

HCA INC/TN  
Form 10-Q  
November 08, 2007

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

**Form 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2007**

or

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

**For the transition period from to**

**Commission file number 1-11239**

**HCA Inc.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

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

**75-2497104**

*(I.R.S. Employer )  
Identification No.*

**One Park Plaza**

**Nashville, Tennessee**

*(Address of principal executive offices)*

**37203 )**

*(Zip Code*

**(615) 344-9551**

*(Registrant's telephone number, including area code)*

**Not Applicable**

*(Former name, former address and former fiscal year, if changed since last report)*

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

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

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Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

| <b>Class of Common Stock</b>         | <b>Outstanding at October 31, 2007</b> |
|--------------------------------------|--|
| Voting common stock, \$.01 par value | 94,178,200 shares                      |

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**HCA INC.**

**Form 10-Q**  
**September 30, 2007**

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**HCA INC.**  
**CONDENSED CONSOLIDATED INCOME STATEMENTS**  
**FOR THE QUARTERS AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006**  
**Unaudited**  
**(Dollars in millions)**

|   | <b>Quarter</b>  |             | <b>Nine Months</b> |             |
|---|-----------------|-------------|--------------------|-------------|
|   | <b>2007</b>     | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Revenues  | \$ <b>6,569</b> | \$ 6,213    | \$ <b>19,975</b>   | \$ 18,988   |
| Salaries and benefits                                   | <b>2,701</b>    | 2,600       | <b>8,002</b>       | 7,816       |
| Supplies  | <b>1,085</b>    | 1,046       | <b>3,284</b>       | 3,251       |
| Other operating expenses                                | <b>1,076</b>    | 1,054       | <b>3,194</b>       | 3,063       |
| Provision for doubtful accounts                         | <b>774</b>      | 677         | <b>2,218</b>       | 1,950       |
| Losses (gains) on investments                           | <b>1</b>        | (40)        | <b>(6)</b>         | (140)       |
| Equity in earnings of affiliates                        | <b>(51)</b>     | (43)        | <b>(156)</b>       | (151)       |
| Depreciation and amortization                           | <b>356</b>      | 348         | <b>1,072</b>       | 1,045       |
| Interest expense  | <b>560</b>      | 200         | <b>1,674</b>       | 582         |
| Gains on sales of facilities                            | <b>(316)</b>    | (41)        | <b>(332)</b>       | (46)        |
| Impairment of long-lived assets                         |                 |             | <b>24</b>          |             |
| Transaction costs                                       |                 | 9           |                    | 9           |
|   | <b>6,186</b>    | 5,810       | <b>18,974</b>      | 17,379      |
| Income before minority interests and income taxes       | <b>383</b>      | 403         | <b>1,001</b>       | 1,609       |
| Minority interests in earnings of consolidated entities | <b>44</b>       | 44          | <b>160</b>         | 145         |
| Income before income taxes                              | <b>339</b>      | 359         | <b>841</b>         | 1,464       |
| Provision for income taxes                              | <b>39</b>       | 119         | <b>245</b>         | 550         |
| Net income  | \$ <b>300</b>   | \$ 240      | \$ <b>596</b>      | \$ 914      |

See accompanying notes.

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**HCA INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**Unaudited**  
**(Dollars in millions)**

|  | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|-------------------------------|------------------------------|
| <b>ASSETS</b>  |                               |                              |
| Current assets:  |                               |                              |
| Cash and cash equivalents  | \$ 347                        | \$ 634                       |
| Accounts receivable, less allowance for doubtful accounts of \$3,908 and \$3,428 | 3,857                         | 3,705                        |
| Inventories  | 689                           | 669                          |
| Deferred income taxes  | 487                           | 476                          |
| Other  | 649                           | 594                          |
|  | <b>6,029</b>                  | <b>6,078</b>                 |
| Property and equipment, at cost  | <b>22,449</b>                 | 21,907                       |
| Accumulated depreciation   | <b>(10,999)</b>               | (10,238)                     |
|  | <b>11,450</b>                 | <b>11,669</b>                |
| Investments of insurance subsidiary  | <b>1,737</b>                  | 1,886                        |
| Investments in and advances to affiliates  | <b>683</b>                    | 679                          |
| Goodwill   | <b>2,652</b>                  | 2,601                        |
| Deferred loan costs  | <b>559</b>                    | 614                          |
| Other  | <b>667</b>                    | 148                          |
|  | <b>\$ 23,777</b>              | <b>\$ 23,675</b>             |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>                                      |                               |                              |
| Current liabilities:   |                               |                              |
| Accounts payable   | \$ 1,290                      | \$ 1,415                     |
| Accrued salaries   | <b>731</b>                    | 675                          |
| Other accrued expenses   | <b>1,389</b>                  | 1,193                        |
| Long-term debt due within one year   | <b>299</b>                    | 293                          |
|  | <b>3,709</b>                  | <b>3,576</b>                 |
| Long-term debt   | <b>27,246</b>                 | 28,115                       |
| Professional liability risks   | <b>1,276</b>                  | 1,309                        |
| Income taxes and other liabilities   | <b>1,189</b>                  | 1,017                        |
| Minority interests in equity of consolidated entities                            | <b>915</b>                    | 907                          |
| Equity securities with contingent redemption rights                              | <b>164</b>                    | 125                          |

Stockholders' deficit:

Common stock \$.01 par; authorized 125,000,000 shares; outstanding

94,178,200 shares in 2007 and 92,217,800 shares in 2006

Capital in excess of par value

Accumulated other comprehensive (loss) income

Retained deficit

**1**

1

**86**

**(52)**

16

**(10,757)**

(11,391)

**(10,722)**

(11,374)

**\$ 23,777**

**\$ 23,675**

See accompanying notes.

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**HCA INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006**  
**Unaudited**  
**(Dollars in millions)**

|   | 2007    | 2006    |
|---|---------|---------|
| Cash flows from operating activities:   |         |         |
| Net income  | \$ 596  | \$ 914  |
| Adjustments to reconcile net income to net cash provided by operating activities: |         |         |
| Provision for doubtful accounts   | 2,218   | 1,950   |
| Depreciation and amortization   | 1,072   | 1,045   |
| Income taxes  | (103)   | (399)   |
| Gains on sales of facilities  | (332)   | (46)    |
| Impairment of long-lived assets   | 24      |         |
| Changes in operating assets and liabilities                                       | (2,598) | (2,250) |
| Change in minority interests  | 33      | 79      |
| Share-based compensation  | 17      | 69      |
| Other   | 58      | (9)     |
| Net cash provided by operating activities   | 985     | 1,353   |
| Cash flows from investing activities:   |         |         |
| Purchase of property and equipment  | (997)   | (1,330) |
| Acquisition of hospitals and health care entities                                 | (21)    | (103)   |
| Disposition of hospitals and health care entities                                 | 484     | 328     |
| Change in investments   | 156     | (122)   |
| Other   | 13      | 1       |
| Net cash used in investing activities   | (365)   | (1,226) |
| Cash flows from financing activities:   |         |         |
| Issuance of long-term debt  | 2       | 1,400   |
| Net change in revolving bank credit facility                                      | (370)   | 665     |
| Repayment of long-term debt   | (623)   | (1,222) |
| Repurchases of common stock   | (1)     | (653)   |
| Issuances of common stock   | 100     | 97      |
| Payment of cash dividends   |         | (201)   |
| Other   | (15)    | (8)     |
| Net cash (used in) provided by financing activities                               | (907)   | 78      |
| Change in cash and cash equivalents   | (287)   | 205     |
| Cash and cash equivalents at beginning of period                                  | 634     | 336     |
| Cash and cash equivalents at end of period  | \$ 347  | \$ 541  |



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|                                     |          |        |
|-------------------------------------|----------|--------|
| Interest payments                   | \$ 1,522 | \$ 554 |
| Income tax payments, net of refunds | \$ 348   | \$ 935 |

See accompanying notes.

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**HCA INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Unaudited**

**NOTE 1 INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*Merger, Recapitalization and Reporting Entity*

On November 17, 2006 HCA Inc. (the *Company* ) completed its merger (the *Merger* ) with Hercules Acquisition Corporation pursuant to which the Company was acquired by Hercules Holding II, LLC, a Delaware limited liability company owned by a private investor group including affiliates of Bain Capital, Kohlberg Kravis Roberts & Co., Merrill Lynch Global Private Equity (each a *Sponsor* ) and affiliates of HCA founder, Dr. Thomas F. Frist Jr., (the *Frist Entities*, and together with the Sponsors, the *Investors* ), and by members of management and certain other investors. The Merger, the financing transactions related to the Merger and other related transactions are collectively referred to in this quarterly report as the *Recapitalization*. The Merger was accounted for as a recapitalization in our financial statements, with no adjustments to the historical basis of our assets and liabilities. As a result of the Recapitalization, our outstanding capital stock is owned by the Investors, certain members of management and key employees and certain other investors. Our common stock is no longer registered under the Securities Exchange Act of 1934, as amended, and is no longer traded on a national securities exchange. Effective September 26, 2007, we registered certain of our senior secured notes issued in connection with the Recapitalization with the Securities and Exchange Commission, thus subjecting us to the reporting requirements of Section 15(d) of the Securities Exchange Act of 1934.

*Basis of Presentation*

HCA Inc. is a holding company whose affiliates own and operate hospitals and related health care entities. The term *affiliates* includes direct and indirect subsidiaries of HCA Inc. and partnerships and joint ventures in which such subsidiaries are partners. At September 30, 2007, these affiliates owned and operated 162 hospitals, 98 freestanding surgery centers and facilities which provide extensive outpatient and ancillary services. Affiliates of HCA Inc. are also partners in joint ventures that own and operate eight hospitals and nine freestanding surgery centers which are accounted for using the equity method. The *Company's* facilities are located in 20 states and England. The terms *HCA, Company, we, our or us*, as used in this Quarterly Report on Form 10-Q, refer to HCA Inc. and its affiliates unless otherwise stated or indicated by context.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal and recurring nature. The majority of our expenses are *cost of revenue* items. Costs that could be classified as general and administrative would include our corporate office costs, which were \$42 million and \$47 million for the quarters ended September 30, 2007 and 2006, respectively, and \$122 million and \$133 million for the nine months ended September 30, 2007 and 2006, respectively. Operating results for the quarter and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Certain prior year amounts have been reclassified to conform to the current year presentation.

*Recent Pronouncements*

In September 2006, the Financial Accounting Standards Board (the FASB ) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 establishes a generally accepted accounting principles ( GAAP ) framework for measuring fair value, clarifies the definition of fair value within that framework and expands disclosures about the use of fair value measurements. SFAS 157 is effective for

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**HCA INC.**

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

**NOTE 1 INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

*Recent Pronouncements (continued)*

fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 157 to have a material effect on our financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, then all subsequent changes in fair value for that instrument should be reported in results of operations. SFAS 159 is effective for fiscal years beginning after November 15, 2007. Differences between the amounts recognized in the statements of financial position prior to the adoption of SFAS 159 and the amounts recognized after adoption will be accounted for as a cumulative effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the impact of adopting SFAS 159.

**NOTE 2 SHARE-BASED COMPENSATION**

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payment ( SFAS 123(R) ), using the modified prospective application transition method. Under this method, compensation cost is recognized, beginning January 1, 2006, based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date, and based on Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation for all awards granted to employees prior to January 1, 2006 that remain unvested on the effective date. Share-based compensation related to stock options (and our employee stock purchase plan in 2006) was \$6 million and \$11 million for the quarters ended September 30, 2007 and 2006, respectively, and \$17 million and \$29 million for the nine months ended September 30, 2007 and 2006, respectively.

We have the following share-based compensation plans:

*2006 Stock Incentive Plan*

In connection with the Recapitalization, the HCA Inc. 2006 Stock Incentive Plan for Key Employees of HCA Inc. and its Affiliates (the 2006 Plan ) was established. The 2006 Plan is designed to promote the long term financial interests and growth of the Company and its subsidiaries by attracting and retaining management and other personnel and key service providers. The 2006 Plan permits the granting of awards covering 10% of our fully diluted equity immediately after consummation of the Recapitalization. A portion of the options under the 2006 Plan will vest solely based upon continued employment over a specific period of time, and a portion of the options will vest based both upon continued employment over a specific period of time and upon the achievement of predetermined operating performance and market condition targets over time. We granted 147,100 options during the quarter ended September 30, 2007. As of September 30, 2007, no options granted under the 2006 Plan have vested, and there were 1,878,700 shares available for future grants under the 2006 Plan.

*2005 Equity Incentive Plan*

Prior to the Recapitalization, the HCA 2005 Equity Incentive Plan was the primary plan under which stock options and restricted stock were granted to officers, employees and directors. During the quarter and nine months ended September 30, 2006, we recognized \$15 million and \$40 million, respectively, of compensation expense related to restricted share grants. Upon consummation of the Recapitalization, all shares of restricted stock became fully vested, were cancelled and converted into the right to receive a cash payment of \$51.00 per restricted share. All outstanding stock options became fully vested and (other than certain options held by certain rollover shareholders)

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**HCA INC.**

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

**NOTE 2 SHARE-BASED COMPENSATION (continued)**

*2005 Equity Incentive Plan (continued)*

were cancelled and converted into the right to receive a cash payment equal to the number of shares underlying the options multiplied by the amount (if any) by which \$51.00 exceeded the option exercise price. Certain management holders of outstanding HCA stock options were permitted to retain certain of their stock options (the Rollover Options ) in lieu of receiving the merger consideration (the amount, if any, by which \$51.00 exceeded the option exercise price). The Rollover Options remain outstanding in accordance with the terms of the governing stock incentive plans and grant agreements pursuant to which the holder originally received the stock option grants. However, immediately after the Recapitalization, the exercise price and number of shares subject to the rollover option agreement were adjusted so that the aggregate intrinsic value for each applicable option holder was maintained and the exercise price for substantially all of the options was adjusted to \$12.75 per option. Pursuant to the rollover option agreement, 10,967,500 prerecapitalization HCA stock options were converted into 2,285,200 Rollover Options, of which 2,264,900 are outstanding and exercisable at September 30, 2007.

**NOTE 3 INCOME TAXES**

We are currently contesting before the Appeals Division of the Internal Revenue Service (the IRS ) certain claimed deficiencies and adjustments proposed by the IRS in connection with its examination of the 2001 and 2002 federal income tax returns for HCA and 15 affiliates that are treated as partnerships for federal income tax purposes ( affiliated partnerships ). During 2006, the IRS began an examination of the 2003 and 2004 federal income tax returns for HCA and 19 affiliated partnerships.

The disputed items pending before the IRS Appeals Division or proposed by the IRS Examination Division through September 30, 2007, include the deductibility of a portion of the 2001 and 2003 government settlement payments, the timing of recognition of certain patient service revenues in 2001 through 2004, the method for calculating the tax allowance for doubtful accounts in 2002 through 2004, and the amount of insurance expense deducted in 2001 and 2002. The IRS has not determined the final amount of additional income tax, interest and penalties that it may claim upon completion of the 2003 and 2004 examinations. We expect the IRS will complete its examination of the 2003 and 2004 federal income tax returns and begin an examination of our 2005 and 2006 federal income tax returns within the next twelve months.

Thirty-five taxable periods of HCA, its predecessors, and subsidiaries ended in 1987 through 2000, for which the primary remaining issue is the computation of the tax allowance for doubtful accounts, are pending before the IRS Examination Division, the United States Tax Court and the United States Court of Federal Claims as of September 30, 2007. In 2004, we made a payment of \$109 million for additional federal tax and interest, based on our estimate of amounts due for the 31 taxable periods through 1996. We have reached tentative agreement with the IRS with respect to the tax and interest computations for two of these taxable periods. HCA, its predecessors and subsidiaries are also subject to examination in approximately 36 states for taxable periods ended in 1987 through 2006. Our international operations are subject to examination by United Kingdom taxing authorities for taxable periods from 2004 through 2006 and by Swiss taxing authorities for taxable periods from 2002 through 2006.

Effective January 1, 2007, we adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). FIN 48 creates a single model to address uncertainty in income tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement No. 109, Accounting for Income Taxes. FIN 48 requires expanded disclosures, which include a tabular rollforward of the beginning and ending aggregate unrecognized tax benefits, as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These

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disclosures will be required at each annual reporting period and during any interim period in which a significant change in any uncertain tax position occurs.

Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts recognized after adoption of \$38 million were recorded as a cumulative effect adjustment, decreasing our liability for unrecognized tax benefits and increasing the balance of our retained earnings as of January 1, 2007. FIN 48 permits interest and penalties on any underpayments of income taxes to be classified in income tax expense, interest expense or another appropriate expense classification. A \$9 million reduction to interest expense related to taxing authority examinations is included in the provision for income taxes for the quarter ended September 30, 2007, and \$13 million of interest expense related to taxing authority examinations is included in the provision for income taxes for the nine months ended September 30, 2007.

Our liability for unrecognized tax benefits was \$760 million, including accrued interest of \$209 million, as of January 1, 2007 (\$803 million and \$204 million, respectively, as of September 30, 2007). Of the \$760 million, \$556 (\$489 million as of September 30, 2007) million would affect the effective tax rate, if recognized. The liability for unrecognized tax benefits does not reflect deferred tax assets related to deductible interest and state income taxes or a \$215 million refundable deposit that we made in 2006, which is recorded in noncurrent assets. During the quarter and the nine months ended September 30, 2007, we recognized increases of \$23 million and \$43 million, respectively, in our liability for unrecognized tax benefits, including interest. Based on new information received during the third quarter of 2007 related primarily to tax positions taken in prior taxable periods, we reduced our provision for income taxes and the related liability by \$85 million and increased our deferred tax assets and the related liabilities, including interest, by \$108 million.

Depending on the resolution of the IRS disputes, the completion of examinations by federal, state or international taxing authorities, or the expiration of statutes of limitation for specific taxing jurisdictions, we believe it is reasonably possible that our liability for unrecognized tax benefits may significantly increase or decrease within the next twelve months. However, we are currently unable to estimate the range of any possible change.

**NOTE 4 INVESTMENTS OF INSURANCE SUBSIDIARY**

A summary of the insurance subsidiary's investments at September 30, 2007 and December 31, 2006 follows (dollars in millions):

|                           | <b>September 30, 2007</b> |                               |               |                       |
|---------------------------|---------------------------|-------------------------------|---------------|-----------------------|
|                           | <b>Amortized<br/>Cost</b> | <b>Unrealized<br/>Amounts</b> |               | <b>Fair<br/>Value</b> |
|                           |                           | <b>Gains</b>                  | <b>Losses</b> |                       |
| Debt securities:          |                           |                               |               |                       |
| States and municipalities | \$ 1,618                  | \$ 20                         | \$ (3)        | \$ 1,635              |
| Money market funds        | 118                       |                               |               | 118                   |
| Asset-backed securities   | 60                        | 1                             |               | 61                    |



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|                                     |          |       |        |          |
|-------------------------------------|----------|-------|--------|----------|
| Corporate and other                 | 12       |       | (1)    | 11       |
|                                     | 1,808    | 21    | (4)    | 1,825    |
| Equity securities:                  |          |       |        |          |
| Preferred stocks                    | 158      | 1     | (1)    | 158      |
| Common stocks                       | 4        |       |        | 4        |
|                                     | 162      | 1     | (1)    | 162      |
|                                     | \$ 1,970 | \$ 22 | \$ (5) | 1,987    |
| Amount classified as current assets |          |       |        | (250)    |
| Investment carrying value           |          |       |        | \$ 1,737 |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 4 INVESTMENTS OF INSURANCE SUBSIDIARY (continued)**

|                                     |                  | <b>December 31, 2006</b> |               |              |
|-------------------------------------|------------------|--------------------------|---------------|--------------|
|                                     | <b>Amortized</b> | <b>Unrealized</b>        |               | <b>Fair</b>  |
|                                     | <b>Cost</b>      | <b>Gains</b>             | <b>Losses</b> | <b>Value</b> |
| Debt securities:                    |                  |                          |               |              |
| States and municipalities           | \$ 1,174         | \$ 24                    | \$ (3)        | \$ 1,195     |
| Money market funds                  | 858              |                          |               | 858          |
| Asset-backed securities             | 64               | 4                        |               | 68           |
| Corporate and other                 | 8                |                          |               | 8            |
|                                     | 2,104            | 28                       | (3)           | 2,129        |
| Equity securities:                  |                  |                          |               |              |
| Preferred stocks                    | 10               |                          | (1)           | 9            |
| Common stocks                       | 4                | 1                        |               | 5            |
|                                     | 14               | 1                        | (1)           | 14           |
|                                     | \$ 2,118         | \$ 29                    | \$ (4)        | 2,143        |
| Amount classified as current assets |                  |                          |               | (257)        |
| Investment carrying value           |                  |                          |               | \$ 1,886     |

At September 30, 2007 and December 31, 2006, the investments of our insurance subsidiary were classified as available-for-sale. The fair value of investment securities is generally based on quoted market prices. Changes in temporary unrealized gains and losses are recorded as adjustments to other comprehensive income. At September 30, 2007, \$99 million of money market funds were subject to the restrictions included in insurance bond collateralization and assumed reinsurance contracts.

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 5 LONG-TERM DEBT**

A summary of long-term debt at September 30, 2007 and December 31, 2006, including related interest rates at September 30, 2007, follows (dollars in millions):

|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| Senior secured asset-based revolving credit facility (effective interest rate of 6.9%) | \$ 1,500              | \$ 1,830             |
| Senior secured revolving credit facility   |                       | 40                   |
| Senior secured term loan facilities (effective interest rate of 7.1%)                  | 12,403                | 12,870               |
| Other senior secured debt (effective interest rate of 6.7%)                            | 419                   | 445                  |
| First lien debt  | 14,322                | 15,185               |
| Senior secured cash-pay notes (effective interest rate of 9.6%)                        | 4,200                 | 4,200                |
| Senior secured toggle notes (effective interest rate of 10.0%)                         | 1,500                 | 1,500                |
| Second lien debt   | 5,700                 | 5,700                |
| Senior unsecured notes payable through 2095 (effective interest rate of 7.3%)          | 7,523                 | 7,523                |
| Total debt (average life of seven years, rates averaging 7.7%)                         | 27,545                | 28,408               |
| Less amounts due within one year   | 299                   | 293                  |
|  | \$ 27,246             | \$ 28,115            |

*Senior Secured Credit Facilities*

On November 17, 2006, in connection with the Recapitalization, we entered into (i) a \$2.000 billion senior secured asset-based revolving credit facility with a borrowing base of 85% of eligible accounts receivable, subject to customary reserves and eligibility criteria (\$419 million available at September 30, 2007) (the ABL credit facility ) and (ii) a senior secured credit agreement (the cash flow credit facility and, together with the ABL credit facility, the senior secured credit facilities ), consisting of a \$2.000 billion revolving credit facility (\$1.858 billion available at September 30, 2007, after giving effect to certain outstanding letters of credit), a \$2.750 billion term loan A (\$2.666 billion outstanding at September 30, 2007), a \$8.800 billion term loan B (\$8.734 billion outstanding at September 30, 2007) and a 1.000 billion European term loan ( 703 million or \$1.003 billion outstanding at September 30, 2007) under which one of our European subsidiaries is the borrower.

Borrowings under the senior secured credit facilities bear interest at a rate equal to, as determined by the type of borrowing, either (a) a base rate determined by reference to the higher of (1) the federal funds rate plus 1/2 of 1% or

(2) the prime rate of Bank of America or (b) a LIBOR rate for the currency of such borrowing for the relevant interest period, plus, in each case, an applicable margin. The applicable margin for borrowings under the senior secured credit facilities, with the exception of term loan B where the margin is static, may be reduced subject to attaining certain leverage ratios. On February 16, 2007, we amended the cash flow credit facility to reduce the applicable margins with respect to the term loan borrowings thereunder. On June 20, 2007, we amended the ABL credit facility to reduce the applicable margin effective January 1, 2008, with respect to borrowings thereunder.

The senior secured credit facilities and senior secured notes are fully and unconditionally guaranteed by substantially all existing and future, direct and indirect, wholly-owned material domestic subsidiaries that are Unrestricted Subsidiaries under our Indenture dated as of December 16, 1993 (except for certain special purpose subsidiaries that only guarantee and pledge their assets under our ABL credit facility). In addition, borrowings under the European term loan are guaranteed by all material, wholly-owned European subsidiaries.

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**HCA INC.**

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

**NOTE 5 LONG-TERM DEBT (continued)**

*Senior Secured Credit Facilities (continued)*

The ABL credit facility and the \$2.000 billion revolving credit facility portion of the cash flow credit facility expire November 2012. We began making required, quarterly installment payments on each of the term loan facilities during March 2007. The final payment under term loan A is in November 2012. The final payments under term loan B and the European term loan are in November 2013. The senior secured credit facilities contain a number of covenants that restrict, subject to certain exceptions, our (and some or all of our subsidiaries ) ability to incur additional indebtedness, repay subordinated indebtedness, create liens on assets, sell assets, make investments, loans or advances, engage in certain transactions with affiliates, pay dividends and distributions, and enter into sale and leaseback transactions. In addition, we are required to satisfy a maximum total leverage ratio covenant under the cash flow credit facility and, in certain situations under the ABL credit facility, a minimum interest coverage ratio covenant.

We use interest rate swap agreements to manage the variable rate exposure of our debt portfolio. In the fourth quarter of 2006, we entered into two interest rate swap agreements, in a total notional amount of \$8 billion, in order to hedge a portion of our exposure to variable rate interest payments associated with the cash flow credit facility. The interest rate swaps expire in November 2011.

*Senior Secured Notes*

In November 2006, we issued \$4.200 billion of senior secured notes (comprised of \$1.000 billion of 91/8% notes due 2014 and \$3.200 billion of 91/4% notes due 2016), and \$1.500 billion of 95/8% senior secured toggle notes (which allow us, at our option, to pay interest in-kind during the first five years) due 2016, which are subject to certain standard covenants.

**NOTE 6 CONTINGENCIES**

*Significant Legal Proceedings*

We operate in a highly regulated and litigious industry. As a result, various lawsuits, claims and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. The resolution of any such lawsuits, claims or legal and regulatory proceedings could have a material, adverse effect on our results of operations or financial position in a given period.

In 2005, the Company and certain of its executive officers and directors were named in various federal securities law class actions and several shareholders filed derivative lawsuits purportedly on behalf of the Company. Additionally, a former employee filed a complaint against certain of our executive officers pursuant to the Employee Retirement Income Security Act and the Company has been served with a shareholder demand letter addressed to our Board of Directors. We have reached an agreement in principle for the settlement of the derivative lawsuits, subject to court approval. We have also settled the federal securities law class actions. We are aware of eight asserted class action lawsuits related to the Merger filed against us, certain of our executive officers, our directors and the Sponsors, and one lawsuit filed against us and one of our affiliates seeking enforcement of contractual obligations allegedly arising

from the Merger. Certain of these lawsuits, though not all, are the subject of an agreement in principle to settle, which is subject to court approval. We believe the settlements, once approved, will have the effect of resolving the remaining class action suits.

*General Liability Claims*

We are subject to claims and suits arising in the ordinary course of business, including claims for personal injuries or wrongful restriction of, or interference with, physicians' staff privileges. In certain of these actions the claimants may seek punitive damages against us which may not be covered by insurance. It is management's

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 6 CONTINGENCIES (continued)***General Liability Claims (continued)*

opinion that the ultimate resolution of these pending claims and legal proceedings will not have a material, adverse effect on our results of operations or financial position.

*Investigations*

In January 2001, we entered into an eight-year Corporate Integrity Agreement ( CIA ) with the Office of Inspector General of the Department of Health and Human Services. Violation or breach of the CIA, or violation of federal or state laws relating to Medicare, Medicaid or similar programs, could subject us to substantial monetary fines, civil and criminal penalties and/or exclusion from participation in the Medicare and Medicaid programs. Alleged violations may be pursued by the government or through private *qui tam* actions. Sanctions imposed against us as a result of such actions could have a material, adverse effect on our results of operations or financial position.

**NOTE 7 COMPREHENSIVE INCOME**

The components of comprehensive income, net of related taxes, for the quarters and nine months ended September 30, 2007 and 2006 are as follows (dollars in millions):

|   | <b>Quarter</b> |             | <b>Nine Months</b> |             |
|---|----------------|-------------|--------------------|-------------|
|   | <b>2007</b>    | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Net income  | \$ 300         | \$ 240      | \$ 596             | \$ 914      |
| Change in fair value of derivative instruments                  | (126)          |             | (58)               |             |
| Change in unrealized net gains on available-for-sale securities | 8              | 10          | (5)                | (51)        |
| Currency translation adjustments                                | (10)           | 2           | (10)               | 21          |
| Defined benefit plans   | 2              |             | 5                  |             |
| Comprehensive income  | \$ 174         | \$ 252      | \$ 528             | \$ 884      |

The components of accumulated other comprehensive (loss) income, net of related taxes, are as follows (dollars in millions):

|   | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|---|-------------------------------|------------------------------|
| Change in fair value of derivative instruments        | \$ (40)                       | \$ 18                        |
| Net unrealized gains on available-for-sale securities | 11                            | 16                           |

|   |    |             |    |      |
|---|----|-------------|----|------|
| Currency translation adjustments              |    | <b>39</b>   |    | 49   |
| Defined benefit plans                         |    | <b>(62)</b> |    | (67) |
| Accumulated other comprehensive (loss) income | \$ | <b>(52)</b> | \$ | 16   |

## **NOTE 8 SEGMENT AND GEOGRAPHIC INFORMATION**

We operate in one line of business, which is operating hospitals and related health care entities. During the quarters ended September 30, 2007 and 2006, approximately 24% and 25%, respectively, of our patient revenues related to patients participating in the Medicare program. During the nine months ended September 30, 2007 and 2006, approximately 24% and 26%, respectively, of our patient revenues related to patients participating in the Medicare program.

Our operations are structured into three geographically organized groups: the Eastern Group includes 50 consolidating hospitals located in the Eastern United States, the Central Group includes 52 consolidating hospitals



Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 8 SEGMENT AND GEOGRAPHIC INFORMATION (continued)**

located in the Central United States and the Western Group includes 54 consolidating hospitals located in the Western United States. We also operate six consolidating hospitals in England, and these facilities are included in the Corporate and other group.

Adjusted segment EBITDA is defined as income before depreciation and amortization, interest expense, gains on sales of facilities, impairment of long-lived assets, transaction costs, minority interests and income taxes. We use adjusted segment EBITDA as an analytical indicator for purposes of allocating resources to geographic areas and assessing their performance. Adjusted segment EBITDA is commonly used as an analytical indicator within the health care industry, and also serves as a measure of leverage capacity and debt service ability. Adjusted segment EBITDA should not be considered as a measure of financial performance under generally accepted accounting principles, and the items excluded from adjusted segment EBITDA are significant components in understanding and assessing financial performance. Because adjusted segment EBITDA is not a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, adjusted segment EBITDA, as presented, may not be comparable to other similarly titled measures of other companies. The geographic distributions of our revenues, equity in earnings of affiliates, adjusted segment EBITDA and depreciation and amortization for the quarters and nine months ended September 30, 2007 and 2006, with prior year amounts reclassified to conform to the 2007 operational structure, are summarized in the following table (dollars in millions):

|                                   | <b>Quarter</b> |             | <b>Nine Months</b> |             |
|-----------------------------------|----------------|-------------|--------------------|-------------|
|                                   | <b>2007</b>    | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Revenues:                         |                |             |                    |             |
| Central Group                     | \$ 1,567       | \$ 1,470    | \$ 4,691           | \$ 4,409    |
| Eastern Group                     | 1,990          | 1,867       | 6,071              | 5,794       |
| Western Group                     | 2,782          | 2,590       | 8,473              | 7,729       |
| Corporate and other               | 230            | 286         | 740                | 1,056       |
|                                   | \$ 6,569       | \$ 6,213    | \$ 19,975          | \$ 18,988   |
| Equity in earnings of affiliates: |                |             |                    |             |
| Central Group                     | \$ 1           | \$          | \$ 6               | \$ (3)      |
| Eastern Group                     | (1)            | (1)         | (2)                | (3)         |
| Western Group                     | (52)           | (41)        | (161)              | (143)       |
| Corporate and other               | 1              | (1)         | 1                  | (2)         |
|                                   | \$ (51)        | \$ (43)     | \$ (156)           | \$ (151)    |
| Adjusted segment EBITDA:          |                |             |                    |             |
| Central Group                     | \$ 254         | \$ 208      | \$ 813             | \$ 719      |
| Eastern Group                     | 256            | 243         | 939                | 875         |
| Western Group                     | 484            | 489         | 1,641              | 1,497       |
| Corporate and other               | (11)           | (21)        | 46                 | 108         |

|                                |    |            |    |     |    |              |    |       |
|--------------------------------|----|------------|----|-----|----|--------------|----|-------|
|                                | \$ | <b>983</b> | \$ | 919 | \$ | <b>3,439</b> | \$ | 3,199 |
| Depreciation and amortization: |    |            |    |     |    |              |    |       |
| Central Group                  | \$ | <b>90</b>  | \$ | 83  | \$ | <b>275</b>   | \$ | 246   |
| Eastern Group                  |    | <b>92</b>  |    | 92  |    | <b>277</b>   |    | 273   |
| Western Group                  |    | <b>135</b> |    | 121 |    | <b>396</b>   |    | 366   |
| Corporate and other            |    | <b>39</b>  |    | 52  |    | <b>124</b>   |    | 160   |
|                                | \$ | <b>356</b> | \$ | 348 | \$ | <b>1,072</b> | \$ | 1,045 |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 8 SEGMENT AND GEOGRAPHIC INFORMATION (continued)**

|   | <b>Quarter</b> |             | <b>Nine Months</b> |             |
|---|----------------|-------------|--------------------|-------------|
|   | <b>2007</b>    | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Adjusted segment EBITDA                           | \$ 983         | \$ 919      | \$ 3,439           | \$ 3,199    |
| Depreciation and amortization                     | 356            | 348         | 1,072              | 1,045       |
| Interest expense                                  | 560            | 200         | 1,674              | 582         |
| Gains on sales of facilities                      | (316)          | (41)        | (332)              | (46)        |
| Impairment of long-lived assets                   |                |             | 24                 |             |
| Transaction costs                                 |                | 9           |                    | 9           |
| Income before minority interests and income taxes | \$ 383         | \$ 403      | \$ 1,001           | \$ 1,609    |

**NOTE 9 ACQUISITIONS, DIVESTITURES AND IMPAIRMENT OF LONG-LIVED ASSETS**

During the nine months ended September 30, 2007, we paid \$21 million for health care entity acquisitions. During the nine months ended September 30, 2006, we paid \$62 million to acquire three hospitals and \$41 million to acquire other health care entities.

During the quarter and nine months ended September 30, 2007, we received proceeds of \$419 million and \$484 million, respectively, and recognized gains of \$316 million and \$332 million, respectively, related to sales of our two Switzerland hospitals and certain real estate investments. We recognized gains of \$46 million during the nine months ended September 30, 2006, related primarily to sales of one of our Virginia hospitals and an investment in a hospital joint venture. The results of operations of the sold hospitals were not significant to our consolidated results of operations.

During the nine months ended September 30, 2007, we recorded a charge of \$24 million to adjust the value of a building in our Central Group to estimated fair value.

**NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

The senior secured credit facilities and senior secured notes described in Note 5 are fully and unconditionally guaranteed by substantially all existing and future, direct and indirect, wholly-owned material domestic subsidiaries that are Unrestricted Subsidiaries under our Indenture dated as of December 16, 1993 (except for certain special purpose subsidiaries that only guarantee and pledge their assets under our ABL credit facility).

Our summarized condensed consolidating balance sheets at September 30, 2007 and December 31, 2006, condensed consolidating statements of income for the quarters and nine months ended September 30, 2007 and 2006 and condensed consolidating statements of cash flows for the nine months ended September 30, 2007 and 2006, segregating the parent company issuer, the subsidiary guarantors, the subsidiary non-guarantors and eliminations, follow:



Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING INCOME STATEMENT**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2007**  
**(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Revenues  | \$                       | \$ 3,826                         | \$ 2,743                                  | \$                  | \$ 6,569                          |
| Salaries and benefits                                       |                          | 1,640                            | 1,061                                     |                     | 2,701                             |
| Supplies  |                          | 628                              | 457                                       |                     | 1,085                             |
| Other operating expenses                                    |                          | 592                              | 484                                       |                     | 1,076                             |
| Provision for doubtful accounts                             |                          | 469                              | 305                                       |                     | 774                               |
| Losses on investments                                       |                          |                                  | 1   |                     | 1                                 |
| Equity in earnings of affiliates                            | (809)                    | (23)                             | (28)                                      | 809                 | (51)                              |
| Depreciation and amortization                               |                          | 195                              | 161                                       |                     | 356                               |
| Interest expense  | 540                      | 16                               | 4   |                     | 560                               |
| Gains on sales of facilities                                |                          | (2)                              | (314)                                     |                     | (316)                             |
| Management fees   |                          | (103)                            | 103                                       |                     |                                   |
|   | (269)                    | 3,412                            | 2,234                                     | 809                 | 6,186                             |
| Income (loss) before minority interests<br>and income taxes | 269                      | 414                              | 509                                       | (809)               | 383                               |
| Minority interests in earnings of<br>consolidated entities  |                          | 5                                | 39  |                     | 44                                |
| Income (loss) before income taxes                           | 269                      | 409                              | 470                                       | (809)               | 339                               |
| Provision for income taxes                                  | (31)                     | (5)                              | 75  |                     | 39                                |
| Net income (loss)   | \$ 300                   | \$ 414                           | \$ 395                                    | \$ (809)            | \$ 300                            |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING INCOME STATEMENT**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2006**  
**(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Revenues  | \$                       | \$ 3,640                         | \$ 2,573                                  | \$                  | \$ 6,213                          |
| Salaries and benefits                                       |                          | 1,580                            | 1,020                                     |                     | 2,600                             |
| Supplies  |                          | 601                              | 445                                       |                     | 1,046                             |
| Other operating expenses                                    |                          | 591                              | 463                                       |                     | 1,054                             |
| Provision for doubtful accounts                             |                          | 425                              | 252                                       |                     | 677                               |
| Gains on investments  |                          |                                  | (40)                                      |                     | (40)                              |
| Equity in earnings of affiliates                            | (355)                    | (17)                             | (26)                                      | 355                 | (43)                              |
| Depreciation and amortization                               |                          | 187                              | 161                                       |                     | 348                               |
| Interest expense  | 184                      | 21                               | (5)                                       |                     | 200                               |
| Gains on sales of facilities                                |                          | (7)                              | (34)                                      |                     | (41)                              |
| Transaction costs   |                          | 9                                |   |                     | 9                                 |
| Management fees   |                          | (110)                            | 110                                       |                     |                                   |
|   | (171)                    | 3,280                            | 2,346                                     | 355                 | 5,810                             |
| Income (loss) before minority interests<br>and income taxes | 171                      | 360                              | 227                                       | (355)               | 403                               |
| Minority interests in earnings of<br>consolidated entities  |                          | 5                                | 39  |                     | 44                                |
| Income (loss) before income taxes                           | 171                      | 355                              | 188                                       | (355)               | 359                               |
| Provision for income taxes                                  | (69)                     | 116                              | 72  |                     | 119                               |
| Net income (loss)   | \$ 240                   | \$ 239                           | \$ 116                                    | \$ (355)            | \$ 240                            |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)****HCA INC.****CONDENSED CONSOLIDATING INCOME STATEMENT  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007  
(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Revenues  | \$                       | \$ 11,574                        | \$ 8,401                                  | \$                  | \$ 19,975                         |
| Salaries and benefits                                       |                          | 4,835                            | 3,167                                     |                     | 8,002                             |
| Supplies  |                          | 1,903                            | 1,381                                     |                     | 3,284                             |
| Other operating expenses                                    |                          | 1,719                            | 1,475                                     |                     | 3,194                             |
| Provision for doubtful accounts                             |                          | 1,376                            | 842                                       |                     | 2,218                             |
| Gains on investments  |                          |                                  | (6)                                       |                     | (6)                               |
| Equity in earnings of affiliates                            | (1,736)                  | (69)                             | (87)                                      | 1,736               | (156)                             |
| Depreciation and amortization                               |                          | 589                              | 483                                       |                     | 1,072                             |
| Interest expense  | 1,609                    | 50                               | 15  |                     | 1,674                             |
| Gains on sales of facilities                                |                          | (2)                              | (330)                                     |                     | (332)                             |
| Impairment of long-lived assets                             |                          |                                  | 24  |                     | 24                                |
| Management fees   |                          | (304)                            | 304                                       |                     |                                   |
|   | (127)                    | 10,097                           | 7,268                                     | 1,736               | 18,974                            |
| Income (loss) before minority interests<br>and income taxes | 127                      | 1,477                            | 1,133                                     | (1,736)             | 1,001                             |
| Minority interests in earnings of<br>consolidated entities  |                          | 17                               | 143                                       |                     | 160                               |
| Income (loss) before income taxes                           | 127                      | 1,460                            | 990                                       | (1,736)             | 841                               |
| Provision for income taxes                                  | (469)                    | 426                              | 288                                       |                     | 245                               |
| Net income (loss)   | \$ 596                   | \$ 1,034                         | \$ 702                                    | \$ (1,736)          | \$ 596                            |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING INCOME STATEMENT**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006**  
**(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Revenues  | \$                       | \$ 11,088                        | \$ 7,900                                  | \$                  | \$ 18,988                         |
| Salaries and benefits                                       |                          | 4,752                            | 3,064                                     |                     | 7,816                             |
| Supplies  |                          | 1,870                            | 1,381                                     |                     | 3,251                             |
| Other operating expenses                                    |                          | 1,732                            | 1,331                                     |                     | 3,063                             |
| Provision for doubtful accounts                             |                          | 1,192                            | 758                                       |                     | 1,950                             |
| Gains on investments  |                          |                                  | (140)                                     |                     | (140)                             |
| Equity in earnings of affiliates                            | (1,251)                  | (62)                             | (89)                                      | 1,251               | (151)                             |
| Depreciation and amortization                               |                          | 565                              | 480                                       |                     | 1,045                             |
| Interest expense  | 538                      | 47                               | (3)                                       |                     | 582                               |
| Gains on sales of facilities                                |                          | (12)                             | (34)                                      |                     | (46)                              |
| Transaction costs   |                          | 9                                |   |                     | 9                                 |
| Management fees   |                          | (311)                            | 311                                       |                     |                                   |
|   | (713)                    | 9,782                            | 7,059                                     | 1,251               | 17,379                            |
| Income (loss) before minority interests<br>and income taxes | 713                      | 1,306                            | 841                                       | (1,251)             | 1,609                             |
| Minority interests in earnings of<br>consolidated entities  |                          | 17                               | 128                                       |                     | 145                               |
| Income (loss) before income taxes                           | 713                      | 1,289                            | 713                                       | (1,251)             | 1,464                             |
| Provision for income taxes                                  | (201)                    | 485                              | 266                                       |                     | 550                               |
| Net income (loss)   | \$ 914                   | \$ 804                           | \$ 447                                    | \$ (1,251)          | \$ 914                            |



Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**SEPTEMBER 30, 2007**  
**(Dollars in millions)**

|  | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|--|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| <b>ASSETS</b>  |                          |                                  |   |                     |                                   |
| Current assets:                                      |                          |                                  |   |                     |                                   |
| Cash and cash equivalents                            | \$                       | \$ 132                           | \$ 215                                    | \$                  | \$ 347                            |
| Accounts receivable, net                             |                          | 2,224                            | 1,633                                     |                     | 3,857                             |
| Inventories  |                          | 419                              | 270                                       |                     | 689                               |
| Deferred income taxes                                | 487                      |                                  |   |                     | 487                               |
| Other  |                          | 133                              | 516                                       |                     | 649                               |
|  | 487                      | 2,908                            | 2,634                                     |                     | 6,029                             |
| Property and equipment, net                          |                          | 6,863                            | 4,587                                     |                     | 11,450                            |
| Investments of insurance subsidiary                  |                          |                                  | 1,737                                     |                     | 1,737                             |
| Investments in and advances to affiliates            |                          | 225                              | 458                                       |                     | 683                               |
| Goodwill   |                          | 1,633                            | 1,019                                     |                     | 2,652                             |
| Deferred loan costs                                  | 559                      |                                  |   |                     | 559                               |
| Investments in and advances to subsidiaries          | 16,607                   |                                  |   | (16,607)            |                                   |
| Other  | 595                      | 21                               | 51  |                     | 667                               |
|  | \$ 18,248                | \$ 11,650                        | \$ 10,486                                 | \$ (16,607)         | \$ 23,777                         |
| <b>LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY</b> |                          |                                  |   |                     |                                   |
| Current liabilities:                                 |                          |                                  |   |                     |                                   |
| Accounts payable                                     | \$                       | \$ 819                           | \$ 471                                    | \$                  | \$ 1,290                          |
| Accrued salaries                                     |                          | 478                              | 253                                       |                     | 731                               |
| Other accrued expenses                               | 346                      | 420                              | 623                                       |                     | 1,389                             |
| Long-term debt due within one year                   | 256                      |                                  | 43  |                     | 299                               |

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|   |           |           |           |             |           |
|---|-----------|-----------|-----------|-------------|-----------|
|   | 602       | 1,717     | 1,390     |             | 3,709     |
| Long-term debt  | 26,293    | 94        | 859       |             | 27,246    |
| Intercompany balances                                 | 1,135     | (6,078)   | 4,943     |             |           |
| Professional liability risks                          |           |           | 1,276     |             | 1,276     |
| Income taxes and other liabilities                    | 776       | 261       | 152       |             | 1,189     |
| Minority interests in equity of consolidated entities |           | 105       | 810       |             | 915       |
|   | 28,806    | (3,901)   | 9,430     |             | 34,335    |
| Equity securities with contingent redemption rights   | 164       |           |           |             | 164       |
| Stockholders' (deficit) equity                        | (10,722)  | 15,551    | 1,056     | (16,607)    | (10,722)  |
|   | \$ 18,248 | \$ 11,650 | \$ 10,486 | \$ (16,607) | \$ 23,777 |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**DECEMBER 31, 2006**  
**(Dollars in millions)**

|  | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|--|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| <b>ASSETS</b>  |                          |                                  |   |                     |                                   |
| Current assets:                                      |                          |                                  |   |                     |                                   |
| Cash and cash equivalents                            | \$                       | \$ 282                           | \$ 352                                    | \$                  | \$ 634                            |
| Accounts receivable, net                             |                          | 2,145                            | 1,560                                     |                     | 3,705                             |
| Inventories  |                          | 408                              | 261                                       |                     | 669                               |
| Deferred income taxes                                | 476                      |                                  |   |                     | 476                               |
| Other  | 171                      | 134                              | 289                                       |                     | 594                               |
|  | 647                      | 2,969                            | 2,462                                     |                     | 6,078                             |
| Property and equipment, net                          |                          | 7,130                            | 4,539                                     |                     | 11,669                            |
| Investments of insurance subsidiary                  |                          |                                  | 1,886                                     |                     | 1,886                             |
| Investments in and advances to affiliates            |                          | 227                              | 452                                       |                     | 679                               |
| Goodwill   |                          | 1,629                            | 972                                       |                     | 2,601                             |
| Deferred loan costs                                  | 614                      |                                  |   |                     | 614                               |
| Investments in and advances to subsidiaries          | 14,945                   |                                  |   | (14,945)            |                                   |
| Other  | 69                       | 22                               | 57  |                     | 148                               |
|  | \$ 16,275                | \$ 11,977                        | \$ 10,368                                 | \$ (14,945)         | \$ 23,675                         |
| <b>LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY</b> |                          |                                  |   |                     |                                   |
| Current liabilities:                                 |                          |                                  |   |                     |                                   |
| Accounts payable                                     | \$                       | \$ 1,052                         | \$ 363                                    | \$                  | \$ 1,415                          |
| Accrued salaries                                     |                          | 442                              | 233                                       |                     | 675                               |
| Other accrued expenses                               | 228                      | 345                              | 620                                       |                     | 1,193                             |
| Long-term debt due within one year                   | 254                      | 4                                | 35  |                     | 293                               |

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|   |           |           |           |             |           |
|---|-----------|-----------|-----------|-------------|-----------|
|   | 482       | 1,843     | 1,251     |             | 3,576     |
| Long-term debt  | 26,651    | 194       | 1,270     |             | 28,115    |
| Intercompany balances                                 |           | (5,289)   | 5,289     |             |           |
| Professional liability risks                          |           |           | 1,309     |             | 1,309     |
| Income taxes and other liabilities                    | 391       | 441       | 185       |             | 1,017     |
| Minority interests in equity of consolidated entities |           | 129       | 778       |             | 907       |
|   | 27,524    | (2,682)   | 10,082    |             | 34,924    |
| Equity securities with contingent redemption rights   | 125       |           |           |             | 125       |
| Stockholders' (deficit) equity                        | (11,374)  | 14,659    | 286       | (14,945)    | (11,374)  |
|   | \$ 16,275 | \$ 11,977 | \$ 10,368 | \$ (14,945) | \$ 23,675 |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007**  
**(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Cash flows from operating activities:   |                          |                                  |   |                     |                                   |
| Net income  | \$ 596                   | \$ 1,034                         | \$ 702                                    | \$ (1,736)          | \$ 596                            |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                          |                                  |   |                     |                                   |
| Provision for doubtful accounts   |                          | 1,376                            | 842                                       |                     | 2,218                             |
| Depreciation and amortization   |                          | 589                              | 483                                       |                     | 1,072                             |
| Income taxes  | (103)                    |                                  |   |                     | (103)                             |
| Gains on sales of facilities  |                          | (2)                              | (330)                                     |                     | (332)                             |
| Impairment of long-lived assets   |                          |                                  | 24  |                     | 24                                |
| Equity in earnings of affiliates  | (1,736)                  |                                  |   | 1,736               |                                   |
| Changes in operating assets and liabilities   | 107                      | (1,588)                          | (1,117)                                   |                     | (2,598)                           |
| Change in minority interests  |                          | 4                                | 29  |                     | 33                                |
| Share-based compensation  | 17                       |                                  |   |                     | 17                                |
| Other   | 66                       | 13                               | (21)                                      |                     | 58                                |
| Net cash provided by (used in) operating activities   | (1,053)                  | 1,426                            | 612                                       |                     | 985                               |
| Cash flows from investing activities:   |                          |                                  |   |                     |                                   |
| Purchase of property and equipment  |                          | (363)                            | (634)                                     |                     | (997)                             |
| Acquisition of hospitals and health care entities   |                          |                                  | (21)                                      |                     | (21)                              |
| Disposal of hospitals and health care entities  |                          | 13                               | 471                                       |                     | 484                               |
| Change in investments   |                          | 3                                | 153                                       |                     | 156                               |
| Other   |                          | (3)                              | 16  |                     | 13                                |
| Net cash used in investing activities   |                          | (350)                            | (15)                                      |                     | (365)                             |
| Cash flows from financing activities:   |                          |                                  |   |                     |                                   |

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|   |       |         |        |    |        |
|---|-------|---------|--------|----|--------|
| Issuance of long-term debt                            |       |         | 2      |    | 2      |
| Net change in revolving bank credit facility          | (370) |         |        |    | (370)  |
| Repayment of long-term debt                           | (193) | (3)     | (427)  |    | (623)  |
| Repurchase of common stock                            | (1)   |         |        |    | (1)    |
| Issuances of common stock                             | 100   |         |        |    | 100    |
| Changes in intercompany balances with affiliates, net | 1,526 | (1,223) | (303)  |    |        |
| Other   | (9)   |         | (6)    |    | (15)   |
| Net cash provided by (used in) financing activities   | 1,053 | (1,226) | (734)  |    | (907)  |
| Change in cash and cash equivalents                   |       | (150)   | (137)  |    | (287)  |
| Cash and cash equivalents at beginning of period      |       | 282     | 352    |    | 634    |
| Cash and cash equivalents at end of period            | \$    | \$ 132  | \$ 215 | \$ | \$ 347 |

Table of Contents**HCA INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 10 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION  
(continued)**

**HCA INC.**  
**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006**  
**(Dollars in millions)**

|   | <b>Parent<br/>Issuer</b> | <b>Subsidiary<br/>Guarantors</b> | <b>Subsidiary<br/>Non-<br/>Guarantors</b> | <b>Eliminations</b> | <b>Condensed<br/>Consolidated</b> |
|---|--------------------------|----------------------------------|---|---------------------|-----------------------------------|
| Cash flows from operating activities:   |                          |                                  |   |                     |                                   |
| Net income  | \$ 914                   | \$ 804                           | \$ 447                                    | \$ (1,251)          | \$ 914                            |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                          |                                  |   |                     |                                   |
| Provision for doubtful accounts   |                          | 1,192                            | 758                                       |                     | 1,950                             |
| Depreciation and amortization   |                          | 565                              | 480                                       |                     | 1,045                             |
| Income taxes  | (399)                    |                                  |   |                     | (399)                             |
| Gains on sales of facilities  |                          | (12)                             | (34)                                      |                     | (46)                              |
| Equity in earnings of affiliates  | (1,251)                  |                                  |   | 1,251               |                                   |
| Changes in operating assets and liabilities   | 12                       | (1,377)                          | (885)                                     |                     | (2,250)                           |
| Change in minority interests  |                          | 14                               | 65  |                     | 79                                |
| Share-based compensation  | 69                       |                                  |   |                     | 69                                |
| Other   | 8                        | 4                                | (21)                                      |                     | (9)                               |
| Net cash provided by (used in) operating activities   | (647)                    | 1,190                            | 810                                       |                     | 1,353                             |
| Cash flows from investing activities:   |                          |                                  |   |                     |                                   |
| Purchase of property and equipment  |                          | (753)                            | (577)                                     |                     | (1,330)                           |
| Acquisition of hospitals and health care entities   |                          | (28)                             | (75)                                      |                     | (103)                             |
| Disposal of hospitals and health care entities  |                          | 104                              | 224                                       |                     | 328                               |
| Change in investments   |                          |                                  | (122)                                     |                     | (122)                             |
| Other   |                          |                                  | 1   |                     | 1                                 |
| Net cash used in investing activities   |                          | (677)                            | (549)                                     |                     | (1,226)                           |
| Cash flows from financing activities:   |                          |                                  |   |                     |                                   |
| Issuance of long-term debt  | 1,400                    |                                  |   |                     | 1,400                             |
| Net change in revolving bank credit facility  | 665                      |                                  |   |                     | 665                               |

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|   |         |       |        |         |
|---|---------|-------|--------|---------|
| Repayment of long-term debt                           | (1,180) | (5)   | (37)   | (1,222) |
| Repurchases of common stock                           | (653)   |       |        | (653)   |
| Issuances of common stock                             | 97      |       |        | 97      |
| Payment of cash dividends                             | (201)   |       |        | (201)   |
| Changes in intercompany balances with affiliates, net | 527     | (563) | 36     |         |
| Other   | (8)     |       |        | (8)     |
| Net cash provided by (used in) financing activities   | 647     | (568) | (1)    | 78      |
| Change in cash and cash equivalents                   |         | (55)  | 260    | 205     |
| Cash and cash equivalents at beginning of period      |         | 131   | 205    | 336     |
| Cash and cash equivalents at end of period            | \$      | \$ 76 | \$ 465 | \$ 541  |



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

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains disclosures which contain forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words like may, believe, will, expect, project, estimate, anticipate, plan, initiative or continue. Forward-looking statements are based on our current plans and expectations and are subject to a number of known and unknown uncertainties and risks, many of which are beyond our control, which could significantly affect current plans and expectations and our future financial position and results of operations. These factors include, but are not limited to, (1) the ability to recognize the benefits of the Recapitalization and the effect of the Recapitalization on our customer, employee and other relationships, (2) the impact of the substantial indebtedness incurred to finance the Recapitalization, (3) increases in the amount and risk of collectibility of uninsured accounts and deductibles and copayment amounts for insured accounts, (4) the ability to achieve operating and financial targets, and attain expected levels of patient volumes and control the costs of providing services, (5) possible changes in the Medicare, Medicaid and other state programs, including Medicaid supplemental payments pursuant to upper payment limit ( UPL ) programs, that may impact reimbursements to health care providers and insurers, (6) the highly competitive nature of the health care business, (7) changes in revenue mix and the ability to enter into and renew managed care provider agreements on acceptable terms, (8) the efforts of insurers, health care providers and others to contain health care costs, (9) the outcome of our continuing efforts to monitor, maintain and comply with appropriate laws, regulations, policies and procedures and the CIA, (10) changes in federal, state or local laws or regulations affecting the health care industry, (11) the ability to attract and retain qualified management and personnel, including affiliated physicians, nurses and medical support personnel, (12) the outcome of certain class action and derivative litigation filed with respect to us, (13) the possible enactment of federal or state health care reform, (14) the availability and terms of capital to fund the expansion of our business, (15) the continuing impact of hurricane damage in certain markets and the ability to obtain recoveries under our insurance policies, (16) changes in accounting practices, (17) changes in general economic conditions, (18) future divestitures which may result in charges, (19) changes in business strategy or development plans, (20) delays in receiving payments for services provided, (21) the outcome of pending and any future tax audits, appeals and litigation associated with our tax positions, (22) potential liabilities and other claims that may be asserted against us, and (23) other risk factors described in our Annual Report on Form 10-K and other filings with the Securities and Exchange Commission. As a consequence, current plans, anticipated actions and future financial position and results may differ from those expressed in any forward-looking statements made by or on behalf of HCA. You are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this report.

*Third Quarter 2007 Operations Summary*

Net income totaled \$300 million for the quarter ended September 30, 2007, compared to \$240 million for the quarter ended September 30, 2006. Revenues increased to \$6.569 billion in the third quarter of 2007 from \$6.213 billion in the third quarter of 2006. For the third quarters of 2007 and 2006, the provision for doubtful accounts was 11.8% and 10.9% of revenues, respectively. The third quarter 2007 results include interest expense of \$560 million, compared to \$200 million in the third quarter of 2006. The \$360 million increase in interest expense is primarily due to the increased debt related to the Recapitalization.

The financial results for the third quarters of 2007 and 2006 include gains on sales of facilities of \$316 million and \$41 million, respectively. The tax provision for the third quarter of 2007 includes an \$85 million benefit based on new information received during the third quarter of 2007 related primarily to tax positions taken in prior taxable periods.

For the third quarter of 2006, the financial results include transaction costs related to the Recapitalization of \$9 million and gains on sales of investments of \$40 million related to securities held by our wholly-owned insurance subsidiary.

During the third quarter of 2007, same facility admissions decreased 1.6% and same facility equivalent admissions decreased 0.5% compared to the third quarter of 2006. Same facility inpatient surgeries decreased 1.1% and same facility outpatient surgeries decreased 0.7% during the third quarter of 2007 compared to the third quarter of 2006. Same facility revenue per equivalent admission increased 7.5% in the third quarter of 2007 compared to the third quarter of 2006.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations***Revenue/Volume Trends*

Our revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the charge and negotiated payment rates for such services. Gross charges typically do not reflect what our facilities are actually paid. Our facilities have entered into agreements with third-party payers, including government programs and managed care health plans, under which the facilities are paid based upon the cost of providing services, predetermined rates per diagnosis, fixed per diem rates or discounts from gross charges. We do not pursue collection of amounts related to patients who meet our guidelines to qualify for charity care; therefore, they are not reported in revenues. We provide discounts to uninsured patients who do not qualify for Medicaid or charity care. These discounts are similar to those provided to many local managed care plans.

Revenues increased 5.7% from \$6.213 billion in the third quarter of 2006 to \$6.569 billion for the third quarter of 2007. The increase in revenues can be attributed to the net impact of a 7.7% increase in revenue per equivalent admission and a 1.9% decline in equivalent admissions for the third quarter of 2007 compared to the third quarter of 2006.

In the third quarter of 2007, consolidated admissions decreased 3.3% and same facility admissions decreased 1.6% compared to the third quarter of 2006. Consolidated inpatient surgeries decreased 4.1% and same facility inpatient surgeries decreased 1.1% in the third quarter of 2007 compared to the third quarter of 2006. Consolidated outpatient surgeries decreased 0.2% and same facility outpatient surgeries decreased 0.7% in the third quarter of 2007 compared to the third quarter of 2006.

Same facility uninsured admissions increased by 1,260 admissions, or 5.2%, in the third quarter of 2007 compared to the third quarter of 2006. Same facility uninsured admissions increased, compared to 2006, 9.9% in the second quarter of 2007 and 12.4% in the first quarter of 2007. The trend of quarterly same facility uninsured admissions growth during 2006, compared to 2005, was 13.1% during the first quarter, 10.5% during the second quarter, 10.1% during the third quarter and 8.7% during the fourth quarter.

Admissions related to Medicare, managed Medicare, Medicaid, managed Medicaid, managed care and other insurers and the uninsured for the quarters and nine months ended September 30, 2007 and 2006 are set forth in the following table.

|                                 | <b>Quarter</b> |             | <b>Nine Months</b> |             |
|---------------------------------|----------------|-------------|--------------------|-------------|
|                                 | <b>2007</b>    | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Medicare                        | <b>34%</b>     | 35%         | <b>35%</b>         | 37%         |
| Managed Medicare                | <b>7</b>       | 7           | <b>7</b>           | 6           |
| Medicaid                        | <b>9</b>       | 9           | <b>9</b>           | 9           |
| Managed Medicaid                | <b>7</b>       | 6           | <b>7</b>           | 6           |
| Managed care and other insurers | <b>36</b>      | 37          | <b>36</b>          | 36          |
| Uninsured                       | <b>7</b>       | 6           | <b>6</b>           | 6           |

**100%**

100%

**100%**

100%

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)***Revenue/Volume Trends (continued)*

The approximate percentages of our inpatient revenues related to Medicare, managed Medicare, Medicaid, managed Medicaid, managed care and other insurers and the uninsured for the quarters and nine months ended September 30, 2007 and 2006 are set forth in the following table.

|                                 | <b>Quarter</b> |             | <b>Nine Months</b> |             |
|---------------------------------|----------------|-------------|--------------------|-------------|
|                                 | <b>2007</b>    | <b>2006</b> | <b>2007</b>        | <b>2006</b> |
| Medicare                        | <b>31%</b>     | 33%         | <b>32%</b>         | 35%         |
| Managed Medicare                | <b>7</b>       | 7           | <b>7</b>           | 6           |
| Medicaid                        | <b>7</b>       | 6           | <b>7</b>           | 6           |
| Managed Medicaid                | <b>4</b>       | 3           | <b>4</b>           | 3           |
| Managed care and other insurers | <b>45</b>      | 45          | <b>44</b>          | 45          |
| Uninsured                       | <b>6</b>       | 6           | <b>6</b>           | 5           |
|                                 | <b>100%</b>    | 100%        | <b>100%</b>        | 100%        |

At September 30, 2007, we had 73 hospitals in the states of Texas and Florida. During the third quarter of 2007, 55% of our admissions and 50% of our revenues were generated by these hospitals. Uninsured admissions in Texas and Florida represented 63% of our uninsured admissions during the third quarter of 2007.

We receive a significant portion of our revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. During the past year, we have increased the indigent care services we provide in several communities in the state of Texas, in affiliation with other hospitals. The state of Texas has been involved in the effort to increase the indigent care provided by private hospitals. As a result of this additional indigent care provided by private hospitals, public hospital districts or counties in Texas have available funds that were previously devoted to indigent care. The public hospital districts or counties are under no contractual or legal obligation to provide such indigent care. The public hospital districts or counties have elected to offer some portion of these amounts of newly available ad valorem tax revenues as the state portion of the Medicaid program (which is funded by both state and federal dollars). Such action is at the sole discretion of the public hospital districts or counties. It is anticipated that the state contributions will be matched with federal Medicaid funds. The state then may make Medicaid supplemental payments to hospitals in the state, including those that are providing additional indigent care services. Such payments must be within the federal UPL established by federal regulation.

Our Texas Medicaid revenues increased by \$32 million during the third quarter of 2007 and \$210 million during the first nine months of 2007 compared to the same periods in 2006, due to increases in Medicaid supplemental payments pursuant to UPL programs in which we, local governments and other unaffiliated providers participate.

Based upon a review of certain expenditures claimed for federal Medicaid matching funds by the state of Texas, the Centers for Medicare and Medicaid Services ( CMS ) recently deferred a portion of claimed amounts. The federal deferral is expected to continue until CMS completes its review. The outcome of such review might affect the federal portion of these supplemental payments, which is a significant component of the total supplemental payments. We did not recognize any net benefit related to the Texas Medicaid supplemental payments in our operating results during the third quarter and will continue this revenue recognition policy until we receive further guidance from responsible federal and state agencies.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)***Operating Results Summary*

The following are comparative summaries of results of operations for the quarters and nine months ended September 30, 2007 and 2006 (dollars in millions):

|   | Quarter  |       | Quarter  |       |
|---|----------|-------|----------|-------|
|   | 2007     |       | 2006     |       |
|   | Amount   | Ratio | Amount   | Ratio |
| Revenues  | \$ 6,569 | 100.0 | \$ 6,213 | 100.0 |
| Salaries and benefits                                   | 2,701    | 41.1  | 2,600    | 41.8  |
| Supplies  | 1,085    | 16.5  | 1,046    | 16.8  |
| Other operating expenses                                | 1,076    | 16.4  | 1,054    | 17.1  |
| Provision for doubtful accounts                         | 774      | 11.8  | 677      | 10.9  |
| Losses (gains) on investments                           | 1        |       | (40)     | (0.7) |
| Equity in earnings of affiliates                        | (51)     | (0.8) | (43)     | (0.7) |
| Depreciation and amortization                           | 356      | 5.5   | 348      | 5.6   |
| Interest expense  | 560      | 8.5   | 200      | 3.2   |
| Gains on sales of facilities                            | (316)    | (4.8) | (41)     | (0.7) |
| Transaction costs                                       |          |       | 9        | 0.2   |
|   | 6,186    | 94.2  | 5,810    | 93.5  |
| Income before minority interests and income taxes       | 383      | 5.8   | 403      | 6.5   |
| Minority interests in earnings of consolidated entities | 44       | 0.6   | 44       | 0.7   |
| Income before income taxes                              | 339      | 5.2   | 359      | 5.8   |
| Provision for income taxes                              | 39       | 0.6   | 119      | 1.9   |
| Net income  | \$ 300   | 4.6   | \$ 240   | 3.9   |
| % changes from prior year:                              |          |       |          |       |
| Revenues  | 5.7%     |       | 3.1%     |       |
| Income before income taxes                              | (5.6)    |       | (11.0)   |       |
| Net income  | 24.9     |       | (14.6)   |       |
| Admissions(a)   | (3.3)    |       | (2.6)    |       |
| Equivalent admissions(b)                                | (1.9)    |       | (3.4)    |       |
| Revenue per equivalent admission                        | 7.7      |       | 6.8      |       |
| Same facility % changes from prior year(c):             |          |       |          |       |
| Revenues  | 7.0      |       | 5.4      |       |

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|                                  |              |       |
|----------------------------------|--------------|-------|
| Admissions(a)                    | <b>(1.6)</b> | 0.1   |
| Equivalent admissions(b)         | <b>(0.5)</b> | (0.9) |
| Revenue per equivalent admission | <b>7.5</b>   | 6.4   |



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)***Operating Results Summary (continued)*

|   | Nine Months |       |           |       |
|---|-------------|-------|-----------|-------|
|   | 2007        |       | 2006      |       |
|   | Amount      | Ratio | Amount    | Ratio |
| Revenues  | \$ 19,975   | 100.0 | \$ 18,988 | 100.0 |
| Salaries and benefits                                   | 8,002       | 40.1  | 7,816     | 41.2  |
| Supplies  | 3,284       | 16.4  | 3,251     | 17.1  |
| Other operating expenses                                | 3,194       | 16.0  | 3,063     | 16.1  |
| Provision for doubtful accounts                         | 2,218       | 11.1  | 1,950     | 10.3  |
| Gains on investments                                    | (6)         |       | (140)     | (0.7) |
| Equity in earnings of affiliates                        | (156)       | (0.8) | (151)     | (0.8) |
| Depreciation and amortization                           | 1,072       | 5.4   | 1,045     | 5.4   |
| Interest expense  | 1,674       | 8.4   | 582       | 3.1   |
| Gains on sales of facilities                            | (332)       | (1.7) | (46)      | (0.2) |
| Impairment of long-lived assets                         | 24          | 0.1   |           |       |
| Transaction costs                                       |             |       | 9         |       |
|   | 18,974      | 95.0  | 17,379    | 91.5  |
| Income before minority interests and income taxes       | 1,001       | 5.0   | 1,609     | 8.5   |
| Minority interests in earnings of consolidated entities | 160         | 0.8   | 145       | 0.8   |
| Income before income taxes                              | 841         | 4.2   | 1,464     | 7.7   |
| Provision for income taxes                              | 245         | 1.2   | 550       | 2.9   |
| Net income  | \$ 596      | 3.0   | \$ 914    | 4.8   |
| % changes from prior year:                              |             |       |           |       |
| Revenues  | 5.2%        |       | 3.9%      |       |
| Income before income taxes                              | (42.5)      |       | (10.4)    |       |
| Net income  | (34.8)      |       | (16.9)    |       |
| Admissions(a)   | (4.1)       |       | (2.1)     |       |
| Equivalent admissions(b)                                | (3.5)       |       | (2.2)     |       |
| Revenue per equivalent admission                        | 9.0         |       | 6.2       |       |
| Same facility % changes from prior year(c):             |             |       |           |       |
| Revenues  | 7.3         |       | 5.5       |       |
| Admissions(a)   | (1.6)       |       |           |       |

|                                  |       |       |
|----------------------------------|-------|-------|
| Equivalent admissions(b)         | (1.0) | (0.2) |
| Revenue per equivalent admission | 8.5   | 5.6   |

- (a) Represents the total number of patients admitted to our hospitals and is used by management and certain investors as a general measure of inpatient volume.
- (b) Equivalent admissions are used by management and certain investors as a general measure of combined inpatient and outpatient volume. Equivalent admissions are computed by multiplying admissions (inpatient volume) by the sum of gross inpatient revenue and gross outpatient revenue and then dividing the resulting amount by gross inpatient revenue. The equivalent admissions computation equates outpatient revenue to the volume measure (admissions) used to measure inpatient volume, resulting in a general measure of combined inpatient and outpatient volume.
- (c) Same facility information excludes the operations of hospitals and their related facilities which were either acquired or divested during the current and prior period.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)**

*Quarters Ended September 30, 2007 and 2006*

Net income totaled \$300 million for the third quarter of 2007 compared to \$240 million for the third quarter of 2006. Revenues increased 5.7% due to favorable pricing trends, evidenced by net revenue per equivalent admission growth of 7.7%, and weak volume trends that resulted in a decline in equivalent admissions of 1.9%. The \$60 million increase in net income was primarily due to the net impact of the \$41 million reduction in gains on investments, the \$275 million increase in gains on sales of facilities, the \$360 million increase in interest expense and the \$85 million income tax benefit related to new information received during the third quarter of 2007 related primarily to tax positions taken in prior taxable periods.

For the third quarter of 2007, consolidated admissions decreased 3.3% and same facility admissions decreased 1.6% compared to the third quarter of 2006. Inpatient surgical volumes decreased 4.1% on a consolidated basis and decreased 1.1% on a same facility basis during the third quarter of 2007, compared to the third quarter of 2006. Outpatient surgical volumes decreased 0.2% on a consolidated basis and decreased 0.7% on a same facility basis during the third quarter of 2007, compared to the third quarter of 2006.

Salaries and benefits, as a percentage of revenues, were 41.1% in the third quarter of 2007 and 41.8% in the third quarter of 2006. Salaries and benefits per equivalent admission increased 5.9% in the third quarter of 2007 compared to the third quarter of 2006. Labor rate increases averaged 4.9% for the third quarter of 2007 compared to the third quarter of 2006.

Supplies, as a percentage of revenues, were 16.5% in the third quarter of 2007 and 16.8% in the third quarter of 2006. Supply costs per equivalent admission increased 5.7% in the third quarter of 2007 compared to the third quarter of 2006. Same facility supply costs increased 4.8% for orthopedic devices and 16.3% for blood products in the third quarter of 2007 compared to the third quarter of 2006.

Other operating expenses, as a percentage of revenues, decreased to 16.4% in the third quarter of 2007 compared to 17.1% in the third quarter of 2006. Other operating expenses are primarily comprised of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance (including professional liability insurance) and nonincome taxes. We recorded \$33 million of indigent care costs in certain Texas markets during the third quarter of 2007 for indigent care programs that we did not participate in during the third quarter of 2006. Provisions for losses related to professional liability risks were \$44 million and \$81 million for the third quarters of 2007 and 2006, respectively. We expect the favorable professional liability trends experienced during 2006 and 2005 to continue during the remainder of 2007 and have considered those favorable trends in our 2007 estimated professional liability expense accruals.

Provision for doubtful accounts, as a percentage of revenues, increased to 11.8% in the third quarter of 2007 compared to 10.9% in the third quarter of 2006. The provision for doubtful accounts and the allowance for doubtful accounts relate primarily to uninsured amounts due directly from patients. At September 30, 2007, our allowance for doubtful accounts represented approximately 88% of the \$4.466 billion total patient due accounts receivable balance.

Losses on investments of \$1 million in the third quarter of 2007 and gains on investments of \$40 million in the third quarter of 2006 relate to sales of investment securities by our wholly-owned insurance subsidiary. During the fourth quarter of 2006, we reallocated the investment securities portfolio by converting the majority of our equity securities investments into investments in debt securities, and we expect gains on sales of investments to be lower in the remainder of 2007 and future years than what was realized during 2006.

Equity in earnings of affiliates was \$51 million and \$43 million in the third quarters of 2007 and 2006, respectively. These amounts related primarily to the operations of our Denver market joint venture, which is accounted for under the equity method of accounting.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)**

*Quarters Ended September 30, 2007 and 2006 (continued)*

Depreciation and amortization increased by \$8 million, from \$348 million in the third quarter of 2006 to \$356 million in the third quarter of 2007.

Interest expense increased from \$200 million in the third quarter of 2006 to \$560 million in the third quarter of 2007 due to the increased debt related to the Recapitalization. Our average debt balance was \$27.625 billion for the third quarter of 2007 compared to \$11.362 billion for the third quarter of 2006. The average interest rate for our long term debt increased from 7.1% at September 30, 2006 to 7.7% at September 30, 2007.

During the third quarter of 2007, we recognized gains on sales of facilities of \$316 million, which included a gain of \$311 million on the sale of our two Switzerland hospitals. Gains on sales of facilities were \$41 million for the third quarter of 2006 and included a gain of \$32 million on the sale of a hospital located in Virginia.

Minority interests in earnings of consolidated entities were \$44 million for both the third quarters of 2007 and 2006.

Our effective tax rate was 11.7% in the third quarter of 2007 and 33.3% in the third quarter of 2006. Based on new information received during the third quarter of 2007 related primarily to tax positions taken in prior taxable periods, we reduced our provision for income taxes by \$85 million. Excluding the effect of this adjustment, the effective rate for the third quarter of 2007 would have been 36.9%.

*Nine Months Ended September 30, 2007 and 2006*

Net income totaled \$596 million for the nine months ended September 30, 2007 compared to \$914 million for the nine months ended September 30, 2006. Revenues increased 5.2% due to favorable pricing trends, evidenced by net revenue per equivalent admission growth of 9.0%, and weak volume trends that resulted in a decline in equivalent admissions of 3.5%. The \$318 million decline in net income was primarily due to the net impact of the \$286 million increase in gains on sales of facilities, the \$1.092 billion increase in interest expense and the \$305 million reduction in the provision for income taxes.

For the nine months ended September 30, 2007, consolidated admissions decreased 4.1% and same facility admissions decreased 1.6% compared to the nine months ended September 30, 2006. Inpatient surgical volumes decreased 3.3% on a consolidated basis and decreased 0.9% on a same facility basis during the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006. Outpatient surgical volumes decreased 2.5% on a consolidated basis and decreased 1.2% on a same facility basis during the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006.

Salaries and benefits, as a percentage of revenues, were 40.1% in the first nine months of 2007 and 41.2% in the first nine months of 2006. Salaries and benefits per equivalent admission increased 6.0% for the first nine months of 2007 compared to the first nine months of 2006. Labor rate increases averaged 5.4% for the first nine months of 2007 compared to the first nine months of 2006.

Supplies, as a percentage of revenues, were 16.4% in the first nine months of 2007 compared to 17.1% in the first nine months of 2006. Supply costs per equivalent admission increased 4.6% for the first nine months of 2007 compared to the first nine months of 2006. Same facility supply costs increased 5.3% for medical devices (cardiology and orthopedic) and 9.8% for blood products in the first nine months of 2007 compared to the first nine months of 2006.

Other operating expenses, as a percentage of revenues, were 16.0% in the first nine months of 2007, compared to 16.1% in the first nine months of 2006. Other operating expenses are primarily comprised of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance (including professional liability insurance) and nonincome taxes. We recorded \$164 million of indigent care costs in certain Texas markets during

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Results of Operations (continued)**

*Nine Months Ended September 30, 2007 and 2006 (continued)*

the first nine months of 2007 for indigent care programs that we did not participate in during the first nine months of 2006. Provisions for losses related to professional liability risks were \$141 million and \$178 million for the nine months ended September 30, 2007 and 2006, respectively. We recorded reductions to our estimated professional liability reserves of \$85 million and \$36 million during the nine months ended September 30, 2006 and 2005, respectively, to reflect the recognition by our external actuaries of improving frequency and severity claim trends at our facilities. We expect the favorable professional liability trends experienced during 2006 and 2005 to continue during the remainder of 2007 and have considered those favorable trends in our 2007 estimated professional liability expense accruals.

Provision for doubtful accounts, as a percentage of revenues, was 11.1% in the first nine months of 2007 compared to 10.3% in the first nine months of 2006. The provision for doubtful accounts and the allowance for doubtful accounts relate primarily to uninsured amounts due directly from patients. At September 30, 2007, our allowance for doubtful accounts represented approximately 88% of the \$4.466 billion total patient due accounts receivable balance.

Gains on investments of \$6 million in the first nine months of 2007 and \$140 million in the first nine months of 2006 relate to sales of investment securities by our wholly-owned insurance subsidiary. We converted the majority of our equity investments to investments in debt securities during the fourth quarter of 2006 and do not expect to realize gains on investments during the remainder of 2007 and future years at amounts comparable to those realized during 2006.

Equity in earnings of affiliates was \$156 million and \$151 million in the first nine months of 2007 and 2006, respectively. These amounts related primarily to the operations of our Denver market joint venture, which is accounted for under the equity method of accounting.

Depreciation and amortization increased by \$27 million, from \$1.045 billion in the first nine months of 2006 to \$1.072 billion in the first nine months of 2007.

Interest expense increased from \$582 million in the first nine months of 2006 to \$1.674 billion in the first nine months of 2007 due to the increased debt related to the Recapitalization. Our average debt balance was \$27.843 billion for the first nine months of 2007 compared to \$11.228 billion for the first nine months of 2006. The average interest rate for our long term debt increased from 7.1% at September 30, 2006 to 7.7% at September 30, 2007.

During the first nine months of 2007, we recognized gains on sales of facilities of \$332 million, which included a gain of \$311 million on the sale of our two Switzerland hospitals. Gains on sales of facilities were \$46 million for the first nine months of 2006, and included a \$32 million gain on the sale of a hospital in Virginia.

We recorded an impairment charge of \$24 million to adjust the value of a building to estimated fair value during the first nine months of 2007.

Minority interest in earnings of consolidated entities increased from \$145 million in the first nine months of 2006 to \$160 million for the first nine months of 2007 due primarily to improved operations in two Texas market partnerships.

Our effective tax rate was 29.2% in the first nine months of 2007 and 37.6% in the first nine months of 2006. Based on new information received during the first nine months of 2007 related primarily to tax positions taken in prior taxable periods, we reduced our provision for income taxes by \$85 million. Excluding the effect of this adjustment, the effective rate for the first nine months of 2007 would have been 39.3%.



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Liquidity and Capital Resources**

Cash provided by operating activities totaled \$985 million in the first nine months of 2007 compared to \$1.353 billion in the first nine months of 2006. Net income was \$318 million lower in the first nine months of 2007 compared to the first nine months of 2006. In the first nine months of 2007, our combined payments for interest and taxes were \$1.870 billion, which represented a \$381 million increase compared to the first nine months of 2006. Working capital totaled \$2.320 billion at September 30, 2007 and \$2.502 billion at December 31, 2006.

Cash used in investing activities was \$365 million in the first nine months of 2007 compared to \$1.226 billion in the first nine months of 2006. Excluding acquisitions, capital expenditures were \$997 million and \$1.330 billion in the first nine months of 2007 and 2006, respectively. Capital expenditures are expected to approximate \$1.6 billion in 2007 and \$1.7 billion in 2008. At September 30, 2007, there were projects under construction which had estimated additional costs to complete and equip over the next five years of approximately \$1.7 billion. We expect to finance capital expenditures with internally generated and borrowed funds. During the first nine months of 2007 and 2006, we received cash proceeds of \$484 million and \$328 million, respectively, from dispositions of hospitals and health care entities. We received cash flows from our investments of \$156 million for the first nine months of 2007 and expended \$122 million to increase investments for the first nine months of 2006. Effective January 1, 2007, our facilities are generally self-insured for the first \$5 million of per occurrence losses and we are not required to maintain investments to fund the liabilities for claims that occurred after December 31, 2006.

Cash used in financing activities totaled \$907 million during the first nine months of 2007 compared to \$78 million provided by financing activities during the first nine months of 2006. During the first nine months of 2007, we decreased net borrowings by \$991 million and received proceeds of \$100 million for issuances of 1,972,100 shares of common stock. During the first nine months of 2006, we increased net borrowings by \$843 million, repurchased 13.0 million shares of common stock for \$653 million and paid \$201 million in cash dividends.

In addition to cash flows from operations, available sources of capital include amounts available under the senior secured credit facilities (\$2.524 billion available as of October 31, 2007) and anticipated access to public and private debt markets.

Investments of our professional liability insurance subsidiary, to maintain statutory equity and pay claims (primarily claims that occurred prior to January 1, 2007), totaled \$1.987 billion at September 30, 2007 and \$2.143 billion at December 31, 2006, respectively. Claims payments, net of reinsurance recoveries, during the next twelve months are expected to approximate \$250 million. Our wholly-owned insurance subsidiary has entered into certain reinsurance contracts, and the obligations covered by the reinsurance contracts are included in the reserves for professional liability risks, as the subsidiary remains liable to the extent that the reinsurers do not meet their obligations under the reinsurance contracts. To minimize our exposure to losses from reinsurer insolvencies, we routinely monitor the financial condition of our reinsurers. The amounts receivable related to the reinsurance contracts were \$43 million and \$42 million at September 30, 2007 and December 31, 2006, respectively.

*Financing Activities*

Due to the Recapitalization, we are highly leveraged and have significant debt service requirements. Our debt totaled \$27.545 billion at September 30, 2007, which represents a \$16.202 billion increase from the total debt of \$11.343 billion at September 30, 2006. Interest expense increased from \$200 million in the third quarter of 2006 to

\$560 million in the third quarter of 2007. Interest expense for the nine months ended September 30, 2007 and 2006 was \$1.674 billion and \$582 million, respectively.

In connection with the Recapitalization, we entered into (i) a \$2.000 billion senior secured asset-based revolving credit facility with a borrowing base of 85% of eligible accounts receivable, subject to customary reserves and eligibility criteria (\$419 million available at September 30, 2007) (the ABL credit facility ) and (ii) a senior

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Liquidity and Capital Resources (continued)**

*Financing Activities (continued)*

secured credit agreement (the cash flow credit facility and, together with the ABL credit facility, the senior secured credit facilities), consisting of a \$2.000 billion revolving credit facility (\$1.858 billion available at September 30, 2007 after giving effect to certain outstanding letters of credit), a \$2.750 billion term loan A (\$2.666 billion outstanding at September 30, 2007), a \$8.800 billion term loan B (\$8.734 billion outstanding at September 30, 2007) and a 1.000 billion European term loan (703 million or \$1.003 billion outstanding at September 30, 2007). The senior secured credit facilities and senior secured notes are fully and unconditionally guaranteed by substantially all existing and future, direct and indirect, wholly-owned material domestic subsidiaries that are Unrestricted Subsidiaries under our Indenture dated as of December 16, 1993 (except for certain special purpose subsidiaries that only guarantee and pledge their assets under our ABL credit facility). In addition, borrowings under the European term loan are guaranteed by all material, wholly-owned European subsidiaries.

Also in connection with the Recapitalization, we issued \$4.200 billion of senior secured notes (comprised of \$1.000 billion of 91/8% notes due 2014 and \$3.200 billion of 91/4% notes due 2016) and \$1.500 billion of 95/8% senior secured toggle notes (which allow us, at our option, to pay interest in kind during the first five years) due 2016, which are subject to certain standard covenants. The notes are guaranteed by certain of our subsidiaries.

In 2006, we issued \$1.000 billion of 6.5% notes due 2016. Proceeds of \$625 million were used to refinance the amounts outstanding under our 2005 term loan and the remaining proceeds were used to pay down amounts advanced under our bank revolving credit facility.

Management believes that cash flows from operations, amounts available under our senior secured credit facilities and our anticipated access to public and private debt markets will be sufficient to meet expected liquidity needs during the next twelve months.

*Market Risk*

HCA is exposed to market risk related to changes in market values of securities. The investments in debt and equity securities of our wholly-owned insurance subsidiary were \$1.825 billion and \$162 million, respectively, at September 30, 2007. These investments are carried at fair value, with changes in unrealized gains and losses being recorded as adjustments to other comprehensive income. The fair value of investments is generally based on quoted market prices. At September 30, 2007, we had a net unrealized gain of \$17 million on the insurance subsidiary's investment securities.

We are also exposed to market risk related to changes in interest rates and we periodically enter into interest rate swap agreements to manage our exposure to these fluctuations. Our interest rate swap agreements involve the exchange of fixed and variable rate interest payments between two parties, based on common notional principal amounts and maturity dates. The notional amounts of the swap agreements represent balances used to calculate the exchange of cash flows and are not our assets or liabilities. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions. The interest payments under these agreements are

settled on a net basis. These derivatives have been recognized in the financial statements at their respective fair values. Changes in the fair value of these derivatives are included in other comprehensive income.

With respect to our interest-bearing liabilities, approximately \$5.909 billion of long-term debt at September 30, 2007 is subject to variable rates of interest, while the remaining balance in long-term debt of \$21.636 billion at September 30, 2007 is subject to fixed rates of interest. Both the general level of interest rates and, for the senior secured credit facilities, our leverage affect our variable interest rates. Our variable rate debt is comprised primarily of amounts outstanding under the senior secured credit facilities. Borrowings under the senior secured credit facilities bear interest at a rate equal to, as determined by the type of borrowing, either (a) a base rate determined by reference to the higher of (1) the federal funds rate plus 1/2 of 1% or (2) the prime rate of Bank of America or (b) a LIBOR rate for the currency of such borrowing for the relevant interest period, plus, in each case, an applicable

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Liquidity and Capital Resources (continued)**

*Market Risk (continued)*

margin. The applicable margin for borrowings under the senior secured credit facilities, with the exception of term loan B where the margin is static, may be reduced subject to attaining certain leverage ratios. On February 16, 2007, we amended the cash flow credit facility to reduce the applicable margins with respect to the term loan borrowings thereunder. On June 20, 2007, we amended the ABL credit facility to reduce the applicable margin effective January 1, 2008, with respect to borrowings thereunder.

Due primarily to the lowering of our credit ratings in connection with the Recapitalization, the average rate for our long-term debt increased from 7.1% at September 30, 2006 to 7.7% at September 30, 2007. The estimated fair value of our total long-term debt was \$26.718 billion at September 30, 2007. The estimates of fair value are based upon the quoted market prices for the same or similar issues of long-term debt with the same maturities. Based on a hypothetical 1% increase in interest rates, the potential annualized reduction to future pretax earnings would be approximately \$59 million. To mitigate the impact of fluctuations in interest rates, we generally target a portion of our debt portfolio to be maintained at fixed rates.

Our international operations and the European term loan expose us to market risks associated with foreign currencies. In order to mitigate the currency exposure related to debt service obligations through December 31, 2011 under the European term loan, we have entered into cross currency swap agreements. A cross currency swap is an agreement between two parties to exchange a stream of principal and interest payments in one currency for a stream of principal and interest payments in another currency over a specified period.

**Pending IRS Disputes**

We are currently contesting before the Appeals Division of the Internal Revenue Service (the "IRS") certain claimed deficiencies and adjustments proposed by the IRS in connection with its examination of the 2001 and 2002 federal income tax returns for HCA and 15 affiliates that are treated as partnerships for federal income tax purposes ("affiliated partnerships"). During 2006, the IRS began an examination of the 2003 and 2004 federal income tax returns for HCA and 19 affiliated partnerships.

The disputed items pending before the IRS Appeals Division or proposed by the IRS Examination Division through September 30, 2007, include the deductibility of a portion of the 2001 and 2003 government settlement payments, the timing of recognition of certain patient service revenues in 2001 through 2004, the method for calculating the tax allowance for doubtful accounts in 2002 through 2004, and the amount of insurance expense deducted in 2001 and 2002. Through September 30, 2007, the IRS is seeking an additional \$1.4 billion in income taxes, interest and penalties with respect to these issues. This amount is net of a refundable deposit of \$215 million that we made during 2006. The IRS has not determined the final amount of additional income tax, interest and penalties that it may claim upon completion of the 2003 and 2004 examinations. We expect the IRS will complete its examination of the 2003 and 2004 federal income tax returns and begin an examination of our 2005 and 2006 federal income tax returns within the next twelve months.

During 2003, the United States Court of Appeals for the Sixth Circuit affirmed a United States Tax Court ( Tax Court ) decision received in 1996 related to the IRS examination of Hospital Corporation of America s 1987 through 1988 federal income tax returns, in which the IRS contested the method that Hospital Corporation of America used to calculate its tax allowance for doubtful accounts. Due to the volume and complexity of calculating the tax allowance for doubtful accounts, the IRS has not determined the amount of additional tax and interest that it may claim for taxable years after 1988. Thirty-one federal taxable periods for HCA, its predecessors and subsidiaries from 1987 through 1996 are affected by the Tax Court decision. These taxable periods are pending before the IRS Examination Division, the Tax Court and the United States Court of Federal Claims. In 2004, we made a payment of \$109 million for additional federal tax and interest, based on our estimate of amounts due for

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Pending IRS Disputes (continued)**

taxable periods through 1996. As of September 30, 2007, we had reached tentative agreement with the IRS with respect to the tax and interest computations for two of the 31 federal taxable periods.

Management believes that adequate provisions have been recorded to satisfy final resolution of the disputed issues. Management believes that HCA, its predecessors, subsidiaries and affiliates properly reported taxable income and paid taxes in accordance with applicable laws and agreements established with the IRS and that final resolution of these disputes will not have a material, adverse effect on our results of operations or financial position. However, if payments due upon final resolution of these issues exceed our recorded estimates, such resolutions could have a material, adverse effect on our results of operations or financial position.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Operating Data**

|   | <b>2007</b>    | <b>2006</b> |
|---|----------------|-------------|
| <b>CONSOLIDATING</b>  |                |             |
| Number of hospitals in operation at:                                |                |             |
| March 31  | <b>165</b>     | 176         |
| June 30   | <b>164</b>     | 176         |
| September 30  | <b>162</b>     | 172         |
| December 31   |                | 166         |
| Number of freestanding outpatient surgical centers in operation at: |                |             |
| March 31  | <b>99</b>      | 91          |
| June 30   | <b>98</b>      | 92          |
| September 30  | <b>98</b>      | 95          |
| December 31   |                | 98          |
| Licensed hospital beds at(a):                                       |                |             |
| March 31  | <b>39,269</b>  | 41,539      |
| June 30   | <b>39,175</b>  | 41,300      |
| September 30  | <b>38,939</b>  | 40,382      |
| December 31   |                | 39,354      |
| Weighted average licensed beds(b):                                  |                |             |
| Quarter:  |                |             |
| First   | <b>39,269</b>  | 41,255      |
| Second  | <b>39,222</b>  | 41,263      |
| Third   | <b>38,990</b>  | 40,352      |
| Fourth  |                | 39,762      |
| Year  |                | 40,653      |
| Average daily census(c):  |                |             |
| Quarter:  |                |             |
| First   | <b>22,461</b>  | 23,228      |
| Second  | <b>20,874</b>  | 21,682      |
| Third   | <b>20,444</b>  | 20,993      |
| Fourth  |                | 20,883      |
| Year  |                | 21,688      |
| Admissions(d):  |                |             |
| Quarter:  |                |             |
| First   | <b>403,800</b> | 421,000     |
| Second  | <b>383,200</b> | 402,900     |
| Third   | <b>381,700</b> | 394,700     |
| Fourth  |                | 391,500     |
| Year  |                | 1,610,100   |



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)**

**Operating Data (Continued)**

|                                   | <b>2007</b>      | <b>2006</b> |
|-----------------------------------|------------------|-------------|
| Equivalent admissions(e):         |                  |             |
| Quarter:                          |                  |             |
| First                             | <b>601,200</b>   | 626,000     |
| Second                            | <b>582,500</b>   | 609,900     |
| Third                             | <b>583,400</b>   | 594,500     |
| Fourth                            |                  | 586,300     |
| Year                              |                  | 2,416,700   |
| Average length of stay (days)(f): |                  |             |
| Quarter:                          |                  |             |
| First                             | <b>5.0</b>       | 5.0         |
| Second                            | <b>5.0</b>       | 4.9         |
| Third                             | <b>4.9</b>       | 4.9         |
| Fourth                            |                  | 4.9         |
| Year                              |                  | 4.9         |
| Emergency room visits(g):         |                  |             |
| Quarter:                          |                  |             |
| First                             | <b>1,295,200</b> | 1,332,500   |
| Second                            | <b>1,258,700</b> | 1,325,600   |
| Third                             | <b>1,273,900</b> | 1,289,600   |
| Fourth                            |                  | 1,265,800   |
| Year                              |                  | 5,213,500   |
| Outpatient surgeries(h):          |                  |             |
| Quarter:                          |                  |             |
| First                             | <b>204,200</b>   | 212,900     |
| Second                            | <b>204,200</b>   | 210,700     |
| Third                             | <b>196,400</b>   | 196,700     |
| Fourth                            |                  | 200,600     |
| Year                              |                  | 820,900     |
| Inpatient surgeries(i):           |                  |             |
| Quarter:                          |                  |             |
| First                             | <b>130,500</b>   | 135,300     |
| Second                            | <b>131,200</b>   | 134,000     |
| Third                             | <b>128,300</b>   | 133,800     |
| Fourth                            |                  | 130,000     |
| Year                              |                  | 533,100     |

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Operating Data (Continued)**

|   | <b>2007</b>      | <b>2006</b> |
|---|------------------|-------------|
| Days in accounts receivable(j):                                     |                  |             |
| Quarter:  |                  |             |
| First   | <b>52</b>        | 49          |
| Second  | <b>51</b>        | 49          |
| Third   | <b>54</b>        | 53          |
| Fourth  |                  | 53          |
| Year  |                  | 53          |
| Gross patient revenues(k) (dollars in millions):                    |                  |             |
| Quarter:  |                  |             |
| First   | <b>\$ 23,161</b> | \$ 21,530   |
| Second  | <b>22,503</b>    | 20,908      |
| Third   | <b>22,381</b>    | 20,493      |
| Fourth  |                  | 21,982      |
| Year  |                  | 84,913      |
| Outpatient revenues as a % of patient revenues(l)                   |                  |             |
| Quarter:  |                  |             |
| First   | <b>36%</b>       | 36%         |
| Second  | <b>37%</b>       | 37%         |
| Third   | <b>38%</b>       | 36%         |
| Fourth  |                  | 36%         |
| Year  |                  | 36%         |
| <b>NONCONSOLIDATING(m)</b>  |                  |             |
| Number of hospitals in operation at:                                |                  |             |
| March 31  | <b>8</b>         | 7           |
| June 30   | <b>8</b>         | 7           |
| September 30  | <b>8</b>         | 7           |
| December 31   |                  | 7           |
| Number of freestanding outpatient surgical centers in operation at: |                  |             |
| March 31  | <b>9</b>         | 7           |
| June 30   | <b>9</b>         | 9           |
| September 30  | <b>9</b>         | 9           |
| December 31   |                  | 9           |
| Licensed hospital beds at:  |                  |             |
| March 31  | <b>2,356</b>     | 2,249       |
| June 30   | <b>2,334</b>     | 2,249       |
| September 30  | <b>2,337</b>     | 2,246       |
| December 31   |                  | 2,246       |

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)****Operating Data (Continued)****BALANCE SHEET DATA**

|  | <b>% of Accounts Receivable</b> |                        |                          |
|--|---------------------------------|------------------------|--------------------------|
|  | <b>Under 91<br/>Days</b>        | <b>91 180<br/>Days</b> | <b>Over 180<br/>Days</b> |
| Accounts receivable aging at September 30, 2007: |                                 |                        |                          |
| Medicare and Medicaid                            | 12%                             | 1%                     | 2%                       |
| Managed care and other discounted                | 19                              | 4                      | 4                        |
| Uninsured  | 20                              | 11                     | 27                       |
| Total  | 51%                             | 16%                    | 33%                      |

- (a) Licensed beds are those beds for which a facility has been granted approval to operate from the applicable state licensing agency.
- (b) Weighted average licensed beds represents the average number of licensed beds, weighted based on periods owned.
- (c) Represents the average number of patients in our hospital beds each day.
- (d) Represents the total number of patients admitted to our hospitals and is used by management and certain investors as a general measure of inpatient volume.
- (e) Equivalent admissions are used by management and certain investors as a general measure of combined inpatient and outpatient volume. Equivalent admissions are computed by multiplying admissions (inpatient volume) by the sum of gross inpatient revenue and gross outpatient revenue and then dividing the resulting amount by gross inpatient revenue. The equivalent admissions computation equates outpatient revenue to the volume measure (admissions) used to measure inpatient volume resulting in a general measure of combined inpatient and outpatient volume.
- (f) Represents the average number of days admitted patients stay in our hospitals.
- (g) Represents the number of patients treated in our emergency rooms.
- (h) Represents the number of surgeries performed on patients who were not admitted to our hospitals. Pain management and endoscopy procedures are not included in outpatient surgeries.
- (i) Represents the number of surgeries performed on patients who have been admitted to our hospitals. Pain management and endoscopy procedures are not included in inpatient surgeries.

- (j) Days in accounts receivable are calculated by dividing the revenues for the period by the days in the period (revenues per day). Accounts receivable, net of allowance for doubtful accounts, at the end of the period is then divided by the revenues per day.
- (k) Gross patient revenues are based upon our standard charge listing. Gross charges/revenues typically do not reflect what our hospital facilities are paid. Gross charges/revenues are reduced by contractual adjustments, discounts and charity care to determine reported revenues.
- (l) Represents the percentage of patient revenues related to patients who are not admitted to our hospitals.
- (m) The nonconsolidating facilities include facilities operated through 50/50 joint ventures which we do not control and are accounted for using the equity method of accounting.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information called for by this item is provided under the caption "Market Risk" under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

HCA's chief executive officer and chief financial officer have reviewed and evaluated the effectiveness of HCA's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this quarterly report. Based on that evaluation, the chief executive officer and chief financial officer have concluded that HCA's disclosure controls and procedures effectively and timely provide them with material information relating to HCA and its consolidated subsidiaries required to be disclosed in the reports HCA files or submits under the Exchange Act.

**Changes in Internal Control Over Financial Reporting**

During the period covered by this report, there have been no changes in the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

**Part II: Other Information**

**Item 1: *Legal Proceedings***

**General Liability**

We operate in a highly regulated and litigious industry. As a result, various lawsuits, claims and legal and regulatory proceedings have been and can be expected to be instituted or asserted against us. The resolution of any such lawsuits, claims or legal and regulatory proceedings could have a material, adverse effect on our results of operations or financial position in a given period.

**Government Investigations, Claims and Litigation**

In January 2001, we entered into an eight-year Corporate Integrity Agreement ("CIA") with the Office of Inspector General of the Department of Health and Human Services. Violation or breach of the CIA, or violation of federal or state laws relating to Medicare, Medicaid or similar programs, could subject us to substantial monetary fines, civil and criminal penalties and/or exclusion from participation in the Medicare and Medicaid programs. Alleged violations may be pursued by the government or through private *qui tam* actions. Sanctions imposed against us as a result of such actions could have a material, adverse effect on our results of operations or financial position.

***Securities Class Action Litigation***

In November 2005, two putative federal securities law class actions were filed in the United States District Court for the Middle District of Tennessee seeking monetary damages on behalf of persons who purchased our stock between January 12, 2005 and July 13, 2005. These substantially similar lawsuits assert claims pursuant to Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, against us and our Chairman and Chief Executive

Officer, President and Chief Operating Officer, and Executive Vice President and Chief Financial Officer, related to our July 13, 2005 announcement of preliminary results of operations for the quarter ended June 30, 2005.

On January 5, 2006, the court consolidated these actions and all later-filed related securities actions under the caption *In re HCA Inc. Securities Litigation*, case number 3:05-CV-00960. Pursuant to federal statute, on January 25, 2006, the court appointed co-lead plaintiffs to represent the interests of the asserted class members in this litigation. Co-lead plaintiffs filed a consolidated amended complaint on April 21, 2006. We believe that the allegations

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contained within these class action lawsuits are without merit. These cases have now been settled, with approval by the court on October 12, 2007.

*Shareholder Derivative Lawsuits in Federal Court*

In November 2005, two then current shareholders each filed a derivative lawsuit, purportedly on behalf of HCA, in the United States District Court for the Middle District of Tennessee against our Chairman and Chief Executive Officer, President and Chief Operating Officer, Executive Vice President and Chief Financial Officer, other executives, and certain members of our Board of Directors. Each lawsuit asserts claims for breaches of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment in connection with our July 13, 2005 announcement of preliminary results of operations for the quarter ended June 30, 2005 and seeks monetary damages.

On January 23, 2006, the Court consolidated these actions as *In re HCA Inc. Derivative Litigation*, case number 3:05-CV-0968. The court stayed this action on February 27, 2006, pending resolution of a motion to dismiss the consolidated amended complaint in the related federal securities class action against us. On March 24, 2006, a consolidated derivative complaint was filed pursuant to a prior court order. On November 8, 2006, we reached an agreement in principle for the settlement of this consolidated action. The proposed settlement is subject to definitive documentation and court approval.

*Shareholder Derivative Lawsuit in State Court*

On January 18, 2006, a then current shareholder filed a derivative lawsuit, purportedly on behalf of HCA, in the Circuit Court for the State of Tennessee (Nashville District), against our Chairman and Chief Executive Officer, President and Chief Operating Officer, Executive Vice President and Chief Financial Officer, other executives, and certain members of our Board of Directors. This lawsuit is substantially identical in all material respects to the consolidated federal litigation described above under *Shareholder Derivative Lawsuits in Federal Court*. The Court stayed this action on April 3, 2006, pending resolution of a motion to dismiss the consolidated amended complaint in the related federal securities class action against us. On November 8, 2006, we reached an agreement in principle for the settlement of this action. The proposed settlement is subject to definitive documentation and court approval.

*ERISA Litigation*

On November 22, 2005, Brenda Thurman, a former employee of an HCA affiliate, filed a complaint in the United States District Court for the Middle District of Tennessee on behalf of herself, the HCA Savings and Retirement Program (the Plan), and a class of participants in the Plan who held an interest in our common stock, against our Chairman and Chief Executive Officer, President and Chief Operating Officer, Executive Vice President and Chief Financial Officer, and other unnamed individuals. The lawsuit, filed under sections 502(a)(2) and 502(a)(3) of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1132(a)(2) and (3), alleges that defendants breached their fiduciary duties owed to the Plan and to plan participants and seeks monetary damages and injunctions and other relief.

On January 13, 2006, the court signed an order staying all proceedings and discovery in this matter, pending resolution of a motion to dismiss the consolidated amended complaint in the related federal securities class action against HCA. On January 18, 2006, the magistrate judge signed an order (1) consolidating Thurman's cause of action with all other future actions making the same claims and arising out of the same operative facts, (2) appointing Thurman as lead plaintiff, and (3) appointing Thurman's attorneys as lead counsel and liaison counsel in the case. On January 26, 2006, the court issued an order reassigning the case to United States District Court Judge William J. Haynes, Jr., who has been presiding over the federal securities class action and federal derivative lawsuits.

*Merger Litigation in State Court*

We are aware of six asserted class action lawsuits related to the Merger filed against us, our Chairman and Chief Executive Officer, our President and Chief Operating Officer, members of the Board of Directors and each of



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the Sponsors in the Chancery Court for Davidson County, Tennessee. The complaints are substantially similar and allege, among other things, that the Merger was the product of a flawed process, that the consideration to be paid to our shareholders in the Merger was unfair and inadequate, and that there was a breach of fiduciary duties. The complaints further allege that the Sponsors abetted the actions of our officers and directors in breaching their fiduciary duties to our shareholders. The complaints sought, among other relief, an injunction preventing completion of the Merger. On August 3, 2006, the Chancery Court consolidated these actions and all later-filed actions as *In re HCA Inc. Shareholder Litigation*, case number 06-1816-III.

On November 8, 2006, we and the other named parties entered into a memorandum of understanding with plaintiffs counsel in connection with these actions.

Under the terms of the memorandum, we, the other named parties and the plaintiffs have agreed to settle the lawsuit subject to court approval. If the court approves the settlement contemplated in the memorandum, the lawsuit will be dismissed with prejudice. We and the other defendants deny all of the allegations in the lawsuit. Pursuant to the terms of the memorandum, Hercules Holding agreed to waive that portion in excess of \$220 million of any termination fee that it had a right to receive under the Merger Agreement. Also, we and the other parties agreed not to assert that a then current shareholder's demand for appraisal was untimely under Section 262 of the General Corporation Law of the State of Delaware (the "DGCL") where such shareholder submitted a written demand for appraisal within 30 calendar days of the shareholders meeting held to adopt the Merger Agreement. We and the other parties also agreed not to assert that (i) the surviving corporation in the Merger or then current shareholder who was entitled to appraisal rights may not file a petition in the Court of Chancery of the State of Delaware demanding a determination of the value of the shares held by all such shareholders if such petition was not filed within 120 days of the effective time of the Merger so long as such petition was filed within 150 days of the effective time, (ii) a then current shareholder may not withdraw such shareholder's demand for appraisal and accept the terms offered by the Merger if such withdrawal was not made within 60 days of the effective time of the Merger so long as such withdrawal was made within 90 days of the effective time of the Merger and (iii) that a then current shareholder may not, upon written request, receive from the surviving corporation a statement setting forth the aggregate number of shares not voted in favor of the Merger with respect to which demands for appraisal have been received and the aggregate number of holders of such shares if such request was not made within 120 days of the effective time of the Merger so long as such request was made within 150 days of the effective time. We and the other parties' counsel also agreed to a payment of attorney fees, as awarded by the court, of up to \$12.4 million. Court approval of the settlement and attorney's fees is pending.

Two cases making similar allegations and seeking similar relief on behalf of purported classes of then current shareholders have also been filed in Delaware. These two actions have also been consolidated under case number 2307-N and are pending in the Delaware Chancery Court, New Castle County. We believe this lawsuit is without merit and plan to defend it vigorously. We further believe the claims asserted in this lawsuit are subject to the November 8, 2006 agreement in principle to settle the Merger litigation and shareholder derivative lawsuits.

On October 23, 2006, the Foundation for Seacoast Health filed a lawsuit against us and one of our affiliates, HCA Health Services of New Hampshire, Inc., in the Superior Court of Rockingham County, New Hampshire. Among other things, the complaint seeks to enforce certain provisions of an asset purchase agreement between the parties, including a purported right of first refusal to purchase a New Hampshire hospital, that allegedly were triggered by the Merger and other prior events. The Foundation initially sought to enjoin the Merger. However, the parties reached an agreement that allowed the Merger to proceed, while preserving the plaintiff's opportunity to litigate whether the Merger triggered the right of first refusal to purchase the hospital and, if so, at what price the hospital could be repurchased. On May 25, 2007, the court granted HCA's motion for summary judgment disposing of the Foundation's central claims. The Foundation has filed an appeal from the final judgment.

## **General Liability and Other Claims**

On April 10, 2006, a class action complaint was filed against us in the District Court of Kansas alleging, among other matters, nurse understaffing at all of our hospitals, certain consumer protection act violations, negligence and unjust enrichment. The complaint is seeking, among other relief, declaratory relief and monetary damages, including disgorgement of profits of \$12.250 billion. A motion to dismiss this action was granted on July 27, 2006,

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but the plaintiffs have appealed this dismissal. We believe this lawsuit is without merit and plan to defend it vigorously.

We are a party to certain proceedings relating to claims for income taxes and related interest in the United States Tax Court and the United States Court of Federal Claims. For a description of those proceedings, see Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations Pending IRS Disputes and Note 3 to our condensed consolidated financial statements.

We are also subject to claims and suits arising in the ordinary course of business, including claims for personal injuries or for wrongful restriction of, or interference with, physicians' staff privileges. In certain of these actions the claimants have asked for punitive damages against us, which may not be covered by insurance. In the opinion of management, the ultimate resolution of these pending claims and legal proceedings will not have a material, adverse effect on our results of operations or financial position.

### **Item 1A: Risk Factors**

Reference is made to the factors set forth under the caption Forward-Looking Statements in Part I, Item 2 of this Form 10-Q and other risk factors described in our Annual Report on Form 10-K, which are incorporated herein by reference. There have not been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K other than as set forth below.

#### *Changes In Governmental Interpretations May Negatively Impact Our Ability To Obtain Reimbursement Of Medicare Bad Debts.*

The Medicare program will reimburse 70% of bad debts related to deductibles and coinsurance for patients with Medicare coverage, after the provider has made a reasonable effort to collect these amounts. On March 30, 2006, the United States District Court for the Western District of Michigan entered a final order in Battle Creek Health System v. Thompson, which provided that reasonable collection efforts have not been satisfied as long as the Medicare accounts remained with an external collection agency. The case was appealed to the United States Court of Appeals for the Sixth Circuit. A decision adverse to Battle Creek was issued on August 14, 2007. We utilize extensive in-house and external collection efforts for our accounts receivable, including deductible and coinsurance amounts owed by patients with Medicare coverage. We utilize a secondary collection agency after in-house and primary collection agency efforts have been unsuccessful. We have modified our accounts receivable collection processes to provide us with reasonable collection results and comply with CMS's interpretation of reasonable collection efforts. Possible future changes in judicial and administrative interpretations of laws and regulations governing Medicare could disrupt our collections processes, increase our costs or otherwise adversely affect our business and results of operations.

#### *Changes In Governmental Programs May Reduce Our Revenues.*

A significant portion of our patient volumes is derived from government health care programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. We derived approximately 58% of our admissions from the Medicare and Medicaid programs in 2006. In recent years, legislative and regulatory changes have resulted in limitations on and, in some cases, reductions in levels of payments to health care providers for certain services under these government programs. Possible future changes in the Medicare, Medicaid, and other state programs, including Medicaid supplement payments pursuant to UPL programs, may impact reimbursements to health care providers and insurers. Such changes may also increase our operating costs, which could reduce our profitability.

Effective January 1, 2007, as a result of the federal Deficit Reduction Act of 2005 ( DRA 2005 ), reimbursements for ambulatory surgery center ( ASC ) overhead costs are limited to no more than the overhead costs paid to hospital outpatient departments under the Medicare hospital outpatient prospective payment system for the same procedure. On August 2, 2007, CMS issued final regulations that change payment for procedures performed in an ASC, effective January 1, 2008. Under this rule, ASC payment groups will increase from the current nine clinically disparate payment groups to the 221 Ambulatory Procedure Classification groups ( APCs ) used under the outpatient prospective payment system for these surgical services. CMS estimates that the rates for procedures performed in an ASC setting will equal 65% of the corresponding rates paid for the same procedures performed in an outpatient hospital setting. Moreover, if CMS determines that a procedure is commonly performed in a

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physician's office, the ASC reimbursement for that procedure will be limited to the reimbursement allowable under the Medicare Part B Physician Fee Schedule. In addition, all surgical procedures, other than those that pose a significant safety risk or generally require an overnight stay, will be payable as ASC procedures. This will expand the number of procedures that Medicare will pay for if performed in an ASC. Because the new payment system will have a significant impact on payments for certain procedures, the final rule establishes a four-year transition period for implementing the revised payment rates. More Medicare procedures that are now performed in hospitals, such as ours, may be moved to ASCs reducing surgical volume in our hospitals. Also, more Medicare procedures that are now performed in ASCs, such as ours, may be moved to physicians' offices. Commercial third-party payers may adopt similar policies.

On August 1, 2007, CMS announced a final rule for federal fiscal year 2008 for the hospital inpatient prospective payment system. This rule adopts a two-year implementation of Medicare Severity Diagnosis-Related Groups (MS-DRGs), a severity-adjusted diagnosis-related group system. This change represents a refinement to the existing diagnosis-related group (DRG) system, making its impact on revenue difficult to predict. Realignment in the DRG system could impact the margins we receive for certain services. This rule provides for a 3.3% market basket update for hospitals that submit certain quality patient care indicators and a 1.3% update for hospitals that do not submit this data. While we will endeavor to comply with all data submission requirements, our submissions may not be deemed timely or sufficient to entitle us to the full market basket adjustment for all of our hospitals. Medicare payments to hospitals in federal fiscal year 2008 will be reduced by 0.6% to eliminate what CMS estimates will be the effect of coding or classification changes as a result of hospitals implementing the MS-DRG system. This documentation and coding adjustment will increase to 0.9% for federal fiscal year 2009. For federal fiscal year 2010 and subsequent years, in the process of rate setting, CMS will be able to evaluate actual claims data from experience with the MS-DRG system. This evaluation of changes in case-mix based on actual claims data may yield a higher documentation and coding adjustment thereby potentially reducing our revenues and impacting our results of operations in ways that cannot be quantified at this time. Additionally, Medicare payments to hospitals are subject to a number of other adjustments, and the actual impact on payments to specific hospitals may vary. In some cases, commercial third-party payers rely on all or portions of the Medicare DRG system to determine payment rates. The change from traditional Medicare DRGs to MS-DRGs could adversely impact those rates if commercial third-party payers adopt MS-DRGs.

Hospital operating margins have been, and may continue to be, under pressure because of deterioration in pricing flexibility and payer mix, and growth in operating expenses in excess of the increase in prospective payment system payments under the Medicare program.

Since states must operate with balanced budgets and since the Medicaid program is often the state's largest program, states can be expected to adopt or consider adopting legislation designed to reduce their Medicaid expenditures. DRA 2005 includes Medicaid cuts of approximately \$4.8 billion over five years. On May 29, 2007, CMS published a final rule entitled "Medicaid Program; Cost Limit for Providers Operated by Units of Government and Provisions to Ensure the Integrity of Federal-State Financial Partnership." A moratorium was placed on this rule, delaying its implementation until 2008. However, when the moratorium expires next year, this final rule could significantly impact state Medicaid programs. In its proposed form, this rule was expected to reduce federal Medicaid funding by \$12.2 billion over five years. As a result of the moratorium on implementing the final rule, the impact of the final rule has not been quantified. States have also adopted, or are considering, legislation designed to reduce coverage and program eligibility, enroll Medicaid recipients in managed care programs and/or impose additional taxes on hospitals to help finance or expand the states' Medicaid systems. Future legislation or other changes in the administration or interpretation of government health programs could have a material, adverse effect on our financial position and results of operations.

*We May Be Subject To Liabilities From Claims By The IRS.*

We are currently contesting certain claimed deficiencies and adjustments proposed by the Internal Revenue Service (the IRS) in connection with its examinations of prior year federal income tax returns for HCA and certain affiliates that are treated as partnerships for federal income tax purposes (affiliated partnerships). The disputed items include the deductibility of a portion of the 2001 and 2003 government settlement payments, the timing of recognition of certain patient service revenues in 2001 through 2004, the method for calculating the tax allowance for doubtful accounts in 2002 through 2004, and the amount of insurance expense deducted in 2001 and 2002. See

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Management's Discussion and Analysis of Financial Condition and Results of Operations Pending IRS Disputes.

Through September 30, 2007, the IRS is seeking an additional \$1.4 billion in federal income taxes, interest and penalties with respect to these issues. These amounts are net of a refundable deposit of \$215 million that we made in 2006. The IRS has not determined the final amount of additional income tax, interest and penalties that it may claim upon completion of current or future examinations.

We believe that HCA and the affiliated partnerships properly reported taxable income in accordance with applicable laws and agreements established with the IRS and that adequate provisions have been recorded to satisfy final resolution of the disputed issues. However, if payments due upon final resolution of these issues exceed our recorded estimates, such resolutions could have a material, adverse effect on our results of operations or financial position.

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

During the quarter ended September 30, 2007, HCA issued 14,862 shares of common stock in connection with the exercise of stock options for aggregate consideration of \$189,491. The shares were issued without registration in reliance on the exemptions afforded by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act") and Rule 701 promulgated thereunder.

HCA recently completed exchange offers pursuant to a registration statement on Form S-4; as disclosed in the prospectus relating thereto, we did not receive any cash proceeds from the exchange offers.

**Item 6: *Exhibits***

(a) List of Exhibits:

|              |   |
|--------------|---|
| Exhibit 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                 |
| Exhibit 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                 |
| Exhibit 32   | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |

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**SIGNATURES**

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

HCA INC.

By: /s/ R. Milton Johnson  
R. Milton Johnson  
*Executive Vice President and  
Chief Financial Officer*

Date: November 8, 2007