HCA INC/TN
Form 10-Q
August 14, 2009

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

or

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

For the transition period from to

Commission file number 1-11239

HCA Inc.
(Exact name of registrant as specified in its charter)

Delaware	**75-2497104**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
One Park Plaza Nashville, Tennessee	**37203**
(Address of principal executive offices)	*(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 þ No o

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

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ (Do not check if a smaller reporting company) Smaller reporting company o

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

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

Class of Common Stock	**Outstanding at July 31, 2009**
Voting common stock, $.01 par value	94,410,100 shares

HCA INC.

Form 10-Q
June 30, 2009

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HCA INC.
CONDENSED CONSOLIDATED INCOME STATEMENTS
FOR THE QUARTERS AND SIX MONTHS ENDED JUNE 30, 2009 AND 2008
Unaudited
(Dollars in millions)

	Quarter		Six Months	
	2009	**2008**	**2009**	**2008**
Revenues	**$ 7,483**	$ 6,980	**$ 14,914**	$ 14,107
Salaries and benefits	**2,944**	2,841	**5,867**	5,680
Supplies	**1,211**	1,149	**2,421**	2,322
Other operating expenses	**1,124**	1,135	**2,226**	2,249
Provision for doubtful accounts	**866**	813	**1,673**	1,701
Equity in earnings of affiliates	**(61)**	(62)	**(129)**	(129)
Depreciation and amortization	**360**	355	**713**	712
Interest expense	**506**	494	**977**	1,024
Losses (gains) on sales of facilities	**3**	11	**8**	(40)
Impairment of long-lived assets	**4**	9	**13**	9
	6,957	6,745	**13,769**	13,528
Income before income taxes	**526**	235	**1,145**	579
Provision for income taxes	**161**	38	**348**	157
Net income	**365**	197	**797**	422
Net income attributable to noncontrolling interests	**83**	56	**155**	111
Net income attributable to HCA Inc.	**$ 282**	$ 141	**$ 642**	$ 311

See accompanying notes.

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

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 450**	$ 465
Accounts receivable, less allowance for doubtful accounts of $5,764 and $5,435	**3,680**	3,780
Inventories	**730**	737
Deferred income taxes	**1,032**	914
Other	**556**	405
	6,448	6,301
Property and equipment, at cost	**24,185**	23,714
Accumulated depreciation	**(12,752)**	(12,185)
	11,433	11,529
Investments of insurance subsidiary	**1,322**	1,422
Investments in and advances to affiliates	**854**	842
Goodwill	**2,594**	2,580
Deferred loan costs	**444**	458
Other	**1,146**	1,148
	$ 24,241	$ 24,280
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	**$ 1,206**	$ 1,370
Accrued salaries	**876**	854
Other accrued expenses	**1,119**	1,282
Long-term debt due within one year	**194**	404
	3,395	3,910
Long-term debt	**26,351**	26,585
Professional liability risks	**1,108**	1,108
Income taxes and other liabilities	**1,713**	1,782
Equity securities with contingent redemption rights	**155**	155
Stockholders deficit:		

Common stock $.01 par; authorized 125,000,000 shares; outstanding 94,409,800 shares in 2009 and 94,367,500 shares in 2008	**1**	1
Capital in excess of par value	**186**	165
Accumulated other comprehensive loss	**(498)**	(604)
Retained deficit	**(9,175)**	(9,817)
Stockholders deficit attributable to HCA Inc.	**(9,486)**	(10,255)
Noncontrolling interests	**1,005**	995
	(8,481)	(9,260)
	$ 24,241	$ 24,280

See accompanying notes.

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HCA INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008
Unaudited
(Dollars in millions)

	2009	2008
Cash flows from operating activities:		
Net income	**$ 797**	$ 422
Adjustments to reconcile net income to net cash provided by operating activities:		
Changes in operating assets and liabilities	**(1,654)**	(1,994)
Provision for doubtful accounts	**1,673**	1,701
Depreciation and amortization	**713**	712
Income taxes	**(417)**	(376)
Losses (gains) on sales of facilities	**8**	(40)
Impairment of long-lived assets	**13**	9
Amortization of deferred loan costs	**60**	43
Pay-in-kind interest	**58**	
Share-based compensation	**14**	19
Other	**9**	24
Net cash provided by operating activities	**1,274**	520
Cash flows from investing activities:		
Purchase of property and equipment	**(619)**	(717)
Acquisition of hospitals and health care entities	**(41)**	(44)
Disposition of hospitals and health care entities	**29**	110
Change in investments	**71**	(11)
Other	**11**	13
Net cash used in investing activities	**(549)**	(649)
Cash flows from financing activities:		
Issuance of long-term debt	**1,751**	4
Net change in revolving bank credit facility	**(505)**	900
Repayment of long-term debt	**(1,782)**	(703)
Distributions to noncontrolling interests	**(159)**	(83)
Payment of debt issuance costs	**(45)**	
Other		(14)
Net cash (used in) provided by financing activities	**(740)**	104
Change in cash and cash equivalents	**(15)**	(25)
Cash and cash equivalents at beginning of period	**465**	393
Cash and cash equivalents at end of period	**$ 450**	$ 368

Interest payments	**$ 822**	$ 1,007
Income tax payments, net	**$ 765**	$ 533

See accompanying notes.

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. completed its merger (the Merger) with Hercules Acquisition Corporation, pursuant to which the Company was acquired by Hercules Holding II, LLC (Hercules Holding), a Delaware limited liability company owned by a private investor group comprised of affiliates of Bain Capital Partners (Bain), Kohlberg Kravis Roberts & Co. (KKR), Merrill Lynch Global Private Equity (MLGPE) (each a Sponsor) and of Citigroup Inc. and Bank of America Corporation (the Sponsor Assignees), by affiliates of HCA founder, Dr. Thomas F. Frist Jr., (the Frist Entities, and together with the Sponsors and the Sponsor Assignees, 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. On April 29, 2008, we registered our common stock pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended, thus subjecting us to the reporting requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended. Our common stock is not traded on a national securities exchange.

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 June 30, 2009, these affiliates owned and operated 155 hospitals, 97 freestanding surgery centers and facilities which provided extensive outpatient and ancillary services. Affiliates of HCA are also partners in joint ventures that own and operate eight hospitals and eight 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 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. In accordance with Statement of Financial Accounting Standards (SFAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements-an Amendment of ARB No. 51 (SFAS 160), references in this report to our net income attributable to HCA Inc. and stockholders deficit attributable to HCA Inc. do not include noncontrolling interests (previously known as minority interests), which we now report separately. The implementation of SFAS 160 also results in the cash flow impact of distributions to and certain other transactions with noncontrolling interests that were previously classified within operating activities being classified within financing activities. Such treatment is consistent with the view that under SFAS 160 transactions between HCA Inc. and noncontrolling interests are considered to be equity transactions. The presentation and disclosure provisions of SFAS 160 have been applied retrospectively for all periods presented.

We adopted the provisions of SFAS No. 165, Subsequent Events (SFAS 165), during the period ended June 30, 2009. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. We evaluated all events or transactions that occurred after June 30, 2009, through August 14, 2009, the date we issued these financial statements. During this period we did not have any material recognizable subsequent events that required recognition or disclosure in the June 30, 2009 financial statements.

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1 INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Basis of Presentation (continued)

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 $40 million and $43 million for the quarters ended June 30, 2009 and 2008, respectively, and $77 million and $83 million for the six months ended June 30, 2009 and 2008, respectively. Operating results for the quarter and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. 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, 2008.

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

NOTE 2 INCOME TAXES

At June 30, 2009, we were contesting before the Appeals Division of the Internal Revenue Service (IRS), certain claimed deficiencies and adjustments proposed by the IRS in connection with its examination of the 2003 and 2004 federal income tax returns for HCA and 11 affiliates that are treated as partnerships for federal income tax purposes (affiliated partnerships). The disputed items include the timing of recognition of certain patient service revenues and our method for calculating the tax allowance for doubtful accounts.

Eight taxable periods of HCA and its predecessors ended in 1995 through 2002 and the 2002 taxable year for seven affiliated partnerships, for which the primary remaining issue is the computation of the tax allowance for doubtful accounts, are pending before the IRS Examination Division or the United States Tax Court as of June 30, 2009. The IRS began an audit of the 2005 and 2006 federal income tax returns for HCA and seven affiliated partnerships during 2008.

Our liability for unrecognized tax benefits was $613 million, including accrued interest of $153 million, as of June 30, 2009 ($625 million and $156 million, respectively, as of December 31, 2008). Unrecognized tax benefits of $250 million ($264 million as of December 31, 2008) would affect the effective rate, if recognized. The liability for unrecognized tax benefits does not reflect deferred tax assets of $76 million ($81 million as of December 31, 2008) related to deductible interest and state income taxes or the balance of a refundable deposit of $104 million we made in 2006, which is recorded in noncurrent assets. The provision for income taxes reflects $14 million and $6 million reductions in interest expense related to taxing authority examinations for the quarters ended June 30, 2009 and 2008, respectively. The provision for income taxes reflects a $34 million reduction in interest expense and interest expense of $6 million related to taxing authority examinations for the six months ended June 30, 2009 and 2008, respectively.

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 our liability for unrecognized tax benefits may significantly increase or decrease within the next 12 months. However, we are currently unable to estimate the range of any possible change.

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 INVESTMENTS OF INSURANCE SUBSIDIARY

A summary of our insurance subsidiary s investments at June 30, 2009 and December 31, 2008 follows (dollars in millions):

	June 30, 2009			
	Amortized Cost	Unrealized Amounts Gains	Unrealized Amounts Losses	Fair Value
Debt securities:				
States and municipalities	$ 754	$ 22	$ (10)	$ 766
Auction rate securities	503		(31)	472
Asset-backed securities	47		(3)	44
Money market funds	214			214
	1,518	22	(44)	1,496
Equity securities:				
Preferred stocks	5		(2)	3
Common stocks	3			3
	8		(2)	6
	$ 1,526	$ 22	$ (46)	1,502
Amount classified as current assets				(180)
Investment carrying value				$ 1,322

	December 31, 2008			
	Amortized Cost	Unrealized Amounts Gains	Unrealized Amounts Losses	Fair Value
Debt securities:				
States and municipalities	$ 808	$ 20	$ (23)	$ 805
Auction rate securities	576		(40)	536
Asset-backed securities	51	1	(5)	47
Money market funds	226			226

	1,661	21	(68)	1,614
Equity securities:				
Preferred stocks	6		(1)	5
Common stocks	3			3
	9		(1)	8
	$ 1,670	$ 21	$ (69)	1,622
Amount classified as current assets				(200)
Investment carrying value				$ 1,422

At June 30, 2009 and December 31, 2008, the investments of our insurance subsidiary were classified as available-for-sale. Changes in temporary unrealized gains and losses are recorded as adjustments to other comprehensive income. At June 30, 2009 and December 31, 2008, $99 million and $119 million, respectively, of our investments were subject to restrictions included in insurance bond collateralization and assumed reinsurance contracts.

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 3 INVESTMENTS OF INSURANCE SUBSIDIARY (continued)

Scheduled maturities of investments in debt securities at June 30, 2009 were as follows (dollars in millions):

	Amortized Cost	Fair Value
Due in one year or less	$ 295	$ 296
Due after one year through five years	295	305
Due after five years through ten years	229	235
Due after ten years	149	144
	968	980
Auction rate securities	503	472
Asset-backed securities	47	44
	$ 1,518	$ 1,496

The average expected maturity of the investments in debt securities at June 30, 2009 was 3.8 years, compared to the average scheduled maturity of 12.2 years. Expected and scheduled maturities may differ because the issuers of certain securities have the right to call, prepay or otherwise redeem such obligations prior to the scheduled maturity date. The average expected maturity for our auction rate and asset-backed securities were derived from valuation models of expected cash flows and involved management s judgment. The average expected maturities for our auction rate and asset-backed securities at June 30, 2009 were 5.6 years and 6.4 years, respectively, compared to average scheduled maturities of 25.0 years and 25.7 years, respectively.

NOTE 4 LONG-TERM DEBT

A summary of long-term debt at June 30, 2009 and December 31, 2008, including related interest rates at June 30, 2009, follows (dollars in millions):

	June 30, 2009	December 31, 2008
Senior secured asset-based revolving credit facility (effective interest rate of 1.8%)	**$ 1,545**	$ 2,000
Senior secured revolving credit facility		50
Senior secured term loan facilities (effective interest rate of 6.3%)	**10,254**	12,002
Senior secured first lien notes (effective interest rate of 9.3%)	**1,452**	
Other senior secured debt (effective interest rate of 6.9%)	**366**	406
First lien debt	**13,617**	14,458

Senior secured cash-pay notes (effective interest rate of 9.7%)	**4,500**		4,200
Senior secured toggle notes (effective interest rate of 10.0%)	**1,578**		1,500
Second lien debt	**6,078**		5,700
Senior unsecured notes payable through 2095 (effective interest rate of 7.2%)	**6,850**		6,831
Total debt (average life of six years, rates averaging 7.2%)	**26,545**		26,989
Less amounts due within one year	**194**		404
	$ 26,351	$	26,585

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 4 LONG-TERM DEBT (continued)

During February 2009, we issued $310 million aggregate principal amount of 97/8% senior secured second lien notes due 2017 at a price of 96.673% of their face value, resulting in $300 million of gross proceeds. After the payment of related fees and expenses, we used the proceeds to repay outstanding indebtedness under our senior secured term loan facilities.

During April 2009, we issued $1.500 billion aggregate principal amount of 81/2% senior secured first lien notes due 2019 at a price of 96.755% of their face value, resulting in $1.451 billion of gross proceeds. After the payment of related fees and expenses, we used the proceeds to repay outstanding indebtedness under our senior secured term loan facilities.

During August 2009, we issued $1.250 billion aggregate principal amount of 77/8% senior secured first lien notes due 2020 at a price of 98.254% of their face value, resulting in $1.228 billion of gross proceeds. After the payment of related fees and expenses, we used the proceeds to repay outstanding indebtedness under our senior secured term loan facilities.

NOTE 5 FINANCIAL INSTRUMENTS

Interest Rate Swap Agreements

We have entered into interest rate swap agreements to manage our exposure to fluctuations in interest rates. These swap agreements involve the exchange of fixed and variable rate interest payments between two parties based on common notional principal amounts and maturity dates. Pay-fixed interest rate swaps effectively convert LIBOR indexed variable rate instruments to fixed interest rate obligations. The net interest payments, based on the notional amounts in these agreements, generally match the timing of the related liabilities. The notional amounts of the swap agreements represent amounts 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.

The following table sets forth our interest rate swap agreements, which have been designated as cash flow hedges, at June 30, 2009 (dollars in millions):

	Notional Amount	Termination Date	Fair Value
Pay-fixed interest rate swap	$ 4,000	November 2011	$ (290)
Pay-fixed interest rate swap	4,000	November 2011	(274)
Pay-fixed interest rate swap	500	March 2011	(14)
Pay-fixed interest rate swap	500	March 2011	(13)

During the next 12 months, we estimate $347 million will be reclassified from other comprehensive income (OCI) to interest expense.

Cross Currency Swaps

The Company and certain subsidiaries have incurred obligations and entered into various intercompany transactions where such obligations are denominated in currencies (Great Britain Pound and Euro), other than the functional currencies (United States Dollar and Great Britain Pound) of the parties executing the trade. In order to mitigate the currency exposure risks and better match the cash flows of our obligations and intercompany transactions with cash flows from operations, we entered into various cross currency swaps. Our credit risk related to these agreements is considered low because the swap agreements are with creditworthy financial institutions.

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5 FINANCIAL INSTRUMENTS (continued)

Cross Currency Swaps (continued)

Certain of our cross currency swaps were not designated as hedges, and changes in fair value are recognized in results of operations. The following table sets forth these cross currency swap agreements at June 30, 2009 (amounts in millions):

	Notional Amount	Termination Date	Fair Value
Euro United States Dollar currency swap	471 Euro	December 2011	$ 66
Euro Great Britain Pound (GBP) currency swap	30 Euro	December 2011	14

The following table sets forth our cross currency swap agreements, which have been designated as cash flow hedges, at June 30, 2009 (amounts in millions):

	Notional Amount	Termination Date	Fair Value
GBP United States Dollar currency swap	50 GBP	November 2010	$ (4)
GBP United States Dollar currency swap	50 GBP	November 2010	(5)

During the next 12 months, we estimate $3 million will be reclassified from OCI to interest expense.

Derivatives Results of Operations

The following tables present the effect on our results of operations of our interest rate and cross currency swaps for the six months ended June 30, 2009 (dollars in millions):

Derivatives in Cash Flow Hedging Relationships	Amount of Loss (Gain) Recognized in OCI on Derivatives, Net of Tax	Location of Loss Reclassified from Accumulated OCI into Operations	Amount of Loss Reclassified from Accumulated OCI into Operations
Interest rate swaps	$ 53	Interest expense	$ 150

Cross currency swaps	(11)	Interest expense	
	$ 42		$ 150

Derivatives Not Designated as Hedging Instruments	**Location of Loss Recognized in Operations on Derivatives**	**Amount of Loss Recognized in Operations on Derivatives**
Cross currency swaps	Other operating expense	$ 19

Credit-risk-related Contingent Features

We have agreements with each of our derivative counterparties that contain a provision where we could be declared in default on our derivative obligations if repayment of the underlying indebtedness is accelerated by the lender due to our default on the indebtedness. As of June 30, 2009, we have not been required to post any collateral related to these agreements. If we had breached these provisions at June 30, 2009, we would have been required to settle our obligations under the agreements at their aggregate, estimated termination value of $568 million.

NOTE 6 ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

On January 1, 2008, we adopted SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements.

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (continued)

SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, SFAS 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity s own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Cash Traded Investments

Our cash traded investments are generally classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. Certain types of cash traded instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. Such instruments include auction rate securities (ARS) and limited partnership investments. The transaction price is initially used as the best estimate of fair value.

Our wholly-owned insurance subsidiary had investments in municipal, tax-exempt ARS, that are backed by student loans substantially guaranteed by the federal government, of $472 million ($502 million par value) at June 30, 2009. We do not currently intend to attempt to sell the ARS as the liquidity needs of our insurance subsidiary are expected to be met by other investments in its investment portfolio. These securities continue to accrue and pay interest semi-annually based on the failed auction maximum rate formulas stated in their respective Official Statements. During 2008 and the first six months of 2009, certain issuers of our ARS redeemed $93 million and $71 million, respectively, of our securities at par value. The valuation of these securities involved management s judgment, after consideration of market factors and the absence of market transparency, market liquidity and observable inputs. Our valuation models derived a fair market value compared to tax-equivalent yields of other student loan backed variable rate securities of similar credit worthiness.

Derivative Financial Instruments

We have entered into interest rate and cross currency swap agreements to manage our exposure to fluctuations in interest rates and foreign currency risks. The valuation of these instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves, foreign exchange rates and implied volatilities. To comply with the provisions of SFAS 157, we incorporate credit valuation adjustments to reflect both our own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements.

Although we have determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize Level 3 inputs, such

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 6 ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (continued)

Derivative Financial Instruments (continued)

as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties. We have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and have determined that the credit valuation adjustments are significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified in Level 3 of the fair value hierarchy at June 30, 2009.

The following table summarizes our assets and liabilities measured at fair value on a recurring basis as of June 30, 2009, aggregated by the level in the fair value hierarchy within which those measurements fall (dollars in millions):

		Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Investments of insurance subsidiary	$ 1,502	$ 215	$ 813	$ 474
Less amounts classified as current assets	(180)	(180)		
	1,322	35	813	474
Cross currency swaps (Other assets)	80			80
Liabilities:				
Interest rate swaps (Income taxes and other liabilities)	591			591
Cross currency swaps (Income taxes and other liabilities)	9			9

The following table summarizes the activity related to the investments of our insurance subsidiary and our cross currency and interest rate swaps which have fair value measurements based on significant unobservable inputs (Level 3) during the six months ended June 30, 2009 (dollars in millions):

	Investments	Interest

	of Insurance Subsidiary		Cross Currency Swaps	Rate Swaps
Asset (liability) balances at December 31, 2008	$ 538	$ 97	$ (26)	$ (657)
Realized gains and losses included in earnings		(19)		150
Unrealized gains (losses) included in other comprehensive income	9	2	17	(84)
Purchases, issuances and settlements	(73)			
Asset (liability) balances at June 30, 2009	$ 474	$ 80	$ (9)	$ (591)

The estimated fair value of our long-term debt was $24.124 billion and $20.225 billion at June 30, 2009 and December 31, 2008, respectively, compared to carrying amounts aggregating $26.545 billion and $26.989 billion, respectively. The estimates of fair value are generally based upon the quoted market prices or quoted market prices for similar issues of long-term debt with the same maturities.

NOTE 7 CONTINGENCIES

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

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 7 CONTINGENCIES (continued)

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.

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 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.

NOTE 8 COMPREHENSIVE INCOME AND CAPITAL STRUCTURE

The components of comprehensive income, net of related taxes, for the quarters and six months ended June 30, 2009 and 2008 are only attributable to HCA Inc. and are as follows (dollars in millions):

	Quarter		Six Months	
	2009	**2008**	**2009**	**2008**
Net income attributable to HCA Inc.	**$ 282**	$ 141	**$ 642**	$ 311
Change in fair value of derivative instruments	**62**	195	**54**	28
Change in fair value of available-for-sale securities	**11**	(8)	**15**	(11)
Foreign currency translation adjustments	**34**		**32**	
Defined benefit plans	**3**	(2)	**5**	(1)
Comprehensive income	**$ 392**	$ 326	**$ 748**	$ 327

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

	June 30, 2009	December 31, 2008
Change in fair value of derivative instruments	**$ (386)**	$ (440)
Change in fair value of available-for-sale securities	**(15)**	(30)
Foreign currency translation adjustments	**4**	(28)
Defined benefit plans	**(101)**	(106)
Accumulated other comprehensive loss	**$ (498)**	$ (604)

The changes in stockholders deficit, including changes in stockholders deficit attributable to HCA Inc. and changes in equity attributable to noncontrolling interests are as follows (dollars in millions):

	Equity Attributable to HCA Inc.						
	Common Stock		Capital in Excess of Par Value	Accumulated Other Comprehensive Loss	Retained Deficit	Equity Attributable to Noncontrolling Interests	Total
	Shares (000)	Par Value					
Balances, December 31, 2008	94,367	$ 1	$ 165	$ (604)	$ (9,817)	$ 995	$ (9,260)
Net income					642	155	797
Other comprehensive income				106			106
Distributions						(159)	(159)
Share-based benefit plans	43		14				14
Other			7			14	21
Balances, June 30, 2009	94,410	$ 1	$ 186	$ (498)	$ (9,175)	$ 1,005	$ (8,481)

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 SEGMENT AND GEOGRAPHIC INFORMATION

We operate in one line of business, which is operating hospitals and related health care entities. During the quarters ended June 30, 2009 and 2008, approximately 23% of our patient revenues related to patients participating in the fee-for-service Medicare program. During the six months ended June 30, 2009 and 2008, approximately 24% of our patient revenues related to patients participating in the fee-for-service Medicare program.

Our operations are structured into three geographically organized groups: the Eastern Group includes 48 consolidating hospitals located in the Eastern United States, the Central Group includes 47 consolidating hospitals 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, losses (gains) on sales of facilities, impairment of long-lived assets, income taxes and noncontrolling interests. 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 are summarized in the following table (dollars in millions):

	Quarter		Six Months	
	2009	2008	**2009**	2008
Revenues:				
Central Group	**$ 1,805**	$ 1,652	**$ 3,608**	$ 3,344
Eastern Group	**2,181**	2,103	**4,456**	4,323
Western Group	**3,278**	2,964	**6,429**	5,939
Corporate and other	**219**	261	**421**	501
	$ 7,483	$ 6,980	**$ 14,914**	$ 14,107
Equity in earnings of affiliates:				
Central Group	**$ (1)**	$	**$ (2)**	$ (1)
Eastern Group	**(1)**		**(1)**	(1)
Western Group	**(59)**	(60)	**(126)**	(126)
Corporate and other		(2)		(1)

	$ (61)	$ (62)	**$ (129)**	$ (129)
Adjusted segment EBITDA:				
Central Group	**$ 344**	$ 255	**$ 695**	$ 551
Eastern Group	**340**	300	**773**	654
Western Group	**712**	550	**1,445**	1,120
Corporate and other	**3**	(1)	**(57)**	(41)
	$ 1,399	$ 1,104	**$ 2,856**	$ 2,284

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 SEGMENT AND GEOGRAPHIC INFORMATION (continued)

	Quarter		Six Months	
	2009	**2008**	**2009**	**2008**
Depreciation and amortization:				
Central Group	**$ 88**	$ 91	**$ 176**	$ 182
Eastern Group	**93**	90	**183**	180
Western Group	**146**	138	**290**	276
Corporate and other	**33**	36	**64**	74
	$ 360	$ 355	**$ 713**	$ 712
Adjusted segment EBITDA	**$ 1,399**	$ 1,104	**$ 2,856**	$ 2,284
Depreciation and amortization	**360**	355	**713**	712
Interest expense	**506**	494	**977**	1,024
Losses (gains) on sales of facilities	**3**	11	**8**	(40)
Impairment of long-lived assets	**4**	9	**13**	9
Income before income taxes	**$ 526**	$ 235	**$ 1,145**	$ 579

NOTE 10 ACQUISITIONS, DISPOSITIONS AND IMPAIRMENT OF LONG-LIVED ASSETS

During the six months ended June 30, 2009, we paid $41 million to acquire other health care entities. During the six months ended June 30, 2008, we paid $18 million to acquire one hospital and $26 million to acquire other health care entities.

During the quarter ended June 30, 2009, we recognized a net pretax loss of $3 million related to sales of hospital facilities and other investments. During the six months ended June 30, 2009, we received proceeds of $29 million and recognized a net pretax loss of $8 million related to sales of hospital facilities and other investments. During the quarter ended June 30, 2008, we recognized a net loss of $11 million related to sales of real estate investments. During the six months ended June 30, 2008, we received proceeds of $110 million and recognized a net gain of $40 million, which includes a $43 million gain on the sale of a hospital facility and a $3 million net loss on sales of real estate and other health care entity investments.

During the quarter and six months ended June 30, 2009, we recorded charges of $4 million and $13 million, respectively, to adjust the values of certain real estate investments in our Central Group to estimated fair value. During the quarter and six months ended June 30, 2008, we recorded a charge of $9 million to adjust the value of certain hospital facilities in our Central Group to estimated fair value.

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Our 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 December 16, 1993 (except for certain special purpose subsidiaries that only guarantee and pledge their assets under our senior secured asset-based revolving credit facility).

Our summarized condensed consolidating balance sheets at June 30, 2009 and December 31, 2008 and condensed consolidating statements of income for the quarters and six months ended June 30, 2009 and 2008 and condensed consolidating statements of cash flows for the six months ended June 30, 2009 and 2008, segregating the parent company issuer, the subsidiary guarantors, the subsidiary non-guarantors and eliminations, follow:

HCA INC.
CONDENSED CONSOLIDATING INCOME STATEMENT
FOR THE QUARTER ENDED JUNE 30, 2009
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Revenues	$	$ 4,420	$ 3,063	$	$ 7,483
Salaries and benefits		1,760	1,184		2,944
Supplies		712	499		1,211
Other operating expenses	7	619	498		1,124
Provision for doubtful accounts		546	320		866
Equity in earnings of affiliates	(674)	(24)	(37)	674	(61)
Depreciation and amortization		200	160		360
Interest expense (income)	583	(70)	(7)		506
Losses (gains) on sales of facilities		5	(2)		3
Impairment of long-lived assets		4			4
Management fees		(115)	115		
	(84)	3,637	2,730	674	6,957
Income before income taxes	84	783	333	(674)	526
Provision for income taxes	(198)	273	86		161
Net income	282	510	247	(674)	365
Net income attributable to noncontrolling interests		12	71		83

Net income attributable to HCA Inc.	$	282	$	498	$	176	$	(674)	$	282

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING INCOME STATEMENT
FOR THE QUARTER ENDED JUNE 30, 2008
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Revenues	$	$ 4,038	$ 2,942	$	$ 6,980
Salaries and benefits		1,697	1,144		2,841
Supplies		663	486		1,149
Other operating expenses	(4)	622	517		1,135
Provision for doubtful accounts		500	313		813
Equity in earnings of affiliates	(463)	(23)	(39)	463	(62)
Depreciation and amortization		193	162		355
Interest expense (income)	525	(12)	(19)		494
Losses on sales of facilities		10	1		11
Impairment of long-lived assets			9		9
Management fees		(107)	107		
	58	3,543	2,681	463	6,745
Income (loss) before income taxes	(58)	495	261	(463)	235
Provision for income taxes	(199)	155	82		38
Net income	141	340	179	(463)	197
Net income attributable to noncontrolling interests		14	42		56
Net income attributable to HCA Inc.	$ 141	$ 326	$ 137	$ (463)	$ 141

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING INCOME STATEMENT
FOR THE SIX MONTHS ENDED JUNE 30, 2009
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Revenues	$	$ 8,813	$ 6,101	$	$ 14,914
Salaries and benefits		3,515	2,352		5,867
Supplies		1,433	988		2,421
Other operating expenses	12	1,236	978		2,226
Provision for doubtful accounts		1,054	619		1,673
Equity in earnings of affiliates	(1,379)	(48)	(81)	1,379	(129)
Depreciation and amortization		396	317		713
Interest expense (income)	1,125	(136)	(12)		977
Losses (gains) on sales of facilities		6	2		8
Impairment of long-lived assets		13			13
Management fees		(231)	231		
	(242)	7,238	5,394	1,379	13,769
Income before income taxes	242	1,575	707	(1,379)	1,145
Provision for income taxes	(400)	543	205		348
Net income	642	1,032	502	(1,379)	797
Net income attributable to noncontrolling interests		26	129		155
Net income attributable to HCA Inc.	$ 642	$ 1,006	$ 373	$ (1,379)	$ 642

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING INCOME STATEMENT
FOR THE SIX MONTHS ENDED JUNE 30, 2008
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Revenues	$	$ 8,197	$ 5,910	$	$ 14,107
Salaries and benefits		3,406	2,274		5,680
Supplies		1,342	980		2,322
Other operating expenses	2	1,211	1,036		2,249
Provision for doubtful accounts		1,056	645		1,701
Equity in earnings of affiliates	(988)	(49)	(80)	988	(129)
Depreciation and amortization		389	323		712
Interest expense (income)	1,083	(19)	(40)		1,024
Losses (gains) on sales of facilities		8	(48)		(40)
Impairment of long-lived assets			9		9
Management fees		(220)	220		
	97	7,124	5,319	988	13,528
Income (loss) before income taxes	(97)	1,073	591	(988)	579
Provision for income taxes	(408)	375	190		157
Net income	311	698	401	(988)	422
Net income attributable to noncontrolling interests		26	85		111
Net income attributable to HCA Inc.	$ 311	$ 672	$ 316	$ (988)	$ 311

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING BALANCE SHEET
JUNE 30, 2009
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 91	$ 359	$	$ 450
Accounts receivable, net		2,172	1,508		3,680
Inventories		442	288		730
Deferred income taxes	1,032				1,032
Other	40	171	345		556
	1,072	2,876	2,500		6,448
Property and equipment, net		7,035	4,398		11,433
Investments of insurance subsidiary			1,322		1,322
Investments in and advances to affiliates		243	611		854
Goodwill		1,659	935		2,594
Deferred loan costs	444				444
Investments in and advances to subsidiaries	20,669			(20,669)	
Other	1,012	19	115		1,146
	$ 23,197	$ 11,832	$ 9,881	$ (20,669)	$ 24,241
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY					
Current liabilities:					
Accounts payable	$	$ 747	$ 459	$	$ 1,206
Accrued salaries		566	310		876
Other accrued expenses	242	325	552		1,119
Long-term debt due within one year	168		26		194

	410	1,638	1,347		3,395
Long-term debt	25,880	95	376		26,351
Intercompany balances	5,055	(9,193)	4,138		
Professional liability risks			1,108		1,108
Income taxes and other liabilities	1,183	384	146		1,713
	32,528	(7,076)	7,115		32,567
Equity securities with contingent redemption rights	155				155
Stockholders (deficit) equity attributable to HCA Inc.	(9,486)	18,794	1,875	(20,669)	(9,486)
Noncontrolling interests		114	891		1,005
	(9,486)	18,908	2,766	(20,669)	(8,481)
	$ 23,197	$ 11,832	$ 9,881	$ (20,669)	$ 24,241

HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING BALANCE SHEET
DECEMBER 31, 2008
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 134	$ 331	$	$ 465
Accounts receivable, net		2,214	1,566		3,780
Inventories		455	282		737
Deferred income taxes	914				914
Other		140	265		405
	914	2,943	2,444		6,301
Property and equipment, net		7,122	4,407		11,529
Investments of insurance subsidiary			1,422		1,422
Investments in and advances to affiliates		243	599		842
Goodwill		1,643	937		2,580
Deferred loan costs	458				458
Investments in and advances to subsidiaries	19,290			(19,290)	
Other	1,050	31	67		1,148
	$ 21,712	$ 11,982	$ 9,876	$ (19,290)	$ 24,280
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY					
Current liabilities:					
Accounts payable	$	$ 881	$ 489	$	$ 1,370
Accrued salaries		549	305		854
Other accrued expenses	435	284	563		1,282
Long-term debt due within one year	355		49		404

	790	1,714	1,406		3,910
Long-term debt	26,089	99	397		26,585
Intercompany balances	3,663	(8,136)	4,473		
Professional liability risks			1,108		1,108
Income taxes and other liabilities	1,270	379	133		1,782
	31,812	(5,944)	7,517		33,385
Equity securities with contingent redemption rights	155				155
Stockholders (deficit) equity attributable to HCA Inc.	(10,255)	17,788	1,502	(19,290)	(10,255)
Noncontrolling interests		138	857		995
	(10,255)	17,926	2,359	(19,290)	(9,260)
	$ 21,712	$ 11,982	$ 9,876	$ (19,290)	$ 24,280

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2009
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Cash flows from operating activities:					
Net income	$ 642	$ 1,032	$ 502	$ (1,379)	$ 797
Adjustments to reconcile net income to net cash (used in) provided by operating activities:					
Increase (decrease) in cash from operating assets and liabilities	50	(1,057)	(647)		(1,654)
Provision for doubtful accounts		1,054	619		1,673
Depreciation and amortization		396	317		713
Income taxes	(417)				(417)
Losses on sales of facilities		6	2		8
Impairments of long-lived assets		13			13
Amortization of deferred loan costs	60				60
Pay-in-kind interest	58				58
Share-based compensation	14				14
Equity in earnings of affiliates	(1,379)			1,379	
Other	3	16	(10)		9
Net cash (used in) provided by operating activities	(969)	1,460	783		1,274
Cash flows from investing activities:					
Purchase of property and equipment		(344)	(275)		(619)
Acquisition of hospitals and health care entities		(38)	(3)		(41)
Disposition of hospitals and health care entities		18	11		29
Change in investments		(2)	73		71
Other		(17)	28		11
Net cash used in investing activities		(383)	(166)		(549)

Cash flows from financing activities:					
Issuance of long-term debt	1,751				1,751
Net change in revolving bank credit facility	(505)				(505)
Repayment of long-term debt	(1,739)	(6)	(37)		(1,782)
Distributions to noncontrolling interests		(50)	(109)		(159)
Changes in intercompany balances with affiliates, net	1,507	(1,064)	(443)		
Payment of debt issuance costs	(45)				(45)
Net cash provided by (used in) financing activities	969	(1,120)	(589)		(740)
Change in cash and cash equivalents		(43)	28		(15)
Cash and cash equivalents at beginning of period		134	331		465
Cash and cash equivalents at end of period	$	$ 91	$ 359	$	$ 450

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HCA INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION (continued)

HCA INC.
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2008
(Dollars in millions)

	Parent Issuer	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Condensed Consolidated
Cash flows from operating activities:					
Net income	$ 311	$ 698	$ 401	$ (988)	$ 422
Adjustments to reconcile net income to net cash (used in) provided by operating activities:					
Increase (decrease) in cash from operating assets and liabilities	(12)	(1,261)	(721)		(1,994)
Provision for doubtful accounts		1,056	645		1,701
Depreciation and amortization		389	323		712
Income taxes	(376)				(376)
Losses (gains) on sales of facilities		8	(48)		(40)
Impairment of long-lived assets			9		9
Amortization of deferred loan costs	43				43
Share-based compensation	19				19
Equity in earnings of affiliates	(988)			988	
Other	2	2	20		24
Net cash (used in) provided by operating activities	(1,001)	892	629		520
Cash flows from investing activities:					
Purchase of property and equipment		(359)	(358)		(717)
Acquisition of hospitals and health care entities		(18)	(26)		(44)
Disposition of hospitals and health care entities		19	91		110
Change in investments		(17)	6		(11)
Other			13		13
Net cash used in investing activities		(375)	(274)		(649)

Cash flows from financing activities:					
Issuance of long-term debt			4		4
Net change in revolving bank credit facility	900				900
Repayment of long-term debt	(636)	(2)	(65)		(703)
Distributions to noncontrolling interests		(11)	(72)		(83)
Changes in intercompany balances with affiliates, net	738	(561)	(177)		
Other	(1)		(13)		(14)
Net cash provided by (used in) financing activities	1,001	(574)	(323)		104
Change in cash and cash equivalents		(57)	32		(25)
Cash and cash equivalents at beginning of period		165	228		393
Cash and cash equivalents at end of period	$	$ 108	$ 260	$	$ 368

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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 includes certain 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, initiat These 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, that 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, (2) the impact of the substantial indebtedness incurred to finance the Recapitalization and the ability to refinance such indebtedness on acceptable terms, (3) the possible enactment of federal or state health care reform and changes in federal, state or local laws or regulations affecting the health care industry, (4) increases, particularly in the current economic downturn, in the amount and risk of collectibility of uninsured accounts and deductibles and copayment amounts for insured accounts, (5) the ability to achieve operating and financial targets, and attain expected levels of patient volumes and control the costs of providing services, (6) 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, (7) the highly competitive nature of the health care business, (8) changes in revenue mix, including potential declines in the population covered under managed care agreements due to the current economic downturn and the ability to enter into and renew managed care provider agreements on acceptable terms, (9) the efforts of insurers, health care providers and others to contain health care costs, (10) the outcome of our continuing efforts to monitor, maintain and comply with appropriate laws, regulations, policies and procedures, (11) increases in wages and the ability to attract and retain qualified management and personnel, including affiliated physicians, nurses and medical and technical support personnel, (12) the availability and terms of capital to fund the expansion of our business and improvements to our existing facilities, (13) changes in accounting practices, (14) changes in general economic conditions nationally and regionally in our markets, (15) future divestitures which may result in charges, (16) changes in business strategy or development plans, (17) delays in receiving payments for services provided, (18) the outcome of pending and any future tax audits, appeals and litigation associated with our tax positions, (19) potential liabilities and other claims that may be asserted against us, and (20) 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 of operations 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, which forward-looking statements reflect management s views only as of the date of this report. We undertake no obligation to revise or update any forward-looking statements, whether as a result of new information, future events or otherwise.

Second Quarter 2009 Operations Summary

Net income attributable to HCA Inc. totaled $282 million for the quarter ended June 30, 2009, compared to $141 million for the quarter ended June 30, 2008. Revenues increased to $7.483 billion in the second quarter of 2009 from $6.980 billion in the second quarter of 2008. Second quarter 2009 results include losses on sales of facilities of $3 million, compared to losses on sales of facilities of $11 million for the second quarter of 2008. Second quarter 2009 results also include an impairment of long-lived assets of $4 million, compared to an impairment of long-lived assets of $9 million for the second quarter of 2008.

Revenues increased 7.2% on a consolidated basis and 7.6% on a same facility basis for the quarter ended June 30, 2009 compared to the quarter ended June 30, 2008. The increase in consolidated revenues can be attributed to the combined impact of a 3.3% increase in revenue per equivalent admission and a 3.8% increase in equivalent admissions. The same facility revenues increase resulted from the combined impact of a 3.0% increase in same facility revenue per equivalent admission and a 4.4% increase in same facility equivalent admissions.

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

Second Quarter 2009 Operations Summary (continued)

During the quarter ended June 30, 2009, consolidated admissions increased 1.2% and same facility admissions increased 1.9% compared to the quarter ended June 30, 2008. Inpatient surgeries declined 0.5% on a consolidated basis and increased 0.5% on a same facility basis during the quarter ended June 30, 2009, compared to the quarter ended June 30, 2008. Outpatient surgeries declined 0.9% on a consolidated basis and declined 0.2% on a same facility basis during the quarter ended June 30, 2009 compared to the quarter ended June 30, 2008.

For the quarter ended June 30, 2009, the provision for doubtful accounts decreased to 11.6% of revenues from 11.7% of revenues for the quarter ended June 30, 2008. The combined self-pay revenue deductions for charity care and uninsured discounts increased $320 million during the second quarter of 2009, compared to the second quarter of 2008. Same facility uninsured admissions increased 10.4% and same facility uninsured emergency room visits increased 10.6% for the quarter ended June 30, 2009 compared to the quarter ended June 30, 2008.

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 that are similar to the discounts provided to many local managed care plans.

Revenues increased 7.2% from $6.980 billion in the second quarter of 2008 to $7.483 billion in the second quarter of 2009. The increase in consolidated revenues can be attributed to the combined impact of a 3.3% increase in revenue per equivalent admission and a 3.8% increase in equivalent admissions. Same facility revenues increased 7.6% from $6.818 billion in the second quarter of 2008 to $7.338 billion in the second quarter of 2009. The increase in same facility revenues can be attributed to the combined impact of a 3.0% increase in same facility revenue per equivalent admission and a 4.4% increase in same facility equivalent admissions.

Consolidated admissions increased 1.2% and same facility admissions increased 1.9% compared to the second quarter of 2008. Consolidated outpatient surgeries declined 0.9% and same facility outpatient surgeries declined 0.2% in the second quarter of 2009 compared to the second quarter of 2008. Consolidated inpatient surgeries declined 0.5% and same facility inpatient surgeries increased 0.5% in the second quarter of 2009 compared to the second quarter of 2008.

Same facility uninsured admissions increased by 2,365 admissions, or 10.4%, in the second quarter of 2009 compared to the second quarter of 2008. Same facility uninsured admissions declined by 0.1% in the first quarter of 2009 compared to the first quarter of 2008. The quarterly trend of same facility uninsured admissions growth during 2008, compared to 2007, was 5.3% during the first quarter, 1.0% during the second quarter, 0.9% during the third quarter and a decline of 0.4% during the fourth quarter.

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 admissions related to Medicare, managed Medicare, Medicaid, managed Medicaid, managed care and other insurers and the uninsured for the quarters and six months ended June 30, 2009 and 2008 are set forth in the following table.

	Quarter		Six Months	
	2009	**2008**	**2009**	**2008**
Medicare	**34%**	34%	**35%**	35%
Managed Medicare	**10**	9	**10**	9
Medicaid	**9**	8	**9**	8
Managed Medicaid	**7**	7	**7**	7
Managed care and other insurers	**33**	36	**33**	35
Uninsured	**7**	6	**6**	6
	100%	100%	**100%**	100%

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 six months ended June 30, 2009 and 2008 are set forth in the following table.

	Quarter		Six Months	
	2009	**2008**	**2009**	**2008**
Medicare	**32%**	32%	**32%**	32%
Managed Medicare	**9**	8	**8**	8
Medicaid	**7**	6	**7**	6
Managed Medicaid	**4**	4	**4**	4
Managed care and other insurers	**43**	44	**45**	44
Uninsured	**5**	6	**4**	6
	100%	100%	**100%**	100%

We have implemented an approach for determining emergency department (ED) evaluation and management (E/M) assignments based on the American College of Emergency Physicians model. This model uses interventions, such as cardiac monitoring, to indicate the acuity of the patient and the resources involved in the E/M of the patient. These E/M assignments are utilized in preparing the patient bill. We converted to this system, which is used by a significant number of hospitals, because it provides for more consistent ED E/M assignments than the point system previously used. As a result of the ED E/M change, we estimated an increase in net revenue, less the related provision for doubtful accounts, of approximately $75 million to $100 million in the first quarter of 2009. We believe the estimated net impact on second quarter 2009 operations was generally consistent with the first quarter estimate. We believe there will be continued future benefits from this change; however, the estimated quarterly impact on operations may vary and will become more difficult to quantify in future quarters.

At June 30, 2009, we had 73 hospitals in the states of Texas and Florida. During the second quarter of 2009, 57% of our admissions and 51% of our revenues were generated by these hospitals. Uninsured admissions in Texas and Florida represented 65% of our uninsured admissions during the second quarter of 2009.

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. 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

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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)

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 transfer some portion of these newly available funds to the state s Medicaid program. Such action is at the sole discretion of the public hospital districts or counties. It is anticipated that these contributions to the state will be matched with federal Medicaid funds. The state then may make supplemental payments to hospitals in the state for Medicaid services rendered. Hospitals receiving Medicaid supplemental payments may include those that are providing additional indigent care services. Such payments must be within the federal UPL established by federal regulation. Our Texas Medicaid revenues included $98 million and $56 million during the second quarters of 2009 and 2008, respectively, and $161 million and $94 million during the first six months of 2009 and 2008, respectively, of Medicaid supplemental payments pursuant to UPL programs. We expect to continue to recognize net benefits related to the Texas Medicaid supplemental payment program based upon the routine incurrence of indigent care expenditures and expected processing of Medicaid supplemental payments.

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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 from operations for the quarters and six months ended June 30, 2009 and 2008 (dollars in millions):

	Quarter			
	2009		2008	
	Amount	Ratio	Amount	Ratio
Revenues	**$ 7,483**	**100.0**	$ 6,980	100.0
Salaries and benefits	**2,944**	**39.3**	2,841	40.7
Supplies	**1,211**	**16.2**	1,149	16.5
Other operating expenses	**1,124**	**15.0**	1,135	16.2
Provision for doubtful accounts	**866**	**11.6**	813	11.7
Equity in earnings of affiliates	**(61)**	**(0.8)**	(62)	(0.9)
Depreciation and amortization	**360**	**4.8**	355	5.0
Interest expense	**506**	**6.8**	494	7.1
Losses on sales of facilities	**3**		11	0.2
Impairment of long-lived assets	**4**	**0.1**	9	0.1
	6,957	**93.0**	6,745	96.6
Income before income taxes	**526**	**7.0**	235	3.4
Provision for income taxes	**161**	**2.1**	38	0.6
Net income	**365**	**4.9**	197	2.8
Net income attributable to noncontrolling interests	**83**	**1.1**	56	0.8
Net income attributable to HCA Inc.	**$ 282**	**3.8**	$ 141	2.0
% changes from prior year:				
Revenues	**7.2%**		3.7%	
Income before income taxes	**123.6**		(5.4)	
Net income attributable to HCA Inc.	**100.9**		21.7	
Admissions(a)	**1.2**		(0.2)	
Equivalent admissions(b)	**3.8**		0.9	
Revenue per equivalent admission	**3.3**		2.8	
Same facility % changes from prior year(c):				
Revenues	**7.6**		5.1	
Admissions(a)	**1.9**		1.3	
Equivalent admissions(b)	**4.4**		2.0	

Revenue per equivalent admission	**3.0**	3.0

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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)

	Six Months			
	2009		2008	
	Amount	Ratio	Amount	Ratio
Revenues	**$ 14,914**	**100.0**	$ 14,107	100.0
Salaries and benefits	**5,867**	**39.3**	5,680	40.3
Supplies	**2,421**	**16.2**	2,322	16.5
Other operating expenses	**2,226**	**15.1**	2,249	15.8
Provision for doubtful accounts	**1,673**	**11.2**	1,701	12.1
Equity in earnings of affiliates	**(129)**	**(0.9)**	(129)	(0.9)
Depreciation and amortization	**713**	**4.7**	712	5.0
Interest expense	**977**	**6.5**	1,024	7.3
Losses (gains) on sales of facilities	**8**	**0.1**	(40)	(0.3)
Impairment of long-lived assets	**13**	**0.1**	9	0.1
	13,769	**92.3**	13,528	95.9
Income before income taxes	**1,145**	**7.7**	579	4.1
Provision for income taxes	**348**	**2.4**	157	1.1
Net income	**797**	**5.3**	422	3.0
Net income attributable to noncontrolling interests	**155**	**1.0**	111	0.8
Net income attributable to HCA Inc.	**$ 642**	**4.3**	$ 311	2.2
% changes from prior year:				
Revenues	**5.7%**		5.2%	
Income before income taxes	**97.8**		(6.3)	
Net income attributable to HCA Inc.	**106.7**		4.9	
Admissions(a)	**(0.1)**		(0.4)	
Equivalent admissions(b)	**2.6**		0.4	
Revenue per equivalent admission	**3.0**		4.8	
Same facility % changes from prior year(c):				
Revenues	**6.1**		6.6	
Admissions(a)	**0.5**		1.1	
Equivalent admissions(b)	**3.2**		1.6	
Revenue per equivalent admission	**2.8**		4.9	

(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 revenues and gross outpatient revenues and then dividing the resulting amount by gross inpatient revenues. The equivalent admissions computation equates outpatient revenues 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 June 30, 2009 and 2008

Net income attributable to HCA Inc. totaled $282 million for the second quarter of 2009 compared to $141 million for the second quarter of 2008. Revenues increased 7.2% due to the combined impact of revenue per equivalent admission growth of 3.3% and an increase of 3.8% in equivalent admissions for the second quarter of 2009 compared to the second quarter of 2008.

For the second quarter of 2009, consolidated admissions increased 1.2% and same facility admissions increased 1.9% compared to the second quarter of 2008. Outpatient surgical volumes declined 0.9% on a consolidated basis and declined 0.2% on a same facility basis during the second quarter of 2009 compared to the second quarter of 2008. Consolidated inpatient surgeries declined 0.5% and same facility inpatient surgeries increased 0.5% in the second quarter of 2009 compared to the second quarter of 2008.

Salaries and benefits, as a percentage of revenues, were 39.3% in the second quarter of 2009 and 40.7% in the same quarter of 2008. Salaries and benefits per equivalent admission declined 0.1% in the second quarter of 2009 compared to the second quarter of 2008. Same facility labor rate increases averaged 4.0% for the second quarter of 2009 compared to the second quarter of 2008.

Supplies, as a percentage of revenues, were 16.2% in the second quarter of 2009 and 16.5% in the same quarter of 2008. Supply cost per equivalent admission increased 1.5% in the second quarter of 2009 compared to the second quarter of 2008. Same facility supply costs increased 6.5% for medical devices, 5.9% for pharmacy supplies, 5.7% for blood products and 6.9% for general medical and surgical items.

Other operating expenses, as a percentage of revenues, declined to 15.0% in the second quarter of 2009 compared to 16.2% in the second quarter of 2008. Other operating expenses is primarily comprised of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance (including professional liability insurance) and nonincome taxes. The overall decline in other operating expenses, as a percentage of revenues, is com0in 0in 0in 0in;width:9.36%;">

2007

2006

Net revenues from external customers:

Churchill Downs Racetrack	$ 7,271	$ 11,055	$ 102,117	$ 104,386

Arlington Park	
	38,100
	35,370
	80,052
	74,739
Calder Race Course	
	33,046
	34,228
	60,879
	63,188
Louisiana Operations	

	15,014
	15,048
	63,327
	50,800
Total racing operations	
	93,431
	95,701
	306,375
	293,113
Other investments	
	9,863

	998
	13,626
	1,741
Corporate	
	611
	471
	1,631
	1,544
Net revenues from continuing operations	
	103,905
	97,170

	321,632
	296,398
Discontinued operations	
	-
	18,414
	7,837
	39,239
	$ 103,905
	$ 115,584

$
329,469

$
335,637

Intercompany net revenues:

Churchill Downs Racetrack	$ 339	$ 172	$ 2,041	$ 1,114
Arlington Park	551			

311

807

507

Calder Race Course

293

214

483

376

Louisiana Operations

6

-

	238
	23
Total racing operations	
	1,189
	697
	3,569
	2,020
Other investments	
	351
	443

1,006

1,281

Eliminations

(1,540
)

(1,264
)

(4,527
)

(3,298
)

-

(124
)

48

3

Discontinued operations

-

124

(48

)

(3

)

$

-

$

-

$

-

$

-

Segment EBITDA and net earnings:

Churchill Downs Racetrack	$ (3,951)	$ (2,606)	$ 36,625	$ 35,270
Arlington Park	8,526	4,112		

10,726

3,839

Calder Race Course

4,940

8,041

5,662

8,436

Louisiana Operations

(330

)

1,211

5,502

16,027

Total racing operations

9,185

10,758

58,515

63,572

Other investments

1,177

472

(667

)

1,170

Corporate	(383)	(1,120)	(1,644)	(2,836)
Total EBITDA from continuing operations	9,979	10,110	56,204	61,906
Eliminations				

-

(65

)

56

103

Depreciation and amortization

(6,141

)

(4,714

)

(16,759

)

(14,231

)

Interest income (expense), net

(960

)

(127

)

(1,426

)

(731

)

Provision for income taxes

(1,741

)

(2,339

)

(15,906

)

(19,294

)

Net earnings from continuing operations

1,137

	2,865
	22,169
	27,753
Discontinued operations, net of income taxes	
	(319)
	5,882
	(223)
	4,074
Net earnings	
	$ 818
	$

8,747

$

21,946

$

31,827

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The table below presents total asset information about reported segments (in thousands):

	September 30, 2007	December 31, 2006
Total assets:		
Churchill Downs Racetrack	$ 270,440	$ 442,724
Arlington Park	97,832	80,956
Calder Race Course	101,642	103,217
Louisiana Operations	98,770	98,053
Other investments	241,794	154,301
Assets held for sale	-	25,422
	810,478	904,673
Eliminations	(211,183)	(358,345)
	$ 599,295	$ 546,328

	Nine Months Ended September 30, 2007	2006
Capital expenditures:		
Churchill Downs Racetrack	$ 5,727	$ 5,189
Arlington Park	16,843	1,984
Calder Race Course	1,395	7,630
Louisiana Operations	11,285	12,818
Hoosier Park	227	300
Ellis Park	-	7,196
Other investments	2,071	276
	$ 37,548	$ 35,393

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

Information set forth in this discussion and analysis contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 (the Act) provides certain safe harbor provisions for forward-looking statements. All forward-looking statements made in this Quarterly Report on Form 10-Q are made pursuant to the Act. The reader is cautioned that such forward-looking statements are based on information available at the time and/or management s good faith belief with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Forward-looking statements speak only as of the date the statement was made. We assume no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. Forward-looking statements are typically identified by the use of terms such as anticipate, believe, could, estimate, expect, intend, may, might, plan, predict, project, should, will, and similar words, although sor statements are expressed differently. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Important factors that could cause actual results to differ materially from expectations include: the effect of global economic conditions; the effect (including possible increases in the cost of doing business) resulting from future war and terrorist activities or political uncertainties; the economic environment; the impact of increasing insurance costs; the impact of interest rate fluctuations; the effect of any change in our accounting policies or practices; the financial performance of our racing operations; the impact of gaming competition (including lotteries and riverboat, cruise ship and land-based casinos) and other sports and entertainment options in those markets in which we operate; the impact of live racing day competition with other Florida and Louisiana racetracks within those respective markets; costs associated with our efforts in support of alternative gaming initiatives; costs associated with customer relationship management initiatives; a substantial change in law or regulations affecting pari-mutuel and gaming activities; a substantial change in allocation of live racing days; changes in Illinois law that impact revenues of racing operations in Illinois; the presence of wagering facilities of Indiana racetracks near our operations; our continued ability to effectively compete for the country s top horses and trainers necessary to field high-quality horse racing; our continued ability to grow our share of the interstate simulcast market; our ability to execute our acquisition strategy and to complete or successfully operate planned expansion projects; our ability to successfully complete any divestiture transaction; our ability to execute on our temporary and permanent slot facilities in Louisiana; market reaction to our expansion projects; the loss of our totalisator companies or their inability to provide us assurance of the reliability of their internal control processes through Statement on Auditing Standards No. 70 audits or to keep their technology current; the need for various alternative gaming approvals in Louisiana; our accountability for environmental contamination; the loss of key personnel; the impact of natural disasters, including Hurricanes Katrina, Rita and Wilma on our operations and our ability to adjust the casualty losses through our property and business interruption insurance coverage; any business disruption associated with a natural disaster and/or its aftermath; our ability to integrate businesses we acquire, including our ability to maintain revenues at historic levels and achieve anticipated cost savings; the impact of wagering laws, including changes in laws or enforcement of those laws by regulatory agencies; the effect of claims of third parties to intellectual property rights; and the volatility of our stock price.

You should read this discussion in conjunction with the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and the Company s Amended Annual Report on Form 10-K/A for the year ended December 31, 2006 for further information, including Part I Item 1A for a discussion regarding some of the reasons that actual results may be materially different from those we anticipate, as modified by Part II Item 1A of this Quarterly Report on Form 10-Q.

Overview

We conduct pari-mutuel wagering on live Thoroughbred horse racing and simulcast signals of races. Additionally, we offer racing services through our other interests as well as alternative gaming through slot machines and video poker machines in Louisiana.

We operate the Churchill Downs Racetrack in Louisville, Kentucky, which has conducted Thoroughbred racing since 1875 and is internationally known as the home of the Kentucky Derby. We also own and operate Arlington Park, a Thoroughbred racing

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operation in Arlington Heights, Illinois; Calder Race Course, a Thoroughbred racing operation in Miami Gardens, Florida; Fair Grounds Race Course (Fair Grounds), a Thoroughbred racing operation in New Orleans, Louisiana and the owner and operator of 245 slot machines; and Video Services Inc. (VSI), the owner and operator of more than 600 video poker machines in Louisiana. We conduct simulcast wagering on horse racing at 19 simulcast wagering facilities in Kentucky, Illinois and Louisiana, as well as at our four racetracks.

During 2006, we sold all of the issued and outstanding shares of common stock (the Stock) of RCA, the parent company of Ellis Park Race Course (Ellis Park). On March 30, 2007, we sold our ownership interest in Hoosier Park. We made the decision to sell Ellis Park and Hoosier Park in order to dispose of two assets which we considered to be underperforming and to provide us with additional opportunities and resources to focus on our other assets and operations. As of the date of the filing of this Quarterly Report on Form 10-Q, we do not anticipate further dispositions of our racing operations. The sold businesses discussed above have been accounted for as discontinued operations in our Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q. Please refer to further sections of the Management s Discussion and Analysis of Financial Condition and Results of Operations included in this Item 2 as well as our Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q for further details regarding these dispositions.

Recent Developments

Empire Racing

On October 10, 2007, the Company withdrew from and terminated its relationship and agreements with Empire Racing Associates, an entity established to bid for the New York racing franchise.

Slots Operations

Fair Grounds previously received all statutory, regulatory and other authorizations to operate up to 700 slot machines in a permanent facility at the racetrack. On September 18, 2007, the Louisiana Gaming Control Board, upon the recommendation of the Louisiana State Police, approved the opening of the Fair Grounds temporary slots facility. The facility was opened to the public on September 21, 2007 with a total of 245 slot machines available. Upon commencement of the temporary slots facility, we were required to cease video poker operations at the on-site simulcast facility.

Also, in September, Fair Grounds resumed its phase one construction of its permanent facility that had been halted due to the damages to its facilities caused by Hurricane Katrina. The permanent facility is scheduled to be completed in late 2008.

Acquisitions

On June 11, 2007, the Company completed its acquisition of certain assets of AmericaTab, Bloodstock Research Information Services (BRIS) and the Thoroughbred Sports Network (TSN) (collectively, ATAB and BRIS) for an aggregate purchase price of $80 million, plus potential earn-out payments of up to $7 million. The transaction includes the acquisition of the following account wagering platforms: winticket.com, BrisBet.com and TsnBet.com. Through these transactions, the Company has also acquired the operations of two industry-leading data services companies, BRIS and TSN, which produce handicapping and pedigree reports that are sold to racetracks, horse owners and breeders, horse players and racing-related publications.

New Ventures

On May 2, 2007, we launched an account wagering platform called TwinSpires.com, which offers racing fans the opportunity to wager on racing content owned by the Company and other sources. We also entered into a definitive agreement on March 4, 2007 with Magna Entertainment Corporation (MEC) to form a venture, TrackNet Media Group, LLC (TrackNet), through which the racing content of the Company and MEC will be made available to third parties, including racetracks, off-track betting facilities (OTBs), casinos and account wagering providers through pre-established accounts. TrackNet will also act as agent on behalf of the Company and MEC to purchase racing content that can be made available at the outlets of the Company and MEC for wagering purposes. On March 4, 2007, we also acquired a 50% interest in a venture, HRTV, LLC, that owns and operates a horse racing television channel, HRTV, previously wholly-owned by MEC. The Company s audio visual signal of its races will be

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distributed by HRTV through certain cable or satellite providers to homes. Finally, on March 4, 2007, the Company and MEC entered into a reciprocal content swap agreement to exchange racing content between each other. As a result of this agreement, the content of the Company and MEC will be available for wagering through the racetracks, OTBs and account wagering providers owned by each of the Company and MEC. With respect to the Company s account wagering racing content, the racing content of Calder Race Course will be available beginning in January 2008 when its agreement with Television Games Network (TVG) expires.

Legislative and Regulatory Changes

Federal

WTO

In 2003, the country of Antigua filed a formal complaint against the United States with the World Trade Organization (WTO), challenging the United States ability to enforce certain Federal gaming laws (Sections 1084, 1952 and 1955 of Title 18 of the United States Code known as the Wire Act, the Travel Act and the Illegal Gambling Business Act, respectively, and collectively the Acts) against foreign companies that were accepting Internet wagers from United States residents. At issue was whether the United States enforcement of the Acts against foreign companies violated the General Agreement on Trade in Services (GATS). In November 2004, a WTO panel ruled that the United States, as a signatory of GATS, could not enforce the Acts against foreign companies that were accepting Internet wagers from United States residents. The United States appealed the ruling and, in April 2005, the WTO s appellate body ruled that the United States had demonstrated that the Acts were measures necessary to protect public morals or maintain public order, but that the United States did not enforce the Acts consistently between domestic companies and foreign companies as required by GATS. The WTO s appellate body specifically referenced the Interstate Horseracing Act (IHA), which appeared to authorize domestic companies to accept Internet wagers on horse racing, as being inconsistent with the United States stated policy against Internet wagering. In arguments and briefs before the WTO s appellate body, the United States argued that the Acts, specifically the Wire Act, apply equally to domestic companies and foreign companies and the IHA does not create an exception for domestic companies to accept Internet wagering on horse racing. The WTO s appellate body did not rule on whether an exception for domestic U.S. companies was created under the IHA, but recommended that the WTO s Dispute Settlement Body request the United States to bring measures found to be inconsistent with GATS into conformity with its obligations under GATS. The United States was given until April 3, 2006 to bring its policies in line with the ruling, assuming it believed any changes were necessary. On April 10, 2006, the United States delegation to the WTO submitted a brief report to the Chairman of the Dispute Settlement Body (U.S. Report) stating that no changes are necessary to bring U.S. policies in line with the ruling. In support of its position, the United States delegation informed the Dispute Settlement Body that on April 5, 2006, the United States Department of Justice confirmed the United States Government position regarding remote wagering on horse racing in testimony before a subcommittee of the United States House of Representatives. According to the U.S. Report, in that testimony, the Department of Justice stated its view that regardless of the IHA, existing criminal statutes prohibit the interstate transmission of bets or wagers, including wagers on horse racing, and informed the subcommittee that it is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. On January 25, 2007, the WTO compliance panel issued its interim finding in response to the U.S. Report and found that the United States has failed to comply with previous WTO rulings regarding restrictions on access to the U.S. Internet gaming market. On March 30, 2007, the final report was issued upholding all lower panel decisions. On May 4, 2007, the United States Trade Representative (the USTR) announced that it had initiated the formal process by the United States of withdrawing its GATS commitment to clarify an error that it had made in 1994 by including gambling services in its schedule of commitments. The USTR stated that the United States will use the WTO procedures for clarifying its commitments under the GATS. The USTR also stated that the United States intends to modify its services schedule by clearly defining gambling as an excluded commitment under the GATS. The result of withdrawal would be that the United States would not be obligated to provide foreign providers of gambling services access to the United States market. At this time, the only remaining issue before the WTO appears to be appropriate compensation to affected members of the treaty. The U.S. Government has made offers of compensation to WTO members affected by the decision of the U.S. to rule out any market access commitments regarding cross-border gambling services. The WTO arbitrators are due to issue their ruling by the end of November 2007. The USTR has made no specific statement regarding how this will impact interstate gambling on horse racing. When the United States submits its proposed modification to the service schedule, we will be able to assess the impact, if any, on our business and results of operations. One of the options available to

Congress and the White House is to prohibit or restrict substantially the conduct of interstate simulcast wagering or account wagering. If the U.S. government elects to take such an approach (including through any action by the Department of Justice), it will have a material, adverse impact on our business, financial condition and results of operations.

Other Federal Legislation/Regulation

On October 13, 2006, President Bush signed into law The Unlawful Internet Gambling Enforcement Act of 2006 (UIGEA). This act prohibits those involved in the business of betting or wagering from accepting any financial instrument, electronic or otherwise, for deposit that is intended to be utilized for unlawful Internet gambling. This act declares that nothing in the act may be construed to prohibit any activity allowed by the IHA. This act also contains a Sense of Congress which explicitly states that it is not intended to criminalize any activity currently permitted by federal law. The Secretary of the Treasury was directed to promulgate regulations to enforce the provisions of this act within 270 days. The Secretary was further directed to ensure the regulations do not prohibit any activity which is excluded from the definition of unlawful Internet gambling, including those activities legal under the IHA. On October 1, 2007, the Treasury Department published proposed rules and regulations that require U.S. financial firms participating in designated payment systems to have policies and procedures reasonably designed to prevent payments being made to gambling businesses in connection with unlawful internet gambling. Activities permitted under IHA are specifically excluded from the definition of unlawful Internet gambling. Comments on the proposed rules will be accepted through December 12, 2007. We are working with other industry representatives to review the proposed regulations and determine what comments, if any, to provide to the Treasury Department.

Florida

On November 2, 2004, Amendment 4, a slot machine question which sought to allow voters in Miami-Dade and Broward counties to hold local referenda on the issue, passed by a margin of 1.4%. On March 8, 2005, voters in Miami-Dade and Broward counties voted in separate local referenda to decide whether slot machines could be installed at the seven existing pari-mutuel sites in those counties, including Calder Race Course. Although the measure passed in Broward County, home of Gulfstream Park, it was unsuccessful in Miami-Dade County, where Calder Race Course is located. Slot machine gaming was approved by the Florida legislature during a special session of the Florida legislature on December 9, 2005. Slot operations are expected to commence in a staggered manner at Broward s four pari-mutuel wagering facilities. Gulfstream Park commenced slot operations in the fall of 2006. The remaining facilities are expected to commence slot operations in a staggered manner through 2008. On July 10, 2007, the Miami-Dade County Commission approved a second referendum for slot machines in local pari-mutuel facilities in Miami-Dade County. The referendum will take place on January 29, 2008, Florida s presidential primary date. We will support this referendum. We anticipate the cost of our support of the referendum to be $3 million to $5 million. In addition, a statewide initiative designed to lower property taxes will be on the ballot. The impact on our results of operations and financial position of the operation of slot machines at pari-mutuel wagering facilities in Broward County is uncertain at this time.

On August 8, 2006, the District Court of Appeals, First District, State of Florida rendered a decision in the case of Floridians Against Expanded Gambling (FAEG), et. al versus Floridians for a Level Playing Field, et. al. FAEG challenged the process by which signatures were collected in order to place a constitutional amendment on the ballot in 2004 allowing Miami-Dade and Broward County voters to approve slot machines in pari-mutuel facilities. The District Court of Appeals reversed a decision of the Florida trial court, which granted summary judgment and dismissed the challenge, and remanded the case back to the trial court for an evidentiary hearing to determine whether sufficient signatures were collected in the petition process. A motion for rehearing by the entire Court of Appeals or in the alternative a motion for certification to the Florida Supreme Court was filed. The case was re-heard by the entire Court of Appeals and the panel s decision was upheld. The question of law has been certified to the Florida Supreme Court, which initially accepted jurisdiction. However, after oral arguments were made on September 17, 2007, the District Court of Appeals issued an opinion on September 27, 2007, which held the case was not properly put before the District Court of Appeals, and therefore upheld the lower court s decision to remand the case back to the trial court for an evidentiary hearing to determine whether sufficient signatures were collected in the petition process. The case has not yet been scheduled for trial, and we are reviewing our legal options moving forward.

Legislation permitting an additional 500 slot machines (from 1,500 to 2,000) in Broward County, permitting ATM machines at the pari-mutuel facilities, and extending hours of operation became law in Florida in 2007. Should voters in Miami-Dade County approve slot machines at pari-mutuel facilities, the provisions of this legislation would apply to Calder Race Course. In addition, legislation allowing year-round operation of poker rooms and raising the maximum wager on poker from $2 to $5 successfully passed both chambers of the Florida legislature. At this time, it is unclear what impact this legislation will have on our results of operations.

During December 2005, Calder Race Course and Gulfstream Park entered into an agreement to allow year-round simulcasting at both facilities in the Miami area. The agreement was the result of a Florida appellate court decision in a case brought by Gulfstream Park invalidating a statute that prohibited a racetrack from simulcasting when it was not conducting live racing. The Division of Pari-Mutuel Wagering appealed the decision to the Florida Supreme Court and, in mid-January 2006, the Florida Supreme Court issued a stay ordering Calder Race Course to cease simulcast operations until the case is decided. On September 6, 2007, the Florida Supreme Court upheld the Florida appellate court decision and invalidated that statute. As a result of that ruling, effective September 21, 2007, all pari-mutuel facilities in Dade and Broward counties, including Calder Race Course, will be permitted to enter into contractual arrangements that allow the host facility to send its live and imported simulcast products to other facilities in the two counties. The impact of this ruling on Calder Race Course's results of operation are uncertain at this time.

Illinois

Pursuant to the Illinois Horse Racing Act, Arlington Park and all other Illinois racetracks are permitted to receive a payment commonly known as purse recapture. Generally, in any year that wagering on Illinois horse races at Arlington Park is less than 75% of wagering both in Illinois and at Arlington Park on Illinois horse races in 1994, Arlington Park is permitted to receive 2% of the difference in wagering in the subsequent year. The payment is funded from the Arlington Park purse account. Under the Illinois Horse Racing Act, the Arlington Park purse account is to be repaid via an appropriation by the Illinois General Assembly from the Illinois General Revenue Fund. However, this appropriation has not been made since 2001. Subsequently, Illinois horsemen unsuccessfully petitioned the Illinois Racing Board (IRB) to prevent Illinois racetracks from receiving this payment in any year that the Illinois General Assembly did not appropriate the repayment to the racetrack s purse accounts from the General Revenue Fund. Further, the Illinois horsemen filed lawsuits seeking, among other things, to block payment to Illinois racetracks, as well as to recover the 2002 and 2003 amounts already paid to the Illinois racetracks. These lawsuits filed by the Illinois horsemen challenging the 2002 and 2003 reimbursements have been resolved in favor of Arlington Park and the other Illinois racetracks. Several bills were filed in the 2003, 2004 and 2005 sessions of the Illinois legislature that, in part, would eliminate the statutory right of Arlington Park and the other Illinois racetracks to continue to receive this payment. None of these bills passed. Since the statute remains in effect, Arlington Park continues to receive the recapture payment from the purse account. If Arlington Park loses the statutory right to receive this payment, there would be a material, adverse impact on Arlington Park s results of operations.

Under previously enacted legislation, the Illinois Horse Racing Equity fund was scheduled to receive a portion (up to 15% of adjusted gross receipts) of wagering tax from the tenth riverboat casino license issued. The grant of the tenth riverboat license is currently the subject of numerous legal and regulatory challenges and, as such, is currently not an operational riverboat license. The funds were scheduled to be utilized for purses and track discretionary spending. Because the tenth license has never been operational, the Illinois Horse Racing Equity fund has never had any funds to distribute.

In the Spring of 2006 session of the Illinois General Assembly, legislation was passed to create and fund the Horse Racing Equity Trust fund. The Horse Racing Equity Trust fund is to be funded from revenues of Illinois riverboat casinos that meet a certain threshold. Sixty percent of the funds is to be used for horsemen s purses (57% for thoroughbred meets and 43% for standardbred meets). The remaining 40% is to be distributed to racetracks (30.4% of that total for Arlington Park) and is to be used for improving, maintaining, marketing and operating Arlington Park and may be used for backstretch services and capital improvements. The legislation expires two years after its immediate effective date. The governor of Illinois signed the legislation on May 26, 2006 as Public Act 94-0805.

In an effort to prevent implementation of Public Act 94-0805, the four Illinois riverboat casinos that meet the threshold to contribute to the Horse Racing Equity Trust fund filed a complaint on May 30, 2006 in the Circuit Court of Will County, Illinois. The complaint was filed against the State Treasurer and the IRB to enjoin the imposition and collection of the 3% surcharge from the casinos, which was to be deposited in the Horse Racing Equity Trust fund. The Will County Circuit Judge ruled in April 2007 that the law was unconstitutional as the law only affects the four suburban casinos and not the five downstate casinos. The Attorney General is filing an appeal of this ruling to the Illinois Supreme Court. The riverboats have been paying the monies into a special escrow account and have demanded that the monies not be distributed. A temporary restraining order was granted to prevent distribution of these monies. The complaint alleges that Public Act 94-0805 is unconstitutional. The Illinois Attorney General is representing Illinois on this matter, and the litigation is on going. As of the date of the filing of this Quarterly Report on Form 10-Q, management does not know the impact that the ultimate outcome of this matter will have on our consolidated financial position and results of operations.

Arlington Park will continue to seek authority to conduct alternative gaming at the racetrack. The 2007 session of the Illinois legislature is currently in extended session in an effort to enact a statewide budget. As part of the budget process, several alternative bills are being considered that could impact Arlington Park, including permitting slot machines at the racetracks, extension of the Horse Racing Equity Trust Fund and potentially a Chicago stand-alone casino. At this point, though the legislature remains in extended session, it is too early to determine whether those initiatives will be successful.

During January, February and a portion of March when there is no live racing in Illinois, the IRB designates a Thoroughbred racetrack as the host track in Illinois, for which the host track receives a higher percentage of earnings from pari-mutuel activity throughout Illinois. The IRB appointed Arlington Park the host track in Illinois during January 2008 for eighteen days, which is a decrease of twelve days compared to the same period of 2006. In addition, Arlington Park was appointed the host track for twenty-nine days in February 2008, which is an increase of fourteen days compared to the same period of 2007. Also, Arlington Park was appointed the host track for two days in March 2008, which is an increase of two days compared to the same period of 2007. Arlington Park s future designation as the host track is subject to the annual designation by the IRB. A change in the number of days that Arlington Park is designated host track could have a material, adverse impact on our results of operations.

Kentucky

The Kentucky horse industry continues to seek legal authority to offer alternative forms of gaming at Kentucky s eight existing racetracks. Alternative forms of gaming would enable our Kentucky racetrack to better compete with neighboring gaming venues by providing substantial new revenues for purses and capital improvements. Several alternative gaming bills were filed in the 2006 and 2007 session of the Kentucky General Assembly. The Kentucky Equine Education Project (KEEP), an alliance of the Commonwealth s equine industry leaders, including our Company, supported legislation in 2006 that called for a statewide voter referendum in the Fall of 2006 to amend the State constitution to allow Kentucky s eight racetracks to offer full casino gaming. None of these bills were successful. Kentucky s gubernatorial election was held on November 6, 2007. The incumbent republican Governor made his opposition to expanded gaming a central theme of the early campaign. The democratic opponent publicly stated his support for limited gaming at racetracks and a few other select locations as a key revenue enhancement strategy for Kentucky. The democratic challenger, Steve Beshear, was elected by a margin of 59% to 41% and is expected to seek legislation in the 2008 General Assembly permitting casino gaming at Kentucky s racetracks.

Louisiana

Senate Bill No. 190, Act No. 469 (SB 190) was signed into law by the Louisiana Governor on July 11, 2007 effective July 1, 2008. SB 190 changes the calculation of the video poker franchise tax from a tax based on gross revenues to a tax based on gross revenues less purse expenses. SB 190 will have a favorable impact on our video poker results of operations beginning July 1, 2008.

Indiana

The 2007 Indiana General Assembly approved the operation of slot machines at Indiana s horse racetracks. Each racetrack is granted permission to operate up to 2,000 slot machines. In order to operate these slot machines, Hoosier Park paid a $150 million licensing fee prior to November 1, 2007 and will be required to invest $100 million in capital improvements and pay an additional $100 million licensing fee by November 1, 2008. We completed the sale of our interest in Hoosier Park on March 30, 2007. As part of that agreement, the Company is entitled to payments of up to $15 million once slot machines are operational. The Governor of Indiana signed this legislation into law. Hoosier Park has secured funding for the $250 million licensing fee, and officials have indicated they intend to move forward with construction and operation of an appropriate slots facility.

Critical Accounting Policies

Our Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Accordingly, we are required to make estimates, judgments and assumptions that we believe are reasonable based on our historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those initial estimates.

Our most significant estimates relate to the valuation of plant and equipment, receivables, goodwill and other intangible assets, which may be significantly affected by changes in the regulatory environment in which we operate, and to the aggregate costs for self-insured liability and workers compensation claims. Additionally, estimates are used for determining income tax liabilities and other derivative instruments.

We evaluate our goodwill, intangible and other long-lived assets in accordance with the Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Intangible Assets and SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. For goodwill and intangible assets, we review the carrying values at least annually during the first quarter of each year or whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. We completed the required annual impairment tests of goodwill and indefinite lived intangible assets as of March 31, 2007, and no adjustment to the carrying value of these assets was required. We assign estimated useful lives to our intangible assets based on the period of time the asset is expected to contribute directly or indirectly to future cash flows. We consider certain factors when assigning useful lives such as legal, regulatory, competition and other economic factors. Intangible assets with finite lives are amortized using the straight-line method.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48). FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes and accounting in interim periods. FIN 48 also requires increased disclosures.

The Company adopted the provisions of FIN 48 on January 1, 2007. The cumulative effect of adopting FIN 48 was an increase of $0.3 million to unrecognized tax benefits, and a corresponding decrease to retained earnings at January 1, 2007. The amount of unrecognized tax benefits at January 1, 2007 was $1.3 million, all of which would impact our effective tax rate, if recognized.

THREE MONTHS ENDED SEPTEMBER 30, 2007 COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2006

Pari-mutuel Financial Data by Segment

The following table sets forth, for the periods indicated, pari-mutuel financial data by our reported segments (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Churchill Downs Racetrack				
Total handle	$ 68,321	$ 119,087	$ (50,766)	(43)%
Net pari-mutuel revenues	$ 5,331	$ 8,329	$ (2,998)	(36)%
Commission %	7.8%	7.0%		
Arlington Park				
Total handle	$ 382,614	$ 355,607	$ 27,007	8%
Net pari-mutuel revenues	$ 31,349	$ 29,422	$ 1,927	7%
Commission %	8.2%	8.3%		
Calder Race Course				
Total handle	$ 313,863	$ 319,392	$ (5,529)	(2)%
Net pari-mutuel revenues	$ 32,183	$ 33,325	$ (1,142)	(3)%
Commission %	10.3%	10.4%		
Louisiana Operations				
Total handle	$ 42,266	$ 43,295	$ (1,029)	(2)%
Net pari-mutuel revenues	$ 7,654	$ 7,965	$ (311)	(4)%
Commission %	18.1%	18.4%		
Other investments				
Total handle	$ 39,453	$ -	$ 39,453	100%
Net pari-mutuel revenues	$ 7,152	$ -	$ 7,152	100%
Commission %	18.1%	-		
Eliminations				
Total handle	$ (24,389)	$ (21,222)	$ (3,167)	(15)%
Net pari-mutuel revenues	$ (1,189)	$ (916)	$ (273)	(30)%
Commision %	4.9%	4.3%		
Total				
Handle	$ 822,128	$ 816,159	$ 5,969	1%
Net pari-mutuel revenues	$ 82,480	$ 78,125	$ 4,355	6%
Commission %	10.0%	9.6%		

Results of Continuing Operations

The following table sets forth, for the periods indicated, certain operating data (in thousands, except per common share data and live race days):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Number of live race days	121	121	-	-
Net pari-mutuel revenues	$ 82,480	$ 78,125	$ 4,355	6%
Other operating revenues	21,425	18,921	2,504	13%
Total net revenues from continuing operations	$ 103,905	$ 97,046	$ 6,859	7%
Operating profit	$ 4,632	$ 5,213	$ (581)	(11)%
Net earnings from continuing operations	$ 1,137	$ 2,865	$ (1,728)	(60)%
Diluted net earnings from continuing operations per common share	$ 0.08	$ 0.21		

Our total net revenues increased $6.9 million primarily as a result of the acquisition of ATAB and BRIS, the launch of TwinSpires.com and the improved performance of Arlington Park. This increase was partially offset by decreased revenues at Churchill Downs Racetrack primarily resulting from six fewer live race days during the three months ended September 30, 2007 compared to the same period of 2006.

Consolidated Expenses

The following table is a summary of our consolidated expenses (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Purse expense	$ 31,303	$ 34,684	$ (3,381)	(10)%
Depreciation and amortization	6,141	4,714	1,427	30%
Other operating expenses	48,820	43,447	5,373	12%
SG&A expenses	13,009	10,820	2,189	20%
Insurance recoveries, net of losses	-	(1,832)	1,832	100%
Total	$ 99,273	$ 91,833	$ 7,440	8%
Percent of revenue	96%	95%		

Total expenses increased 8% during the three months ended September 30, 2007 primarily as a result of the acquisition of ATAB and BRIS and the launch of TwinSpires.com during 2007. Expenses also increased as a result of the recognition of insurance recoveries, net of losses of $1.8 million during the three months ended September 30, 2006 related to damages sustained at Calder Race Course by Hurricane Wilma. Partially offsetting these increases in expenses is a decrease in purse expenses primarily due to six fewer live racing days at Churchill Downs Racetrack during the three months ended September 30, 2007 compared to the same period of 2006. Further discussion of expense variances by our reported segments is detailed below.

Other Income (Expense) and Provision for Income Taxes

The following table is a summary of our other income (expense) and provision for income taxes (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Interest income	$ 163	$ 244	$ (81)	(33)%
Interest expense	(1,123)	(371)	(752)	(203)%
Equity in loss of unconsolidated investments	(1,278)	(319)	(959)	(301)%
Miscellaneous, net	484	437	47	11%
Other income (expense)	$ (1,754)	$ (9)	$ (1,745)	(19,389)%
Provision for income taxes	$ (1,741)	$ (2,339)	$ 598	26%
Effective tax rate	60%	45%		

Significant items affecting the comparability of other income and expense and the provision for income taxes include:

Interest expense increased during the three months ended September 30, 2007 primarily due to interest expense incurred on $55.0 million borrowed to fund the acquisition of ATAB and BRIS during 2007.

Equity in loss of unconsolidated investments increased during the three months ended September 30, 2007 primarily as a result of the performance of our investments in TrackNet and HRTV.

Our effective tax rate increased from 45% to 60% resulting primarily from the non-deductibility of legislative initiative costs recognized during 2007 as well as increased state income tax expense.

Net Revenues By Segment

The following table presents net revenues, including intercompany revenues, by our reported segments (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Churchill Downs Racetrack	$ 7,610	$ 11,227	$ (3,617)	(32)%
Arlington Park	38,651	35,681	2,970	8%

Calder Race Course	33,339	34,442	(1,103)	(3)%
Louisiana Operations	15,020	15,048	(28)	-
Total racing operations	94,620	96,398	(1,778)	(2)%
Other investments	10,214	1,441	8,773	609%
Corporate revenues	611	471	140	30%
Eliminations	(1,540)	(1,264)	(276)	(22)%
	$ 103,905	$ 97,046	$ 6,859	7%

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Significant items affecting comparability of our net revenues by segment include:

- Net revenues from other investments increased primarily as a result of the acquisition of ATAB and BRIS and the launch of TwinSpires.com during 2007.

- Net revenues from Arlington Park increased during the three months ended September 30, 2007 primarily as a result of increased pari-mutuel revenues. We experienced an increase in average starters per race, which we believe is partially attributable to the installation of a new Polytrack racing surface. Additionally, revenues increased as a result of two additional live racing days at Arlington Park during the three months ended September 30, 2007 compared to the same period of 2006.

- Churchill Downs Racetrack revenues decreased during the three months ended September 30, 2007 primarily as a result of six fewer race days during the three months ended September 30, 2007 compared to the same period of 2006.

- Calder Race Course revenues decreased during the three months ended September 30, 2007, despite having four more live racing days during the three months ended September 30, 2007 compared to the same period of 2006, primarily as a result of decreased pari-mutuel revenues. We believe the decrease in pari-mutuel revenues resulted from inclement weather conditions during the three months ended September 30, 2007, which caused numerous turf races to be moved to the dirt track. In addition, we experienced increased competition from new alternative gaming facilities in this market.

Expenses by Segment

The following table presents total expenses, including intercompany expenses, by our reported segments (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Churchill Downs Racetrack	$ 14,114	$ 16,405	$ (2,291)	(14)%
Arlington Park	31,076	32,301	(1,225)	(4)%
Calder Race Course	29,226	27,333	1,893	7%
Louisiana Operations	16,402	14,251	2,151	15%
Total racing operations	90,818	90,290	528	1%
Other investments	8,791	943	7,848	832%
Corporate	5,684	5,781	(97)	(2)%
Eliminations	(6,020)	(5,181)	(839)	(16)%
	$ 99,273	$ 91,833	$ 7,440	8%

Significant items affecting comparability of our expenses by segment include:

- Expenses of other investments increased during the three months ended September 30, 2007 primarily due to the acquisition of ATAB and BRIS and the launch of TwinSpires.com.

- Louisiana Operations expenses increased primarily as a result of pre-opening and operating expenses incurred in connection with the slots operations, which began during September 2007.

- Churchill Downs Racetrack expenses decreased primarily as a result of reduced purse and other racing meet-related expenses due to six fewer race days during the three months ended September 30, 2007 compared to the same period of 2006.

- Arlington Park expenses decreased primarily as a result of increased purse overpayment recoveries during the three months ended September 30, 2007 compared to the same period of 2006.

Discontinued Operations

The following table presents earnings (losses) from discontinued operations, which includes the result of operations of Hoosier Park, Ellis Park and Hollywood Park, for the three months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Change $	Change %
Net revenues	$ -	$ 18,538	$ (18,538)	(100)%
Operating expenses	463	15,304	(14,841)	(97)%
Selling, general and administrative expenses	65	1,385	(1,320)	(95)%
Insurance recoveries, net of losses	-	(1,293)	1,293	100%
Operating (loss) profit	(528)	3,142	(3,670)	(117)%
Other income (expense):				
Interest income	-	28	(28)	(100)%
Interest expense	-	(155)	155	100%
Miscellaneous, net	785	(21)	806	3,838%
	785	(148)	933	630%
Earnings before provision for income taxes	257	2,994	(2,737)	(91)%
Provision for income taxes	(576)	(1,309)	733	56%
(Loss) earnings from operations	(319)	1,685	(2,004)	(119)%
Gain on sale of business, net of income taxes	-	4,197	(4,197)	(100)%
Net (loss) earnings	$ (319)	$ 5,882	$ (6,201)	(105)%

Significant items affecting comparability of losses from discontinued operations include:

- The results of operations of discontinued operations for the three months ended September 30, 2007 include the results of operations of Hoosier Park and Hollywood Park compared to those of Ellis Park, Hoosier Park and Hollywood Park for the three months ended September 30, 2006.

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NINE MONTHS ENDED SEPTEMBER 30, 2007 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2006

Pari-mutuel Handle by Segment

The following table sets forth, for the periods indicated, pari-mutuel financial handle data by our reported segments (in thousands):

	Nine Months Ended September 30, 2007	2006	Change $	%
Churchill Downs Racetrack				
Total handle	$ 661,510	$ 736,040	$ (74,530)	(10)%
Net pari-mutuel revenues	$ 48,483	$ 51,676	$ (3,193)	(6)%
Commission %	7.3%	7.0%		
Arlington Park				
Total handle	$ 759,493	$ 709,551	$ 49,942	7%
Net pari-mutuel revenues	$ 68,316	$ 64,059	$ 4,257	7%
Commission %	9.0%	9.0%		
Calder Race Course				
Total handle	$ 573,488	$ 592,038	$ (18,550)	(3)%
Net pari-mutuel revenues	$ 58,830	$ 60,849	$ (2,019)	(3)%
Commission %	10.3%	10.3%		
Louisiana Operations				
Total handle	$ 394,378	$ 195,799	$ 198,579	101%
Net pari-mutuel revenues	$ 36,421	$ 27,402	$ 9,019	33%
Commission %	9.2%	14.0%		
Other investments				
Total handle	$ 55,187	$ -	$ 55,187	100%
Net pari-mutuel revenues	$ 10,063	$ -	$ 10,063	100%
Commission %	18.2%	-		
Eliminations				
Total handle	$ (72,631)	$ (58,153)	$ (14,478)	(25)%
Net pari-mutuel revenues	$ (3,570)	$ (2,334)	$ (1,236)	(53)%
Commision %	4.9%	4.0%		
Total				
Handle	$ 2,371,425	$ 2,175,275	$ 196,150	9%
Net pari-mutuel revenues	$ 218,543	$ 201,652	$ 16,891	8%
Commission %	9.2%	9.3%		

Results of Continuing Operations

The following table sets forth, for the periods indicated, certain operating data (in thousands, except per common share data and live race days):

	Nine Months Ended September 30, 2007	2006	Change $	%
Number of live race days	308	267	41	15%
Net pari-mutuel revenues	$ 218,543	$ 201,652	$ 16,891	8%
Other operating revenues	103,137	94,749	8,388	9%
Total net revenues from continuing operations	$ 321,680	$ 296,401	$ 25,279	9%
Operating profit	$ 38,795	$ 46,969	$ (8,174)	(17)%
Net earnings from continuing operations	$ 22,169	$ 27,753	$ (5,584)	(20)%
Diluted net earnings from continuing operations per common share	$ 1.59	$ 2.04		

Our total net revenues increased $25.3 million primarily as a result of 46 additional live racing days at Fair Grounds during the nine months ended September 30, 2007 compared to the same period of 2006. Live racing returned to Fair Grounds in New Orleans in November 2006 following the shortened race meet that was conducted at Harrah's Louisiana Downs in the prior year and resulted in only 12 racing days during the nine months ended September 30, 2006. Revenues also increased during the nine months ended September 30, 2007 due to the acquisition of ATAB and BRIS and the launch of TwinSpires.com. Further discussion of net revenue variances by our reported segments is detailed below.

Consolidated Expenses

The following table is a summary of our consolidated expenses (in thousands):

	Nine Months Ended September 30, 2007	2006	Change $	%
Purse expense	$ 93,426	$ 90,772	$ 2,654	3%
Depreciation and amortization	16,759	14,231	2,528	18%
Other operating expenses	137,581	124,175	13,406	11%
SG&A expenses	35,903	33,208	2,695	8%
Insurance recoveries, net of losses	(784)	(12,954)	12,170	94%
Total	$ 282,885	$ 249,432	$ 33,453	13%
Percent of revenue	88%	84%		

Total expenses increased 13% during the nine months ended September 30, 2007 primarily as a result of 46 additional live racing days at Fair Grounds as well as a reduction in the recognition of insurance recoveries, net of losses of $12.2 million related to Hurricanes Katrina and

Wilma. Expenses also increased due to the acquisition of ATAB and BRIS and the launch of TwinSpires.com. These increases were partially offset by decreased purse and other live racing meet-related expenses at Churchill Downs Racetrack primarily as a result of five fewer race days during the nine months ended September 30, 2007 compared to the same period of 2006. Further discussion of expense variances by our reported segments is detailed below.

Other Income (Expense) and Provision for Income Taxes

The following table is a summary of our other income (expense) and provision for income taxes (in thousands):

	Nine Months Ended September 30, 2007	2006	Change $	%
Interest income	$ 828	$ 549	$ 279	51%
Interest expense	(2,254)	(1,280)	(974)	(76)%
Equity in loss of unconsolidated investments	(2,271)	(614)	(1,657)	(270)%
Miscellaneous, net	2,977	1,423	1,554	109%
Other income (expense)	$ (720)	$ 78	$ (798)	(1,023)%
Provision for income taxes	$ (15,906)	$ (19,294)	$ 3,388	18%
Effective tax rate	42%	41%		

Significant items affecting the comparability of other income and expense and provision for income taxes include:

- Equity in loss of unconsolidated investments increased during the nine months ended September 30, 2007 primarily as a result of the performance of our investment in Racing World Limited ("Racing World"), TrackNet and HRTV. Racing World is a subscription television channel that broadcasts races from our racetracks, racetracks of MEC, as well as other North American and international racetracks, into the United Kingdom and Ireland.

- Interest expense increased primarily due to the fact that we borrowed $55.0 million to fund the acquisition of ATAB and BRIS during 2007, as well as a result of the recognition of a loss on extinguishment of debt in the amount of $0.4 million representing the write-off of unamortized deferred financing costs related to our previous credit facility during the nine months ended September 30, 2007. Also, interest income increased during the nine months ended September 30, 2007 primarily due to lower investments of excess cash during the nine months ended September 30, 2006 as a result of the payment of income taxes related to the gain on the sale of the assets of Hollywood Park, which was realized during 2005.

- Miscellaneous income increased primarily as a result of a gain of $1.7 million recognized related to the sale of a tract of land at Arlington Park.

Net Revenues By Segment

The following table presents net revenues, including intercompany revenues, by our reported segments (in thousands):

	Nine Months Ended September 30,		Change	
	2007	2006	$	%
Churchill Downs Racetrack	$ 104,158	$ 105,500	$ (1,342)	(1)%
Arlington Park	80,859	75,246	5,613	7%
Calder Race Course	61,362	63,564	(2,202)	(3)%
Louisiana Operations	63,565	50,823	12,742	25%
Total racing operations	309,944	295,133	14,811	5%
Other investments	14,632	3,022	11,610	384%
Corporate revenues	1,631	1,544	87	6%
Eliminations	(4,527)	(3,298)	(1,229)	(37)%
	$ 321,680	$ 296,401	$ 25,279	9%

Significant items affecting comparability of our net revenues by segment include:

Louisiana Operations revenues increased primarily as a result of 46 additional live racing days at Fair Grounds during the nine months ended September 30, 2007 compared to the same period of 2006.

Other investments revenues increased primarily due to the acquisition of ATAB and BRIS and the launch of TwinSpires.com during the nine months ended September 30, 2007.

Arlington Park revenues increased primarily as a result of increased pari-mutuel revenues. We experienced an increase in average starters per race, which we believe is partially attributable to the installation of a new Polytrack racing surface. In addition, during January and February, when there is no live racing in Illinois, the IRB designates a Thoroughbred racetrack as the host track in Illinois. The IRB appointed Arlington Park as the host track in Illinois for 45 days during portions of January and February of 2007 compared to 37 days during January and February of 2006, which resulted in additional revenues of $1.2 million during the nine months ended September 30, 2007 compared to the same period of 2006.

Net revenues at Calder decreased primarily due to the fact that simulcast operations initiated during January 2006, which were conducted for 20 days, ceased upon a stay issued by the Florida Supreme Court in response to a challenge of such simulcasting activity.

Expenses by Segment

The following table presents total expenses, including intercompany expenses, by our reported segments (in thousands):

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	Change $	Change %
Churchill Downs Racetrack	$ 75,136	$ 77,975	$ (2,839)	(4)%
Arlington Park	74,289	73,652	637	1%
Calder Race Course	58,123	57,556	567	1%
Louisiana Operations	61,030	36,588	24,442	67%
Total racing operations	268,578	245,771	22,807	9%
Other investments	14,969	2,063	12,906	626%
Corporate revenues	17,987	17,572	415	2%
Eliminations	(18,649)	(15,974)	(2,675)	(17)%
	$ 282,885	$ 249,432	$ 33,453	13%

Significant items affecting comparability of our expenses by segment include:

Louisiana Operations expenses increased $24.4 million primarily as a result of the recognition of insurance recoveries, net of losses of $10.3 million related to Hurricane Katrina during the nine months ended September 30, 2006. Additionally, purse expenses increased by $5.0 million, and payroll costs increased by $5.3 million primarily due to 46 more live racing days during the nine months ended September 30, 2007 compared to the same period of 2006.

Other investments expenses increased during the nine months ended September 30, 2007 primarily due to the acquisition of ATAB and BRIS and the launch of TwinSpires.com.

Churchill Downs Racetrack expenses decreased primarily as a result of five fewer race days during the nine months ended September 30, 2007 compared to the same period of 2006.

Discontinued Operations

The following table presents earnings (losses) from discontinued operations, which includes the results of operations of Hoosier Park, Ellis Park and Hollywood Park, for the nine months ended September 30, 2007 and 2006 (in thousands):

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	Change $	Change %
Net revenues	$ 7,789	$ 39,236	$ (31,447)	(80)%
Operating expenses	6,883	36,779	(29,896)	(81)%
Selling, general and administrative expenses	641	2,962	(2,321)	(78)%
Insurance recoveries, net of losses	-	(1,367)	1,367	100%
Operating profit	265	862	(597)	(69)%
Other income (expense):				
Interest income	62	85	(23)	(27)%
Interest expense	(157)	(428)	271	63%
Miscellaneous, net	821	361	460	127%
	726	18	708	3,933%
Earnings before provision for income taxes	991	880	111	13%
Provision for income taxes	(1,032)	(1,003)	(29)	(3)%
Loss from operations	(41)	(123)	82	67%
(Loss) gain on sale of business, net of income taxes	(182)	4,197	(4,379)	(104)%
Net (loss) earnings	$ (223)	$ 4,074	$ (4,297)	(105)%

Significant items affecting comparability of earnings from discontinued operations include:

The results of operations of discontinued operations for the nine months ended September 30, 2007 include the results of operations of Hoosier Park and Hollywood Park compared to those of Ellis Park, Hoosier Park and Hollywood Park for the nine months ended September 30, 2006.

Consolidated Balance Sheet

The following table is a summary of our overall financial position as of September 30, 2007 and December 31, 2006 (in thousands):

	September 30, 2007	December 31, 2006	Change $	Change %
Total assets	$599,295	$546,328	$52,967	10%
Total liabilities	$219,272	$196,249	$23,023	12%
Total shareholders equity	$380,023	$350,079	$29,944	9%

Significant items affecting comparability of our consolidated balance sheet include:

Significant changes within total assets include increases in goodwill of $53.5 million and other intangible assets of $24.5 million associated with the acquisition of ATAB and BRIS and decreases in assets held for sale of $25.4 million. Assets held for sale decreased in connection with the sale of the remaining ownership interest in Hoosier Park in March 2007.

Significant changes within total liabilities include increases in long-term debt and accounts payable of $55.0 million and $9.9 million, respectively. Partially off-setting these increases are decreases in deferred revenue, liabilities associated with assets held for sale, dividends payable, purses payable and accrued expenses of $16.5 million, $13.7 million, $6.7 million, $2.9 million and $2.7 million, respectively. Long-term debt increased in connection with borrowings on our revolving line of credit to fund the acquisition of

ATAB and BRIS. Accounts payable increased due to increased payables associated with our 2007 live racing meets, the addition of deposit wagering liabilities associated with our account wagering businesses and the addition of book overdrafts on our bank accounts resulting from funds used to acquire ATAB and BRIS. Deferred revenue decreased primarily due to the recognition of revenues associated with the 2007 Kentucky Derby, Kentucky Oaks and the remainder of the spring meet held at Churchill Downs Racetrack. Liabilities associated with assets held for sale decreased in connection with the sale of the remaining ownership interest in Hoosier Park in March 2007. Purses payable and accrued expenses decreased primarily as a result of payments made upon the conclusion of the winter meet at Fair Grounds.

Liquidity and Capital Resources

The following table is a summary of our liquidity and capital resources (in thousands):

	Nine Months Ended September 30,		Change	
	2007	**2006**	**$**	**%**
Operating activities	$ 55,341	60,351	$ (5,010)	(8)%
Investing activities	$ (127,315)	$ (35,725)	$ (91,590)	(256)%
Financing activities	$ 59,501	$ (22,251)	$ 81,752	367%

Significant items affecting comparability of our liquidity and capital resources include:

The decrease in cash provided by operating activities is primarily the result of excess cash generated during the nine months ended September 30, 2006 by the collection of insurance proceeds related to damages sustained from natural disasters that occurred during 2005. This decrease was partially offset by cash generated by the additional 46 live race days at Fair Grounds during 2007 as well as cash generated by the operations of ATAB, BRIS and TwinSpires.com. We anticipate that cash flows from operations over the next twelve months will be adequate to fund our business operations and capital expenditures.

The increase in cash used in investing activities is attributable primarily to the acquisition of ATAB and BRIS and cash sold in connection with the sale of the remaining ownership interest of Hoosier Park. Additions to plant and equipment during the nine months ended September 30, 2007 primarily included spending related to the new Polytrack racing surface and a new dormitory at Arlington Park as well as the construction of a temporary slot facility at Fair Grounds.

We borrowed in excess of our repayments on our revolving loan facilities of $60.2 million during the nine months ended September 30, 2007 primarily due to the fact that funding was needed for the acquisition of ATAB and BRIS. Repayments exceeded borrowings on our revolving loan facilities by $15.6 million during the nine months ended September 30, 2006 using cash flows generated by business operations and insurance recoveries.

Credit Facilities and Indebtedness

On May 2, 2007, we entered into Amendment No. 1 (the First Amendment) to the Amended and Restated Credit Agreement dated September 23, 2005 (the Agreement). The First Amendment primarily serves (i) to reduce the maximum aggregate commitment under the credit facility from $200 million to $120 million and (ii) to reduce the interest rates applicable to amounts borrowed under this facility. Given the reduction in the maximum aggregate commitment, four lenders that were originally parties to the Agreement are removed as lenders under the terms of the First Amendment. We recognized a loss on extinguishment of debt in the amount of $0.4 million representing the write-off of unamortized deferred financing costs related to our previous credit facility during the second quarter of 2007. All other major terms of the Agreement remain the same including the facility termination date of September 23, 2010. Subject to certain conditions, we may at any time increase the aggregate commitment up to an amount not to exceed $170 million.

Generally, borrowings made pursuant to the First Amendment will bear interest at a LIBOR-based rate per annum plus an applicable percentage ranging from 0.50% to 1.50% depending on certain of our financial ratios. In addition, under the First Amendment, we agreed to pay a commitment fee at rates that range from 0.10% to 0.25% of the available aggregate commitment, depending on our leverage ratio.

The First Amendment contains customary financial and other covenant requirements, including specific interest coverage and leverage ratios, as well as minimum levels of net worth. The First Amendment adds a negative covenant that imposes a $100 million cap on the amount of any investment that the Company may make to construct a gaming and/or slot machine facility in Florida in the event that laws in the state permit and the Company obtains authority to engage in such activities. The First Amendment also modifies two of the financial covenants, providing for a one-time increase in the maximum leverage ratio for a period of eight consecutive quarters in the event that the Company constructs a gaming and/or slot facility in Florida and increasing the baseline for the minimum consolidated net worth covenant from $190 million to $290 million.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At September 30, 2007, we had $55.0 million outstanding under our revolving credit facility, which bears interest at LIBOR-based variable rates. We are exposed to market risk on variable rate debt due to potential adverse changes in the LIBOR rate. Assuming the outstanding balance of the debt facilities remain constant, a one-percentage point increase in the LIBOR rate would reduce annual pre-tax earnings, recorded fair value and cash flows by $0.6 million.

ITEM 4 CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by the report, the Company carried out an evaluation under the supervision and with the participation of the Company s Disclosure Committee and management, including the President and Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon this evaluation, the CEO and the CFO concluded that our disclosure controls and procedures were effective as of September 30, 2007.

(b) Changes in Internal Control over Financial Reporting

Management of the Company has evaluated, with the participation of the Company s CEO and CFO, changes in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the third quarter of 2007. There have not been any changes in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2007 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

On June 15, 2005, Jerry Jacobs, a resident of New Orleans, Louisiana, filed a petition with the Civil District Court for the Parish of New Orleans, Louisiana for declaratory judgment alleging that slot machines at Fair Grounds Race Course would violate the New Orleans City Charter that prohibits more than one land-based casino and that the Louisiana statute authorizing slots at racetracks violates the Louisiana constitution. The petition requests injunctive relief prohibiting the operation of slot machines at Fair Grounds Race Course. Churchill Downs Louisiana Horseracing Company, L.L.C., the owner of Fair Grounds Race Course, and the State of Louisiana are defendants in the action. The City of New Orleans intervened in support of the Company and the State of Louisiana. On October 30, 2006, the Civil District Court granted the Company s motion for summary judgment and dismissed Mr. Jacobs petition in its entirety. On November 15, 2006, Mr. Jacobs appealed the Civil District Court s dismissal and the appeal is currently pending in the Court of Appeal for the Fourth Circuit of the State of Louisiana. The case has been fully briefed and the Court of Appeal heard oral arguments on October 11, 2007. A decision is expected in several months.

The Company previously disclosed the existence of this litigation in its periodic reports but had concluded that this litigation was not material due to an opinion of the Louisiana Attorney General that the addition of slot machines at Fair Ground Race Course would not violate the New Orleans City Charter and because the Company had not yet made significant capital expenditures for a slot machine facility at Fair Grounds Race Course. However, given the Company s current ongoing level of capital expenditures on this slot machine facility while this legal proceeding is pending and estimates of the revenue to be generated from this slot machine facility, the Company is now disclosing this legal proceeding under this Item.

While the Company believes that the litigation by Mr. Jacobs is without merit and that the Company will ultimately prevail in this litigation, due to the inherent uncertainties in litigation, there is no assurance on the ultimate outcome of this proceeding. If Mr. Jacobs ultimately prevails in the litigation, the Company may not be authorized to operate slot machines at Fair Grounds Race Course. If the Company is not authorized to operate slot machines at Fair Grounds Race Course, there would be a material, adverse impact on the Company s results of operations.

There are no other pending legal proceedings, other than ordinary routine litigation incidental to our business, to which we are a party or of which any of our property is the subject and no such proceedings are known to be contemplated by governmental authorities.

ITEM 1A. Risk Factors

Information regarding risk factors appears in Part I Item 1A of the Company s Amended Annual Report on Form 10-K/A for the year ended December 31, 2006. Other than as described below, there have been no material changes from the risk factors previously disclosed in the Company s Amended Annual Report on Form 10-K/A.

We may experience difficulty in integrating recent or future acquisitions into our operations.

On June 11, 2007, we acquired through two separate acquisitions certain of the assets and business of AmericaTab and certain of its affiliates and Bloodstock Research Information Services, Inc. and certain of its affiliates. These transactions resulted in our acquiring three account wagering platforms and two data services operations which produces handicapping and pedigree reports sold to participants in the horse racing industry, including horseplayers and racing-related publications. We may pursue additional acquisitions in the future.

The successful integration of newly acquired businesses into our operations will require the expenditure of substantial managerial, operating, financial and other resources and may also lead to a diversion of our attention from our ongoing business concerns. We may not be able to successfully integrate these businesses or realize projected revenue gains, cost savings and synergies in connection with those acquisitions on the timetable contemplated, if at all. Furthermore, the costs of integrating businesses we acquire could significantly impact our short-term operating results. These costs could include:

restructuring charges associated with the acquisitions;

non-recurring acquisition costs, including accounting and legal fees, investment banking fees and recognition of transaction-related costs or liabilities; and

costs of imposing financial and management controls (such as compliance with Section 404 of the Sarbanes-Oxley Act of 2002) and operating, administrative and information systems.

Although we perform financial, operational and legal diligence on the businesses we purchase, in light of the circumstances of each transaction, an unavoidable level of risk remains regarding the actual condition of these businesses and our ability to continue to operate them successfully and integrate them into our existing operations. In any acquisition we make we face risks which include:

the risk that the acquired business may not further our business strategy or that we paid more than the business was worth;

the potential adverse impact on our relationships with partner companies or third-party providers of technology or products;

the possibility that we have acquired substantial undisclosed liabilities;

costs and complications in maintaining required regulatory approvals or obtaining further regulatory approvals necessary to implement the acquisition in accordance with our strategy;

the risks of entering markets in which we have limited or no prior experience;

the potential loss of key employees or customers; and

the possibility that we may be unable to recruit additional managers with the necessary skills to supplement the management of the acquired businesses.

If we are unsuccessful in overcoming these risks, our business, financial condition or results of operations could be adversely affected.

Any infringement by us on intellectual property rights of others could adversely affect our business and operating results or result in litigation.

In the course of our business, we become aware of potentially relevant patents or other intellectual property rights held by other parties. Many of our competitors as well as other companies and individuals have obtained, and may be expected to obtain in the future, patents or other intellectual property rights that concern products or services related to the types of products and services we currently offer or may plan to offer in the future. We evaluate the validity and applicability of these intellectual property rights, and determine in each case whether we must negotiate licenses to incorporate or use the proprietary technologies in our products. Claims of intellectual property infringement may also require us to enter into costly royalty or license agreements. However, we may not be able to obtain royalty or license agreements on terms acceptable to us or at all. We also may be subject to significant damages or injunctions against the development and sale of our products and services.

Our results may be affected by the outcome of litigation within our industry and the protection and validity of our intellectual property rights. For example, on May 17, 2007, ODS Technologies, L.P., d/b/a TVG Network filed a patent infringement lawsuit related to account wagering platforms against MEC, HRTV, LLC and XPRESSBET, Inc. HRTV is owned by MEC and us, each holding a 50% ownership interest. Any litigation regarding patents or other intellectual property could be costly and time consuming and could divert our management and key personnel from our business operations. The complexity of the technology involved and the uncertainty of litigation surrounding it has the effect of increasing the risks associated with certain of our product offerings, particularly in the area of account wagering. There can be no assurance that we would not become a party to litigation surrounding our account wagering business or that such litigation would not cause us to suffer losses or disruption in our business strategy.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

ITEM 3. Defaults Upon Senior Securities

Not applicable.

ITEM 4. Submission of Matters to a Vote of Security Holders

Not Applicable

ITEM 5. Other Information

Not applicable.

ITEM 6. Exhibits

See exhibit index.

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.

	CHURCHILL DOWNS INCORPORATED
November 7, 2007	/s/ Robert L. Evans Robert L. Evans President and Chief Executive Officer (Principal Executive Officer)
November 7, 2007	/s/ William E. Mudd William E. Mudd Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT INDEX

Number	Description	By Reference To
10(a)	Employment Agreement dated as of September 27, 2007 by and between Churchill Downs Incorporated and William E. Mudd	Exhibit 10.1 to Report on Form 8-K dated October 5, 2007
10(b)	Employee Relocation Expense Agreement dated as of October 1, 2007 by and between Churchill Downs Incorporated and William E. Mudd	Exhibit 10.2 to Report on Form 8-K dated October 5, 2007
31(i)(a)	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Report on Form 10-Q for the fiscal quarter ended September 30, 2007
31(i)(b)	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Report on Form 10-Q for the fiscal quarter ended September 30, 2007
32	Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Rule 13a 14(b))	Report on Form 10-Q for the fiscal quarter ended September 30, 2007