicaid EHR payment incentive programs. The final rule established an initial set of standards and certification criteria. The implementation period for these new Medicare and Medicaid incentive payments started in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. State Medicaid program participation in this federally funded incentive program is voluntary but we expect that all of the states in which our eligible hospitals operate will ultimately choose to participate. Our acute care hospitals may qualify for these EHR incentive payments upon implementation of the EHR application assuming they meet the meaningful use criteria. The government's ultimate goal is to promote more effective (quality) and efficient healthcare delivery through the use of technology to reduce the total cost of healthcare for all Americans and utilizing the cost savings to expand access to the healthcare system.

During 2011, we began implementing EHR applications at certain of our acute care hospitals and will continue to do so, on a hospital-by-hospital basis, until completion which is scheduled to occur by the end of June, 2013. As of September 30, 2012, EHR applications have been implemented at eleven of our acute care hospitals, the majority of which occurred during the second and third quarters of 2012. Our acute care hospitals will be eligible for Medicare and Medicaid EHR incentive payments upon implementation of the EHR application, assuming they meet the meaningful use criteria. Eight hospitals met the meaningful use criteria during the first nine months of 2012 and we anticipate that one additional hospital will qualify by the end of 2012.

Our consolidated results of operations for the three-month period ended September 30, 2012 includes a favorable pre-tax impact of approximately \$2 million consisting of approximately \$11 million of EHR incentive income less approximately \$3 million of salaries, wages, benefits and other operating expenses, approximately \$5 million of depreciation and amortization expense and approximately \$1 million of income attributable to noncontrolling interests. Our consolidated results of operations for the nine-month period ended September 30, 2012 includes an unfavorable pre-tax impact of approximately \$6 million consisting of approximately \$12 million of EHR incentive income less approximately \$11 million of salaries, wages, benefits and other operating expenses, approximately \$8 million of depreciation and amortization expense and approximately \$1 million of loss attributable to noncontrolling interests. The EHR incentive income recorded during the second and third quarters of 2012 consists of state Medicaid EHR incentive payments attributable to our acute care hospitals that met the meaningful use criteria during those periods.

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We previously classified approximately \$2 million of EHR incentive income as net revenues in our condensed consolidated statements of income for the three and six months ended June 30, 2012. That amount has been reclassified and is now included in the line item "EHR incentive income" in our condensed consolidated statements of income for the nine months ended September 30, 2012.

We have received an aggregate of approximately \$21 million of state Medicaid, EHR incentive payments as of September 30, 2012. These payments, which are/were reflected as deferred EHR incentive income on our consolidated balance sheet (included in other current liabilities), will be/were recorded as EHR incentive income in our consolidated statements of income in the periods in which the applicable hospitals are deemed to have met the "meaningful use" criteria. Upon meeting the "meaningful use" criteria, our hospitals may become entitled to additional Medicaid incentive payments in future periods.

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Federal regulations require that Medicare EHR incentive payments be computed based on the Medicare cost report that begins in the federal fiscal period in which a hospital meets the applicable meaningful use requirements. Since the annual Medicare cost report periods for each of our acute care hospitals ends on December 31<sup>st</sup>, we will recognize Medicare EHR incentive income for each hospital during the fourth quarter of the year in which the facility meets the meaningful use criteria and during the fourth quarter of each applicable subsequent year.

Hospitals that do not qualify as a meaningful user of EHR by 2015 are subject to a reduced market basket update to the IPPS standardized amount in 2015 and each subsequent fiscal year. Although we believe that our acute care hospitals will be in compliance with the EHR standards by 2015, there can be no assurance that all of our facilities will be in compliance and therefore not subject to the penalty provision of the HITECH Act.

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

We receive Medicaid revenues in excess of \$90 million annually from each of Texas, Pennsylvania, Washington, D.C., Illinois, Massachusetts and Virginia, making us particularly sensitive to reductions in Medicaid and other state based revenue programs (which have been implemented in various forms with respect to our areas of operation in the respective 2013 state fiscal years) as well as regulatory, economic, environmental and competitive changes in those states. In the states in which we operate, based upon the state budgets for the 2012 fiscal year (which generally began at various times during the second half of 2011), we estimate that, on a blended basis, our aggregate Medicaid rates have been reduced by approximately 3% to 4% (or approximately \$45 million to \$55 million annually) from the average rates in effect during the states' 2011 fiscal years (which generally ended during the third quarter of 2011). Our consolidated results of operations for the three and nine-month periods ended September 30, 2012 include the pro rata portion of these Medicaid rate reductions. Based upon the state budgets for the 2013 fiscal year (which generally begin at various times during the second half of 2012), we estimate that, on a blended basis, our aggregate Medicaid rates will be reduced by approximately 1% (or approximately \$15 million annually) from the average rates in effect during the states' 2012 fiscal years (which generally end during the third quarter of 2012). We can provide no assurance that further reductions to Medicaid revenues, particularly in the above-mentioned states, will not have a material adverse effect on our future results of operations.

Certain of our acute care hospitals located in various counties of Texas (Hidalgo, Maverick, Potter and Webb) participate in CMS-approved private Medicaid supplemental payment ( UPL ) programs. These hospitals also have affiliation agreements with third-party hospitals to provide free hospital and physician care to qualifying indigent residents of these counties. Our hospitals receive both UPL payments from the Medicaid program and indigent care payments from third-party, affiliated hospitals. The UPL payments are contingent on the county or hospital district making an Inter-Governmental Transfer ( IGT ) to the state Medicaid program while the indigent care payment is contingent on a transfer of funds from the applicable affiliated hospitals. We recorded net UPL and affiliated hospital indigent care revenues of \$6 million and \$7 million during the three-month periods ended September 30, 2012 and 2011, respectively, \$18 million and \$25 million during the nine-month periods ended September 30, 2012 and 2011, respectively. For state fiscal year 2013, Texas Medicaid will continue to operate under a CMS-approved Section 1115 five-year Medicaid waiver demonstration program. During the first five years of this program that started in state fiscal year 2012, the Texas Health and Human Services Commission ( THHSC ) transitioned away from UPL payments to new waiver incentive payment programs. During the first year of transition, which commenced on October 1, 2011, THHSC made payments to Medicaid UPL recipient providers that received payments during the state's prior fiscal year. During transition years two through five, THHSC will make incentive payments under the program after certain qualifying criteria are met by hospitals. If the applicable hospital district or county makes IGTs consistent with 2012 levels, we believe we would be entitled to aggregate net revenues earned pursuant to these programs of approximately \$25 million during the state fiscal year state 2013 which ends September 30, 2013.

We incur health-care related taxes ( Provider Taxes ) imposed by states in the form of a licensing fee, assessment or other mandatory payment which are related to: (i) healthcare items or services; (ii) the provision of, or the authority to provide, the health care items of services, or; (iii) the payment for the health care items or services. Such Provider Taxes are subject to various federal regulations that limit the scope and amount of the taxes that can be levied by states in order to secure federal matching dollars as part of their respective state Medicaid programs. We derive a related Medicaid reimbursement benefit from assessed Provider Taxes in the form of Medicaid claims based payment increases and/or lump sum Medicaid supplemental payments. We earned an aggregate net benefit of approximately \$5 million and \$6 million during the three-month periods ended September 30, 2012 and 2011, respectively, and \$15 million and \$15 million during the nine-month periods ended September 30, 2012 and 2011, respectively, from Medicaid supplemental payments, after assessed Provider Taxes were considered (exclusive of our hospitals located in Oklahoma, Indiana and Ohio, as discussed below). Excluding Oklahoma, Indiana and Ohio, we estimate that our aggregate net benefit from these Provider Tax programs will approximate \$5 million during the remaining three months of 2012. The aggregate net benefit is earned from multiple states and therefore no particular state's portion is individually material to our consolidated financial

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statements. However, Provider Taxes are governed by both federal and state laws and are subject to future legislative changes that, if reduced from current rates in several states, could have a material adverse impact on our consolidated future results of operations.

In January, 2012, the state of Oklahoma was granted federal approval by the Centers for Medicare and Medicaid Services ( CMS ) for the Supplemental Hospital Offset Payment Program ( SHOPP ) which grants the Oklahoma Health Care Authority the authority to assess a 2.5%

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fee on certain Oklahoma hospitals and to make Medicaid supplemental payments to hospitals through December 31, 2014, retroactive to July 1, 2011. The state finalized the initial supplemental payment program amounts in March, 2012. Pursuant to the terms and conditions of the SHOPP program during the state's fiscal years of 2012 and 2013, we estimate that we are entitled to annual net reimbursements of approximately \$14 million, retroactive to July 1, 2011. Our pre-tax consolidated financial results for the three and nine-month periods ended September 30, 2012 were favorably impacted by approximately \$3 million and \$17 million, respectively, consisting of revenues related to the SHOPP program covering the period of July 1, 2011 through September 30, 2012.

In addition, during the second quarter of 2012, new supplemental Medicaid programs were initiated in Indiana and Ohio in which we operate behavioral health care facilities. Our pre-tax consolidated financial results for the three and nine-month periods ended September 30, 2012 were favorably impacted by approximately \$2 million and \$12 million, respectively, recorded in connection with these programs which were retroactive to July, 2011.

In California, a Medicaid state plan amendment ( SPA ) was submitted to CMS by the state requesting an extension of a prior provider tax and related Medicaid supplemental payment program retroactive to July 1, 2011 through December 31, 2013. In June, 2012, CMS approved a portion of the SPA which did not have a material impact on our consolidated financial statements for the three and nine-month periods ended September 30, 2012. Approval of the additional SPA component related to Medicaid managed care supplemental payments would have a favorable impact on our future results of operations.

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

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

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

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

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

Upon meeting certain conditions and serving a disproportionately high share of Texas' and South Carolina's low income patients, five of our facilities located in Texas and one facility located in South Carolina received additional reimbursement from each state's DSH fund. In connection with these DSH programs, included in our financial results was an aggregate of \$13 million and \$11 million during the three-month periods ended September 30, 2012 and 2011, respectively, and \$36 million and \$34 million during each of the nine-month periods ended September 30, 2012 and 2011.

In August, 2012, the THHSC published a final rule that changes the Texas Medicaid Disproportionate Share Hospital ( Texas Medicaid DSH ) payment methodology which resulted in a reduction of our DSH reimbursement for SFY 2012 that was consistent with our expectations and as reflected in our consolidated financial statements as of September 30, 2012. As previously disclosed, the receipt of the Texas Medicaid DSH reimbursements is contingent on certain public hospitals in Texas making Inter-Governmental Transfers ( IGTs ) to THHSC. The remaining

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SFY2012 IGTs were provided to THHSC by the public hospitals prior to September 30, 2012 but we cannot make any assurance that future Texas Medicaid DSH IGTs will be made.

The South Carolina and Texas DSH programs were renewed for the state's 2013 DSH fiscal year (covering the period of October 1, 2012 through September 30, 2013) at amounts that are expected to be similar to the 2012 fiscal year program amounts, assuming the Texas DSH program is funded by the public hospitals for the state's 2013 DSH fiscal year. Failure to renew these DSH programs beyond their scheduled termination dates, failure of the public hospitals to provide the necessary IGTs for the state's share of the DSH programs, failure of our hospitals that currently receive DSH payments to qualify for future DSH funds under these programs, or reductions in reimbursements, could have a material adverse effect on our future results of operations.

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

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

### ***Medicare Revisions:***

The Reconciliation Act reduced the market basket update for inpatient and outpatient hospitals and inpatient behavioral health facilities by 0.25% in each of 2010 and 2011 and by 0.10% in 2012 and 2013. Further, the Affordable Care Act implemented certain reforms to Medicare Advantage payments, effective in 2011.

#### Implemented Medicare Revisions:

A Medicare shared savings program (effective 2012)

A hospital readmissions reduction program (effective 2012)

A value-based purchasing program for hospitals (effective 2012)

#### Future Medicare Revisions:

A national pilot program on payment bundling (effective 2013)

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

### ***Medicaid Revisions:***

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

Reduction to Medicaid DSH (effective 2014)

### ***Health Insurance Revisions:***

Large employer insurance reforms (effective 2014)

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### Individual insurance mandate and related federal subsidies (effective 2014)

#### Federally mandated insurance coverage reforms (2010 and forward)

The above-mentioned Medicare market basket revisions implemented in 2010 did not have a material impact on our results of operations to date. The Medicare shared savings, hospital readmissions reduction and value-based purchasing programs that will become effective in 2012 are not expected to have a material impact on results of operations. We are unable to estimate the future impact of the other remaining legislative changes as outlined above.

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

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



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The combined net revenues and income before income taxes generated at our surgical hospitals, ambulatory surgery centers and radiation oncology centers was not material to our results of operations during each of the three and nine-month periods ended September 30, 2012 and 2011.

***Interest Expense:***

Interest expense was \$45 million and \$48 million during the three-month periods ended September 30, 2012 and 2011, respectively, and \$138 million and \$155 million during the nine-month periods ended September 30, 2012 and 2011, respectively. Below is a schedule of our interest expense for the three and nine month periods ended September 30, 2012 and 2011 (amounts in thousands):

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Revolving credit & demand notes (b.)	\$ 1,182	\$ 1,214	\$ 4,362	\$ 5,251
\$200 million, 6.75% Senior Notes due 2011 (a.)		3,378		10,133
\$400 million, 7.125% Senior Notes due 2016	7,124	7,124	21,372	21,372
\$250 million, 7.00% Senior Notes due 2018	4,375	4,375	13,125	13,125
Term Loan A (b.)	5,564	6,041	16,934	21,521
Term Loan B (b.)	13,234	14,997	41,059	50,241
Term Loan A2 (b.)	644	0	644	0
Accounts receivable securitization program	590	674	1,984	2,015
Subtotal-revolving credit, demand notes, Senior Notes, term loan facilities and accounts receivable securitization program	32,713	37,803	99,480	123,658
Interest rate swap expense, net	5,398	2,248	15,841	5,851
Amortization of financing fees	7,087	7,236	21,653	13,781
Other combined interest expense	1,573	1,387	4,759	11,746
Capitalized interest on major construction and other projects	(1,543)	(178)	(3,858)	(229)
Interest income	(21)	(44)	(70)	(130)
Interest expense, net	\$ 45,207	\$ 48,452	\$ 137,805	\$ 154,677

- (a.) The \$200 million, 6.75% Senior Notes matured and were paid in full on November 15, 2011 utilizing borrowings pursuant to our revolving credit agreement.
- (b.) In September, 2012, we entered into a Second Amendment to our credit agreement, dated as of November 15, 2010, as amended on March 15, 2011. The Second Amendment provides for a new \$900 million Term Loan-A ( Term Loan A-2 ) with a final maturity date of August 15, 2016 and extends the maturity date on the majority of the existing revolving credit facility and Term Loan-A by nine months to mature on August 15, 2016. The Second Amendment also provides for increased flexibility for refinancing and certain other modifications but substantially all other terms of the Credit Agreement as previously amended, including interest rates, remain unchanged. We used \$700 million of the proceeds from the new Term Loan A-2 to extinguish a portion of our higher priced, existing Term Loan-B facility. The remainder of the new Term Loan A-2 was used to pay transaction related fees and expenses and to repay other floating rate debt.

Interest expense decreased \$3 million during the three-month period ended September 30, 2012, as compared to the comparable quarter of 2011. The decreased interest expense during the third quarter of 2012, as compared to the comparable quarter of 2011, was due primarily to: (i) a \$5 million decrease in interest expense due primarily to a decrease in our average outstanding borrowings and a decrease in our average effective borrowing rate (due primarily to the repayment of the \$200 million, 6.75% Senior Notes in November, 2011 utilizing borrowings pursuant to our revolving credit agreement which are borrowed at a lower interest rate and, as mentioned in (b) above, the extinguishment of \$700 million of borrowings pursuant to our Term Loan B with proceeds from the new Term Loan A-2 which are borrowed at a lower interest rate); (ii) a \$1 million decrease in interest expense due to an increase interest being capitalized on major construction and other projects, partially offset by;

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(iii) a \$3 million increase in interest expense due to an increase in our net interest rate swap expense.

Interest expense decreased \$17 million during the nine-month period ended September 30, 2012, as compared to the comparable period of 2011. The decreased interest expense during the first nine months of 2012, as compared to the comparable period of 2011, was due primarily to: (i) a \$24 million decrease in interest expense due primarily to a decrease in our average outstanding borrowings and a decrease in our average effective borrowing rate (due primarily to the repayment of the \$200 million, 6.75% Senior Notes in November, 2011 utilizing borrowings pursuant to our revolving credit agreement which are borrowed at a lower interest rate and, as

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mentioned in (b) above, the extinguishment during the third quarter of 2012 of \$700 million of borrowings pursuant to our Term Loan B with proceeds from the new Term Loan A-2 which are borrowed at a lower interest rate); (ii) a \$4 million decrease in interest expense due to an increase interest being capitalized on major construction and other projects, partially offset by; (iii) a \$10 million increase in interest expense due to an increase in our net interest rate swap expense.

**Discontinued Operations**

In October of 2012, we completed the divestiture of Auburn Regional Medical Center ( Auburn ), a 159-bed acute care hospital located in Auburn, Washington, for total cash proceeds of approximately \$93 million including estimated working capital. This divestiture is expected to result in a substantial pre-tax gain which will be recorded in our consolidated financial statements during the fourth quarter of 2012.

In connection with the receipt of antitrust clearance from the Federal Trade Commission ( FTC ) in connection with our acquisition of Ascend Health Corporation in October of 2012, we have agreed to certain conditions, including the divestiture, within approximately six months, of Peak Behavioral Health Services ( Peak ), a 104-bed behavioral health care facility located in Santa Teresa, New Mexico. The revenues of Peak were approximately \$14 million during each of the nine-month period ended September 30, 2012, and the twelve month period ended December 31, 2011.

In connection with the receipt of antitrust clearance from the Federal Trade Commission ( FTC ) in connection with our acquisition of PSI in November, 2010, we agreed to divest three former PSI facilities (Meadowood Behavioral Health System, Montevista Hospital and Red Rock Hospital) as well as one of our legacy behavioral health facilities in Puerto Rico (San Juan Capestrano). Pursuant to the terms of our agreement with the FTC, we divested:

in July, 2011, the Meadowood Behavioral Health System, a 58-bed facility located in New Castle, Delaware;

in December, 2011, the Montevista Hospital (101-bed) and Red Rock Hospital (21-bed), both of which are located in Las Vegas, Nevada, and;

in January, 2012, the Hospital San Juan Capestrano, a 108-bed facility located in Rio Piedras, Puerto Rico.

The operating results for Auburn, Peak and the three former PSI facilities located in Delaware and Nevada are reflected as discontinued operations during our period of ownership for each of the periods presented herein. Since the aggregate income from discontinued operations before income tax expense for these facilities is not material to our consolidated financial statements, it is included as a reduction to other operating expenses. The aggregate pre-tax net gain on the divestiture of San Juan Capestrano in January, 2012 did not have a material impact on our consolidated results of operations during the first quarter of 2012. Assets and liabilities for Auburn and Peak are reflected as held for sale on our Consolidated Balance Sheet as of September 30, 2012, and the assets and liabilities for the Hospital San Juan Capestrano were reflected as held for sale on our Consolidated Balance Sheet as of December 31, 2011.

The following table shows the results of operations for Auburn and Peak and the former PSI facilities located in Delaware and Nevada, on a combined basis, which were reflected as discontinued operations during our period of ownership for each of the periods presented herein (amounts in thousands):

	Three months ended		Nine months ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Net revenues	\$ 29,372	\$ 36,685	\$ 92,706	\$ 121,011
(Loss) income from discontinued operations, before income taxes	(1,231)	819	(697)	6,532
Income tax benefit (expense)	472	(310)	267	(2,473)
(Loss) income from discontinued operations, net of income taxes	(\$ 759)	\$ 509	(\$ 430)	\$ 4,059

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*Provision for Income Taxes and Effective Tax Rates:*

The effective tax rates, as calculated by dividing the provision for income taxes by income before income taxes, were as follows for the three and nine-month periods ended September 30, 2012 and 2011 (dollar amounts in thousands):

	Three months ended		Nine months ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Provision for income taxes	\$ 42,132	\$ 52,234	\$ 188,880	\$ 192,638
Income before income taxes	123,505	147,076	530,267	533,501
Effective tax rate	34.1%	35.5%	35.6%	36.1%