

TRIAD HOSPITALS INC  
Form 10-Q  
August 12, 2003

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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

**For the quarterly period ended June 30, 2003**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-29816**

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**Triad Hospitals, Inc.**

(Exact name of registrant as specified in its charter)

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|   |  |
|---|--|
| <b>Delaware</b><br>(State or other jurisdiction<br>of incorporation or organization)                | <b>75-2816101</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>5800 Tennyson Parkway</b><br><br><b>Plano, Texas</b><br>(Address of principal executive offices) | <b>75024</b><br>(Zip Code)                                   |

**(214) 473-7000**

(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, and (2) has been subject to such filing requirements for the past 90 days.

YES

NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES

NO

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

As of July 31, 2003, the number of shares of common stock of Triad Hospitals, Inc. outstanding was 75,251,554.

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**Part I: Financial Information****Item 1: Financial Statements****TRIAD HOSPITALS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****For the periods ended June 30, 2003 and 2002****Unaudited****(Dollars in millions, except per share amounts)**

|   | <b>For the three</b> |                | <b>For the six</b>  |                |
|---|----------------------|----------------|---------------------|----------------|
|   | <b>months ended</b>  |                | <b>months ended</b> |                |
|   | <b>2003</b>          | <b>2002</b>    | <b>2003</b>         | <b>2002</b>    |
| Revenues  | \$ 953.8             | \$ 867.2       | \$ 1,908.3          | \$ 1,728.1     |
| Salaries and benefits   | 395.6                | 363.2          | 788.4               | 717.1          |
| Reimbursable expenses   | 13.6                 | 15.4           | 28.4                | 31.8           |
| Supplies  | 149.7                | 137.1          | 294.8               | 270.6          |
| Other operating expenses  | 179.5                | 159.6          | 354.9               | 315.0          |
| Provision for doubtful accounts   | 78.4                 | 65.9           | 154.6               | 129.5          |
| Depreciation  | 43.3                 | 39.3           | 85.5                | 78.4           |
| Amortization  | 1.5                  | 1.5            | 3.0                 | 3.3            |
| Interest expense  | 33.6                 | 34.9           | 66.8                | 68.1           |
| Interest income   | (0.5)                | (0.4)          | (1.1)               | (0.8)          |
| ESOP expense  | 2.0                  | 2.9            | 4.1                 | 5.3            |
| Litigation settlements  |                      | (4.5)          |                     | (4.5)          |
| (Gain) loss on sales of assets  | 0.1                  | (0.3)          | (1.2)               | (1.9)          |
| <b>Total operating expenses</b>   | <b>896.8</b>         | <b>814.6</b>   | <b>1,778.2</b>      | <b>1,611.9</b> |
| Income before minority interests, equity in earnings and income tax provision | 57.0                 | 52.6           | 130.1               | 116.2          |
| Minority interests in earnings of consolidated entities                       | (2.3)                | (3.8)          | (4.7)               | (7.1)          |
| Equity in earnings of affiliates  | 8.1                  | 5.6            | 15.3                | 11.7           |
| Income before income tax provision  | 62.8                 | 54.4           | 140.7               | 120.8          |
| Income tax provision  | (24.8)               | (21.6)         | (55.4)              | (47.6)         |
| <b>Net income</b>   | <b>\$ 38.0</b>       | <b>\$ 32.8</b> | <b>\$ 85.3</b>      | <b>\$ 73.2</b> |

Income per common share:

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|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.52 | \$ 0.46 | \$ 1.16 | \$ 1.03 |
| Diluted | \$ 0.51 | \$ 0.44 | \$ 1.14 | \$ 0.99 |

See notes to the condensed consolidated financial statements.

## TRIAD HOSPITALS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(Dollars in millions)

|   | June 30,<br>2003  | December 31,<br>2002 |
|---|-------------------|----------------------|
| <b>ASSETS</b>   |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents   | \$ 99.7           | \$ 68.3              |
| Accounts receivable, less allowances for doubtful accounts of \$180.2 at June 30, 2003 and \$174.4 at December 31, 2002 | 526.0             | 507.4                |
| Inventories   | 99.7              | 95.5                 |
| Deferred income taxes   | 20.5              | 62.3                 |
| Prepaid expenses  | 38.1              | 36.6                 |
| Other   | 65.8              | 74.3                 |
|   | <u>849.8</u>      | <u>844.4</u>         |
| Property and equipment, at cost:  |                   |                      |
| Land  | 168.2             | 171.5                |
| Buildings and improvements  | 1,406.8           | 1,340.6              |
| Equipment   | 1,192.2           | 1,150.8              |
| Construction in progress  | 73.4              | 79.6                 |
|   | <u>2,840.6</u>    | <u>2,742.5</u>       |
| Accumulated depreciation  | (854.8)           | (787.3)              |
|   | <u>1,985.8</u>    | <u>1,955.2</u>       |
| Goodwill  | 1,224.0           | 1,224.0              |
| Intangible assets, net of accumulated amortization  | 68.4              | 72.0                 |
| Investment in and advances to affiliates  | 189.3             | 179.7                |
| Other   | 109.6             | 106.3                |
|   | <u>4,426.9</u>    | <u>4,381.6</u>       |
| Total assets  | <u>\$ 4,426.9</u> | <u>\$ 4,381.6</u>    |
| <b>LIABILITIES AND EQUITY</b>   |                   |                      |
| Current liabilities:  |                   |                      |
| Accounts payable  | \$ 113.0          | \$ 132.5             |
| Accrued salaries  | 97.9              | 107.6                |
| Current portion of long-term debt   | 82.5              | 73.1                 |
| Other current liabilities   | 128.2             | 132.0                |
|   | <u>421.6</u>      | <u>445.2</u>         |
| Long-term debt  | 1,576.1           | 1,618.9              |
| Other liabilities   | 99.0              | 86.6                 |
| Deferred taxes  | 155.6             | 151.1                |
| Minority interests in equity of consolidated entities   | 124.5             | 125.3                |
| Stockholders' equity:   |                   |                      |

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|   |                   |                   |
|---|-------------------|-------------------|
| Common stock .01 par value: 120,000,000 shares authorized, 75,218,357 and 74,937,635 shares issued and outstanding at June 30, 2003 and December 31, 2002, respectively | 0.8               | 0.7               |
| Additional paid-in capital  | 1,891.8           | 1,883.5           |
| Accumulated other comprehensive loss  | (3.8)             | (4.0)             |
| Unearned ESOP compensation  | (19.0)            | (20.7)            |
| Accumulated earnings  | 180.3             | 95.0              |
|   | <u>          </u> | <u>          </u> |
| Total stockholders' equity  | 2,050.1           | 1,954.5           |
|   | <u>          </u> | <u>          </u> |
| Total liabilities and stockholders' equity  | \$ 4,426.9        | \$ 4,381.6        |
|   | <u>          </u> | <u>          </u> |

See notes to the condensed consolidated financial statements.

**TRIAD HOSPITALS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the periods ended June 30, 2003 and 2002**

**Unaudited**

**(Dollars in millions)**

|   | <b>For the six</b>  |                   |
|---|---------------------|-------------------|
|   | <b>months ended</b> |                   |
|   | <b>2003</b>         | <b>2002</b>       |
|   | <u>          </u>   | <u>          </u> |
| Cash flows from operating activities  |                     |                   |
| Net income  | \$ 85.3             | \$ 73.2           |
| Adjustments to reconcile net income to net cash provided by operating activities: |                     |                   |
| Provision for doubtful accounts   | 154.6               | 129.5             |
| Depreciation and amortization   | 88.5                | 81.7              |
| ESOP expense  | 4.1                 | 5.3               |
| Minority interests  | 4.7                 | 7.1               |
| Equity in earnings of affiliates  | (15.3)              | (11.7)            |
| (Gain) loss on sales of assets  | (1.2)               | (1.9)             |
| Deferred income taxes   | 46.3                | 47.6              |
| Non-cash interest expense   | 3.8                 | 3.7               |
| Non-cash stock option expense   | 0.2                 | 0.2               |
| Increase (decrease) in cash from operating assets and liabilities                 |                     |                   |
| Accounts receivable   | (173.2)             | (158.5)           |
| Inventories and other assets  | (4.0)               | (16.3)            |
| Accounts payable and other current liabilities                                    | (33.0)              | (5.5)             |
| Other   | 12.9                | 1.2               |
|   | <u>          </u>   | <u>          </u> |
| Net cash provided by operating activities   | 173.7               | 155.6             |
| Cash flows from investing activities  |                     |                   |
| Purchases of property and equipment   | (118.9)             | (148.0)           |
| Distributions and advances from affiliates  | 6.4                 | 17.2              |
| Proceeds received on sales of assets  | 3.8                 | 1.9               |
| Restricted cash   |                     | 5.7               |
| Other   | (0.3)               | (0.4)             |
|   | <u>          </u>   | <u>          </u> |
| Net cash used in investing activities   | (109.0)             | (123.6)           |
| Cash flows from financing activities  |                     |                   |
| Payments of long-term debt  | (33.9)              | (61.8)            |
| Proceeds from issuance of common stock  | 6.1                 | 29.1              |
| Proceeds from executive stock purchase plan loans                                 |                     | 10.1              |
| Distributions to minority partners, net   | (5.5)               | (7.7)             |
|   | <u>          </u>   | <u>          </u> |
| Net cash used in financing activities   | (33.3)              | (30.3)            |

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|  |                   |                   |
|--|-------------------|-------------------|
|  | <u>          </u> | <u>          </u> |
| Change in cash and cash equivalents              | 31.4              | 1.7               |
| Cash and cash equivalents at beginning of period | <u>68.3</u>       | <u>16.3</u>       |
| Cash and cash equivalents at end of period       | <u>\$ 99.7</u>    | <u>\$ 18.0</u>    |
| Interest payments                                | \$ 63.7           | \$ 66.4           |
| Income tax payments                              | \$ 2.7            | \$ 7.8            |

See notes to the condensed consolidated financial statements.



**TRIAD HOSPITALS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements of Triad Hospitals, Inc. ( Triad ). In the opinion of management, all adjustments necessary for a fair presentation have been included and are of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the year. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2002 included in Triad s Form 10-K.

The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

**NOTE 2 STOCK BENEFIT PLANS**

Triad s stock-based compensation plans are accounted for under the recognition and measurement principles of APB Opinion No. 25 Accounting for Stock Issued to Employees ( APB 25 ) and related interpretations. APB 25 uses the intrinsic value method to account for options granted to employees. Stock-based compensation is generally not recognized since the option price is typically equal to the market value of the underlying common stock on the date of grant. Triad adopted the disclosure provisions of Statement of Financial Accounting Standards No. 148 Accounting for Stock-Based Compensation Transition and Disclosures ( SFAS 148 ) on December 31, 2002. The disclosure provisions of SFAS 148 require disclosure of the pro forma effect on net income and earnings per share in interim financial statements as if Triad had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 Accounting for Stock-Based Compensation to all stock-based compensation. The following table illustrates the pro forma effect (dollars in millions except per share amounts).

|  | For the three months<br>ended June 30, |                | For the six months<br>ended June 30, |                |
|--|--|----------------|--------------------------------------|----------------|
|  | 2003                                   | 2002           | 2003                                 | 2002           |
| Net income as reported                                   | \$ 38.0                                | \$ 32.8        | \$ 85.3                              | \$ 73.2        |
| Add: Stock option expense recorded, net of income tax    | 0.1                                    | 0.1            | 0.2                                  | 0.2            |
| Less: Fair value stock option expense, net of income tax | (4.7)                                  | (4.5)          | (8.5)                                | (7.7)          |
| <b>Pro forma net income</b>                              | <b>\$ 33.4</b>                         | <b>\$ 28.4</b> | <b>\$ 77.0</b>                       | <b>\$ 65.7</b> |
| <br>   |  |                |                                      |                |
| Basic income per share, as reported                      | \$ 0.52                                | \$ 0.46        | \$ 1.16                              | \$ 1.03        |
| Add: Stock option expense recorded, net of income tax    |  |                |                                      |                |

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|  |         |         |         |         |
|--|---------|---------|---------|---------|
| Less: Fair value stock option expense, net of income tax | (0.06)  | (0.06)  | (0.11)  | (0.10)  |
| Pro forma basic income per share                         | \$ 0.46 | \$ 0.40 | \$ 1.05 | \$ 0.93 |
| Diluted income per share, as reported                    | \$ 0.51 | \$ 0.44 | \$ 1.14 | \$ 0.99 |
| Add: Stock option expense recorded, net of income tax    |         |         |         |         |
| Less: Fair value stock option expense, net of income tax | (0.06)  | (0.06)  | (0.10)  | (0.10)  |
| Pro forma diluted income per share                       | \$ 0.45 | \$ 0.38 | \$ 1.04 | \$ 0.89 |

During the six months ended June 30, 2003, 214,453 shares of common stock were issued through the Employee Stock Purchase Plan for proceeds of \$4.7 million and 16,235 shares of common stock were issued through the Management Stock Purchase Plan, net of cancellations, for proceeds of \$0.4 million. Additionally during the six months ended June 30, 2003, 50,031 stock options were exercised for proceeds of \$1.0 million.

During the six months ended June 30, 2003, 1,276,800 stock options were granted under the 1999 Long-Term Incentive Plan with an exercise price equal to the market price at the date of grant. The options are exercisable over a four-year period and expire ten years from date of grant.

**TRIAD HOSPITAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**NOTE 3 LONG-TERM DEBT**

Triad's senior subordinated notes and senior notes are guaranteed by all wholly-owned operating subsidiaries of Triad (the Guarantor Subsidiaries). The guarantee obligations of the Guarantor Subsidiaries are full, unconditional and joint and several. Triad's non-wholly owned operating subsidiaries do not guarantee the notes (the Non-Guarantor Subsidiaries).

Condensed unaudited consolidating financial statements for Triad and its subsidiaries including the financial statements of Triad Hospitals, Inc. (parent only), the combined Guarantor Subsidiaries and the combined Non-Guarantor Subsidiaries are as follows:

Consolidating Statement of Operations

For the three months ended June 30, 2003

Unaudited

(Dollars in millions)

|                                 | <b>Triad</b>           |                     | <b>Non-</b>         |                     |                     |
|---------------------------------|------------------------|---------------------|---------------------|---------------------|---------------------|
|                                 | <b>Hospitals, Inc.</b> | <b>Guarantor</b>    | <b>Guarantor</b>    | <b>Eliminations</b> | <b>Consolidated</b> |
|                                 | <u>          </u>      | <u>Subsidiaries</u> | <u>Subsidiaries</u> | <u>          </u>   | <u>          </u>   |
| Revenues                        | \$                     | \$ 799.9            | \$ 156.3            | \$ (2.4)            | \$ 953.8            |
| Salaries and benefits           | 0.1                    | 319.3               | 76.2                |                     | 395.6               |
| Reimbursable expenses           |                        | 13.6                |                     |                     | 13.6                |
| Supplies                        |                        | 128.0               | 21.7                |                     | 149.7               |
| Other operating expenses        | 0.2                    | 149.4               | 30.1                | (0.2)               | 179.5               |
| Provision for doubtful accounts |                        | 68.2                | 10.2                |                     | 78.4                |
| Depreciation                    |                        | 36.9                | 6.4                 |                     | 43.3                |
| Amortization                    |                        | 1.5                 |                     |                     | 1.5                 |
| Interest expense allocated      |                        | (3.4)               | 3.4                 |                     |                     |
| Interest expense, net           | 32.6                   | 0.6                 | (0.1)               |                     | 33.1                |
| ESOP expense                    | 2.0                    |                     |                     |                     | 2.0                 |
| Management fees                 |                        |                     | 2.2                 | (2.2)               |                     |
| Loss on sales of assets         |                        | 0.1                 |                     |                     | 0.1                 |
|                                 | <u>34.9</u>            | <u>714.2</u>        | <u>150.1</u>        | <u>(2.4)</u>        | <u>896.8</u>        |
| Total operating expenses        |                        |                     |                     |                     |                     |

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|  |                 |                 |                 |                 |                 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|
| Income (loss) before minority interests, equity in earnings and income tax provision | (34.9)          | 85.7            | 6.2             |                 | 57.0            |
| Minority interests   |                 | (2.2)           | (0.1)           |                 | (2.3)           |
| Equity in earnings of affiliates   | 97.7            | 14.2            |                 | (103.8)         | 8.1             |
|  | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Income before income tax provision   | 62.8            | 97.7            | 6.1             | (103.8)         | 62.8            |
| Income tax provision   | (24.8)          |                 |                 |                 | (24.8)          |
|  | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Net income   | \$ 38.0         | \$ 97.7         | \$ 6.1          | \$ (103.8)      | \$ 38.0         |
|  | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |

## TRIAD HOSPITAL INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

## NOTE 3 LONG-TERM DEBT (continued)

Consolidating Statement of Operations

For the three months ended June 30, 2002

Unaudited

(dollars in millions)

|  | Triad                  | Guarantor           | Non-<br>Guarantor   | Eliminations | Consolidated |
|--|------------------------|---------------------|---------------------|--------------|--------------|
|  | <u>Hospitals, Inc.</u> | <u>Subsidiaries</u> | <u>Subsidiaries</u> | <u></u>      | <u></u>      |
| Revenues   | \$                     | \$ 721.5            | \$ 148.1            | \$ (2.4)     | \$ 867.2     |
| Salaries and benefits  | 0.1                    | 290.7               | 72.4                |              | 363.2        |
| Reimbursable expenses  |                        | 15.4                |                     |              | 15.4         |
| Supplies   |                        | 115.8               | 21.3                |              | 137.1        |
| Other operating expenses   | 1.5                    | 130.8               | 27.3                |              | 159.6        |
| Provision for doubtful accounts  |                        | 55.8                | 10.1                |              | 65.9         |
| Depreciation   |                        | 33.1                | 6.2                 |              | 39.3         |
| Amortization   |                        | 1.5                 |                     |              | 1.5          |
| Interest expense allocated   |                        | (2.3)               | 2.3                 |              |              |
| Interest expense, net  | 33.3                   | 1.2                 |                     |              | 34.5         |
| ESOP expense   | 2.9                    |                     |                     |              | 2.9          |
| Litigation settlements   | (4.5)                  |                     |                     |              | (4.5)        |
| Management fees  |                        |                     | 2.4                 | (2.4)        |              |
| Gain on sales of assets  |                        | (0.2)               | (0.1)               |              | (0.3)        |
| Total operating expenses   | <u>33.3</u>            | <u>641.8</u>        | <u>141.9</u>        | <u>(2.4)</u> | <u>814.6</u> |
| Income (loss) before minority interests, equity in earnings and income tax provision | (33.3)                 | 79.7                | 6.2                 |              | 52.6         |
| Minority interests   |                        | (4.6)               | 0.8                 |              | (3.8)        |
| Equity in earnings of affiliates   | 87.7                   | 12.6                |                     | (94.7)       | 5.6          |
| Income before income tax provision   | 54.4                   | 87.7                | 7.0                 | (94.7)       | 54.4         |
| Income tax provision   | (21.6)                 |                     |                     |              | (21.6)       |

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|------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|            | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net income | \$ 32.8           | \$ 87.7           | \$ 7.0            | \$ (94.7)         | \$ 32.8           |
|            | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

## TRIAD HOSPITAL INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

## NOTE 3 LONG-TERM DEBT (continued)

Consolidating Statement of Operations

For the six months ended June 30, 2003

Unaudited

(Dollars in millions)

|  | Triad                  | Guarantor           | Non-<br>Guarantor   | Eliminations | Consolidated   |
|--|------------------------|---------------------|---------------------|--------------|----------------|
|  | <u>Hospitals, Inc.</u> | <u>Subsidiaries</u> | <u>Subsidiaries</u> | <u></u>      | <u></u>        |
| Revenues   | \$                     | \$ 1,598.9          | \$ 314.0            | \$ (4.6)     | \$ 1,908.3     |
| Salaries and benefits  | 0.2                    | 633.3               | 154.9               |              | 788.4          |
| Reimbursable expenses  |                        | 28.4                |                     |              | 28.4           |
| Supplies   |                        | 252.1               | 42.7                |              | 294.8          |
| Other operating expenses   | 0.3                    | 293.5               | 61.3                | (0.2)        | 354.9          |
| Provision for doubtful accounts  |                        | 134.2               | 20.4                |              | 154.6          |
| Depreciation   |                        | 72.6                | 12.9                |              | 85.5           |
| Amortization   |                        | 3.0                 |                     |              | 3.0            |
| Interest expense allocated   |                        | (6.5)               | 6.5                 |              |                |
| Interest expense, net  | 65.3                   | 0.5                 | (0.1)               |              | 65.7           |
| ESOP expense   | 4.1                    |                     |                     |              | 4.1            |
| Management fees  |                        |                     | 4.4                 | (4.4)        |                |
| Gain on sales of assets  |                        | (1.2)               |                     |              | (1.2)          |
| Total operating expenses   | <u>69.9</u>            | <u>1,409.9</u>      | <u>303.0</u>        | <u>(4.6)</u> | <u>1,778.2</u> |
| Income (loss) before minority interests, equity in earnings and income tax provision | (69.9)                 | 189.0               | 11.0                |              | 130.1          |
| Minority interests   |                        | (4.6)               | (0.1)               |              | (4.7)          |
| Equity in earnings of affiliates   | 210.6                  | 26.2                |                     | (221.5)      | 15.3           |
| Income before income tax provision   | 140.7                  | 210.6               | 10.9                | (221.5)      | 140.7          |
| Income tax provision   | (55.4)                 |                     |                     |              | (55.4)         |

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|            |         |          |         |            |         |
|------------|---------|----------|---------|------------|---------|
| Net income | \$ 85.3 | \$ 210.6 | \$ 10.9 | \$ (221.5) | \$ 85.3 |
|------------|---------|----------|---------|------------|---------|



## TRIAD HOSPITAL INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

## NOTE 3 LONG-TERM DEBT (continued)

Consolidating Statement of Operations

For the six months ended June 30, 2002

Unaudited

(dollars in millions)

|  | Triad<br>Hospitals, Inc. | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations   | Consolidated   |
|--|--------------------------|---------------------------|-----------------------------------|----------------|----------------|
| Revenues   | \$                       | \$ 1,439.4                | \$ 293.8                          | \$ (5.1)       | \$ 1,728.1     |
| Salaries and benefits  | 0.2                      | 573.1                     | 143.8                             |                | 717.1          |
| Reimbursable expenses  |                          | 31.8                      |                                   |                | 31.8           |
| Supplies   |                          | 228.7                     | 41.9                              |                | 270.6          |
| Other operating expenses   | 1.7                      | 260.2                     | 53.1                              |                | 315.0          |
| Provision for doubtful accounts  |                          | 109.2                     | 20.3                              |                | 129.5          |
| Depreciation   |                          | 66.6                      | 11.8                              |                | 78.4           |
| Amortization   |                          | 3.0                       | 0.3                               |                | 3.3            |
| Interest expense allocated   |                          | (4.5)                     | 4.5                               |                |                |
| Interest expense, net  | 65.8                     | 1.4                       | 0.1                               |                | 67.3           |
| ESOP expense   | 5.3                      |                           |                                   |                | 5.3            |
| Litigation settlements   | (4.5)                    |                           |                                   |                | (4.5)          |
| Management fees  |                          |                           | 5.1                               | (5.1)          |                |
| Gain on sales of assets  |                          | (1.8)                     | (0.1)                             |                | (1.9)          |
| <b>Total operating expenses</b>  | <b>68.5</b>              | <b>1,267.7</b>            | <b>280.8</b>                      | <b>(5.1)</b>   | <b>1,611.9</b> |
| Income (loss) before minority interests, equity in earnings and income tax provision | (68.5)                   | 171.7                     | 13.0                              |                | 116.2          |
| Minority interests   |                          | (8.1)                     | 1.0                               |                | (7.1)          |
| Equity in earnings of affiliates   | 189.3                    | 25.7                      |                                   | (203.3)        | 11.7           |
| <b>Income before income tax provision</b>  | <b>120.8</b>             | <b>189.3</b>              | <b>14.0</b>                       | <b>(203.3)</b> | <b>120.8</b>   |

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|                      |                |                   |                   |                   |                |
|----------------------|----------------|-------------------|-------------------|-------------------|----------------|
| Income tax provision | <u>(47.6)</u>  | <u>          </u> | <u>          </u> | <u>          </u> | <u>(47.6)</u>  |
| Net income           | <u>\$ 73.2</u> | <u>\$ 189.3</u>   | <u>\$ 14.0</u>    | <u>\$ (203.3)</u> | <u>\$ 73.2</u> |

**TRIAD HOSPITAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**NOTE 3 LONG-TERM DEBT (continued)**

Condensed Consolidating Balance Sheets

June 30, 2003

Unaudited

(Dollars in millions)

|   | <b>Triad</b>           |                   | <b>Non-Guarantor</b> |                     |                     |
|---|------------------------|-------------------|----------------------|---------------------|---------------------|
|   | <b>Hospitals, Inc.</b> | <b>Guarantor</b>  | <b>Subsidiaries</b>  | <b>Eliminations</b> | <b>Consolidated</b> |
|   | <u>          </u>      | <u>          </u> | <u>          </u>    | <u>          </u>   | <u>          </u>   |
| <b>Assets</b>   |                        |                   |                      |                     |                     |
| Current assets  |                        |                   |                      |                     |                     |
| Cash and cash equivalents                             | \$                     | \$ 95.0           | \$ 4.7               | \$                  | \$ 99.7             |
| Accounts receivable, net                              |                        | 429.3             | 96.7                 |                     | 526.0               |
| Other current assets                                  | 29.5                   | 176.8             | 25.6                 | (7.8)               | 224.1               |
|   | <u>          </u>      | <u>          </u> | <u>          </u>    | <u>          </u>   | <u>          </u>   |
| Total current assets                                  | 29.5                   | 701.1             | 127.0                | (7.8)               | 849.8               |
| Net property and equipment, at cost                   |                        | 1,673.8           | 312.0                |                     | 1,985.8             |
| Goodwill  |                        | 1,185.3           | 38.7                 |                     | 1,224.0             |
| Intangible assets                                     |                        | 68.4              |                      |                     | 68.4                |
| Investment in and advances to affiliates              | 1,857.7                | 436.5             |                      | (2,104.9)           | 189.3               |
| Due from affiliates                                   | 1,913.2                |                   |                      | (1,913.2)           |                     |
| Other   | 53.1                   | 83.2              | 0.3                  | (27.0)              | 109.6               |
|   | <u>          </u>      | <u>          </u> | <u>          </u>    | <u>          </u>   | <u>          </u>   |
| Total assets  | \$ 3,853.5             | \$ 4,148.3        | \$ 478.0             | \$ (4,052.9)        | \$ 4,426.9          |
| <b>Liabilities and Equity</b>                         |                        |                   |                      |                     |                     |
| Current liabilities                                   | \$ 70.0                | \$ 313.2          | \$ 39.9              | \$ (1.5)            | \$ 421.6            |
| Due to affiliates                                     |                        | 1,780.8           | 132.4                | (1,913.2)           |                     |
| Long-term debt  | 1,572.8                | 30.3              | 6.3                  | (33.3)              | 1,576.1             |
| Deferred taxes and other liabilities                  | 160.6                  | 94.0              |                      |                     | 254.6               |
| Minority interests in equity of consolidated entities |                        | 72.3              | 52.2                 |                     | 124.5               |
| Equity  | 2,050.1                | 1,857.7           | 247.2                | (2,104.9)           | 2,050.1             |
|   | <u>          </u>      | <u>          </u> | <u>          </u>    | <u>          </u>   | <u>          </u>   |
| Total liabilities and equity                          | \$ 3,853.5             | \$ 4,148.3        | \$ 478.0             | \$ (4,052.9)        | \$ 4,426.9          |

Condensed Consolidating Balance Sheets

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December 31, 2002

Unaudited

(Dollars in millions)

|   | <b>Triad</b>           | <b>Guarantor</b>    | <b>Non-Guarantor</b> |                     |                     |
|---|------------------------|---------------------|----------------------|---------------------|---------------------|
|   | <b>Hospitals, Inc.</b> | <b>Subsidiaries</b> | <b>Subsidiaries</b>  | <b>Eliminations</b> | <b>Consolidated</b> |
| <b>Assets</b>   |                        |                     |                      |                     |                     |
| Current assets  |                        |                     |                      |                     |                     |
| Cash and cash equivalents                             | \$                     | \$ 60.5             | \$ 7.8               | \$                  | \$ 68.3             |
| Accounts receivable, net                              |                        | 420.8               | 86.6                 |                     | 507.4               |
| Other current assets                                  | 78.0                   | 176.1               | 22.6                 | (8.0)               | 268.7               |
|   | <u>78.0</u>            | <u>657.4</u>        | <u>117.0</u>         | <u>(8.0)</u>        | <u>844.4</u>        |
| Total current assets                                  | 78.0                   | 657.4               | 117.0                | (8.0)               | 844.4               |
| Net property and equipment, at cost                   |                        | 1,639.5             | 315.7                |                     | 1,955.2             |
| Goodwill  |                        | 1,175.7             | 48.3                 |                     | 1,224.0             |
| Intangible assets                                     |                        | 72.0                |                      |                     | 72.0                |
| Investment in and advances to affiliates              | 1,674.3                | 445.1               |                      | (1,939.7)           | 179.7               |
| Due from affiliates                                   | 2,004.5                |                     |                      | (2,004.5)           |                     |
| Other   | 56.4                   | 76.9                |                      | (27.0)              | 106.3               |
|   | <u>3,813.2</u>         | <u>4,066.6</u>      | <u>481.0</u>         | <u>(3,979.2)</u>    | <u>4,381.6</u>      |
| Total assets  | \$ 3,813.2             | \$ 4,066.6          | \$ 481.0             | \$ (3,979.2)        | \$ 4,381.6          |
| <b>Liabilities and Equity</b>                         |                        |                     |                      |                     |                     |
| Current liabilities                                   | \$ 85.9                | \$ 313.9            | \$ 46.8              | \$ (1.4)            | \$ 445.2            |
| Due to affiliates                                     |                        | 1,895.1             | 109.4                | (2,004.5)           |                     |
| Long-term debt  | 1,615.3                | 30.7                | 6.5                  | (33.6)              | 1,618.9             |
| Deferred taxes and other liabilities                  | 157.5                  | 80.2                |                      |                     | 237.7               |
| Minority interests in equity of consolidated entities |                        | 72.4                | 52.9                 |                     | 125.3               |
| Equity  | 1,954.5                | 1,674.3             | 265.4                | (1,939.7)           | 1,954.5             |
|   | <u>3,813.2</u>         | <u>4,066.6</u>      | <u>481.0</u>         | <u>(3,979.2)</u>    | <u>4,381.6</u>      |
| Total liabilities and equity                          | \$ 3,813.2             | \$ 4,066.6          | \$ 481.0             | \$ (3,979.2)        | \$ 4,381.6          |

**TRIAD HOSPITAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**NOTE 3 LONG-TERM DEBT (continued)**

Condensed Consolidating Statements of Cash Flows

For the six months ended June 30, 2003

Unaudited

(Dollars in millions)

|   | <b>Triad</b>           | <b>Guarantor</b>    | <b>Non-Guarantor</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|------------------------|---------------------|----------------------|---------------------|---------------------|
|   | <b>Hospitals, Inc.</b> | <b>Subsidiaries</b> | <b>Subsidiaries</b>  | <b>Eliminations</b> | <b>Consolidated</b> |
| Net cash provided by (used in) operating activities | \$ (84.9)              | \$ 262.7            | \$ (4.1)             | \$                  | \$ 173.7            |
| Cash flows from investing activities                |                        |                     |                      |                     |                     |
| Purchases of property and equipment                 |                        | (109.6)             | (9.3)                |                     | (118.9)             |
| Distributions and advances (to) from affiliates     | 20.8                   | (14.4)              |                      |                     | 6.4                 |
| Proceeds received on sales of assets                |                        | 3.8                 |                      |                     | 3.8                 |
| Other   |                        | (0.3)               |                      |                     | (0.3)               |
| Net cash provided by (used in) investing activities | 20.8                   | (120.5)             | (9.3)                |                     | (109.0)             |
| Cash flows from financing activities                |                        |                     |                      |                     |                     |
| Payments of long-term debt                          | (33.0)                 | (0.7)               | (0.2)                |                     | (33.9)              |
| Proceeds from issuance of common stock              | 6.1                    |                     |                      |                     | 6.1                 |
| Distributions to minority partners                  |                        | (4.7)               | (0.8)                |                     | (5.5)               |
| Net change in due to (from) affiliates              | 91.0                   | (102.3)             | 11.3                 |                     |                     |
| Net cash provided by (used in) financing activities | 64.1                   | (107.7)             | 10.3                 |                     | (33.3)              |
| Change in cash and cash equivalents                 |                        | 34.5                | (3.1)                |                     | 31.4                |
| Cash and cash equivalents at beginning of period    |                        | 60.5                | 7.8                  |                     | 68.3                |
| Cash and cash equivalents at end of period          | \$                     | \$ 95.0             | \$ 4.7               | \$                  | \$ 99.7             |

Condensed Consolidating Statements of Cash Flows

For the six months ended June 30, 2002

Unaudited

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(Dollars in millions)

|   | Triad<br>Hospitals, Inc. | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--------------------------|---------------------------|-------------------------------|--------------|--------------|
| Net cash provided by (used in) operating activities | \$ (67.3)                | \$ 197.9                  | \$ 25.0                       | \$           | \$ 155.6     |
| Cash flows from investing activities                |                          |                           |                               |              |              |
| Purchases of property and equipment                 |                          | (109.1)                   | (38.9)                        |              | (148.0)      |
| Distributions and advances (to) from affiliates     | 169.5                    | (122.5)                   | (29.8)                        |              | 17.2         |
| Proceeds received on sales of assets                |                          | 1.8                       | 0.1                           |              | 1.9          |
| Restricted cash                                     | 5.7                      |                           |                               |              | 5.7          |
| Other   |                          | (0.4)                     |                               |              | (0.4)        |
| Net cash provided by (used in) investing activities | 175.2                    | (230.2)                   | (68.6)                        |              | (123.6)      |
| Cash flows from financing activities                |                          |                           |                               |              |              |
| Payments of long-term debt                          | (53.6)                   | (1.3)                     | (6.9)                         |              | (61.8)       |
| Proceeds from issuance of common stock              | 29.1                     |                           |                               |              | 29.1         |
| Proceeds from executive stock purchase plan loans   | 10.1                     |                           |                               |              | 10.1         |
| Distributions to minority partners                  |                          | (6.8)                     | (0.9)                         |              | (7.7)        |
| Net long term borrowing (to) from affiliates        | (33.9)                   | 27.0                      | 6.9                           |              |              |
| Net change in due to (from) affiliates              | (59.6)                   | 13.3                      | 46.3                          |              |              |
| Net cash provided by (used in) financing activities | (107.9)                  | 32.2                      | 45.4                          |              | (30.3)       |
| Change in cash and cash equivalents                 |                          | (0.1)                     | 1.8                           |              | 1.7          |
| Cash and cash equivalents at beginning of period    |                          | 14.7                      | 1.6                           |              | 16.3         |
| Cash and cash equivalents at end of period          | \$                       | \$ 14.6                   | \$ 3.4                        | \$           | \$ 18.0      |

**NOTE 4 GUARANTEES**

Triad has entered into agreements whereby it has guaranteed certain loans entered into by patients who had services performed at Triad's facilities. These loans are provided by various financial institutions. Triad would be obligated to repay the financial institutions if a patient fails to repay the loan. Triad would then pursue collections from the patient. At June 30, 2003, the amounts subject to the guarantees were \$17.0 million. Triad had accrued liabilities of \$3.7 million at June 30, 2003 for the estimated loan defaults that would be covered under the guarantees.

Prior to January 1, 2003, Triad entered into agreements to guarantee the indebtedness of certain joint ventures that are accounted for by the equity method. The ultimate amounts of the guarantees are \$1.9 million at June 30, 2003.

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**TRIAD HOSPITAL INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Unaudited****NOTE 5 DERIVATIVE FINANCIAL INSTRUMENTS**

Triad has entered into an interest rate swap agreement, which effectively converts a notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in January 2004. Triad pays a rate of 3.22% and receives LIBOR, which was set at 1.29% at June 30, 2003. Subsequent to June 30, 2003, the LIBOR rate was reset at 1.11%. Triad has entered into another interest rate swap agreement, which effectively converts an additional notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in June 2005. Triad pays a rate of 3.99% and receives LIBOR, which was set at 1.09% at June 30, 2003.

Both of the interest rate swap agreements are with the same counterparty. Triad is exposed to credit losses in the event of nonperformance by the counterparty. The counterparty is a creditworthy financial institution and it is anticipated that the counterparty will be able to fully satisfy its obligations under the contracts. The interest rate swaps are designated as cash flow hedges and Triad believes that the hedges are highly effective.

At June 30, 2003 the fair value of the interest rate swaps were liabilities of \$5.0 million recorded in other liabilities and \$1.1 million recorded in other current liabilities in the condensed consolidated balance sheet. At December 31, 2002 the fair value of the interest rate swaps was a liability of \$6.4 million and was recorded in other liabilities in the condensed consolidated balance sheet. The change in the fair value of the interest rate swaps was recognized through other comprehensive loss (see NOTE 8).

**NOTE 6 INCOME PER SHARE**

Income per common share is based on the weighted average number of shares outstanding adjusted for the shares issued to Triad's Employee Stock Ownership Plan (ESOP). Diluted weighted average shares outstanding is calculated by adjusting basic Weighted average shares outstanding by all potentially dilutive stock options. Options outstanding of 6,627,488 and 162,890 were not included in the computation of diluted earnings per share in 2003 and 2002, respectively, because the exercise prices of the options were greater than the average market price of the common stock. Weighted average shares for the three and six months ended June 30, 2003 and 2002 are as follows:

|   | <b>For the three months<br/>ended</b> |             | <b>For the six months ended</b> |             |
|---|---------------------------------------|-------------|---------------------------------|-------------|
|   | <b>2003</b>                           | <b>2002</b> | <b>2003</b>                     | <b>2002</b> |
| Weighted average shares exclusive of unreleased ESOP shares | 73,227,240                            | 71,126,433  | 73,193,133                      | 70,659,441  |
| Weighted average of ESOP shares committed to be released    | 112,500                               | 112,500     | 75,000                          | 75,000      |
| Basic weighted average shares outstanding                   | 73,339,740                            | 71,238,933  | 73,268,133                      | 70,734,441  |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Effect of dilutive securities – employee stock options | 1,560,407  | 3,727,364  | 1,707,696  | 3,529,104  |
| Diluted weighted average shares outstanding            | 74,900,147 | 74,966,297 | 74,975,829 | 74,263,545 |

**NOTE 7 SEGMENT AND GEOGRAPHIC INFORMATION**

The distribution of Triad's revenues and EBITDA (which is used by management for operating performance review, see (a)) is summarized in the following table (dollars in millions):



## TRIAD HOSPITAL INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

## NOTE 7 SEGMENT AND GEOGRAPHIC INFORMATION (continued)

|                     | For the three months |                 | For the six months |                   |
|---------------------|----------------------|-----------------|--------------------|-------------------|
|                     | ended June 30,       |                 | ended June 30,     |                   |
|                     | 2003                 | 2002            | 2003               | 2002              |
| <b>Revenues:</b>    |                      |                 |                    |                   |
| Owne d operations   | \$ 916.0             | \$ 825.8        | \$ 1,832.2         | \$ 1,644.2        |
| Management services | 33.2                 | 35.8            | 66.9               | 72.4              |
| Corporate and other | 4.6                  | 5.6             | 9.2                | 11.5              |
|                     | <u>\$ 953.8</u>      | <u>\$ 867.2</u> | <u>\$ 1,908.3</u>  | <u>\$ 1,728.1</u> |
| <b>EBITDA (a):</b>  |                      |                 |                    |                   |
| Owne d operations   | \$ 153.6             | \$ 137.2        | \$ 313.7           | \$ 284.6          |
| Management services | 2.8                  | 6.5             | 7.5                | 12.7              |
| Corporate and other | (11.3)               | (12.1)          | (18.7)             | (21.5)            |
|                     | <u>\$ 145.1</u>      | <u>\$ 131.6</u> | <u>\$ 302.5</u>    | <u>\$ 275.8</u>   |

EBITDA for owned operations includes equity in earnings of affiliates of \$8.1 million and \$5.6 million in the three months ended June 30, 2003 and 2002, respectively, and \$15.3 million and \$11.7 million for the six months ended June 30, 2003 and 2002, respectively.

A reconciliation of EBITDA to income before income tax provision follows (in millions):

|                                      | For the three months |          | For the six months |          |
|--------------------------------------|----------------------|----------|--------------------|----------|
|                                      | ended June 30,       |          | ended June 30,     |          |
|                                      | 2003                 | 2002     | 2003               | 2002     |
| Total EBITDA for reportable segments | \$ 145.1             | \$ 131.6 | \$ 302.5           | \$ 275.8 |
| Depreciation                         | 43.3                 | 39.3     | 85.5               | 78.4     |
| Amortization                         | 1.5                  | 1.5      | 3.0                | 3.3      |
| Interest expense                     | 33.6                 | 34.9     | 66.8               | 68.1     |
| Interest income                      | (0.5)                | (0.4)    | (1.1)              | (0.8)    |
| ESOP expense                         | 2.0                  | 2.9      | 4.1                | 5.3      |

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|   |                 |                 |                 |                 |
|---|-----------------|-----------------|-----------------|-----------------|
| Litigation settlements                                  |                 | (4.5)           |                 | (4.5)           |
| (Gain) loss on sales of assets                          | 0.1             | (0.3)           | (1.2)           | (1.9)           |
| Minority interests in earnings of consolidated entities | 2.3             | 3.8             | 4.7             | 7.1             |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |
| Income before income tax provision                      | \$ 62.8         | \$ 54.4         | \$ 140.7        | \$ 120.8        |
|   | <u>        </u> | <u>        </u> | <u>        </u> | <u>        </u> |

- (a) EBITDA is defined as earnings before depreciation, amortization, interest expense, interest income, ESOP expense, litigation settlements, (gain) loss on sales of assets, minority interests in earnings of consolidated entities and income tax provision. EBITDA is used by management to evaluate financial performance and resource allocation for each facility and for Triad as a whole. 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. EBITDA should not be considered as a measure of financial performance under generally accepted accounting principles, and the items excluded from EBITDA are significant components in understanding and assessing financial performance. EBITDA should not be considered in isolation or as an alternative to net income, cash flows generated by operating, investing or financing activities or other financial statement data presented in the condensed consolidated financial statements as an indicator of financial performance or liquidity. Because EBITDA is not a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, EBITDA as presented may not be comparable to other similarly titled measures of other companies.

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**TRIAD HOSPITAL INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Unaudited****NOTE 8 COMPREHENSIVE INCOME**

Statement of Financial Accounting Standards No. 130 Reporting Comprehensive Income ( SFAS 130 ) establishes guidelines for reporting changes in equity during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income includes the net change in the fair value of interest rate swaps, net of income tax, and is included as a component of stockholders' equity.

The components of comprehensive income, net of income tax, are as follows (in millions):

|   | For the three months |         | For the six months |         |
|---|----------------------|---------|--------------------|---------|
|   | ended June 30,       |         | ended June 30,     |         |
|   | 2003                 | 2002    | 2003               | 2002    |
| Net income  | \$ 38.0              | \$ 32.8 | \$ 85.3            | \$ 73.2 |
| Other comprehensive income (loss), net of income tax: |                      |         |                    |         |
| Net change in fair value of interest rate swaps       | 0.4                  | (1.5)   | 0.2                | (1.0)   |
| Comprehensive income                                  | \$ 38.4              | \$ 31.3 | \$ 85.5            | \$ 72.2 |

Accumulated other comprehensive loss, net of income tax, at June 30, 2003 is comprised of \$3.8 million relating to the fair value of interest rate swaps.

**NOTE 9 LITIGATION SETTLEMENTS**

In June 2002, Triad received notification that HCA had agreed to reimburse Triad for a portion of the settlement on a False Claims Act case, settled by Quorum Health Group, Inc. ( Quorum ) prior to Triad's acquisition. Triad received this reimbursement in the amount of \$4.5 million, in July 2002.

**NOTE 10 CONTINGENCIES***False Claims Act Litigation*

As a result of its ongoing discussions with the government prior to the merger of Quorum with and into Triad on April 27, 2001, Quorum learned of two *qui tam* complaints against it alleging violations of the False Claims Act for claims allegedly submitted to the government involving one owned and two managed hospitals. Quorum accrued the estimated liability on these items prior to the merger. The matter involving the two managed hospitals remains under seal and the matter involving the owned hospital has been settled. With respect to the matter involving the two managed hospitals, the government has requested that Quorum conduct a self audit with respect to one Medicare cost report for one managed hospital and three other specific issues. The government has stated that it intends to investigate certain other allegations.

At this time Triad cannot predict the final effect or outcome of the ongoing investigations or *qui tam* action. If violations of Federal or state laws relating to Medicare, Medicaid or other government programs are found, then Triad may be required to pay substantial fines and civil and criminal damages and also may be excluded from participation in the Medicare and Medicaid programs and other government programs. Similarly, the amount of damages sought in the *qui tam* action or in the future may be substantial. Triad could be subject to substantial costs resulting from defending, or from an adverse outcome in, any current or future investigations, administrative proceedings or litigation. In an effort to resolve one or more of these matters, Triad may choose to negotiate a settlement. Amounts paid to settle any of these matters may be material. Agreements entered into as a part of any settlement could also materially adversely affect Triad. Any current or future investigations or actions could have a material adverse effect on Triad's results of operations or financial position.

From time to time Triad may be the subject of additional investigations or a party to additional litigation which alleges violations of law. Triad may not know about those investigations, or about *qui tam* actions filed against it unless and to the extent such are unsealed. If any of those matters were successfully asserted against Triad, there could be a material adverse effect on Triad's business, financial position, results of operations or prospects.

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TRIAD HOSPITAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

NOTE 10 CONTINGENCIES (continued)

*Income Taxes*

The Internal Revenue Service ( IRS ) is in the process of conducting an examination of the Federal income tax returns of Triad for the calendar years ended December 31, 1999 and 2000, and the Federal income tax returns of Quorum for the fiscal years ended June 30, 1999 and 2000. To date the IRS has not proposed any adjustments.

The IRS has proposed adjustments with respect to partnership returns of income for certain joint ventures in which Quorum owned a majority interest for the fiscal years ended June 30, 1997 and 1998. The most significant adjustments involve the tax accounting methods adopted for computing bad debt expense, the valuation of purchased hospital property and equipment and related depreciable lives, income recognition related to cost reports and the loss calculation on a taxable liquidation of a subsidiary. Triad has filed protests on behalf of the joint ventures with the Appeals Division of the IRS contesting substantially all of the proposed adjustments. In the opinion of management, the ultimate outcome of the IRS examinations will not have a material effect on Triad's results of operations or financial position.

*HCA Litigation and Investigations*

HCA is the subject of Federal investigations and litigation relating to its business practices. The investigations, actions and claims relate to HCA and its subsidiaries, including subsidiaries that, prior to Triad's spin-off from HCA, owned facilities now owned by Triad. HCA is also the subject of a formal order of investigation by the Securities and Exchange Commission ( SEC ). HCA understands that the SEC's investigation includes the anti-fraud, insider trading, periodic reporting and internal accounting control provisions of the Federal securities laws.

HCA is a defendant in *qui tam* actions on behalf of the United States of America alleging, in general, submission of improper claims to the government for reimbursement. The lawsuits seek three times the amount of damages caused to the United States by the submission of any Medicare or Medicaid false claims presented by the defendants to the Federal government, civil damages of not less than \$5,500 nor more than \$11,000 for each such Medicare or Medicaid claim, attorneys' fees and costs. HCA has disclosed that of the original 30 *qui tam* actions, the U.S. Department of Justice ( DOJ ) intervened in eight actions, which have been settled under the settlement agreement with the Civil Division of the DOJ described below. HCA also has disclosed that it is aware of additional *qui tam* actions that remain under seal and believes that there may be other sealed *qui tam* cases of which it is unaware.

On May 5, 2000, Triad was advised that one of the *qui tam* cases referenced above, which occurred prior to the spin-off, listed three of Triad's hospitals as defendants. This *qui tam* action alleges various violations arising out of the relationship between Curative Health Services and the other defendants, including allegations of false claims relating to contracts with Curative Health Services for the management of certain wound care centers and excessive and unreasonable management fees paid to Curative Health Services and submitted for reimbursement. Two of the three Triad hospitals named as defendants terminated their relationship with Curative Health Services prior to the spin-off and the third hospital terminated its contract thereafter. HCA has stated that this action has been dismissed under the settlement agreement with the Civil Division of

the DOJ described below.

HCA is also a defendant in a number of other suits, which allege, in general, improper and fraudulent billing, overcharging, coding and physician referrals, as well as other violations of law. Certain of the suits have been conditionally certified as class actions. Since April 1997, numerous securities class action and derivative lawsuits have been filed against HCA and a number of its current and former directors, officers and/or employees alleging breach of fiduciary duty, and failure to take reasonable steps to ensure that HCA did not engage in illegal practices thereby exposing it to significant damages.

In December 2000, HCA entered into an agreement with the Criminal Division of the DOJ and various U.S. Attorney's Offices and a civil and administrative settlement agreement with the Civil Division of the DOJ. These agreements resolve only the specific Federal criminal issues outstanding against HCA and certain issues involving Federal civil claims by or on behalf of the government involving DRG coding, outpatient laboratory billing and home health issues. Civil issues that were not covered include claims related to cost reports, wound care

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TRIAD HOSPITAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

**NOTE 10 CONTINGENCIES (continued)**

and physician relations issues. These agreements did not resolve any of the *qui tam* actions or any pending state actions.

In addition, 14 of Triad's current and former hospitals received notices in early 2001 from the Centers for Medicare and Medicaid Services (CMS) that it was re-opening for examination cost reports for Medicare and Medicaid reimbursement filed by these hospitals for periods between 1993 and 1998, which pre-dates Triad's spin-off from HCA. Furthermore, two of Triad's hospitals formerly owned by Quorum have received such notices. HCA or its predecessors owned these hospitals during the period covered by the notices. HCA is obligated to indemnify Triad for liabilities arising out of cost reports filed during these periods.

In June 2003, HCA announced that it signed an agreement with CMS to resolve all Medicare cost report, home office cost statement and appeal issues between HCA and CMS for cost report periods ending before August 1, 2001. Under the terms of this agreement, HCA paid CMS \$250 million in June 2003. The agreement does not include resolution of outstanding civil issues with the DOJ and relators under HCA's various *qui tam* cases with respect to cost reports and physician relations.

In June 2003, HCA also announced that it had signed agreements with the Civil Division of the DOJ dismissing the various claims the Civil Division had brought against HCA related to physician relations, cost reports and wound care issues. This settlement agreement received court approval, and HCA made a payment to the government of \$641 million (including accrued interest of \$10 million) in July 2003. HCA has stated that this settlement agreement with the DOJ effectively ends the DOJ's investigation of HCA that was first made public in 1997. The settlement agreement, however, does not affect *qui tam* cases in which the government has not intervened. In June 2003, HCA also finalized an agreement with a negotiating team representing states that may have claims against it. Under this agreement, HCA paid \$17.7 million in July 2003 to state Medicaid agencies to resolve these claims. HCA also paid \$33.0 million for legal fees of the private parties.

Triad is unable to predict the effect or outcome of any of the ongoing investigations or *qui tam* and other actions, or whether any additional investigations or litigation will be commenced. In connection with the spin-off from HCA, Triad entered into a distribution agreement with HCA. The terms of the distribution agreement provide that HCA will indemnify Triad for any losses (other than consequential damages) which it may incur as a result of the proceedings described above. HCA has also agreed to indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings which may be commenced by government authorities or by private parties in the future that arise from acts, practices or omissions engaged in prior to the date of the spin-off and that relate to the proceedings described above. HCA has also agreed that, in the event that any hospital owned by Triad at the time of the spin-off is permanently excluded from participation in the Medicare and Medicaid programs as a result of the proceedings described above, then HCA will make a cash payment to Triad, in an amount (if positive) equal to five times the excluded hospital's 1998 income from continuing operations before depreciation and amortization, interest expense, management fees, impairment of long-lived assets, minority interests and income taxes, as set forth on a schedule to the distribution agreement, less the net proceeds of the sale or other disposition of the excluded hospital.

HCA will not indemnify Triad under the distribution agreement for losses relating to any acts, practices and omissions engaged in by Triad after the spin-off date, whether or not Triad is indemnified for similar acts, practices and omissions occurring prior to the spin-off. HCA also will not indemnify Triad under the distribution agreement for similar *qui tam* litigation, governmental investigations and other actions to which Quorum

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was subject, some of which are described above. If indemnified matters were asserted successfully against Triad or any of its facilities, and HCA failed to meet its indemnification obligations, then this event could have a material adverse effect on Triad's business, financial condition, results of operations or prospects.

The extent to which Triad may or may not continue to be affected by the ongoing investigations of HCA and the initiation of additional investigations, if any, cannot be predicted. These matters could have a material adverse effect on Triad's business, financial condition, results of operations or prospects.



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**TRIAD HOSPITAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Unaudited**

**NOTE 10 CONTINGENCIES (continued)**

*General Liability Claims*

Triad is 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 Triad, which are usually not 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 Triad's results of operations or financial position.

**NOTE 11 RECENT ACCOUNTING PRONOUNCEMENTS**

Triad adopted Statement of Financial Accounting Standards No. 145 Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS 145), on January 1, 2003. SFAS 145 rescinds Statement of Financial Accounting Standards No. 4 Reporting Gains and Losses From Extinguishment of Debt. SFAS 145 requires any gains or losses on extinguishment of debt that were classified as an extraordinary item in prior periods that do not meet the criteria in Accounting Principles Board Opinion No. 30 Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions for classification as an extraordinary item shall be reclassified into income from operations. If Triad incurs any gains or losses on retirement of debt, those gains or losses would be recorded in income from operations.

Triad adopted Statement of Financial Accounting Standards No. 146 Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146) on January 1, 2003. SFAS 146 addresses the accounting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3 Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). Triad's adoption of SFAS 146 did not have a material impact on its results of operations or financial position.

Triad adopted the Financial Accounting Standards Board Interpretation No. 45 Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45) on January 1, 2003. FIN 45 states that the fair value of certain guarantee obligations be recorded at the inception of the guarantee and clarifies disclosures required for guarantee obligations. The initial recognition provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure provisions are effective for financial statements of interim or annual periods ending after December 31, 2002. Triad did not have a material impact on its results of operations or financial position from the adoption of FIN 45.

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS 149). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities. SFAS 149 is effective for contracts entered into or modified after June 30, 2003. Triad does not anticipate a material impact on its results of operations or financial position from the adoption of SFAS 149.

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ( SFAS 150 ). SFAS 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity, such as redeemable preferred stock and certain equity derivatives that frequently are used in connection with share repurchase programs. SFAS 150 is effective immediately for instruments entered into or modified after May 15, 2003 and to all other instruments that exist as of the beginning of the first interim reporting period beginning after June 15, 2003. Triad does not anticipate a material impact from the adoption of SFAS 150.

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

**OVERVIEW**

Information regarding HCA included in this Report on Form 10-Q is derived from reports and other information filed by HCA with the Securities and Exchange Commission ( SEC ).

**FORWARD LOOKING STATEMENTS**

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains disclosures which are 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 such as may, believe, will, expect, project, estimate, anticipate, plan or continue. These forward-looking statements are the current plans and expectations of Triad and are subject to a number of uncertainties and risks that could significantly affect current plans and expectations and the future financial condition and results of Triad. These factors include, but are not limited to:

- the highly competitive nature of the health care business,
- the efforts of insurers and other payers, health care providers and others to contain health care costs,
- possible changes in Medicare, Medicaid and other government programs that may further limit reimbursements to health care providers,
- changes in Federal, state or local regulations affecting the health care industry,
- the possible enactment of Federal or state health care reform,
- the ability to attract and retain qualified management and personnel, including physicians and nurses,
- the departure of key executive officers from Triad,
- claims and legal actions relating to professional liabilities and other matters,
- fluctuations in the market value of Triad's common stock,
- changes in accounting standards,
- changes in general economic conditions or geopolitical events,
- future acquisitions, joint venture development or divestitures which may result in additional charges,
- the ability to enter into managed care provider arrangements on acceptable terms,
- the availability and terms of capital to fund the expansion of Triad's business,
- changes in business strategy or development plans,
- the ability to obtain adequate levels of general and professional liability insurance,
- potential adverse impact of known and unknown government investigations,
- timeliness of reimbursement payments received under government programs, and
- other risk factors.

As a consequence, current plans, anticipated actions and future financial condition and results may differ from those expressed in any forward-looking statements made by or on behalf of Triad. Investors are cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

**RESULTS OF OPERATIONS**

**Revenue/Volume Trends**

Triad has entered into agreements with third-party payers, including government programs and managed care health plans, under which Triad's facilities are paid based upon established charges, the cost of providing services, predetermined rates per diagnosis, fixed per diem rates or discounts from established charges. Triad's facilities have experienced revenue rate growth due to changes in patient acuity, closure of unprofitable services, favorable pricing trends and contract structure. The increases in pricing trends and contract structure were the result of renegotiating and renewing certain managed care contracts on more favorable terms (to include more stop losses, carve outs and pass throughs). Increased volumes for more intensive cases, such as inpatient surgeries, also contributed to revenue rate growth. There can be no assurances that Triad will continue to receive these levels of revenue increases in the future.

Patient volumes, on a same facility basis, have decreased slightly in 2003 compared to 2002. Volumes have been affected by the general weakness in the overall economy. With healthcare costs increasing, many employers

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

have increased the amounts of deductibles and co-payments required by their employees. The increase in out-of-pocket costs and the uncertainty of continuing employment have led to a decline in elective procedures. If the trend of decreased volumes continues, then Triad's results of operations and cash flows could be adversely affected.

Triad's revenues continue to be affected by an increasing proportion of revenue being derived from fixed payment, higher discount sources, including Medicare, Medicaid and managed care plans. Triad expects patient volumes from Medicare and Medicaid to continue to increase due to the general aging of the population and expansion of state Medicaid programs. Volumes from managed care plans are expected to increase due to insurance companies, government programs (other than Medicare) and employers purchasing health care services for their employees by negotiating discounted amounts that they will pay health care providers rather than by paying standard prices. Patient revenues related to Medicare and Medicaid patients were 36.2% and 37.9% of total patient revenues for the three months ended June 30, 2003 and 2002, respectively and 36.7% and 38.5% of total patient revenues for the six months ended June 30, 2003 and 2002, respectively. Patient revenues related to managed care plan patients were 41.7% and 39.6% of total patient revenues for the three months ended June 30, 2003 and 2002, respectively and 41.2% and 38.3% of total patient revenues for the six months ended June 30, 2003 and 2002, respectively. With an increasing proportion of services over the last several years being reimbursed based upon fixed payment amounts where the payment is based upon the diagnosis, regardless of the cost incurred or level of service provided, revenues, earnings and cash flows are being impacted.

Triad's revenues have been affected by the trend toward certain services being performed more frequently on an outpatient basis. Growth in outpatient services is expected to continue, although possibly at a slower rate, in the health care industry as procedures performed on an inpatient basis are converted to outpatient procedures through continuing advances in pharmaceutical and medical technologies. The redirection of certain procedures to an outpatient basis is also influenced by pressures from payers and patients to perform certain procedures as outpatient care rather than inpatient care. Outpatient revenues were 46% and 45% of patient revenues for the three months ended June 30, 2003 and 2002, respectively, and 45% of patient revenues in each of the six months ended June 30, 2003 and 2002.

Pressures on the rate of increase in Medicare and Medicaid reimbursement, increasing percentages of patient volume being related to patients participating in managed care plans and continuing trends toward more services being performed on an outpatient basis are expected to present ongoing challenges. The challenges presented by these trends are magnified by Triad's inability to control these trends and the associated risks. To maintain and improve its operating margins in future periods, Triad must increase patient volumes and improve contracts while controlling the costs of providing services. If Triad is not able to achieve reductions in the cost of providing services through increased operational efficiencies, and the rate of increase in reimbursements and payments decline, results of operations and cash flows will deteriorate.

Management believes that the proper response to these challenges includes the delivery of a broad range of quality health care services to physicians and patients with operating decisions being primarily made by the local management teams and local physicians.

In August 2002, Triad opened a new acute care hospital in Las Cruces, New Mexico. On July 1, 2002, Triad acquired all of the assets comprising, and a 60% interest in the operations of, a hospital in Johnson, Arkansas.

In connection with Triad's spin-off from HCA, HCA agreed to indemnify Triad for any payments which it is required to make in respect of Medicare, Medicaid and Blue Cross cost reports relating to periods ending on or prior to the date of the spin-off, and Triad agreed to indemnify HCA for and pay to HCA any payments received by it relating to such cost reports. Triad was responsible for the filing of these cost reports which are recorded in accounts receivable in the condensed consolidated balance sheets. Triad has recorded a receivable from HCA relating to

the indemnification of \$23.2 million as of June 30, 2003 which is recorded in other current assets in the condensed consolidated balance sheets.

***Other Trends***

Insurance costs across the industry have been increasing substantially. Triad is facing the same pressures of its insurance costs increasing. Triad has an extensive insurance program, with the largest component being general and

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**

**RESULTS OF OPERATIONS (continued)**

professional liability insurance. Many of the factors contributing to the increasing costs are beyond Triad's control. To help mitigate the increases in premiums, Triad may increase deductibles in these programs, which would increase the risk assumed by Triad. Triad currently records liabilities for its estimated retentions. During the three months ended June 30, 2003, Triad recorded a \$4.0 million reduction to the estimated liability, primarily related to liabilities associated with claims incurred prior to the merger with Quorum Health Group, Inc. (Quorum) due to settlement of claims at lower amounts than previously estimated. Including this reduction, Triad's total insurance costs increased approximately \$4.7 million, or 33% and \$13.7 million, or 48% in the three and six months ended June 30, 2003, respectively, compared to the three and six months ended June 30, 2002, respectively. If the trend of increasing costs continues, Triad's results of operations and cash flows could be affected.

One of Triad's hospitals had impairment indicators and was evaluated for potential impairment. Currently, the undiscounted future cash flows expected from the use of the assets and eventual disposition indicate that the recorded amounts are recoverable. If the projections of future cash flows deteriorate, then impairment of these assets may be required.

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

**Operating Results Summary**

The following is a summary of operating results for the three and six months ended June 30, 2003 and 2002 (dollars in millions, except per share amounts and ratios):

|   | For the three months ended |            |          |            | For the six months ended |            |            |            |
|---|----------------------------|------------|----------|------------|--------------------------|------------|------------|------------|
|   | 2003                       |            | 2002     |            | 2003                     |            | 2002       |            |
|   | Amount                     | Percentage | Amount   | Percentage | Amount                   | Percentage | Amount     | Percentage |
| Revenues  | \$ 953.8                   | 100.0      | \$ 867.2 | 100.0      | \$ 1,908.3               | 100.0      | \$ 1,728.1 | 100.0      |
| Salaries and benefits   | 395.6                      | 41.5       | 363.2    | 41.9       | 788.4                    | 41.3       | 717.1      | 41.5       |
| Reimbursable expenses   | 13.6                       | 1.4        | 15.4     | 1.7        | 28.4                     | 1.5        | 31.8       | 1.8        |
| Supplies  | 149.7                      | 15.7       | 137.1    | 15.8       | 294.8                    | 15.4       | 270.6      | 15.7       |
| Other operating expenses  | 179.5                      | 18.8       | 159.6    | 18.4       | 354.9                    | 18.6       | 315.0      | 18.2       |
| Provision for doubtful accounts   | 78.4                       | 8.2        | 65.9     | 7.6        | 154.6                    | 8.1        | 129.5      | 7.5        |
| Depreciation and amortization   | 44.8                       | 4.7        | 40.8     | 4.7        | 88.5                     | 4.7        | 81.7       | 4.7        |
| Interest expense, net   | 33.1                       | 3.5        | 34.5     | 4.0        | 65.7                     | 3.5        | 67.3       | 3.9        |
| Litigation settlements  |                            |            | (4.5)    | (0.5)      |                          |            | (4.5)      | (0.2)      |
| ESOP expense  | 2.0                        | 0.2        | 2.9      | 0.3        | 4.1                      | 0.2        | 5.3        | 0.3        |
| (Gain) loss on sales of assets  | 0.1                        |            | (0.3)    |            | (1.2)                    | (0.1)      | (1.9)      | (0.1)      |
|   | 896.8                      | 94.0       | 814.6    | 93.9       | 1,778.2                  | 93.2       | 1,611.9    | 93.3       |
| Income before minority interests, equity in earnings and income tax provision | 57.0                       | 6.0        | 52.6     | 6.1        | 130.1                    | 6.8        | 116.2      | 6.7        |
| Minority interests in earnings of consolidated entities                       | (2.3)                      | (0.2)      | (3.8)    | (0.4)      | (4.7)                    | (0.2)      | (7.1)      | (0.4)      |
| Equity in earnings of affiliates  | 8.1                        | 0.8        | 5.6      | 0.6        | 15.3                     | 0.8        | 11.7       | 0.7        |
| Income before income tax provision  | 62.8                       | 6.6        | 54.4     | 6.3        | 140.7                    | 7.4        | 120.8      | 7.0        |
| Income tax provision  | (24.8)                     | (2.6)      | (21.6)   | (2.5)      | (55.4)                   | (2.9)      | (47.6)     | (2.8)      |
| Net income  | \$ 38.0                    | 4.0        | \$ 32.8  | 3.8        | \$ 85.3                  | 4.5        | \$ 73.2    | 4.2        |
| Income per common share   |                            |            |          |            |                          |            |            |            |
| Basic   | \$ 0.52                    |            | \$ 0.46  |            | \$ 1.16                  |            | \$ 1.03    |            |
| Diluted   | \$ 0.51                    |            | \$ 0.44  |            | \$ 1.14                  |            | \$ 0.99    |            |
| Number of hospitals at end of period (a)                                      |                            |            |          |            |                          |            |            |            |
| Owned   | 45                         |            | 43       |            | 45                       |            | 43         |            |
| Managed joint ventures  | 1                          |            | 1        |            | 1                        |            | 1          |            |



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|   |          |          |           |           |
|---|----------|----------|-----------|-----------|
| Leased to others                        | 2        | 2        | 2         | 2         |
| Total                                   | 48       | 46       | 48        | 46        |
| Licensed beds at end of period (b)      | 7,907    | 7,580    | 7,907     | 7,580     |
| Available beds at end of period (c)     | 7,182    | 6,902    | 7,182     | 6,902     |
| Admissions (d)                          |          |          |           |           |
| Owned                                   | 71,412   | 69,271   | 144,658   | 142,687   |
| Managed joint ventures                  | 1,377    | 1,358    | 2,907     | 3,005     |
| Total                                   | 72,789   | 70,629   | 147,565   | 145,692   |
| Adjusted admissions (e)                 | 123,119  | 119,640  | 244,987   | 242,027   |
| Outpatient visits                       | 845,674  | 828,992  | 1,670,961 | 1,661,195 |
| Inpatient surgeries                     | 27,567   | 26,288   | 54,599    | 51,065    |
| Outpatient surgeries                    | 73,004   | 72,081   | 142,626   | 139,771   |
| Total surgeries                         | 100,571  | 98,369   | 197,225   | 190,836   |
| Average length of stay (f)              | 4.8      | 4.8      | 4.9       | 4.9       |
| Outpatient revenue percentage           | 46%      | 45%      | 45%       | 45%       |
| Inpatient revenue per admission         | \$ 6,741 | \$ 6,365 | \$ 6,772  | \$ 6,170  |
| Outpatient revenue per outpatient visit | \$ 492   | \$ 439   | \$ 487    | \$ 437    |
| Patient revenue per adjusted admission  | \$ 7,287 | \$ 6,728 | \$ 7,320  | \$ 6,636  |

- (a) Number of hospitals excludes a facility under construction. This table does not include any operating statistics for the joint ventures and facilities leased to others, except for admissions.
- (b) Licensed beds are those beds for which a facility has been granted approval to operate from the applicable state-licensing agency.
- (c) Available beds are those beds a facility actually has in use.
- (d) Represents the total number of patients admitted (in the facility for a period in excess of 23 hours) to Triad's facilities and is used by management and certain investors as a general measure of inpatient volume.
- (e) Adjusted admissions are used by management and certain investors as a general measure of combined inpatient and outpatient volume. Adjusted admissions are computed by multiplying admissions (inpatient volume) by the sum of gross inpatient revenue and gross outpatient revenue and then dividing the resulting amount by gross inpatient revenue. The adjusted admissions computation equates outpatient revenue to the volume measure.

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

(admissions) used to measure inpatient volume resulting in a general measure of combined inpatient and outpatient volume.  
(f) Represents the average number of days an admitted patient stays in Triad's hospitals.

**Three Months Ended June 30, 2003 and 2002**

Net income increased to \$38.0 million in the three months ended June 30, 2003 from \$32.8 million in the three months ended June 30, 2002. This was due primarily to a 10.0% increase in revenues. This was partially offset by increases in employee health benefits, insurance and provision for doubtful accounts as a percentage of revenues. Triad also had \$4.5 million in litigation settlement income in 2002 relating to an indemnification settlement with HCA on a False Claims Act litigation case that was settled by Quorum prior to the merger.

Revenues increased 10.0% to \$953.8 million in the three months ended June 30, 2003 compared to \$867.2 million in the three months ended June 30, 2002. This includes \$5.8 million in favorable prior year cost report settlements during 2003 compared to \$4.1 million in favorable prior year cost report settlements in 2002. Excluding prior year cost report settlements, patient revenue per adjusted admission increased 8.6% due primarily to favorable pricing trends, changes in contract structure and higher acuity procedures. Managed care contract pricing increased approximately 5% to 7% from renegotiation and renewal of contracts to include pricing increases and more favorable contract structure. Triad's slightly higher acuity procedures in 2003 compared to 2002 resulted primarily from same facility inpatient surgeries increasing 1.7% in 2003 compared to 2002. Same facility admissions, adjusted admissions and outpatient surgeries were relatively constant in 2003 compared to 2002.

Salaries and benefits (which included contract nursing) as a percentage of revenues decreased to 41.5% in the three months ended June 30, 2003 from 41.9% in the three months ended June 30, 2002. This was due to a reduction of contract labor usage of approximately \$2.2 million and increased productivity. This was offset by employee health benefit costs increasing approximately \$7.3 million, or 21%, in 2003 compared to 2002.

Reimbursable expenses as a percentage of revenue decreased to 1.4% in the three months ended June 30, 2003 from 1.7% in the three months ended June 30, 2002. Reimbursable expenses relate primarily to salaries and benefits of QHR employees who serve as executives at hospitals managed by QHR. These expenses are also included as a component of revenues. The decrease was due primarily to changes in contract structure for certain contracts whereby the executives at hospitals managed by QHR are no longer QHR employees.

Supplies decreased as a percentage of revenues to 15.7% in the three months ended June 30, 2003 from 15.8% in the three months ended June 30, 2002. This was due primarily to the revenue rate increases resulting from favorable pricing trends and changes in contract structure discussed above, although supplies per adjusted admission increased 6.1% due to increased patient acuity.

Other operating expenses (primarily consisting of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance and non-income taxes) increased as a percentage of revenues to 18.8% in the three months ended June 30, 2003 compared to 18.4% in the three months ended June 30, 2002. This was due to an increase in insurance costs, primarily malpractice insurance, of approximately \$4.7 million or 33% (see Other Trends). This change includes a \$4.0 million reduction in the estimated general and professional liability primarily related to claims incurred prior to the merger with Quorum due to settlement of claims at lower amounts than previously estimated. This was partially offset by the revenue rate increases, resulting from favorable pricing trends and changes in contract structure discussed above.

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Provision for doubtful accounts as a percentage of revenues increased to 8.2% in the three months ended June 30, 2003 compared to 7.6% in the three months ended June 30, 2002. Triad recorded \$5.0 million of additional allowance in the three months ended June 30, 2003. This was due primarily to an increase in uninsured accounts of approximately 3% as a percentage of receivables. If the trend of increasing uninsured accounts continues, then Triad's results of operations could be adversely affected.

Depreciation and amortization increased to \$44.8 million in the three months ended June 30, 2003 compared to \$40.8 million in the three months ended June 30, 2002. This was due primarily to the opening of a new acute care hospital in Las Cruces, New Mexico in August 2002 and completion of several major renovation projects.

Interest expense, which was offset by \$0.5 million and \$0.4 million of interest income in the three months ended June 30, 2003 and 2002, respectively, decreased to \$33.1 million in the three months ended June 30, 2003.

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**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**

**RESULTS OF OPERATIONS (continued)**

compared to \$34.5 million in the three months ended June 30, 2002. This was due to decreases in floating rate debt interest rates and reduction of principal balances from scheduled repayments.

In June 2002, Triad received notification that HCA had agreed to reimburse Triad for a portion of the settlement on a False Claims Act case, settled by Quorum prior to Triad's acquisition. Triad received this reimbursement in the amount of \$4.5 million, in July 2002. This was recorded as litigation settlements in the condensed consolidated statements of operations in the three months ended June 30, 2002.

Minority interests decreased to \$2.3 million in the three months ended June 30, 2003 from \$3.8 million in the three months ended June 30, 2002 due to decreases in earnings at certain of Triad's non-wholly owned facilities.

Equity in earnings of affiliates was \$8.1 million in the three months ended June 30, 2003 compared to \$5.6 million in the three months ended June 30, 2002 due to improved earnings at non-consolidating joint ventures in El Dorado, Arkansas and Macon, Georgia.

Income tax provision was \$24.8 million in the three months ended June 30, 2003 compared to \$21.6 million in the three months ended June 30, 2002. Triad's effective tax rate is affected primarily by nondeductible ESOP expense.

**Six Months Ended June 30, 2003 and 2002**

Net income increased to \$85.3 million in the six months ended June 30, 2003 from \$73.2 million in the six months ended June 30, 2002. This was due primarily to a 10.4% increase in revenues. This was partially offset by increases in employee health benefits, insurance and provision for doubtful accounts as a percentage of revenues. In addition, Triad had increases in estimates in its retirement plan contributions of \$1.4 million in 2003 compared to decreases in estimates of \$6.6 million in 2002. Triad also had \$4.5 million in litigation settlement income in 2002 relating to an indemnification settlement with HCA on a False Claims Act litigation case that was settled by Quorum prior to the merger.

Revenues increased 10.4% to \$1,908.3 million in the six months ended June 30, 2003 compared to \$1,728.1 million in the six months ended June 30, 2002. This includes \$12.4 million in favorable prior year cost report settlements during 2003 compared to \$1.4 million in favorable prior year cost report settlements in 2002. This was due primarily to a delay in Triad's cost report filings in 2002 because of outpatient prospective payment system implementation issues at the Centers for Medicare and Medicaid Services (CMS). Excluding prior year cost report settlements, patient revenue per adjusted admission increased 10.1% due primarily to favorable pricing trends, changes in contract structure and higher acuity procedures. Managed care contract pricing increased approximately 5% to 7% from renegotiation and renewal of contracts to include pricing increases and more favorable contract structure. Triad's higher acuity procedures in 2003 compared to 2002 resulted primarily from same facility inpatient surgeries increasing 3.8% in 2003 compared to 2002. These increases were partially offset by overall decreases in same facility patient volumes. Volumes have been affected by the general weakness in the overall economy. With healthcare costs increasing, many employers have increased the amounts of deductibles and co-payments required by their employees. The increase in out-of-pocket costs and the uncertainty of continuing employment have led to a decline in elective procedures. Same facility admissions decreased 1.2% and adjusted admissions decreased 1.1% in 2003 compared to 2002, respectively.

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Salaries and benefits (which included contract nursing) as a percentage of revenues decreased to 41.3% in the six months ended June 30, 2003 from 41.5% in the six months ended June 30, 2002. This was due to a reduction of contract labor usage of approximately \$4.2 million and increased productivity. This was offset by employee health benefit costs increasing approximately \$15.7 million, or 22%, in 2003 compared to 2002. In addition, Triad had increases in estimates in its retirement plan contributions of \$1.4 million in 2003 compared to decreases in estimates of \$6.6 million in 2002.

Reimbursable expenses as a percentage of revenue decreased to 1.5% in the six months ended June 30, 2003 from 1.8% in the six months ended June 30, 2002. Reimbursable expenses relate primarily to salaries and benefits of QHR employees who serve as executives at hospitals managed by QHR. These expenses are also included as a component of revenues. The decrease was due primarily to changes in contract structure for certain contracts whereby the executives at hospitals managed by QHR are no longer QHR employees.

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**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**

**RESULTS OF OPERATIONS (continued)**

Supplies decreased as a percentage of revenues to 15.4% in the six months ended June 30, 2003 from 15.7% in the six months ended June 30, 2002. This was due primarily to the revenue rate increases resulting from favorable pricing trends and changes in contract structure discussed above, although supplies per adjusted admission increased 7.6% due to increased patient acuity.

Other operating expenses (primarily consisting of contract services, professional fees, repairs and maintenance, rents and leases, utilities, insurance and non-income taxes) increased as a percentage of revenues to 18.6% in the six months ended June 30, 2003 compared to 18.2% in the six months ended June 30, 2002. This was due to an increase in insurance costs, primarily malpractice insurance, of approximately \$13.7 million or 48% (see Other Trends ). This change includes a \$4.0 million reduction in the estimated general and professional liability primarily related to claims incurred prior to the merger with Quorum due to settlement of claims at lower amounts than previously estimated. This was partially offset by the revenue rate increases, resulting from favorable pricing trends and changes in contract structure discussed above.

Provision for doubtful accounts as a percentage of revenues increased to 8.1% in the six months ended June 30, 2003 compared to 7.5% in the six months ended June 30, 2002. Triad recorded \$5.0 million of additional allowance in the six months ended June 30, 2003. This was due primarily to an increase in uninsured accounts of approximately 3% as a percentage of receivables. If the trend of increasing uninsured accounts continues, then Triad's results of operations could be adversely affected. The increase was also due to a settlement received on a bankrupt account and recoveries on other non-patient receivables in 2002.

Depreciation and amortization increased to \$88.5 million in the six months ended June 30, 2003 compared to \$81.7 million in the six months ended June 30, 2002. This was due primarily to the opening of a new acute care hospital in Las Cruces, New Mexico in August 2002 and completion of several major renovation projects.

Interest expense, which was offset by \$1.1 million and \$0.8 million of interest income in the six months ended June 30, 2003 and 2002, respectively, decreased to \$65.7 million in the six months ended June 30, 2003 compared to \$67.3 million in the six months ended June 30, 2002. This was due to decreases in floating rate debt interest rates and reduction of principal balances from scheduled repayments.

In June 2002, Triad received notification that HCA had agreed to reimburse Triad for a portion of the settlement on a False Claims Act case, settled by Quorum prior to Triad's acquisition. Triad received this reimbursement in the amount of \$4.5 million, in July 2002. This was recorded as litigation settlements in the condensed consolidated statements of operations in the three months ended June 30, 2002.

Gain on sales of assets included a \$1.1 million gain on the sale of a parcel of land in the six months ended June 30, 2003. In the six months ended June 30, 2002, gain on sales of assets was primarily comprised of a \$1.6 million gain on the sale of an investment in a rehabilitation center.

Minority interests decreased to \$4.7 million in the six months ended June 30, 2003 from \$7.1 million in the six months ended June 30, 2002 due to decreases in earnings at certain of Triad's non-wholly owned facilities.

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Equity in earnings of affiliates was \$15.3 million in the six months ended June 30, 2003 compared to \$11.7 million in the six months ended June 30, 2002 due to improved earnings at non-consolidating joint ventures in Las Vegas, Nevada and Macon, Georgia.

Income tax provision was \$55.4 million in the six months ended June 30, 2003 compared to \$47.6 million in the six months ended June 30, 2002. Triad's effective tax rate is affected primarily by nondeductible ESOP expense.

### **LIQUIDITY AND CAPITAL RESOURCES**

Cash provided by operating activities was \$173.7 million in the six months ended June 30, 2003 compared to \$155.6 million in the six months ended June 30, 2002. The increase was due to improved operating results and a reduction in the increase in accounts receivable of \$18.6 million in 2003 compared to \$29.0 million in 2002 primarily from improved collections on insured accounts. Accounts receivable days have decreased approximately two days in 2003 compared to 2002. Additionally, payments for prepaid expenses decreased \$8.9 million due to changes in payment structure of insurance programs in 2002, while the 2003 payments remained relatively constant. Also, income tax payments decreased \$5.1 million in 2003 from 2002 due primarily to overpayment of estimated taxes in 2002. The overpayment is being applied to 2003 income taxes. There were also increases in self insured

**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**

**RESULTS OF OPERATIONS (continued)**

reserves of \$16.4 million in 2003 compared to \$9.1 million in 2002. This was partially offset by approximately \$14.8 million of increased incentive compensation payments throughout the organization in 2003 compared to 2002. Accounts payable payments increased \$22.3 million in 2003 compared to 2002 due to timing of payments.

Cash used in investing activities was \$109.0 million in the six months ended June 30, 2003 compared to \$123.6 million in the six months ended June 30, 2002. This reduction was due primarily to a decrease in capital expenditures from the completion of several projects during 2002. Triad currently anticipates expending up to \$150.0-\$180.0 million (approximately \$100.0-\$120.0 million for expansion and development) in capital expenditures for the remainder of 2003. This was partially offset by a decrease in distributions received from non-consolidating joint ventures of \$10.8 million.

Cash used in financing activities was \$33.3 million in the six months ended June 30, 2003 compared to \$30.3 million in the six months ended June 30, 2002.

Triad's indebtedness consists of a Tranche A term loan of \$195.0 million bearing interest at LIBOR plus 2.25% (3.37% at June 30, 2003) with principal amounts due through 2007, a Tranche B term loan of \$539.5 million bearing interest at LIBOR plus 3.0% (4.12% at June 30, 2003) with principal amounts due through 2008, \$600.0 million of senior notes bearing interest at 8.75% with principal amounts due in 2009 and \$325.0 million of senior subordinated notes, which have an unamortized discount of \$5.7 million, bearing interest at 11.00% with principal amounts due in 2009. The senior subordinated notes are callable, at Triad's option, in May 2004 and the senior notes are callable, at Triad's option, in May 2005. At June 30, 2003 Triad had a \$250 million line of credit which bears interest at LIBOR plus 2.25%. No amounts were outstanding under the line of credit at June 30, 2003. The revolving credit line reduces to \$225 million in 2004, \$200 million in 2005 and matures in 2007. As of June 30, 2003, Triad had \$36.6 million in letters of credit outstanding which reduce the amount available under the revolving credit line. The LIBOR spread on the revolving credit line and the Tranche A term loan are subject to reduction or increase depending upon the total leverage of Triad. Triad anticipates that the LIBOR spread on the revolving credit line and the Tranche A term loan will decrease to 2.00% based on the financial ratios calculated from the results of operations for the three months ended June 30, 2003.

In July 2003, Standard and Poor's upgraded its ratings on Triad's term loans, senior notes and senior subordinated notes.

Triad's term loans and revolving lines of credit are collateralized by a pledge of substantially all of its assets other than real estate associated with the former Quorum facilities. The debt agreements require that Triad comply with various financial ratios and tests and have restrictions on, among other things, new indebtedness, asset sales and use of proceeds therefrom, capital expenditures and dividends. Triad currently is in compliance with all debt agreement covenants and restrictions. If an event of default occurs with respect to the debt agreements, then the balances of the term loans and revolving line of credit could become due and payable which could result in other debt obligations of Triad also becoming due and payable.

Triad has entered into an interest rate swap agreement, which effectively converts a notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in January 2004. Triad pays a rate of 3.22% and receives LIBOR, which was set at 1.29% at June 30, 2003. Subsequent to June 30, 2003, the LIBOR rate was reset at 1.11%. Triad has entered into another interest rate swap agreement, which effectively converts an additional notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in June 2005. Triad pays a rate of 3.99% and receives LIBOR, which was set at 1.09% at June 30, 2003. Both of the interest rate swap agreements are with the same counterparty. Triad is exposed to credit losses in the event of nonperformance by the



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counterparty. The counterparty is a creditworthy financial institution and it is anticipated that the counterparty will be able to fully satisfy its obligations under the contracts. Triad's interest rate swap agreements are designated as cash flow hedges.

Triad has entered into agreements whereby it has guaranteed certain loans entered into by patients who had services performed at Triad's facilities. These loans are provided by various financial institutions. Triad would be obligated to repay the financial institutions if a patient fails to pay the loan. Triad would then pursue collections from the patient. At June 30, 2003, the amounts subject to the guarantees were \$17.0 million. Triad had accrued liabilities of \$3.7 million at June 30, 2003 for the estimated loan defaults that would be covered under the guarantees.

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

Prior to January 1, 2003, Triad entered into agreements to guarantee the indebtedness of certain joint ventures that are accounted for by the equity method. The ultimate amounts of the guarantees are \$1.9 million at June 30, 2003.

At June 30, 2003, Triad had working capital of \$428.2 million. Management expects that operating cash flow and its revolving credit line will provide sufficient liquidity for the remainder of fiscal 2003.

Triad completed development of a replacement hospital in Bentonville, Arkansas in the second quarter of 2003. The anticipated final cost of the replacement facility is approximately \$63.0 million. As of June 30, 2003, approximately \$60.0 million had been spent on this project.

Triad has commenced development of a new hospital in Mesquite, Nevada. The project is expected to be completed in the third quarter of 2004. The anticipated cost of this project is approximately \$30 million. As of June 30, 2003, approximately \$1.8 million had been spent on this project.

Triad began development of a new hospital in Tucson, Arizona during the third quarter of 2003. The anticipated cost of the project is approximately \$85 million and completion is expected in the first quarter of 2005.

Triad has entered into a joint venture with a not-for-profit hospital organization to build a second hospital in Denton, Texas. The anticipated cost of the project is approximately \$100 million, of which Triad would fund approximately 80% with the joint venture partner funding the remainder. Triad would also lease its existing facility to the joint venture. Triad anticipates that the construction of this project will begin in the third quarter of 2003 and be completed in the first quarter of 2005.

Triad has entered into a definitive agreement to be a capital partner in building a replacement acute care hospital in Palmer, Alaska. Triad will be the majority partner owning approximately 75% of the partnership with the existing local not-for-profit hospital owning the remainder. At closing, the not-for-profit hospital will contribute its current facility to the partnership. The replacement facility would cost approximately \$88 million. Triad anticipates that a closing under the definitive agreement could be completed in the fourth quarter of 2003.

Triad has entered into a letter of intent to form a partnership with a not-for-profit hospital in Springfield, Oregon. Triad would own approximately 80% of the partnership. The not-for-profit hospital would contribute its current facility to the partnership. The partnership intends to construct a replacement facility for approximately \$85 million. Triad anticipates that a definitive agreement could be completed in the third quarter of 2003.

One of Triad's non-consolidating joint ventures is constructing a new acute care hospital. Triad's investment in this project will be approximately \$20.0 million, funded by partnership distributions it would have otherwise received. Triad has contributed approximately \$14.0 million to this project as of June 30, 2003.

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Triad has entered into a letter of intent to acquire the operations of an acute care hospital in Erwin, North Carolina. As part of the proposed transaction, Triad would lease the operations of the existing hospital and build a replacement facility for approximately \$34.0 million. Triad anticipates that a definitive agreement could be completed in the fourth quarter of 2003.

Triad has entered into a letter of intent to acquire the operations of an acute care hospital in Fairmont, West Virginia. As part of the proposed transaction, Triad would lease the operations of the hospital and build a replacement facility for approximately \$85.0 million. Triad anticipates that a definitive agreement could be completed in the fourth quarter of 2003, although the agreement would be contingent upon certain state regulatory approvals.

Triad is exploring various other opportunities with not-for-profit hospitals to become a capital partner to construct replacement facilities. Although no definitive agreements have been reached at this time, agreements could be reached in the future. Any future agreements could increase future capital expenditures.

Triad has various other existing hospital expansion projects in progress. Triad anticipates expending an aggregate of approximately \$130.0 million related to these projects.

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**ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
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Triad expects that the above referenced projects will be funded with either operating cash flows, existing credit facilities, or proceeds from the potential sales of debt or equity securities under its existing shelf registration statement or a private placement.

**RECENT ACCOUNTING PRONOUNCEMENTS**

Triad adopted Statement of Financial Accounting Standards No. 145 Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections ( SFAS 145 ), on January 1, 2003. SFAS 145 rescinds Statement of Financial Accounting Standards No. 4 Reporting Gains and Losses From Extinguishment of Debt . SFAS 145 requires any gains or losses on extinguishment of debt that were classified as an extraordinary item in prior periods that do not meet the criteria in Accounting Principles Board Opinion No. 30 Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions for classification as an extraordinary item shall be reclassified into income from operations. If Triad incurs any gains or losses on retirement of debt, those gains or losses would be recorded in income from operations.

Triad adopted Statement of Financial Accounting Standards No. 146 Accounting for Costs Associated with Exit or Disposal Activities ( SFAS 146 ), on January 1, 2003. SFAS 146 addresses the accounting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3 Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) . Triad's adoption of SFAS 146 did not have a material impact on its results of operations or financial position.

Triad adopted the Financial Accounting Standards Board Interpretation No. 45 Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ( FIN 45 ) on January 1, 2003. FIN 45 states that the fair value of certain guarantee obligations be recorded at the inception of the guarantee and clarifies disclosures required for guarantee obligations. The initial recognition provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure provisions are effective for financial statements of interim or annual periods ending after December 31, 2002. Triad did not have a material impact on its results of operations or financial position from the adoption of FIN 45.

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities ( SFAS 149 ). SFAS 149 amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities. SFAS 149 is effective for contracts entered into or modified after June 30, 2003. Triad does not anticipate a material impact on its results of operations or financial position from the adoption of SFAS 149.

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ( SFAS 150 ). SFAS 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity, such as redeemable preferred stock and certain equity derivatives that frequently are used in connection with share repurchase programs. SFAS 150 is effective immediately for instruments entered into or modified after May 15, 2003 and to all other instruments that exist as of the beginning of the first interim reporting period beginning after June 15, 2003. Triad does not anticipate a material impact from the adoption of SFAS 150.

**CONTINGENCIES**

*False Claims Act Litigation*

As a result of its ongoing discussions with the government prior to the merger of Quorum with and into Triad on April 27, 2001, Quorum learned of two *qui tam* complaints against it alleging violations of the False Claims Act for claims allegedly submitted to the government involving one owned and two managed hospitals. Quorum accrued the estimated liability on these items prior to the merger. The matter involving the two managed hospitals remains under seal and the matter involving the owned hospital has been settled. With respect to the matter involving the two managed hospitals, the government has requested that Quorum conduct a self audit with respect to one Medicare cost report for one managed hospital and three other specific issues. The government has stated that it intends to investigate certain other allegations.

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

At this time Triad cannot predict the final effect or outcome of the ongoing investigations or *qui tam* action. If violations of Federal or state laws relating to Medicare, Medicaid or other government programs are found, then Triad may be required to pay substantial fines and civil and criminal damages and also may be excluded from participation in the Medicare and Medicaid programs and other government programs. Similarly, the amount of damages sought in the *qui tam* action or in the future may be substantial. Triad could be subject to substantial costs resulting from defending, or from an adverse outcome in, any current or future investigations, administrative proceedings or litigation. In an effort to resolve one or more of these matters, Triad may choose to negotiate a settlement. Amounts paid to settle any of these matters may be material. Agreements entered into as a part of any settlement could also materially adversely affect Triad. Any current or future investigations or actions could have a material adverse effect on Triad's results of operations or financial position.

From time to time Triad may be the subject of additional investigations or a party to additional litigation which alleges violations of law. Triad may not know about those investigations, or about *qui tam* actions filed against it unless and to the extent such are unsealed. If any of those matters were successfully asserted against Triad, there could be a material adverse effect on Triad's business, financial position, results of operations or prospects.

*Income Taxes*

The Internal Revenue Service ( IRS ) is in the process of conducting an examination of the Federal income tax returns of Triad for the calendar years ended December 31, 1999 and 2000, and the Federal income tax returns of Quorum for the fiscal years ended June 30, 1999 and 2000. To date the IRS has not proposed any adjustments.

The IRS has proposed adjustments with respect to partnership returns of income for certain joint ventures in which Quorum owned a majority interest for the fiscal years ended June 30, 1997 and 1998. The most significant adjustments involve the tax accounting methods adopted for computing bad debt expense, the valuation of purchased hospital property and equipment and related depreciable lives, income recognition related to cost reports and the loss calculation on a taxable liquidation of a subsidiary. Triad has filed protests on behalf of the joint ventures with the Appeals Division of the IRS contesting substantially all of the proposed adjustments. In the opinion of management, the ultimate outcome of the IRS examinations will not have a material effect on Triad's results of operations or financial position.

*HCA Litigation and Investigations*

HCA is the subject of Federal investigations and litigation relating to its business practices. The investigations, actions and claims relate to HCA and its subsidiaries, including subsidiaries that, prior to the spin-off from HCA, owned facilities now owned by Triad. HCA is also the subject of a formal order of investigation by the SEC. HCA understands that the SEC's investigation includes the anti-fraud, insider trading, periodic reporting and internal accounting control provisions of the Federal securities laws.

HCA is a defendant in *qui tam* actions on behalf of the United States of America alleging, in general, submission of improper claims to the government for reimbursement. The lawsuits seek three times the amount of damages caused to the United States by the submission of any Medicare or Medicaid false claims presented by the defendants to the Federal government, civil damages of not less than \$5,500 nor more than \$11,000 for each such Medicare or Medicaid claim, attorneys' fees and costs. HCA has disclosed that of the original 30 *qui tam* actions, the U.S.

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Department of Justice ( DOJ ) intervened in eight actions, which have been settled under the settlement agreement with the Civil Division of the DOJ described below. HCA also has disclosed that it is aware of additional *qui tam* actions that remain under seal and believes that there may be other sealed *qui tam* cases of which it is unaware.

On May 5, 2000, Triad was advised that one of the *qui tam* cases referenced above, which occurred prior to the spin-off, listed three of Triad's hospitals as defendants. This *qui tam* action alleges various violations arising out of the relationship between Curative Health Services and the other defendants, including allegations of false claims relating to contracts with Curative Health Services for the management of certain wound care centers and excessive and unreasonable management fees paid to Curative Health Services and submitted for reimbursement. Two of the three Triad hospitals named as defendants terminated their relationship with Curative Health Services prior to the spin-off and the third hospital terminated its contract thereafter. HCA has stated that this action has been dismissed under the settlement agreement with the Civil Division of the DOJ described below.

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

HCA is also a defendant in a number of other suits, which allege, in general, improper and fraudulent billing, overcharging, coding and physician referrals, as well as other violations of law. Certain of the suits have been conditionally certified as class actions. Since April 1997, numerous securities class action and derivative lawsuits have been filed against HCA and a number of its current and former directors, officers and/or employees alleging breach of fiduciary duty, and failure to take reasonable steps to ensure that HCA did not engage in illegal practices thereby exposing it to significant damages.

In December 2000, HCA entered into an agreement with the Criminal Division of the DOJ and various U.S. Attorney's Offices and a civil and administrative settlement agreement with the Civil Division of the DOJ. These agreements resolve only the specific Federal criminal issues outstanding against HCA and certain issues involving Federal civil claims by or on behalf of the government involving DRG coding, outpatient laboratory billing and home health issues. Civil issues that were not covered include claims related to cost reports, wound care and physician relations issues. These agreements did not resolve any of the *qui tam* actions or any pending state actions.

In addition, 14 of Triad's current and former hospitals received notices in early 2001 from CMS that it was re-opening for examination cost reports for Medicare and Medicaid reimbursement filed by these hospitals for periods between 1993 and 1998, which pre-dates Triad's spin-off from HCA. Furthermore, two of Triad's hospitals formerly owned by Quorum have received such notices. HCA or its predecessors owned these hospitals during the period covered by the notices. HCA is obligated to indemnify Triad for liabilities arising out of cost reports filed during these periods.

In June 2003, HCA announced that it signed an agreement with CMS to resolve all Medicare cost report, home office cost statement and appeal issues between HCA and CMS for cost report periods ending before August 1, 2001. Under the terms of this agreement, HCA paid CMS \$250 million in June 2003. The agreement does not include resolution of outstanding civil issues with the DOJ and relators under HCA's various *qui tam* cases with respect to cost reports and physician relations.

In June 2003, HCA also announced that it had signed agreements with the Civil Division of the DOJ dismissing the various claims the Civil Division had brought against HCA related to physician relations, cost reports and wound care issues. This settlement agreement received court approval, and HCA made a payment to the government of \$641.0 million (including accrued interest of \$10.0 million) in July 2003. HCA has stated that this settlement agreement with the DOJ effectively ends the DOJ's investigation of HCA that was first made public in 1997. The settlement agreement, however, does not affect *qui tam* cases in which the government has not intervened. In June 2003, HCA also finalized an agreement with a negotiating team representing states that may have claims against it. Under this agreement, HCA paid \$17.7 million in July 2003 to state Medicaid agencies to resolve these claims. HCA also paid \$33.0 million for legal fees of the private parties.

Triad is unable to predict the effect or outcome of any of the ongoing investigations or *qui tam* and other actions, or whether any additional investigations or litigation will be commenced. In connection with the spin-off from HCA, Triad entered into a distribution agreement with HCA. The terms of the distribution agreement provide that HCA will indemnify Triad for any losses (other than consequential damages) which it may incur as a result of the proceedings described above. HCA has also agreed to indemnify Triad for any losses (other than consequential damages) which it may incur as a result of proceedings which may be commenced by government authorities or by private parties in the future that arise from acts, practices or omissions engaged in prior to the date of the spin-off and that relate to the proceedings described above. HCA has also agreed that, in the event that any hospital owned by Triad at the time of the spin-off is permanently excluded from participation in the Medicare and Medicaid programs as a result of the proceedings described above, then HCA will make a cash payment to Triad, in an amount (if positive) equal to five times the excluded hospital's 1998 income from continuing operations before depreciation and amortization, interest expense, management fees, impairment of long-lived assets, minority interests and income taxes, as set forth on a schedule to the distribution agreement, less the net proceeds of the sale or other disposition of the excluded hospital.



HCA will not indemnify Triad under the distribution agreement for losses relating to any acts, practices and omissions engaged in by Triad after the spin-off date, whether or not Triad is indemnified for similar acts, practices and omissions occurring prior to the spin-off. HCA also will not indemnify Triad under the distribution agreement for similar *qui tam* litigation, governmental investigations and other actions to which Quorum was subject, some of which are described above. If indemnified matters were asserted successfully against Triad or any of its facilities,

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

and HCA failed to meet its indemnification obligations, then this event could have a material adverse effect on Triad's business, financial condition, results of operations or prospects.

The extent to which Triad may or may not continue to be affected by the ongoing investigations of HCA and the initiation of additional investigations, if any, cannot be predicted. These matters could have a material adverse effect on Triad's business, financial condition, results of operations or prospects.

*General Liability Claims*

Triad is 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 Triad, which are usually not 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 Triad's results of operations or financial position.

**HEALTH CARE REFORM**

In recent years, an increasing number of legislative proposals have been introduced or proposed to Congress and in some state legislatures that would significantly affect health care systems in Triad's markets. The cost of certain proposals would be funded, in significant part, by reduction in payments by government programs, including Medicare and Medicaid, to health care providers. While Triad is unable to predict whether any proposals for health care reform will be adopted, there can be no assurance that proposals adverse to the business of Triad will not be adopted.

In December 2000, the CMS acting under the Health Insurance Portability and Accountability Act of 1996 released final regulations, which required compliance in April 2003, relating to adoption of standards to protect the security and privacy of health-related information. These regulations require healthcare providers to implement organizational and technical practices to protect the security of electronically maintained or transmitted health-related information. The privacy regulations extensively regulate the use and disclosure of individually identifiable health-related information. The security regulations and the privacy regulations could impose significant costs on Triad in order to comply with these standards. Violations of the regulations could result in civil penalties of up to \$25,000 per type of violation in each calendar year and criminal penalties of up to \$250,000 per violation.

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

Triad is exposed to market risk related to changes in interest rates. To mitigate the impact of fluctuations in interest rates, Triad has entered into two interest rate swaps. Interest rate swaps are contracts which allow the parties to exchange fixed and floating rate interest rate payments periodically over the life of the agreements. Floating rate payments are based on LIBOR and fixed rate payments are dependent upon market levels at the time the interest rate swap was consummated. The interest rate swaps were entered into as cash flow hedges, which effectively

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convert a notional amount of floating rate borrowings to fixed rate borrowings. Triad's policy is to not hold or issue derivatives for trading purposes and to avoid derivatives with leverage features. Both of Triad's interest rate swaps are with the same counterparty. Triad is exposed to credit losses in the event of nonperformance by the counterparty. The counterparty is a creditworthy financial institution and it is anticipated that the counterparty will be able to fully satisfy its obligation under the contracts.

Triad has entered into an interest rate swap which effectively converts a notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in January 2004. Triad pays a rate of 3.22% and receives LIBOR, which was set at 1.29% at June 30, 2003. Subsequent to June 30, 2003, the LIBOR rate was reset at 1.11%. Triad has entered into another interest rate swap agreement, which effectively converts an additional notional amount of \$100 million of floating rate borrowings to fixed rate borrowings. The term of the interest rate swap expires in June 2005. Triad pays a rate of 3.99% and receives LIBOR, which was set at 1.09% at June 30, 2003.

**ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (continued)**

With respect to Triad's interest-bearing liabilities, approximately \$734.5 million of long-term debt at June 30, 2003 was subject to variable rates of interest, while the remaining balance in long-term debt of \$924.1 million at June 30, 2003 was subject to fixed rates of interest. As discussed previously, \$200 million of the long-term debt subject to variable rates of interest is protected by interest rate swaps expiring in January 2004 and June 2005. The estimated fair value of Triad's total long-term debt was \$1,736.4 million at June 30, 2003. The estimates of fair value are based upon the quoted market prices for the same or similar issues of long-term debt with the same maturities, when available, or discounted cash flows. Based on a hypothetical 1% increase in interest rates, the potential annualized losses in future pretax earnings would be approximately \$5.3 million. The impact of such a change in interest rates on the carrying value of long-term debt would not be significant. The estimated changes to interest expense and the fair value of long-term debt are determined considering the impact of hypothetical interest rates on Triad's borrowing costs and long-term debt balances. These analyses do not consider the effects, if any, of the potential changes in Triad's credit ratings or the overall level of economic activity. Further, in the event of a change of significant magnitude, management would expect to take actions intended to further mitigate its exposure to such change.

**ITEM 4: CONTROLS AND PROCEDURES**

As of June 30, 2003, Triad's management, including the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of Triad's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in timely alerting them to material information required to be included in Triad's periodic SEC filings. There have been no changes during the last quarter that have materially affected, or are reasonably likely to materially affect, Triad's internal controls over financial reporting.

**Part II: Other Information****ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

Triad's annual meeting of stockholders was held on May 20, 2003. The following matters were voted upon at the meeting:

|   | <u>Votes in<br/>Favor</u> | <u>Votes<br/>Against</u> | <u>Votes<br/>Abstained</u> | <u>Broker<br/>Non-Voting</u> |
|---|---------------------------|--------------------------|----------------------------|------------------------------|
| 1. Election of directors:               |                           |                          |                            |                              |
| (Class I Term Expires in 2006):         |                           |                          |                            |                              |
| Dale V. Kesler                          | 66,375,416                |                          | 3,006,486                  |                              |
| Barbara A. Durand, R.N., Ed.D.          | 66,959,675                |                          | 2,422,227                  |                              |
| Donald B. Halverstadt, M.D.             | 68,891,395                |                          | 490,507                    |                              |
| 2. Ratification of Ernst & Young LLP as | 64,245,857                | 5,073,693                | 62,352                     |                              |

independent auditor.

3. Approval of Outside Directors Stock and

|  |            |            |        |
|--|------------|------------|--------|
| Incentive Compensation Plan, as amended. | 55,396,308 | 13,922,521 | 62,073 |
|--|------------|------------|--------|

|   |            |            |        |
|---|------------|------------|--------|
| 4. Approval of 1999 Long-Term Incentive Plan, as amended. | 48,776,264 | 20,526,114 | 79,524 |
|---|------------|------------|--------|

The names of directors whose term of office as a director continued after the meeting are as follows:

**CLASS II TERM EXPIRING IN 2004**

Nancy-Ann DeParle

Marvin T. Runyon

James D. Shelton

Thomas F. Frist III

Gale E. Sayers

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**CLASS III TERM EXPIRING IN 2005**

Michael J. Parsons

Thomas G. Loeffler, Esq.

Uwe E. Reinhardt, PhD

**ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K**

(a) List of Exhibits:

| <u>Exhibit Number</u> | <u>Description</u>   |
|-----------------------|--|
| 31.1                  | Certification of James D. Shelton, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2                  | Certification of Burke W. Whitman, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1                  | Certification of James D. Shelton, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350.                        |
| 32.2                  | Certification of Burke W. Whitman, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350.                        |

(b) Reports on Form 8-K filed during the quarter ended June 30, 2003:

On April 23, 2003, Triad reported that it had issued a press release reporting first quarter 2003 earnings results.

**SIGNATURES**

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

Triad Hospitals, Inc.

Date: August 12, 2003  
\_\_\_\_\_

By:

/s/ BURKE W. WHITMAN  
\_\_\_\_\_

Burke W. Whitman

Executive Vice President and

Chief Financial Officer

(Principal Financial Officer)

**INDEX TO EXHIBITS**

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