TENET HEALTHCARE CORP
Form 10-Q
August 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

x	**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2007**
	OR
o	**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 1-7293

TENET HEALTHCARE CORPORATION

(Exact name of Registrant as specified in its charter)

Nevada	**95-2557091**
(State of Incorporation)	(IRS Employer Identification No.)

13737 Noel Road
Dallas, TX 75240
(Address of principal executive offices, including zip code)

(469) 893-2200
(Registrant s telephone number, including area code)

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, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2). Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

As of July 31, 2007, there were 473,863,859 shares of the Registrant s common stock outstanding.

TENET HEALTHCARE CORPORATION

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PART I.

ITEM 1. FINANCIAL STATEMENTS

TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

Dollars in Millions

(Unaudited)

	June 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 675	$ 784
Investments in marketable debt securities	39	39
Accounts receivable, less allowance for doubtful accounts ($483 at June 30, 2007 and $498 at December 31, 2006)	1,363	1,413
Inventories of supplies, at cost	184	184
Income tax receivable	3	171
Deferred income taxes	63	69
Assets held for sale	66	119
Other current assets	215	246
Total current assets	**2,608**	**3,025**
Investments and other assets	417	383
Property and equipment, at cost, less accumulated depreciation and amortization ($2,666 at June 30, 2007 and $2,548 at December 31, 2006)	4,354	4,299
Goodwill	603	601
Other intangible assets, at cost, less accumulated amortization ($168 at June 30, 2007 and $149 at December 31, 2006)	271	231
Total assets	**$ 8,253**	**$ 8,539**
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 22	$ 22
Accounts payable	642	775
Accrued compensation and benefits	333	390
Professional and general liability reserves	140	145
Accrued interest payable	136	130
Accrued legal settlement costs	93	71
Other current liabilities	477	392
Total current liabilities	**1,843**	**1,925**
Long-term debt, net of current portion	4,764	4,760
Professional and general liability reserves	577	586
Accrued legal settlement costs	207	251
Other long-term liabilities and minority interests	631	646
Deferred income taxes	82	107
Total liabilities	**8,104**	**8,275**
Commitments and contingencies		
Shareholders equity:		
Common stock, $0.05 par value; authorized 1,050,000,000 shares; 530,253,825 shares issued at June 30, 2007 and 527,384,164 shares issued at December 31, 2006	26	26
Additional paid-in capital	4,391	4,372
Accumulated other comprehensive loss	(46)	(45)
Accumulated deficit	(2,743)	(2,610)
Less common stock in treasury, at cost, 56,811,675 shares at June 30, 2007 and 55,798,815 shares at December 31, 2006	(1,479)	(1,479)
Total shareholders equity	**149**	**264**
Total liabilities and shareholders equity	**$ 8,253**	**$ 8,539**

See accompanying Notes to Condensed Consolidated Financial Statements.

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TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Dollars in Millions,

Except Per-Share Amounts

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net operating revenues	**$ 2,228**	**$ 2,195**	**$ 4,507**	**$ 4,405**
Operating expenses:				
Salaries, wages and benefits	993	963	2,012	1,944
Supplies	399	398	807	809
Provision for doubtful accounts	151	128	292	249
Other operating expenses, net	529	497	1,051	977
Depreciation	81	76	162	152
Amortization	8	6	16	12
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries	10	27	13	56
Hurricane insurance recoveries, net of costs		(13)		(10)
Litigation and investigation costs (benefit)	(1)	728	(2)	744
Operating income (loss)	**58**	**(615)**	**156**	**(528)**
Interest expense	(105)	(101)	(211)	(203)
Investment earnings	15	17	26	34
Minority interests	(1)		(3)	(1)
Net gains on sales of investments				2
Loss from continuing operations, before income taxes	**(33)**	**(699)**	**(32)**	**(696)**
Income tax benefit	4	252	96	248
Income (loss) from continuing operations, before discontinued operations and cumulative effect of change in accounting principle	**(29)**	**(447)**	**64**	**(448)**
Discontinued operations:				
Loss from operations		(21)	(21)	(18)
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries	(1)	(101)	(10)	(76)
Hurricane insurance recoveries, net of costs		194		193
Litigation settlements, net of insurance recoveries		(21)		24
Net gain (loss) on sales of facilities	2	(1)	1	(1)
Income tax (expense) benefit	(2)	(1)	11	(4)
Income (loss) from discontinued operations, net of tax	**(1)**	**49**	**(19)**	**118**
Income (loss) before cumulative effect of change in accounting principle	**(30)**	**(398)**	**45**	**(330)**
Cumulative effect of change in accounting principle, net of tax				**2**
Net income (loss)	**$ (30)**	**$ (398)**	**$ 45**	**$ (328)**
Basic and diluted earnings (loss) per common share and common equivalent share				
Continuing operations	$ (0.06)	$ (0.95)	$ 0.13	$ (0.95)
Discontinued operations		0.10	(0.04)	0.25
Cumulative effect of change in accounting principle, net of tax				
	$ (0.06)	**$ (0.85)**	**$ 0.09**	**$ (0.70)**

Weighted average shares and dilutive securities outstanding (in thousands):				
Basic	473,212	470,608	472,729	470,338
Diluted	473,212	470,608	474,514	470,338

See accompanying Notes to Condensed Consolidated Financial Statements.

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TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in Millions

(Unaudited)

	Six Months Ended June 30, 2007	2006
Net income (loss)	**$ 45**	**$ (328)**
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	178	164
Provision for doubtful accounts	292	249
Deferred income tax benefit		(85)
Stock-based compensation charges	21	22
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries	13	56
Litigation and investigation costs (benefit)	(2)	744
Pretax (income) loss from discontinued operations	30	(122)
Cumulative effect of change in accounting principle		(2)
Other items, net	(8)	10
Increases (decreases) in cash from changes in operating assets and liabilities:		
Accounts receivable	(304)	(216)
Inventories and other current assets	7	(39)
Income taxes	60	(163)
Accounts payable, accrued expenses and other current liabilities	(197)	(238)
Other long-term liabilities	15	20
Payments against reserves for restructuring charges and litigation costs and settlements	**(28)**	**(664)**
Net cash provided by (used in) operating activities from discontinued operations, excluding income taxes	**9**	**(49)**
Net cash provided by (used in) operating activities	**131**	**(641)**
Cash flows from investing activities:		
Purchases of property and equipment continuing operations	(231)	(213)
Construction of new hospitals.	(27)	
Purchases of property and equipment discontinued operations	(3)	(30)
Purchase of business	(36)	
Proceeds from sales of facilities discontinued operations	47	15
Proceeds from sales of marketable securities, long-term investments and other assets	447	15
Purchases of marketable securities	(434)	(6)
Insurance recoveries for property damage		36
Other items, net	(4)	17
Net cash used in investing activities	**(241)**	**(166)**
Cash flows from financing activities:		
Repayments of borrowings		(1)
Other items, net	1	3
Net cash provided by financing activities	**1**	**2**
Net decrease in cash and cash equivalents	(109)	(805)
Cash and cash equivalents at beginning of period	784	1,373
Cash and cash equivalents at end of period	**$ 675**	**$ 568**
Supplemental disclosures:		
Interest paid, net of capitalized interest	$ (191)	$ (189)
Income tax (payments) refunds, net	$ 168	$ (3)

See accompanying Notes to Condensed Consolidated Financial Statements.

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Description of Business

Tenet Healthcare Corporation (together with our subsidiaries, referred to as Tenet, the Company, we or us) is an investor-owned health care services company whose subsidiaries and affiliates (collectively, subsidiaries) operate general hospitals and related health care facilities, and hold investments in other companies (including health care companies). At June 30, 2007, prior to our acquisition of Coastal Carolina Medical Center (see Note 13), our subsidiaries operated 61 general hospitals (including four hospitals not yet divested at that date that are classified as discontinued operations), a cancer hospital and a critical access hospital, with a combined total of 15,726 licensed beds, serving urban and rural communities in 12 states. We also own or lease: various related health care facilities, including a rehabilitation hospital, a long-term acute care hospital, a skilled nursing facility and a number of medical office buildings all of which are located on, or nearby, one of our general hospital campuses; physician practices; captive insurance companies; and other ancillary health care businesses (including outpatient surgery centers, diagnostic imaging centers, and occupational and rural health care clinics).

Basis of Presentation

This quarterly report supplements our Annual Report on Form 10-K for the year ended December 31, 2006 (Annual Report). As permitted by the Securities and Exchange Commission (SEC) for interim reporting, we have omitted certain notes and disclosures that substantially duplicate those in our Annual Report. For further information, refer to the audited Consolidated Financial Statements and notes included in our Annual Report. Unless otherwise indicated, all financial and statistical data included in these notes to the Condensed Consolidated Financial Statements relate to our continuing operations, with dollar amounts expressed in millions (except per-share amounts).

Although the Condensed Consolidated Financial Statements and related notes within this document are unaudited, we believe all adjustments considered necessary for fair presentation have been included. In preparing our financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP), we must use estimates and assumptions that affect the amounts reported in our Condensed Consolidated Financial Statements and accompanying notes. We regularly evaluate the accounting policies and estimates we use. In general, we base the estimates on historical experience and on assumptions that we believe to be reasonable, given the particular circumstances in which we operate. Actual results may vary from those estimates. Financial information we file with various regulatory agencies may be prepared on a basis other than GAAP or using different assumptions and, therefore, may vary from amounts presented herein.

Operating results for the three-month and six-month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the full fiscal year 2007. Reasons for this include, but are not limited to: overall revenue and cost trends, particularly trends in patient accounts receivable collectibility and associated provisions for doubtful accounts; the timing and magnitude of price changes; fluctuations in contractual allowances and cost report settlements and valuation allowances; managed care contract negotiations or terminations and payer consolidation; changes in Medicare regulations; Medicaid funding levels set by the states in which we operate; levels of malpractice expense and settlement trends; impairment of long-lived assets and goodwill; restructuring charges; losses, costs and insurance recoveries related to natural disasters; litigation and investigation costs; acquisitions and dispositions of facilities and other assets; income tax rates and valuation allowances; the timing and amounts of stock option and restricted stock unit grants to employees and directors; and changes in occupancy levels and patient volumes. Factors that affect patient volumes and, thereby, our results of operations at our hospitals and related health care facilities include, but are not limited to: the business environment of local communities; the number of uninsured and underinsured individuals in local communities treated at our hospitals; seasonal cycles of illness; climate and weather conditions; physician recruitment, retention and attrition; advances in technology and treatments that reduce length of stay; local health care competitors; managed care contract negotiations or terminations; unfavorable publicity about us, which impacts our relationships with physicians and patients; and the timing of elective procedures. These considerations apply to year-to-year comparisons as well.

Change in Accounting Principle

Effective January 1, 2007**,** we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, as amended by FASB Staff Position No. 48-1 (FIN 48), and recorded a cumulative effect adjustment to beginning of year retained earnings of $178 million. See Note 11 for additional information.

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Effective January 1, 2006, we adopted Statement of Financial Accounting Standard (SFAS) No. 123(R), Share-Based Payment, and recorded a $2 million credit, net of tax expense and related deferred tax valuation allowance, ($0.00 per share) as a cumulative effect of a change in accounting principle. See Note 6 for further information.

NOTE 2. ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The principal components of accounts receivable are shown in the table below:

	June 30, 2007	December 31, 2006
Continuing operations:		
Patient accounts receivable	$ 1,710	$ 1,711
Allowance for doubtful accounts	(443)	(447)
Estimated future recovery of accounts assigned to collection agencies	33	39
Net cost report settlements payable and valuation allowances	(26)	(43)
	1,274	1,260
Discontinued operations:		
Patient accounts receivable	123	196
Allowance for doubtful accounts	(40)	(51)
Estimated future recovery of accounts assigned to collection agencies	2	3
Net cost report settlements receivable and valuation allowances	4	5
	89	153
Accounts receivable, net	**$ 1,363**	**$ 1,413**

As of June 30, 2007, our total estimated collection rates on managed care accounts and self-pay accounts were approximately 98% and 35%, respectively, which included collections from point-of-service through collections by our in-house collection agency or external collection vendors. The comparable managed care and self-pay collection rates as of December 31, 2006 were approximately 97% and 32%, respectively.

Accounts that are pursued for collection through regional or hospital-based business offices are maintained on our hospitals books and reflected in patient accounts receivable with an allowance for doubtful accounts established to reduce the carrying value of such receivables to their estimated net realizable value. We estimate this allowance based on the aging of our accounts receivables by hospital, our historical collection experience by hospital and for each type of payer, and other relevant factors. Changes in these factors could have an impact on our estimates.

Accounts assigned to collection agencies (both in-house and external) are written off and excluded from patient accounts receivable and allowance for doubtful accounts; however, an estimate of future recoveries from all accounts at collection agencies is determined based on historical experience and recorded on our hospitals books as a component of accounts receivable in the Condensed Consolidated Balance Sheets.

We provide charity care to patients who are financially unable to pay for the health care services they receive. Most patients who qualify for charity care are charged a per diem amount for services received, subject to a cap. Except for the per diem amounts, our policy is not to pursue collection of amounts determined to qualify as charity care; therefore, we do not report these amounts in net operating revenues or in the allowance for doubtful accounts. For the three and six months ended June 30, 2007, $151 million and $332 million, respectively, in charity care gross charges were excluded from net operating revenues and the allowance for doubtful accounts compared to $138 million and $301 million for the three and six months ended June 30, 2006, respectively.

NOTE 3. DISCONTINUED OPERATIONS

Of the seven hospitals held for sale at December 31, 2006, we completed the sale of Alvarado Hospital Medical Center in California and Graduate Hospital in Pennsylvania during the three months ended March 31, 2007 and, during the three months ended June 30, 2007, we sold the real estate of our Lindy Boggs Medical Center in Louisiana. In July 2007, we completed the sale of Roxborough Memorial Hospital and Warminster Hospital, both in the Philadelphia area. We are continuing to negotiate with buyers for the remaining two hospitals slated for divestiture. We have classified the results of

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

operations of all seven of these hospitals, as well as the wind-down operations of hospitals previously sold, as discontinued operations for all periods presented in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144).

We classified $50 million and $114 million of assets of the hospitals included in discontinued operations as assets held for sale in current assets in the accompanying Condensed Consolidated Balance Sheets at June 30, 2007 and December 31, 2006, respectively. These assets primarily consist of property and equipment and were recorded at the lower of the asset s carrying amount or its fair value less estimated costs to sell. The fair value estimates were derived from independent appraisals, established market values of comparable assets, or internal estimates of future net cash flows. These fair value estimates can change by material amounts in subsequent periods. Many factors and assumptions can impact the estimates, including the future financial results of these hospitals and how they are operated by us until they are divested, changes in health care industry trends and regulations until the hospitals are divested, and whether we ultimately divest the hospital assets to buyers who will continue to operate the assets as general hospitals or utilize the assets for other purposes. In certain cases, these fair value estimates assume the highest and best use of the assets in the future to a market place participant is other than as a hospital. In these cases, the estimates are based on the fair value of the real property and equipment if utilized other than as a hospital. These fair value estimates do not include the costs of closing these hospitals or other future operating costs, which could be substantial. Accordingly, the ultimate net cash realized from the sale of the hospital assets could be significantly less than the fair value estimates. Because we do not intend to sell the accounts receivable of these hospitals, the receivables, less the related allowance for doubtful accounts, estimated future recovery of accounts assigned to collection agencies, and net cost report settlements receivable and valuation allowances, are included in our consolidated net accounts receivable in the accompanying Condensed Consolidated Balance Sheets.

Net operating revenues and income (loss) before income taxes reported in discontinued operations for the three and six months ended June 30, 2007 and 2006 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	**2006**	**2007**	**2006**
Net operating revenues	$ 95	$ 251	$ 190	$ 521
Income (loss) before income taxes	1	50	(30)	122

We recorded $10 million of net impairment and restructuring charges in discontinued operations during the six months ended June 30, 2007, consisting of $4 million for the write-down of long-lived assets to their estimated fair values, less estimated costs to sell, and $10 million of employee severance and retention costs, offset by a $4 million credit to reduce an asset retirement obligation related to asbestos.

We recorded $76 million of impairment and restructuring charges in discontinued operations during the six months ended June 30, 2006 primarily consisting of $126 million for the write-down of long-lived assets to their estimated fair values, less estimated costs to sell, $12 million in goodwill impairment, $2 million for employee severance and retention costs, and $1 million in lease termination and other costs, offset by $65 million in insurance recoveries related to Hurricane Katrina property claims. The total impairment charges include $123 million of charges related to our announced disposition of 10 hospitals in June 2006.

In addition to the $65 million in insurance recoveries recorded as a reduction to the impairment charges in discontinued operations, we also recorded $193 million of insurance recoveries in the three months ended June 30, 2006 related to the disruption of our discontinued operations by Hurricane Katrina.

We have sought up to $275 million in recovery under our excess professional and general liability insurance policies in connection with our $395 million settlement, in December 2004, of the patient litigation related to our former Redding Medical Center. Certain of our insurance carriers have raised objections to coverage under our policies. We are pursuing all means available against the insurance carriers in seeking coverage and, in January 2005, we filed for arbitration against each of the three carriers to resolve the dispute. Subsequently, we reached a settlement with one of the excess carriers in the amount of $45 million, which we recorded as an insurance recovery in the three months ended March 31, 2006 and collected in July 2006. This insurance recovery reduced the total remaining excess limits available under our excess policies to $230 million (including up to a maximum of $200 million for the Redding claims) for all occurrences prior to June 1, 2003. We continue to pursue recovery from the other two carriers under these excess policies up to a maximum of $200 million for the Redding claims. We

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

currently maintain other excess liability insurance policies having a maximum aggregate coverage limit of $275 million for occurrences from June 1, 2003 through May 31, 2008.

In addition to the $45 million insurance recovery related to Redding Medical Center, we recorded a $21 million charge during the three months ended June 30, 2006 related to the civil settlement of a matter involving Alvarado Hospital Medical Center. This charge is reflected in litigation settlements, net of the $45 million insurance recovery, in discontinued operations in the accompanying Condensed Consolidated Statements of Operations.

As we move forward with our previously announced divestiture plans, or should we dispose of additional hospitals in the future, we may incur additional asset impairment and restructuring charges in future periods.

NOTE 4. IMPAIRMENT AND RESTRUCTURING CHARGES

During the six months ended June 30, 2007, we recorded net impairment and restructuring charges of $13 million, consisting of a $2 million impairment charge for the write-down of long-lived assets to their estimated fair values in accordance with SFAS 144, $8 million of employee severance and other related costs, and $3 million for the acceleration of stock-based compensation. During the six months ended June 30, 2006, we recorded net impairment and restructuring charges of $56 million. As we move forward with our restructuring plans, or should we restructure our hospitals in the future, or if the operating results of our hospitals do not meet expectations, or if we expect negative trends to impact our future outlook, additional impairments of long-lived assets and goodwill and restructuring charges may occur.

The tables below are a reconciliation of beginning and ending liability balances in connection with restructuring charges recorded during the six months ended June 30, 2007 and 2006 in continuing and discontinued operations:

	Balances at Beginning of Period	Restructuring Charges, Net	Cash Payments	Other	Balances at End of Period
Six Months Ended June 30, 2007					
Continuing operations:					
Severance costs in connection with hospital cost-control programs and general overhead-reduction plans	$ 23	$ 11	$ (8)	$ (3)	$ 23
Discontinued operations:					
Lease cancellations and estimated costs associated with the sale or closure of hospitals and other facilities	16	10	(10)		16
	$ 39	**$ 21**	**$ (18)**	**$ (3)**	**$ 39**

	Balances at Beginning of Period	Restructuring Charges, Net	Cash Payments	Other	Balances at End of Period
Six Months Ended June 30, 2006					
Continuing operations:					
Severance costs in connection with hospital cost-control programs and general overhead-reduction plans	$ 43	$ (4)	$ (13)	$	$ 26
Discontinued operations:					
Lease cancellations and estimated costs associated with the sale or closure of hospitals and other facilities	22	3	(11)		14
	$ 65	**$ (1)**	**$ (24)**	**$**	**$ 40**

The above liability balances are included in other current liabilities and other long-term liabilities in the accompanying Condensed Consolidated Balance Sheets. Cash payments to be applied against these accruals at June 30, 2007 are expected to be approximately $11 million in 2007 and $28 million thereafter. The other column represents non-cash charges that are recorded in other accounts, such as the acceleration of stock-based compensation expense related to severance agreements.

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. LONG-TERM DEBT, LEASE OBLIGATIONS AND GUARANTEES

The table below shows our long-term debt as of June 30, 2007 and December 31, 2006:

	June 30, 2007	December 31, 2006
Senior notes:		
6 3⁄8%, due 2011	$ 1,000	$ 1,000
6 1⁄2%, due 2012	600	600
7 3⁄8%, due 2013	1,000	1,000
9 7⁄8%, due 2014	1,000	1,000
9 1⁄4%, due 2015	800	800
6 7⁄8%, due 2031	450	450
Capital leases and mortgage notes	29	29
Unamortized note discounts	(93)	(97)
Total long-term debt	**4,786**	**4,782**
Less current portion	22	22
Long-term debt, net of current portion	**$ 4,764**	**$ 4,760**

Credit Agreement

In November 2006, we entered into a five-year, $800 million senior secured revolving credit facility that replaced our $250 million letter of credit facility. The revolving credit facility is collateralized by patient accounts receivable at our acute care and specialty hospitals, and bears interest at our option based on the London Interbank Offered Rate (LIBOR) plus 175 basis points or Citigroup s base rate, as defined in the credit agreement, plus 75 basis points. The letters of credit outstanding under our previous letter of credit facility were transferred into the revolving credit facility, which reduced the amount available for cash borrowings, but eliminated a restriction on $263 million of cash pledged under the letter of credit facility. At June 30, 2007, there were no cash borrowings under the revolving credit facility and $185 million of letters of credit outstanding. Based on our eligible receivables, the borrowing capacity under the revolving credit facility was $601 million at June 30, 2007.

Senior Notes

All of our senior notes are general unsecured senior debt obligations that rank equally in right of payment with all of our other unsecured senior indebtedness, but are effectively subordinated to the obligations of our subsidiaries and any obligations under our revolving credit facility to the extent of the collateral.

Covenants

Our revolving credit agreement contains customary covenants for an asset-backed facility, including a minimum fixed charge coverage ratio to be met when the available credit under the facility falls below $100 million, as well as limits on debt, asset sales and prepayments of senior debt. The revolving credit agreement also includes a provision, which we believe is customary in receivables-backed credit facilities, that gives our banks the right to require that proceeds of collections of substantially all of our consolidated accounts receivable be applied directly to repay outstanding loans and other amounts that are due and payable under the revolving credit facility at any time that unused borrowing availability under the revolving credit facility is less than $100 million or if an event of default has occurred and is continuing thereunder. In that event, we would seek to re-borrow under the revolving credit facility to satisfy our operating cash requirements. Our ability to borrow under the revolving credit facility is subject to conditions that we believe are customary in such facilities, including that no default then exists.

The indentures governing our senior notes contain covenants and conditions that have, among other requirements, limitations on (1) liens on principal properties, as defined under the indentures, and (2) sale and lease-back transactions with respect to principal properties. A principal property is defined in the indentures as a hospital that has an asset value on our books in excess of 5% of our consolidated net tangible assets, as defined. The above limitations do not apply, however, to (1) debt that is not secured by principal properties or (2) debt that is secured by principal properties if the aggregate of such secured debt does not exceed 15% of our consolidated net tangible assets, as further described in the indentures. The

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

indentures also prohibit the consolidation, merger or sale of all or substantially all assets unless no event of default would result after giving effect to such transaction.

Physician Relocation Agreements and Other Minimum Revenue Guarantees

Consistent with our policy on physician relocation and recruitment, we provide income guarantee agreements to certain physicians who agree to relocate to our communities to fill a need in the hospital s service area and commit to remain in practice there. Under such agreements, we are required to make payments to the physicians in excess of the amounts they earn in their practices up to the amount of the income guarantee. The income guarantee periods are typically 12 months. Such payments are recoverable from the physicians if they do not fulfill their commitment period to the community, which is typically three years subsequent to the guarantee period. We also provide minimum revenue collection guarantees to hospital-based physician groups providing certain services at our hospitals with terms ranging from one to three years. At June 30, 2007, the maximum potential amount of future payments under these guarantees was $46 million. In accordance with FASB Staff Position FIN 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners, at June 30, 2007, we had a liability of $46 million for the fair value of these guarantees included in other liabilities.

NOTE 6. EMPLOYEE BENEFIT PLANS

At June 30, 2007, there were approximately 8.8 million shares of common stock available under our 2001 Stock Incentive Plan for future stock option grants and other incentive awards, including restricted stock units. Options generally have an exercise price equal to the fair market value of the shares on the date of grant and generally expire 10 years from the date of grant. A restricted stock unit is a contractual right to receive one share of our common stock in the future. Options and restricted stock units typically vest one-third on each of the first three anniversary dates of the grant.

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment (SFAS 123(R)), using the modified prospective application transition method. Prior to 2006, we used the Black-Scholes option-pricing model to estimate the grant date fair value of stock option awards. For grants subsequent to the adoption of SFAS 123(R), we estimate the fair value of awards on the date of grant using a binomial lattice model. We believe that the binomial lattice model is a more appropriate model for valuing employee stock awards because it better reflects the impact of stock price changes on option exercise behavior. As a result of adopting SFAS 123(R) during the three months ended March 31, 2006, we recorded a $2 million credit as a cumulative effect of a change in accounting principle, net of tax expense and related valuation allowance. This adjustment related to the requirement under SFAS 123(R) to estimate the amount of stock-based awards expected to be forfeited rather than recognizing the effect of forfeitures only as they occur.

Prior to our adoption of SFAS 123(R), benefits of tax deductions in excess of recognized compensation costs were reported as operating cash flows. SFAS 123(R) requires excess tax benefits be reported as a financing cash inflow. We have not recognized any excess tax benefits during the six months ended June 30, 2007 or 2006.

Our income from continuing operations for the six months ended June 30, 2007 includes $22 million pre-tax of compensation costs related to our stock-based compensation arrangements ($14 million after tax, excluding the impact of the deferred tax valuation allowance). Our loss from continuing operations for the six months ended June 30, 2006 includes $22 million pre-tax of compensation costs related to our stock-based compensation arrangements ($14 million after tax, excluding the impact of the deferred tax valuation allowance).

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Stock Options

The following table summarizes stock option activity during the six months ended June 30, 2007:

	Options	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value	Weighted Average Remaining Life
Outstanding as of December 31, 2006	38,690,973	$ 20.41		
Granted	1,418,000	6.60		
Exercised	(5,100)	6.25		
Forfeited/Expired	(1,012,820)	12.83		
Outstanding as of June 30, 2007	**39,091,053**	**$ 20.12**	**$**	**5.0 years**
Vested and expected to vest at June 30, 2007	**38,751,943**	**$ 20.20**	**$**	**4.9 years**
Exercisable as of June 30, 2007	**34,260,519**	**$ 21.75**	**$**	**4.4 years**

There were 5,100 options with a minimal aggregate intrinsic value exercised during the six months ended June 30, 2007, and no options were exercised during the six months ended June 30, 2006.

As of June 30, 2007, there were $11 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 1.3 years.

The weighted average estimated fair value of options we granted in the six months ended June 30, 2007 and 2006 was $2.77 per share and $3.15 per share, respectively, as calculated based on each grant date, using a binomial lattice model with the following assumptions:

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006	
	All Employees	Top Four Employees	All Other Employees
Expected volatility	40%	41%	41%
Expected dividend yield	0%	0%	0%
Expected life	5.75 years	6.25 years	4 years
Expected forfeiture rate	3%	0%	15%
Risk-free interest rate range	4.49%	4.47% - 5.04%	4.47% - 5.04%
Early exercise threshold	50% gain	50% gain	50% gain
Early exercise rate	50% per year	50% per year	50% per year

The expected volatility used in the binomial lattice model incorporates historical and implied share-price volatility and is based on an analysis of historical prices of our stock and open-market exchanged options, and was developed in consultation with an outside valuation specialist. The expected volatility reflects the historical volatility for a duration consistent with the contractual life of the options, and the volatility implied by the trading of options to purchase our stock on open-market exchanges. The historical share-price volatility excludes the movements in our stock price during the period October 1, 2002 through December 31, 2002 due to unique events occurring during that time, which caused extreme volatility of our stock price. The expected life of options granted is derived from the output of the binomial lattice model, and represents the period of time that the options are expected to be outstanding. This model incorporates an early exercise assumption in the event of a significant increase in stock price. The risk-free interest rates are based on zero-coupon United States Treasury yields in effect at the date of grant consistent with the expected exercise timeframes.

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TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes information about our outstanding stock options at June 30, 2007:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number of Options**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number of Options**	**Weighted Average Exercise Price**
$0.00 to $10.639	8,565,361	8.2 years	$ 8.99	3,933,608	$ 9.84
$10.64 to $13.959	6,563,739	4.5 years	11.82	6,481,625	11.82
$13.96 to $17.589	6,486,637	3.9 years	17.26	6,369,970	17.31
$17.59 to $28.759	8,915,653	1.9 years	23.69	8,915,653	23.69
$28.76 and over	8,559,663	3.4 years	36.05	8,559,663	36.05
	39,091,053	**4.4 years**	**$ 20.12**	**34,260,519**	**$ 21.75**

Restricted Stock Units

The following table summarizes restricted stock unit activity during the six months ended June 30, 2007:

	Restricted Stock Units	**Weighted Average Grant Date Fair Value Per Unit**
Unvested as of December 31, 2006	7,101,474	$ 9.31
Granted	5,735,924	6.62
Vested	(2,296,527)	9.07
Forfeited	(377,873)	9.01
Unvested as of June 30, 2007	**10,162,998**	**$ 7.85**

Included in the grants of restricted stock units for the six months ended June 30, 2007 are 3,233,424 restricted stock units that vest ratably over three years. The fair value of these restricted stock units was based on our share price on the grant date. Also, 1,402,500 restricted stock units that include cliff vesting conditions, based on the average closing price of our shares on the last 40 trading days of 2009, were granted in the three months ended March 31, 2007 to certain of our executives. Vesting is based on the following share price criteria and is calculated on a straight-line basis for share prices between the following benchmarks:

Average Share Price	**Vesting %**
$10.25 or above	100%
$8.50 or above, but less than $10.25	66.67% - 99.99%
$6.75 or above, but less than $8.50	33.33% - 66.66%
Less than $6.75	33.33%

One exception to the above vesting criteria is that 100,000 restricted stock units granted to our chief executive officer vest on the first anniversary of the grant and an additional 100,000 restricted stock units vest on the second anniversary, with the remaining 700,000 restricted stock units granted vesting on the third anniversary based on the average share price vesting criteria described above. The fair value of all of the restricted stock units that include cliff vesting conditions is $4.71 per share, which was estimated based on a Monte Carlo valuation model.

In addition to the above grants, 1,100,000 restricted stock units were granted during the three months ended March 31, 2007 to a group of employees for retention purposes. The fair value of these restricted stock units was based on our share price on the grant date. These units vest as follows:

- 25% on the third anniversary;
- 25% on the fifth anniversary;
- 25% on the seventh anniversary; and
- 25% on the tenth anniversary.

As of June 30, 2007, there were $50 million of total unrecognized compensation costs related to restricted stock units. These costs are expected to be recognized over a weighted average period of 2.7 years.

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Restricted Stock

In January 2003, we issued 200,000 shares of restricted stock to our chief executive officer. The stock vested on the second, third and fourth anniversary dates of the grant.

The following table summarizes restricted stock activity during the six months ended June 30, 2007:

	Shares	Weighted Average Grant Date Fair Value Per Share
Unvested as of December 31, 2006	66,667	$ 18.64
Granted		
Vested	(66,667)	18.64
Forfeited		
Unvested as of June 30, 2007		**$**

NOTE 7. SHAREHOLDERS EQUITY

The following table shows the changes in consolidated shareholders equity during the six months ended June 30, 2007 (dollars in millions, shares in thousands):

	Shares Outstanding	Issued Par Amount	Additional Paid-in Capital	Other Comprehensive Loss	Accumulated Deficit	Treasury Stock	Total Shareholders Equity
Balances at December 31, 2006	**471,585**	**$ 26**	**$ 4,372**	**$ (45)**	**$ (2,610)**	**$ (1,479)**	**$ 264**
Cumulative effect of adopting FIN 48					(178)		(178)
Net income					45		45
Other comprehensive loss				(1)			(1)
Stock-based compensation expense and issuance of common stock	1,857		19				19
Balances at June 30, 2007	**473,442**	**$ 26**	**$ 4,391**	**$ (46)**	**$ (2,743)**	**$ (1,479)**	**$ 149**

NOTE 8. OTHER COMPREHENSIVE INCOME (LOSS)

The table below shows each component of other comprehensive income (loss) for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income (loss)	$ (30)	$ (398)	$ 45	$ (328)
Other comprehensive income (loss):				
			1	(1)

Reclassification adjustments for realized (gains) losses included in net income (loss)				
Foreign currency translation adjustment			(2)	
Other comprehensive loss before income taxes			**(1)**	**(1)**
Income tax (expense) benefit related to items of other comprehensive loss				
Other comprehensive loss			**(1)**	**(1)**
Comprehensive income (loss)	**$ (30)**	**$ (398)**	**$ 44**	**$ (329)**

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. PROPERTY AND PROFESSIONAL AND GENERAL LIABILITY INSURANCE

Property Insurance

We have property, business interruption and related insurance coverage to mitigate the financial impact of catastrophic events or perils that is subject to deductible provisions based on the terms of the policies. These policies are on an occurrence basis. For the policy period April 1, 2007 through March 31, 2008, we have coverage totaling $600 million per occurrence, after deductibles and exclusions, with annual aggregate sub-limits of $100 million each for floods and earthquakes and a per-occurrence sub-limit of $100 million for windstorms with no annual aggregate. The insurance program has a deductible for wind-related claims of 5% of insured values. With respect to fires and other perils, excluding windstorms, floods and earthquakes, the total $600 million limit of coverage per occurrence applies. Deductibles are also 5% of insured values for California earthquakes and floods, 2% of insured values for New Madrid fault earthquakes, and $1 million for fires and other perils.

Professional and General Liability Insurance

At June 30, 2007 and December 31, 2006, the current and long-term professional and general liability reserves on our Condensed Consolidated Balance Sheet were approximately $717 million and $731 million, respectively. These reserves include the reserves recorded by our captive insurance subsidiaries and self-insured retention reserves recorded based on actuarial estimates for the portion of our professional and general liability risks, including incurred but not reported claims, for which we do not have insurance coverage. We estimated the reserves for losses and related expenses using expected loss-reporting patterns discounted to their present value under a risk-free rate approach using a Federal Reserve seven-year maturity composite rate of 4.72% and 4.76% at June 30, 2007 and December 31, 2006, respectively.

For the policy period June 1, 2007 through May 31, 2008, our hospitals generally have a self-insurance retention per occurrence of $2 million for losses incurred during the policy period. Our captive insurance company, The Healthcare Insurance Corporation, has a self-insured retention of $13 million per occurrence above our hospitals $2 million self-insurance retention level. The next $10 million of claims in excess of $15 million are 100% reinsured by The Healthcare Insurance Corporation with independent reinsurance companies. Claims in excess of $25 million are covered by our excess professional and general liability insurance policies from major independent insurance companies, on a claims-made basis, subject to an aggregate limit of $275 million.

Included in other operating expenses in the accompanying Condensed Consolidated Statements of Operations is malpractice expense of $48 million and $49 million for the three months ended June 30, 2007 and 2006, respectively, and $97 million and $92 million for the six months ended June 30, 2007 and 2006, respectively.

NOTE 10. CLAIMS AND LAWSUITS

Currently pending and recently resolved material claims, legal proceedings and investigations that are not in the ordinary course of business are set forth below. Where specific amounts are sought in any pending legal proceeding, those amounts are disclosed. For all other matters, where a loss is reasonably possible and estimable, an estimate of the loss or a range of loss is provided. Where no estimate is provided, a loss is not reasonably possible or an amount of loss is not reasonably estimable at this time.

1. Shareholder Derivative Actions and Securities Matter   In January 2006, we announced that we had reached an agreement in principle to settle the shareholder derivative action entitled *In Re Tenet Healthcare Corporation Derivative Litigation*, which was pending against certain current and former members of our board of directors and former members of senior management in California Superior Court in Santa Barbara. In March 2006, we paid a $5 million award of attorneys   fees in connection with the settlement, which we recorded as a charge during the three months ended March 31, 2006. The shareholder derivative settlement received final court approval in May 2006; however, a notice of appeal of the settlement was filed in July 2006. We are defending the trial court   s decision on appeal.

A consolidated shareholder derivative action is pending in federal district court in California against certain current and former members of our board of directors and former members of senior management. Tenet is also named as a nominal defendant. The shareholder plaintiffs allege various causes of action on behalf of the Company and for our benefit, including breach of fiduciary duty, insider trading, unjust enrichment and securities law violations. We anticipate that

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this matter will be dismissed now that the state court in Santa Barbara has approved the settlement of the state derivative litigation, subject to the appeal described above. The federal court has stayed all proceedings in this case until our motion to dismiss is filed and resolved.

In June 2006, four purported Tenet shareholders who opted out of the settlement of the federal securities class action lawsuit entitled *In Re Tenet Healthcare Corporation Securities Litigation* filed a civil complaint in federal court in California against the Company, certain former executive officers of the Company and KPMG LLP (KPMG), the Company s former independent registered public accounting firm. Plaintiffs allege that the Company, KPMG and the former executives are liable for securities fraud under Section 10(b) of and Rule 10b-5 under the Securities Exchange Act of 1934, and that each of the former executive defendants are liable for control person liability pursuant to Section 20(a) of the Exchange Act. Plaintiffs seek an undisclosed amount of compensatory damages and reasonable attorneys fees and expenses.

2. SEC Settlement In April 2007, we announced that the Company entered into a $10 million civil settlement with the Securities and Exchange Commission that concluded an SEC investigation into two separate matters the first primarily concerning whether our disclosures in our financial reports relating to Medicare outlier reimbursements and stop-loss payments under managed care contracts were misleading or otherwise inadequate, and the second relating to whether inappropriate contractual allowances for managed care contracts were established at certain of our hospitals. In the three months ended December 31, 2006, we recorded an accrual of $10 million as an estimated liability to address the potential resolution of the SEC investigation. The civil settlement, filed on April 2, 2007 in the U.S. District Court in Los Angeles, arose from a civil complaint filed simultaneously by the SEC against Tenet and four former officers of the Company, alleging violations of certain anti-fraud and disclosure provisions of the federal securities laws. The settlement, in which Tenet neither admitted nor denied the allegations, was approved by the court on April 4, 2007 and resolved the SEC complaint against the Company. As part of the settlement, the SEC said it would seek to deposit the $10 million civil penalty paid by Tenet into a fair fund to be distributed to eligible individuals and entities that demonstrate losses related to the value of their Tenet shares purchased or sold between April 12, 2002 and November 7, 2002.

3. Wage and Hour Actions We are defending a proposed class action lawsuit alleging that our hospitals violated certain provisions of the California Labor Code and applicable California Industrial Welfare Commission Wage Orders with respect to (a) meal breaks, (b) rest periods, (c) the payment of compensation for meal breaks and rest periods not taken, (d) rounding off practices for time entries on timekeeping records, (e) the information shown on pay stubs and (f) certain overtime payments. Plaintiffs are seeking back pay, statutory penalties and attorneys fees, and seek to certify this action on behalf of virtually all nonexempt employees of our California subsidiaries. Another proposed class action pending in Southern California also involves allegations regarding unpaid overtime. The lawsuit alleges that our pay practices since 2000 for California-based 12-hour shift employees violate California and federal overtime laws by virtue of the alleged failure to include certain payments known as Flexible (or California) Differential payments in the regular rate of pay that is used to calculate overtime pay. This case has been provisionally certified as a collective action under the federal Fair Labor Standards Act for the purpose of giving notice to potential class members. Plaintiff is seeking back pay, statutory penalties and attorneys fees. We have recorded an accrual of $21 million as an estimated liability for the wage and hour actions and other unrelated employment matters (we recorded $18 million in the three months ended June 30, 2006 and $6 million in prior years, offset by a $3 million reduction in the estimated liability in the three months ended March 31, 2007).

4. Investigation by Louisiana Attorney General s Office In connection with an investigation into patient deaths that occurred at various hospitals and nursing homes following Hurricane Katrina, the Louisiana Attorney General s Office conducted a review of events that occurred during the hurricane at two Tenet hospitals in New Orleans Memorial Medical Center and Lindy Boggs Medical Center (both of which have since been divested). On October 1, 2005, representatives of the Louisiana Attorney General s Office conducted a search of Memorial s campus pursuant to a search warrant issued by an Orleans Parish state judge on September 30, 2005. Certain records

and other materials were removed, including materials from a long-term acute care facility on Memorial s campus, which was managed and operated under separate license by LifeCare Holdings Inc., which is not affiliated with us. The Attorney General s Office also issued subpoenas to the Company and Memorial requesting documents pertaining to the matters under investigation and events occurring at the hospital during and after the hurricane. In addition, the Attorney General subpoenaed certain individuals he wanted to question on these matters, including a number of our employees. Subsequently, we learned in mid-July 2006 that the Louisiana Attorney General had

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referred the findings of his ten-month investigation to the New Orleans District Attorney. The Attorney General s Office also announced in July 2006 that it had issued arrest warrants for two nurses who were employees of Memorial and one doctor who was not our employee, but was on the medical staff at Memorial, alleging that they may have administered pain medication that hastened the deaths of four patients of LifeCare s facility in the aftermath of the hurricane. These individuals repeatedly denied the Attorney General s allegations. We learned in July 2007 that the New Orleans District Attorney s Office refused to press charges against the two nurses after they testified before a grand jury. Subsequently, the District Attorney s Office announced that the grand jury had declined to return any indictments in the matter.

5. Tax Disputes See Note 11 for information concerning disputes with the Internal Revenue Service (IRS) regarding our federal tax returns.

Our hospitals are also routinely subject to sales and use tax audits and personal property tax audits by the state and local government jurisdictions in which they do business. The results of the audits are frequently disputed, and such disputes are ordinarily resolved by administrative appeals or litigation.

6. Qui Tam Actions We have been defending a qui tam action in Texas that alleged violations of the federal False Claims Act by our hospitals in El Paso arising out of the alleged manipulation of the hospitals charges in order to increase outlier payments. On April 13, 2007, we filed a motion for summary judgment seeking dismissal of the case. On the same day, the government also filed a summary judgment motion. On July 20, 2007, the court found that the relators had no direct and independent knowledge of the information on which their allegations were based and granted both motions, thereby dismissing this case.

On April 24, 2007, our motion to dismiss an unrelated qui tam action in South Carolina was granted. That action, in which the Department of Justice declined to intervene, alleged violations of the federal False Claims Act by the Company, our Hilton Head Medical Center and Clinics, and related subsidiaries, as well as a cardiologist who formerly practiced at Hilton Head. The relator claimed that we received inappropriate payments from Medicare for certain cardiac catheterization procedures that were performed by the cardiologist from 1997 through 2003, during which time Hilton Head did not have a state certificate of need for open heart surgery capability, which was required under South Carolina regulations for facilities performing those procedures. The suit also alleged that certain of the catheterization procedures were medically unnecessary, although the relator provided no specific information regarding these claims. The relator appealed the district court s decision to dismiss the case to the U.S. Court of Appeals for the Fourth Circuit in Richmond, Virginia, where briefing is ongoing. We believe that the trial court s dismissal was correct and are defending that decision on appeal.

7. Miscellaneous Civil Lawsuits We have been defending a civil case in federal district court in Miami filed as a purported class action by Boca Raton Community Hospital, principally alleging that Tenet s past pricing policies and receipt of Medicare outlier payments violated the federal Racketeer Influenced and Corrupt Organizations Act (RICO), causing harm to plaintiff. Plaintiff sought unspecified amounts of damages (including treble damages under RICO), restitution, disgorgement and punitive damages. In December 2006, the district court denied plaintiff s motion for class certification, which decision the U.S. Court of Appeals for the Eleventh Circuit declined to review. On August 1, 2007, the district court granted our motion for summary judgment on all claims, thereby dismissing this case.

Plaintiff Erin Brockovich, purportedly on behalf of the United States of America, filed a civil complaint alleging that we inappropriately received reimbursement from Medicare for treatment given to patients whose injuries were caused as a result of medical error or neglect. Plaintiff is seeking damages of twice the amount that defendants were allegedly obligated to pay or reimburse Medicare in connection with the treatment in question, plus interest, together with plaintiff s costs and fees, including attorneys fees. Our motion to dismiss this matter was granted in November 2006; however, plaintiff has since filed notice of her intention to appeal the dismissal. We intend to defend the trial court s decision on appeal.

In August 2006, the University of Southern California filed a lawsuit in Los Angeles Superior Court against a Tenet subsidiary seeking to terminate a ground lease and a development and operating agreement between the University and the subsidiary, which built, owns and operates USC University Hospital, an acute care hospital located on land leased from the University in Los Angeles. The University s complaint alleges that the lease and operating agreement

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should be terminated as a result of a default by us and seeks a judicial declaration terminating the agreements in an effort to force us to sell the hospital to the University. We strongly dispute the University s claims and are seeking to compel arbitration of the dispute as is mandated by the development and operating agreement. In December 2006, the trial court denied our motion to compel arbitration; however, on January 2, 2007, we filed an appeal of that decision, and the case has been stayed pending the appeal. Oral arguments in the appeal are scheduled for August 17, 2007.

In April 2007, we received letters from a real estate investment trust from which certain of our subsidiaries lease hospitals and real estate alleging that several of those subsidiaries were in default primarily with respect to a number of deferred maintenance issues under three leases. The leases relate to the following hospitals: the Tarzana campus of Encino-Tarzana Regional Medical Center in California, Community Hospital of Los Gatos, also in California, and NorthShore Regional Medical Center in Slidell, Louisiana. We believe that the alleged defaults are without merit. However, we are taking steps to clarify or remedy any proven claimed deficiencies, as appropriate, and, if found to be deficient, we intend to elect our right to cure any maintenance defaults as provided under the leases. On May 8, 2007, our subsidiaries filed suit in California state court against the lessor and certain of its affiliates asserting various causes of action concerning the lease disputes. Our subsidiaries also initiated an arbitration action against the lessor and its affiliates. With the lawsuit and through the arbitration proceedings, we seek declaratory relief in our favor regarding the leases and alleged defaults, damages, and injunctive relief and restitution under California s unfair competition law. The case and arbitration proceedings are in their initial stages, and discovery has not yet commenced. The leases at issue contain cross-default covenants that state that, under certain circumstances, we may be considered to be in default under other leases if a default has occurred and is continuing under one lease. On July 27, 2007, we received notices from the lessor alleging that certain of our subsidiaries were in default under leases relating to four of our hospitals because of the alleged defaults under the Tarzana lease described above. As a result, the lessor has demanded that we turn over possession of Irvine Regional Hospital Medical Center in California, Palm Beach Gardens Medical Center in Florida, North Fulton Regional Hospital in Georgia and Frye Regional Medical Center in North Carolina by December 31, 2007. We believe the lessor has taken this step as a response to the lawsuit and arbitration proceedings we commenced in May 2007, and we intend to continue to vigorously defend ourselves in this matter.

In addition to the matters described above, our hospitals are subject to claims and lawsuits in the ordinary course of business. The largest category of these relates to medical malpractice. Three of these medical malpractice cases were filed as purported class action lawsuits and involve former patients of Memorial Medical Center and Lindy Boggs Medical Center in New Orleans. In each case, family members allege, on behalf of themselves and a purported class of other patients and their family members, damages as a result of injuries sustained during Hurricane Katrina.

Also, we and our subsidiaries are from time to time engaged in disputes with managed care payers. For the most part, we believe the issues raised in these contract interpretation and rate disputes are commonly encountered by other providers in the health care industry.

While we cannot predict the likelihood of future claims or inquiries, we expect that new matters may be initiated against us from time to time. These matters could (1) require us to pay substantial damages or amounts in judgments or settlements, which individually or in the aggregate could exceed amounts, if any, that may be recovered under our insurance policies where coverage applies and is available, (2) cause us to incur substantial expenses, (3) require significant time and attention from our management, and (4) cause us to close or sell hospitals or otherwise modify the way we conduct business.

The results of claims, lawsuits and investigations also cannot be predicted. We recognize that, where appropriate, our interests may be best served by resolving certain matters without litigation. If non-litigated resolution is not appropriate or possible with respect to a particular matter, we will defend ourselves vigorously. The ultimate resolution of significant claims against us, individually or in the aggregate, whether as a result of litigation or settlement, could have a material adverse effect on our business (both in the near and long term), financial condition, results of operations or cash flows.

We record reserves for claims and lawsuits when they are probable and reasonably estimable. For matters where the likelihood or extent of a loss is not probable or cannot be reasonably estimated, we have not recognized in the accompanying Condensed Consolidated Financial Statements the potential liabilities that may result.

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The table below presents reconciliations of the beginning and ending liability balances in connection with legal settlements and related costs recorded during the six months ended June 30, 2007 and 2006:

	Balances at Beginning of Period	Litigation and Investigation Costs (Benefit)	Cash Payments	Other(1)	Balances at End of Period
Six Months Ended June 30, 2007					
Continuing operations	$ 321	$ (2)	$ (20)	$	$ 299
Discontinued operations	1				1
	$ 322	**$ (2)**	**$ (20)**	**$**	**$ 300**
Six Months Ended June 30, 2006					
Continuing operations	$ 308	$ 744	$ (649)	$ (75)	$ 328
Discontinued operations	5	(24)	(21)	45	5
	$ 313	**$ 720**	**$ (670)**	**$ (30)**	**$ 333**

(1) Other items in 2006 include the funding of $75 million from our insurance carriers for the settlement of a securities class action lawsuit, which was classified as a receivable in other current assets in the Condensed Consolidated Balance Sheet as of December 31, 2005, and the recovery of $45 million in insurance proceeds related to the Redding Medical Center settlement in December 2004, which was classified as a receivable in other current assets in the Condensed Consolidated Balance Sheet as of March 31, 2006.

For the six months ended June 30, 2007 and 2006, we recorded net costs (benefit) of $(2) million and $720 million, respectively, in connection with significant legal proceedings and investigations, including $(24) million in the six months ended June 30, 2006 that was reflected in discontinued operations. The 2007 benefit represents $6 million of costs to defend ourselves in various lawsuits and investigations, offset by an $8 million reduction of reserves recorded in prior periods that are no longer considered necessary based on updated loss estimates. The 2006 payments primarily consisted of the June 30, 2006 global civil settlement payment ($470 million, including $20 million in interest), the settlement of the Alvarado case ($21 million), the settlement of the securities class action ($140 million), attorneys fees associated with a shareholder derivative lawsuit ($5 million), our February 2006 settlement with the Florida Attorney General ($7 million), and legal and other costs to defend ourselves in other ongoing lawsuits and investigations.

NOTE 11. INCOME TAXES

In June 2006, the FASB issued FIN 48, which prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns.

The cumulative effect of adopting FIN 48 was a $178 million decrease to retained earnings as of January 1, 2007, $142 million of which was related to an increase in the valuation allowance for deferred tax assets. The total amount of unrecognized tax benefits as of the date of adoption was $199 million ($141 million related to continuing operations and $58 million related to discontinued operations), all of which, if recognized, would affect our effective tax rate and income tax expense/benefit from continuing and discontinued operations. Total accrued interest and penalties on unrecognized tax benefits as of the date of adoption were $92 million. Included in the balance of unrecognized tax benefits at January 1, 2007 is $172 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next 12 months. This amount represents unrecognized tax benefits related to issues in dispute with the IRS and state income tax authorities and other uncertain tax positions. As a result of actions we took during the three months ended March 31, 2007, we were able to reduce our estimated liabilities for uncertain tax positions as of January 1, 2007 (the effective date of FIN 48) by approximately $107 million, which amount included $36 million of accrued interest. This resulted in an income tax benefit of $107 million being recognized as a credit to income tax expense in the Condensed Consolidated Statements of Operations during the three months ended March 31, 2007 ($93 million of which was recognized in continuing operations and $14 million in discontinued operations). Under FIN 48 and SFAS No. 109, Accounting for Income Taxes, the actions to reduce our liability for uncertain tax positions could not be taken into consideration in our estimate of the liability and our assessment of the recoverability of deferred tax assets as of January 1, 2007. Accordingly, although the initial impact of establishing the $107 million estimated liability was charged directly to shareholders equity effective January 1, 2007 and was included in the $178 million cumulative effect adjustment discussed above, the reduction of the liability was recorded as a tax benefit in the Condensed Consolidated

Statement of Operations in accordance with FIN 48 because we took the actions to reduce the estimated

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exposure related to the uncertain tax positions subsequent to January 1, 2007. The total amount of unrecognized tax benefits as of June 30, 2007 was $128 million ($74 million related to continuing operations and $54 million related to discontinued operations), which, if recognized, would affect our effective tax rate and income tax expense/benefit from continuing and discontinued operations.

As of June 30, 2007, approximately $103 million of unrecognized federal and state tax benefits are related to uncertain tax positions for which settlement is reasonably possible within the next 12 months as pending federal and state audits and appeals are resolved. An estimate of the range of potential outcomes for those matters cannot be made at this time.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense in our Consolidated Statements of Operations. In addition to the adjustments described above, interest and penalties totaling $5 million related to accrued liabilities for uncertain tax positions are included in continuing operations in the six months ended June 30, 2007.

In addition to the impact of the valuation allowance adjustments associated with the FIN 48 adjustments described above, income tax benefit in the six months ended June 30, 2007 included the following: (1) a $14 million income tax expense in continuing operations to increase the valuation allowance for our deferred tax assets; (2) an income tax benefit of $11 million in continuing operations to increase deferred tax assets related to state tax credits as a result of the enactment of recent legislation; and (3) an income tax expense of $13 million in discontinued operations to increase the valuation allowance.

Income tax benefit in the six months ended June 30, 2006 included the following: (1) a $247 million income tax benefit ($171 million recorded as a current income tax receivable and $76 million as a non-current deferred tax asset) to record the tax effects of our June 2006 Civil Settlement Agreement with the United States of America; (2) an income tax expense of $1 million in continuing operations to increase the valuation allowance for our deferred tax assets; (3) an income tax benefit of $7 million in continuing operations reflecting changes in tax contingency reserves; (4) an income tax benefit of $53 million in discontinued operations to decrease the valuation allowance; (5) an income tax benefit of $2 million in discontinued operations reflecting changes in tax contingency reserves; and (6) an income tax benefit of $1 million in cumulative effect of change in accounting principle to decrease the valuation allowance.

Our federal tax returns for 2003, 2004 and 2005 are currently under examination by the IRS. In 2006, the IRS completed its examination of our federal tax returns for fiscal years ended May 31, 1998 through the seven-month transition period ended December 31, 2002, and it issued a Revenue Agent s Report in which it proposed to assess an aggregate tax deficiency of $207 million. We paid $110 million of tax and interest in December 2006 to resolve issues that were not in dispute in that audit. We have filed an appeal of the disputed issues with the Appeals Division of the IRS. We have also petitioned the Tax Court to resolve disputed issues with respect to our federal tax returns for fiscal years ended May 31, 1995 through May 31, 1997. All examinations of our tax returns for years ended prior to the fiscal year ended May 31, 1995 have been resolved. We believe we have adequately provided for all probable tax matters, including interest. We presently cannot determine the ultimate resolution of the disputed issues.

NOTE 12. EARNINGS PER COMMON SHARE

The table below is a reconciliation of the numerators and denominators of our basic and diluted earnings per common share calculations for income (loss) from continuing operations for the three and six months ended June 30, 2007 and 2006. Income (loss) is expressed in millions and weighted average shares are expressed in thousands.

	Income (Loss) (Numerator)	Weighted Average Shares (Denominator)	Per-Share Amount
Three Months Ended June 30, 2007:			
Loss to common shareholders for basic earnings per share	$ (29)	473,212	$ (0.06)
Effect of dilutive stock options and restricted stock units			
Loss to common shareholders for diluted earnings per share	**$ (29)**	**473,212**	**$ (0.06)**

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Income (Loss) (Numerator)	Weighted Average Shares (Denominator)	Per-Share Amount
Three Months Ended June 30, 2006:			
Loss to common shareholders for basic earnings per share	$ (447)	470,608	$ (0.95)
Effect of dilutive stock options and restricted stock units			
Loss to common shareholders for diluted earnings per share	**$ (447)**	**470,608**	**$ (0.95)**
Six Months Ended June 30, 2007:			
Income available to common shareholders for basic earnings per share	$ 64	472,729	$ 0.13
Effect of dilutive stock options and restricted stock units		1,785	
Income available to common shareholders for diluted earnings per share	**$ 64**	**474,514**	**$ 0.13**
Six Months Ended June 30, 2006:			
Loss to common shareholders for basic earnings per share	$ (448)	470,338	$ (0.95)
Effect of dilutive stock options and restricted stock units			
Loss to common shareholders for diluted earnings per share	**$ (448)**	**470,338**	**$ (0.95)**

Stock options (in thousands) whose exercise price exceeded the average market price of our common stock and, therefore, were not included in the computation of diluted shares for the six months ended June 30, 2007 were 37,569 shares.

All potentially dilutive securities were excluded from the calculation of diluted earnings per share for the three months ended June 30, 2007 and the three and six months ended June 30, 2006 because we did not report income from continuing operations in those periods. In circumstances where we do not have income from continuing operations, the effect of stock options and other potentially dilutive securities is anti-dilutive, that is, a loss from continuing operations has the effect of making the diluted earnings per share less than the basic earnings per share. Had we generated income from continuing operations in those periods, the effect (in thousands) of employee stock options, restricted stock units and deferred compensation units on the diluted shares calculation would have been an increase of 1,380 for the three months ended June 30, 2007, and 1,371 and 1,024 shares for the three and six months ended June 30, 2006, respectively. Stock options (in thousands) whose exercise price exceeded the average market price of our common stock and, therefore, would not have been included in the computation of diluted shares if there had been income from continuing operations were 37,569 shares for the three months ended June 30, 2007 and 39,339 and 39,497 shares for the three and six months ended June 30, 2006, respectively.

NOTE 13. ACQUISITION

During the three months ended June 30, 2007, we acquired Coastal Carolina Medical Center pursuant to a stock purchase agreement and recorded our preliminary purchase price allocation based on our initial assessment of the fair values of the assets and liabilities as shown below:

	June 30, 2007
Current assets	$ 1
Property, plant and equipment	34
Goodwill	2
Current liabilities assumed	(1)
Net cash paid	**$ 36**

The goodwill generated from this transaction can be attributed to the significant benefits we expect to obtain by streamlining operating efficiency and partnering this hospital with our nearby Hilton Head Regional Medical Center to expand and enhance services to this area of South Carolina, which we have served for many years.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION TO MANAGEMENT S DISCUSSION AND ANALYSIS

The purpose of this section, Management s Discussion and Analysis of Financial Condition and Results of Operations, is to provide a narrative explanation of our financial statements that enables investors to better understand our business, to enhance our overall financial disclosures, to provide the context within which financial information may be analyzed, and to provide information about the quality of, and potential variability of, our financial condition, results of operations and cash flows. Unless otherwise indicated, all financial and statistical information included herein relates to our continuing operations, with dollar amounts expressed in millions (except per-share amounts). This information should be read in conjunction with the accompanying Condensed Consolidated Financial Statements. It includes the following sections:

- Executive Overview
- Forward-Looking Statements
- Sources of Revenue
- Results of Operations
- Liquidity and Capital Resources
- Off-Balance Sheet Arrangements
- Critical Accounting Estimates

EXECUTIVE OVERVIEW

KEY DEVELOPMENTS

During 2007, we continue to focus on the execution of our turnaround strategies. While we have seen certain areas of improvement, we are still facing several industry and company-specific challenges that continue to negatively affect our progress. We are dedicated to improving our patients , shareholders and other stakeholders confidence in us. We still believe we will do that by providing quality care and generating positive growth and earnings at our hospitals.

Recent key developments include the following events:

- *Realignment of Regions* Effective August 1, 2007, we streamlined our regional operating structure to further reduce our overhead costs. Our Central-Northeast region was eliminated, and our hospitals in Missouri and Tennessee are now part of the renamed Central region (formerly, the Texas region). Our two Philadelphia hospitals now form a separate market reporting directly to our chief operating officer. We do not expect this realignment to result in any impairment of our goodwill.

- *Sale of Two Pennsylvania Hospitals* In July 2007, we completed the previously disclosed sale of Roxborough Memorial Hospital in Philadelphia and Warminster Hospital in Warminster, two of the 10 hospitals we identified for divestiture in June 2006. Pre-tax proceeds from the sale were approximately $25.5 million, consisting of $15.5 million in cash, which will be used for general corporate purposes, and a $10 million note due in December

2009.

- *Acquisition of Coastal Carolina Medical Center* In June 2007, we purchased Coastal Carolina Medical Center, a 41-bed acute care hospital in Hardeeville, South Carolina, for approximately $36 million. The hospital is located 27 miles from our Hilton Head Regional Medical Center. We intend to continue to operate Coastal Carolina as a full service community hospital and will seek to enhance services to meet the community s needs, in coordination with our nearby Hilton Head facility.

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SIGNIFICANT CHALLENGES

Our June 2006 global civil settlement with the federal government and other previously announced settlements have resolved several material threats to our company and should help us move forward in our turnaround strategy. However, there are still significant challenges, both company-specific and industry-wide, that will impact the timing of our turnaround. Below is a summary of these items.

Company-Specific Challenge

Volumes We believe the reasons for declines in our patient volumes include, but are not limited to, decreases in the demand for invasive cardiac procedures, increased competition, physician attrition, managed care contract negotiations or terminations, population trends in Florida, and the impact of our litigation and government investigations. We are taking a number of steps to address the problem of volume decline; however, due to the concentration of our hospitals in California, Florida and Texas, we may not be able to mitigate some factors contributing to volume declines. One of our initiatives is our *Physician Sales and Service Program*, which is centered around understanding the needs of physicians who admit patients both to our hospitals and to our competitors hospitals and responding to those needs with changes and improvements in our hospitals and operations. We have targeted capital spending in order to address specific needs or growth opportunities of our hospitals, which is expected to have a positive impact on their volumes. We are also completing clinical service line market demand analysis and profitability assessments to determine which services are highly valued that can be emphasized and marketed to improve results. This *Targeted Growth Initiative* has resulted in some reductions in unprofitable service lines in several locations, which have had a slightly negative impact on our volumes. However, the elimination of these unprofitable service lines will allow us to focus more resources on services that are highly valued and more profitable.

Our *Commitment to Quality* initiative, which we launched in 2003, is further helping position us to competitively meet the volume challenge. We are working with physicians to implement the most current evidence-based techniques to improve the way we provide care. Our hospitals have improved substantially in quality metrics reported by the government and have been recognized by several managed care companies for their quality of care. We believe that quality of care improvements will continue to have the effect of increasing physician and patient satisfaction, potentially improving our volumes as a result.

Significant Industry Trends

Bad Debt Like other organizations in the health care industry, we continue to provide services to a high volume of uninsured patients and more patients than in prior years with an increased burden of co-payments and deductibles as a result of changes in their health care plans. Although the discounting components of our *Compact with Uninsured Patients* (Compact) reduce our provision for doubtful accounts recorded in our Condensed Consolidated Financial Statements, they are not expected to mitigate the net economic effects of treating uninsured or underinsured patients. We continue to experience a high level of uncollectible accounts. Our collection efforts have improved, and we continue to focus, where applicable, on placement of patients in various government programs such as Medicaid. However, unless our business mix shifts toward a greater number of insured patients or the trend of higher co-payments and deductibles reverses, we anticipate this high level of uncollectible accounts to continue.

Cost Pressures Labor, benefits and supply costs remain a significant cost pressure facing us as well as the industry in general. Controlling labor costs in an environment of fluctuating patient volumes and increased labor union activity will continue to be a challenge. Also, inflation and technology improvements are driving supply costs higher, and our efforts to control supplies expense through product standardization, bulk purchases and improved utilization are constantly challenged.

RESULTS OF OPERATIONS OVERVIEW

Our turnaround timeframe has been and continues to be influenced by company-specific challenges, such as decreasing volumes and demand for inpatient cardiac procedures, and by industry trends, such as bad debt levels, that continue to negatively affect our revenue growth and operating expenses. We believe our future profitability will be achieved through volume growth, appropriate reimbursement levels and cost control across our portfolio of hospitals, as none of our individual hospitals represented more than 5% of our net operating revenues or more than 5% of our total assets, excluding goodwill at June 30, 2007. Below are some of the financial highlights for the three months ended June 30, 2007 compared to the three months ended June 30, 2006:

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- Net inpatient revenue per patient day and per admission increased by 3.2% and 3.0%, respectively, primarily due to the effect of negotiated levels of reimbursement from our managed care contracts.

- Net outpatient revenue per visit increased 8.9%, while outpatient visits declined 3.1%. The increase in revenue per visit is primarily due to the effect of higher negotiated levels of reimbursement under our managed care contracts and a shift in patient service mix.

- Favorable net adjustments for prior-year cost reports and related valuation allowances, primarily related to Medicare and Medicaid, were $13 million in the current period compared to favorable net adjustments of $4 million in the prior-year period.

- Loss per diluted share from continuing operations was $(0.06) in the current period compared to $(0.95) in the prior-year period.

The table below shows the pretax and after-tax impact on continuing operations for the three and six months ended June 30, 2007 and 2006 of the following items:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(Expense) Income			
Impairment of long lived assets and goodwill, and restructuring charges	$ (10)	$ (27)	$ (13)	$ (56)
Litigation and investigation costs (benefit)	1	(728)	2	(744)
Hurricane insurance recoveries, net of costs		13		10
Pretax impact	$ (9)	$ (742)	$ (11)	$ (790)
Deferred tax asset valuation allowance	$ (16)	$ (2)	$ (14)	$ (1)
Change in reserves for uncertain tax positions	$ (2)	$ 7	$ 91	7
State tax credit adjustment for recent legislation	$ 11	$	$ 11	$
Total after-tax impact	$ (13)	$ (474)	$ 81	$ (502)
Diluted per-share impact of above items	$ (0.03)	$ (1.01)	$ 0.17	$ (1.07)
Diluted earnings (loss) per share, including above items	$ (0.06)	$ (0.95)	$ 0.13	$ (0.95)

LIQUIDITY AND CAPITAL RESOURCES OVERVIEW

Net cash provided by operating activities was $131 million in the six months ended June 30, 2007 compared to $641 million net cash used in operating activities in the six months ended June 30, 2006. The principal reasons for the change were lower payments for restructuring and litigation costs and settlements and income tax refunds received in 2007.

Purchases of property and equipment were $234 million and $243 million during the six months ended June 30, 2007 and 2006, respectively. Proceeds from the sales of facilities during the six months ended June 30, 2007 and 2006 aggregated $47 million and $15 million, respectively. In addition, in the six months ended June 30, 2007, we spent approximately $36 million to purchase a hospital in South Carolina and $27 million for construction of a hospital in El Paso, Texas.

In November 2006, we entered into a five-year, $800 million senior secured revolving credit facility that replaced our $250 million letter of credit facility. The revolving credit facility is collateralized by patient accounts receivable at our acute care and specialty hospitals, and bears interest at our option based on the London Interbank Offered Rate (LIBOR) plus 175 basis points or Citigroup s base rate, as defined in the credit agreement, plus 75 basis points. The letters of credit outstanding under our previous letter of credit facility were transferred into the revolving credit facility, which reduced the amount available for cash borrowings, but eliminated a restriction on $263 million of cash pledged under the letter of credit facility. At June 30, 2007, there were no cash borrowings under the revolving credit facility.

We are currently in compliance with all covenants and conditions in our revolving credit agreement and the indentures governing our senior notes. (See Note 5 to the Condensed Consolidated Financial Statements.)

At June 30, 2007, we had approximately $185 million of letters of credit outstanding under our revolving credit facility. In addition, we had $675 million of cash and cash equivalents on hand and borrowing capacity of $601 million under our revolving credit facility as of June 30, 2007.

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FORWARD-LOOKING STATEMENTS

The information in this report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical or present facts, that address activities, events, outcomes, business strategies and other matters that we plan, expect, intend, assume, believe, budget, predict, forecast, project, estimate or anticipate (and other similar expressions) will, should or may occur in the future are forward-looking statements. These forward-looking statements represent management s current belief, based on currently available information, as to the outcome and timing of future events. They involve known and unknown risks, uncertainties and other factors many of which we are unable to predict or control that may cause our actual results, performance or achievements, or health care industry results, to be materially different from those expressed or implied by forward-looking statements. Such factors include, but are not limited to, the following risks, many of which are described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2006 (Annual Report):

- A reduction in the payments we receive from managed care payers as reimbursement for the health care services we provide and difficulties we may encounter collecting amounts owed from managed care payers;
- Changes in the Medicare and Medicaid programs or other government health care programs, including modifications to patient eligibility requirements, funding levels or the method of calculating payments or reimbursements;
- The volume of uninsured and underinsured patients, and our ability to satisfactorily and timely collect our patient accounts receivable;
- Competition;
- The ultimate resolution of claims, lawsuits and investigations;
- Our ability to attract and retain employees, physicians and other health care professionals, and the impact on our labor expenses from union activity and the shortage of nurses in certain specialties and geographic regions;
- The geographic concentration of our licensed hospital beds;
- Changes in, or our ability to comply with, laws and government regulations;
- The cost and future availability of insurance, as well as the effects of insurance policy limits;
- Our ability to execute our turnaround strategy and the impact of other factors on our turnaround timeframe;
- Trends affecting our actual or anticipated results that lead to charges adversely affecting our results of operations;
- Our relative leverage and the amount and terms of our indebtedness;
- Our ability to identify and execute on measures designed to save or control costs or streamline operations;
- The availability and terms of debt and equity financing sources to fund the requirements of our businesses;
- Changes in our business strategies or development plans;

- The impact of natural disasters, including our ability to reopen facilities affected by such disasters;

- Technological and pharmaceutical improvements that increase the cost of providing, or reduce the demand for, health care services;

- Various factors that may increase the cost of supplies;

- National, regional and local economic and business conditions;

- Demographic changes; and

- Other factors and risk factors referenced in this report and our other public filings.

When considering forward-looking statements, a reader should keep in mind the risk factors and other cautionary statements in our Annual Report. Should one or more of the risks and uncertainties described above, elsewhere in this report or in Item 1A, Risk Factors, of our Annual Report occur, or should underlying assumptions prove incorrect, our actual results and plans could differ materially from those expressed in any forward-looking statements. We specifically disclaim all responsibility to publicly update any information contained in a forward-looking statement or any forward-looking statement in its entirety and, therefore, disclaim any resulting liability for potentially related damages.

All forward-looking statements attributable to us are expressly qualified in their entirety by this cautionary statement.

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SOURCES OF REVENUE

We receive revenues for patient services from a variety of sources, primarily managed care payers and the federal Medicare program, as well as state Medicaid programs, indemnity-based health insurance companies and self-pay patients (patients who do not have health insurance and are not covered by some other form of third-party arrangement).

The table below shows the sources of net patient revenues for our general hospitals, expressed as percentages of net patient revenues from all sources:

	Three Months Ended June 30,						Six Months Ended June 30,					
Net Patient Revenues from:	**2007**		**2006**		**Increase (Decrease)(1)**		**2007**		**2006**		**Increase (Decrease) (1)**	
Medicare	25.1	%	26.8	%	(1.7	)%	26.2	%	27.5	%	(1.3	)%
Medicaid	8.9	%	9.3	%	(0.4	)%	7.9	%	8.7	%	(0.8	)%
Managed care governmental	11.4	%	10.8	%	0.6	%	12.1	%	10.6	%	1.5	%
Managed care commercial	41.7	%	41.6	%	0.1	%	41.6	%	41.4	%	0.2	%
Indemnity, self-pay and other	12.9	%	11.5	%	1.4	%	12.2	%	11.8	%	0.4	%

(1) The increase (decrease) is the difference between the 2007 and 2006 percentages shown.

Our payer mix on an admissions basis for our general hospitals, expressed as a percentage of total admissions from all sources, is shown below:

	Three Months Ended June 30,						Six Months Ended June 30,					
Admissions from:	**2007**		**2006**		**Increase (Decrease)(1)**		**2007**		**2006**		**Increase (Decrease) (1)**	
Medicare	31.2	%	32.4	%	(1.2	)%	32.1	%	33.2	%	(1.1	)%
Medicaid	12.3	%	12.5	%	(0.2	)%	11.9	%	12.5	%	(0.6	)%
Managed care governmental	18.3	%	16.9	%	1.4	%	18.4	%	16.7	%	1.7	%
Managed care commercial	29.4	%	29.4	%			28.8	%	29.1	%	(0.3	)%
Indemnity, self-pay and other	8.8	%	8.8	%			8.8	%	8.5	%	0.3	%

(1) The increase (decrease) is the difference between the 2007 and 2006 percentages shown.

GOVERNMENT PROGRAMS

The Medicare program, the nation s largest health insurance program, is administered by the Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services. Medicare is a health insurance program primarily for individuals 65 years of age and older, certain younger people with disabilities, and people with end-stage renal disease, and is provided without regard to income or assets. Medicaid is a program that pays for medical assistance for certain individuals and families with low incomes and resources, and is jointly funded by the federal government and state governments. Medicaid is the largest source of funding for medical and health-related services for the nation s poorest and most vulnerable populations.

These government programs are subject to statutory and regulatory changes, administrative rulings, interpretations and determinations, requirements for utilization review, and federal and state funding restrictions, all of which could materially increase or decrease payments from these government programs in the future, as well as affect the cost of providing services to our patients and the timing of payments to our facilities. We are unable to predict the effect of future government health care funding policy changes on our operations. If the rates paid by governmental payers are reduced, if the scope of services covered by governmental payers is limited, or if we or one or more of our subsidiaries hospitals are excluded from participation in the Medicare or Medicaid program or any other government health care program, there could be a material adverse effect on our business, financial condition, results of operations or cash flows.

Medicare

Medicare offers beneficiaries different ways to obtain their medical benefits. One option, the Original Medicare Plan, is a fee-for-service payment system. The other option, called Medicare Advantage, includes managed care, preferred provider organization, private fee-for-service and specialty plans. The major components of our net patient revenues for services provided

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to patients enrolled in the Original Medicare Plan for the three and six months ended June 30, 2007 and 2006 are set forth in the table below:

	Three Months Ended June 30,		Six Months Ended June 30,	
Revenue Descriptions	**2007**	**2006**	**2007**	**2006**
Diagnosis-related group operating				