

UNIVERSAL HEALTH SERVICES INC

Form 10-Q

May 07, 2010

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

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended March 31, 2010

OR

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

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

Commission file number 1-10765

**UNIVERSAL HEALTH SERVICES, INC.**

(Exact name of registrant as specified in its charter)

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

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

**UNIVERSAL CORPORATE CENTER**

**367 SOUTH GULPH ROAD**

**KING OF PRUSSIA, PENNSYLVANIA 19406**

(Address of principal executive offices) (Zip Code)

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

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding, as of April 30, 2010:

Class A	6,656,808
Class B	89,757,461
Class C	665,400
Class D	37,242

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

(amounts in thousands, except per share amounts)

(unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Net revenues	\$ 1,347,153	\$ 1,312,419
Operating charges:		
Salaries, wages and benefits	578,926	541,297
Other operating expenses	247,028	273,221
Supplies expense	183,816	173,967
Provision for doubtful accounts	125,390	118,978
Depreciation and amortization	53,511	51,134
Lease and rental expense	17,934	17,072
	1,206,605	1,175,669
Income from operations	140,548	136,750
Interest expense, net	12,377	12,638
Income before income taxes	128,171	124,112
Provision for income taxes	45,409	42,078
Net income	82,762	82,034
Less: Income attributable to noncontrolling interests	10,943	14,493
Net income attributable to UHS	\$ 71,819	\$ 67,541
Basic earnings per share attributable to UHS	\$ 0.74	\$ 0.68
Diluted earnings per share attributable to UHS	\$ 0.73	\$ 0.68
Weighted average number of common shares basic	96,539	98,412
Add: Other share equivalents	911	
Weighted average number of common shares and equivalents diluted	97,450	98,412

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

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

(amounts in thousands, unaudited)

	March 31, 2010	December 31, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 6,865	\$ 9,180
Accounts receivable, net	648,831	602,559
Supplies	83,822	84,272
Other current assets	36,863	27,270
Deferred income taxes	39,895	51,336
Current assets held for sale	21,580	21,580
<b>Total current assets</b>	<b>837,856</b>	<b>796,197</b>
Property and equipment	3,771,362	3,738,818
Less: accumulated depreciation	(1,467,874)	(1,423,580)
	2,303,488	2,315,238
Other assets:		
Goodwill	733,626	732,685
Deferred charges	9,316	8,643
Other	115,025	111,700
	<b>\$ 3,999,311</b>	<b>\$ 3,964,463</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 1,526	\$ 2,573
Accounts payable and accrued liabilities	583,028	578,617
Federal and state taxes	25,716	1,627
<b>Total current liabilities</b>	<b>610,270</b>	<b>582,817</b>
Other noncurrent liabilities	367,747	375,580
Long-term debt	891,615	956,429
Deferred income taxes	63,125	60,091
UHS common stockholders' equity	1,821,755	1,751,071
Noncontrolling interest	244,799	238,475
<b>Total equity</b>	<b>2,066,554</b>	<b>1,989,546</b>
	<b>\$ 3,999,311</b>	<b>\$ 3,964,463</b>

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



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

(amounts in thousands, unaudited)

	<b>Three months ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 82,762	\$ 82,034
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation & amortization	53,511	51,134
Gains on sale of asset	(1,848)	
Stock-based compensation expense	4,065	3,463
<i>Changes in assets &amp; liabilities, net of effects from acquisitions and dispositions:</i>		
Accounts receivable	(46,499)	(44,894)
Construction management and other receivable		17,477
Accrued interest	8,357	10,491
Accrued and deferred income taxes	37,380	28,062
Other working capital accounts	(2,389)	6,581
Other assets and deferred charges	(4,231)	(1,902)
Other	(4,164)	(4,537)
Accrued insurance expense, net of commercial premiums paid	18,960	20,014
Payments made in settlement of self-insurance claims	(10,187)	(15,669)
 Net cash provided by operating activities	 135,717	 152,254
<b>Cash Flows from Investing Activities:</b>		
Property and equipment additions, net of disposals	(62,576)	(78,219)
Proceeds received from sale of asset	2,894	
 Net cash used in investing activities	 (59,682)	 (78,219)
<b>Cash Flows from Financing Activities:</b>		
Reduction of long-term debt	(68,363)	(51,800)
Repurchase of common shares	(2,157)	(14,725)
Dividends paid	(4,834)	(3,962)
Issuance of common stock	1,627	667
Profit distributions to noncontrolling interests	(4,623)	(252)
 Net cash used in financing activities	 (78,350)	 (70,072)
 Increase (decrease) in cash and cash equivalents	 (2,315)	 3,963
Cash and cash equivalents, beginning of period	9,180	5,460
 Cash and cash equivalents, end of period	 \$ 6,865	 \$ 9,423
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest paid	\$ 5,482	\$ 3,966

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Income taxes paid, net of refunds	\$ 6,732	\$ 13,784
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The accompanying notes are an integral part of these consolidated financial statements.



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**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) General**

This Report on Form 10-Q is for the quarterly period ended March 31, 2010. In this Quarterly Report, we, us, our, UHS and the Company refer to Universal Health Services, Inc. and its subsidiaries.

You should carefully review the information contained in this Quarterly Report, and should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (the SEC). In this Quarterly Report, we state our beliefs of future events and of our future financial performance. In some cases, you can identify those so-called forward-looking statements by words such as may, will, should, expects, plans, anticipates, believes, estimates, potential, or continue or the negative of those words and other comparable words. You should be aware that those statements are only our predictions. Actual events or results may differ materially. In evaluating those statements, you should specifically consider various factors, including the risks related to healthcare industry trends and those detailed in our filings with the SEC including those set forth in our Annual Report on Form 10-K for the year ended December 31, 2009 in *Item 1A Risk Factors* and in *Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations - Forward Looking Statements and Risk Factors*. Those factors may cause our actual results to differ materially from any of our forward-looking statements.

The condensed consolidated financial statements include the accounts of our majority-owned subsidiaries and partnerships and limited liability companies controlled by us, or our subsidiaries, as managing general partner or managing member. The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. The balance sheet at December 31, 2009 has been derived from the audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements, significant accounting policies and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

***Relationship with Universal Health Realty Income Trust:***

At March 31, 2010, we held approximately 6.5% of the outstanding shares of Universal Health Realty Income Trust (the Trust). We serve as Advisor to the Trust under an annually renewable advisory agreement pursuant to the terms of which we conduct the Trust's day-to-day affairs, provide administrative services and present investment opportunities. In addition, certain of our officers and directors are also officers and/or directors of the Trust. Management believes that it has the ability to exercise significant influence over the Trust, therefore we account for our investment in the Trust using the equity method of accounting. We earned an advisory fee from the Trust, which is included in net revenues in the accompanying condensed consolidated statements of income, of \$437,000 and \$390,000 during the three-month periods ended March 31, 2010 and 2009, respectively. Our pre-tax share of income from the Trust was \$300,000 during each of the three-month periods ended March 31, 2010 and 2009. The carrying value of this investment was \$8.0 million and \$8.1 million at March 31, 2010 and December 31, 2009, respectively, and is included in other assets in the accompanying condensed consolidated balance sheets. The market value of this investment, based on the closing price of the Trust's stock on the respective dates, was \$27.8 million at March 31, 2010 and \$25.2 million at December 31, 2009.

Total rent expense under the operating leases on the hospital facilities with the Trust was \$4.1 million during each of the three-month periods ended March 31, 2010 and 2009. In addition, certain of our subsidiaries are tenants in several medical office buildings owned by limited liability companies in which the Trust holds non-controlling ownership interests.

The table below details the renewal options and terms for each of our four hospital facilities leased from the Trust:

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<b>Hospital Name</b>	<b>Type of Facility</b>	<b>Annual Minimum Rent</b>	<b>End of Lease Term</b>	<b>Renewal Term (years)</b>
McAllen Medical Center	Acute Care	\$ 5,485,000	December, 2011	20(a)
Wellington Regional Medical Center	Acute Care	\$ 3,030,000	December, 2011	20(b)
Southwest Healthcare System, Inland Valley Campus	Acute Care	\$ 2,648,000	December, 2011	20(b)
The Bridgeway	Behavioral Health	\$ 930,000	December, 2014	10(c)

(a) We have four 5-year renewal options at existing lease rates (through 2031).

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

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

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

### **(3) Other Noncurrent liabilities and Noncontrolling Interests**

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

As of March 31, 2010 and December 31, 2009, the noncontrolling interest balance of \$245 million and \$238 million, respectively, consists primarily of: (i) third-party ownership interests of approximately 28% in five acute care facilities located in Las Vegas, Nevada; (ii) a 20% third-party ownership in an acute care facility located in Washington, D.C. and; (iii) third-party ownership interests of approximately 11% in an acute care facility located in Laredo, Texas.

In connection with the five acute care facilities located in Las Vegas, Nevada, the outside owners have certain put rights that may require us to purchase the minority member's interests upon the occurrence of: (i) certain specified financial conditions falling below established thresholds; (ii) breach of the management contract by the managing member (a subsidiary of ours), or; (iii) if the minority member's ownership percentage is reduced to less than certain thresholds.

### **(4) Long-term debt**

We have an \$800 million, unsecured non-amortizing revolving credit agreement, as amended ( Credit Agreement ) which is scheduled to expire in July, 2011. The Credit Agreement includes a \$100 million sub-limit for letters of credit. The interest rate on the borrowings is determined, at our option, as either: (i) the one, two, three or six month London Inter-Bank Offer Rate ( LIBOR ) plus a spread of 0.33% to 0.575%; (ii) at the higher of the Agent's prime rate or the federal funds rate plus 0.50%, or; (iii) a competitive bid rate. A facility fee ranging from 0.07% to 0.175% is required on the total commitment. The applicable margins over LIBOR and the facility fee are based upon our credit ratings from Standard & Poor's Ratings Services and Moody's Investors Service, Inc. At March 31, 2010, the applicable margin over the LIBOR rate was 0.50% and the facility fee was 0.125%. There are no compensating balance requirements. As of March 31, 2010, we had \$155 million of borrowings outstanding under our revolving credit agreement and \$580 million of available borrowing capacity, net of \$65 million of outstanding letters of credit.

In August, 2007, we entered into a \$200 million accounts receivable securitization program ( Securitization ) with a group of conduit lenders and liquidity banks. The patient-related accounts receivable ( Receivables ) for substantially all of our acute care hospitals serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of .35%. The initial term of this Securitization was 364 days and the term can be extended for incremental 364 day periods upon mutual agreement of the parties. The facility was extended for a third 364-day term in August, 2009 and will mature in August, 2010. We have accounted for this Securitization as borrowings. We maintain effective control over the Receivables since, pursuant to the terms of the Securitization, the Receivables are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The wholly-owned special purpose entities use the Receivables to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. As of March 31, 2010, we had \$120 million of borrowings outstanding pursuant to this program and \$80 million of available borrowing capacity. The outstanding borrowings pursuant to the Securitization program are classified as long-term on our balance sheet since they can be refinanced through available borrowings under the terms of our Credit Agreement.

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

During 2001, we issued \$200 million of senior notes which have a 6.75% coupon rate and which mature on November 15, 2011. The interest on the senior notes is paid semiannually in arrears on May 15 and November 15 of each year. The senior notes can be redeemed in whole at any

time and in part from time to time.

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The carrying amount and fair value of our long-term debt was \$892 million and \$951 million at March 31, 2010, respectively. The fair value of our debt was computed based upon quotes received from financial institutions.

Our revolving credit agreement includes a material adverse change clause that must be represented at each draw. The facility also requires compliance with maximum debt to capitalization and minimum fixed charge coverage ratios. We are in compliance with all required covenants as of March 31, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

Effective January 1, 2009, we adopted the authoritative guidance for disclosures in connection with derivative instruments and hedging activities which requires additional disclosure about a company's derivative activities, but does not require any new accounting related to derivative activities. During the fourth quarter of 2007, we entered into two interest rate swaps whereby we pay a fixed rate on a total notional principal amount of \$150 million and receive 3-month LIBOR. Each of the two interest rate swaps has a notional principal amount of \$75 million. The fixed rate payable on the first interest rate swap is 4.7625% and matures on October 5, 2012. The fixed rate payable on the second interest rate swap is 4.865% and the maturity date is October 17, 2011. The notional amount of the second interest rate swap reduces to \$50 million on October 18, 2010. We measure our interest rate swaps at fair value on a recurring basis. The fair value of our interest rate swaps is based primarily on quotes from banks. We consider those inputs to be level 3 in the fair value hierarchy as outlined in the authoritative guidance for disclosures in connection with derivative instruments and hedging activities. The fair value of our interest rate swaps was a liability of approximately \$11.5 million at each of March 31, 2010 and December 31, 2009 which are included in other long-term liabilities on the accompanying balance sheet.

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

Effective January 1, 2008, most of our subsidiaries became self-insured for malpractice exposure up to \$10 million per occurrence, as compared to \$20 million per occurrence in the prior year. We purchased several excess policies through commercial insurance carriers which provide for coverage in excess of \$10 million up to \$195 million per occurrence and in the aggregate. However, we are liable for 10% of the claims paid pursuant to the commercially insured coverage in excess of \$10 million up to \$60 million per occurrence and in the aggregate.

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

As of March 31, 2010, the total accrual for our professional and general liability claims was \$275 million, of which \$46 million is included in accounts payable and accrued liabilities. As of December 31, 2009, the total accrual for our professional and general liability claims was \$266 million, of which \$46 million is included in other current liabilities.

Effective April 1, 2009, we have commercial property insurance policies covering catastrophic losses resulting from windstorm damage up to a \$1 billion policy limit per occurrence. Losses resulting from non-named windstorms are subject to a \$250,000 deductible. Losses resulting from named windstorms are subject to deductibles between 3% and 5% (based upon the location of the facility) of the declared total insurable value of the property. In addition, we have commercial property insurance policies covering catastrophic losses resulting from earthquake and flood damage, each subject to aggregated loss limits (as opposed to per occurrence losses). Our earthquake limit is \$250 million, except for facilities in Alaska, California and the New Madrid (which includes certain counties located in Arkansas, Illinois, Kentucky, Mississippi, Missouri and Tennessee) and Pacific Northwest Seismic Zones which are subject to a \$100 million limitation. The earthquake limit in Puerto Rico is \$25 million. Earthquake losses are subject to a \$250,000 deductible for our facilities located in all states except California, Alaska, Washington, Puerto Rico and the New Madrid where earthquake losses are subject to deductibles ranging from 1% to 5% (based upon the location of the facility) of the declared total insurable value of the property. Flood losses have either a \$250,000 or \$500,000 deductible, based upon the location of the facility. Due to an increase in property losses experienced nationwide in recent years, the cost of commercial property insurance has increased. As a result, catastrophic coverage for earthquake and flood has been limited to annual aggregate losses (as opposed to per occurrence losses). Given these insurance market conditions, there can be no assurance that a continuation of these unfavorable trends, or a sharp increase in uninsured property losses sustained by us, will not have a material adverse effect on our future results of operations.



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### ***Other***

As of March 31, 2010 we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds. Our outstanding letters of credit and surety bonds as of March 31, 2010 totaled \$81 million consisting of: (i) \$64 million related to our self-insurance programs; (ii) \$14 million related primarily to pending appeals of legal judgments (including judgments related to professional and generally liability claims), and; (iii) \$3 million of other debt guarantees related to public utilities and entities in which we own a minority interest.

### ***Legal Proceedings***

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

#### ***Litigation and Administrative Appeal of CMS's Attempt to Terminate Medicare Participation of Two Rivers Psychiatric Hospital:***

Two Rivers Psychiatric Hospital ( Two Rivers ), a behavioral health facility operated by one of our subsidiaries, received a notice of termination of its Medicare/Medicaid Certification as a result of Two Rivers' alleged failure to correct certain deficiencies which make it ineligible for Medicare program participation. We attempted to resolve these issues amicably with the Centers for Medicare and Medicaid Services ( CMS ) in an effort to prevent the termination from going into effect. In the interim, Two Rivers filed an administrative appeal with the U.S. Department of Health and Human Services, Departmental Appeals Board, Civil Remedies Division, seeking review of that decision. In order to prevent CMS from terminating the facility from the program prior to a hearing in the administrative appeal, Two Rivers also filed a complaint in the U.S. District Court for the Western District of Missouri seeking a temporary restraining order and preliminary injunction against CMS' proceeding with the termination. By agreement, the court issued a temporary restraining order preventing CMS from terminating Two Rivers from the Medicare/Medicaid program until such time that a settlement could be reached with CMS or a preliminary injunction could be ruled upon by the court. On April 7, 2010, Two Rivers received a letter from CMS advising that, as a result of a resurvey conducted by CMS surveyors in March, the termination notice was being rescinded and the facility was found to be in compliance with all conditions of participation.

#### ***False Claims Act Case Against Virginia Behavioral Health Facilities:***

In late 2007 and again on July 3, 2008 and January 27, 2009, the Office of Inspector General for the Department of Health and Human Services ( OIG ) issued subpoenas to two of our facilities, Marion Youth Center and Mountain Youth Academy, seeking documents related to the treatment of Medicaid beneficiaries at the facilities. It was our understanding at that time that the OIG was investigating whether claims for reimbursement submitted by those facilities to the Virginia Medicaid program were supported by adequate documentation of the services provided which could be considered to be a basis for a false claims act violation. On August 4, 2008, the Office of the Attorney General for the Commonwealth of Virginia issued a subpoena to Keystone Newport News, another of our facilities. It was our understanding at that time that the Office of Attorney General was investigating whether Keystone Newport News complied with various Virginia laws and regulations, including documentation requirements.

In response to these subpoenas, we produced the requested documents on a rolling basis and we cooperated with the investigations in all respects. We also met with representatives of the OIG, the Virginia Attorney General, the United States Attorney for the Western District of Virginia, and the United States Department of Justice Civil Division on several occasions to discuss a possible resolution of this matter. However, the parties were not able to reach a resolution.

Consequently, on November 4, 2009, the United States Department of Justice and the Virginia Attorney General intervened in a qui tam case that had been filed under seal in 2007 against Universal Health Services, Inc. ( UHS ), and Keystone Marion, LLC and Keystone Education and Youth Center ( Keystone ). The Department of Justice and the Commonwealth of Virginia filed and served their complaint which, at present, relates solely to the Marion Youth Center. The complaint alleges causes of action pursuant to the federal and state false claims acts, Virginia fraud, and unjust enrichment. The former employees filed a separate amended complaint, alleging employment and retaliation claims as well as false claim act violations. On April 30, 2010, UHS and Keystone filed separate motions to dismiss the government's claims in their entirety. Keystone intends to file a separate motion to dismiss the relator's employment claims. We have established a reserve in connection with this matter which did not have a material impact on our financial statements. We will continue to defend ourselves vigorously against the government's and former employees' allegations. There can be no assurance that we will prevail in the litigation or that the case will be limited to the Marion Youth Center.

#### ***Ethridge v. Universal Health Services et. al:***

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In June, 2008, we and one of our acute care facilities, Lancaster Community Hospital, were named as defendants in a wage and hour lawsuit in Los Angeles County Superior Court. This is a purported class action lawsuit alleging that the hospital failed to provide sufficient meal and break periods to certain employees. We have denied liability and are defending the case vigorously which has not yet been certified as a class action by the court. We are still uncertain as to the legal viability and extent of the claims, and, as such, are unable to determine the extent of potential financial exposure at this time.



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### ***Other Matters***

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, there is no assurance that we will not be faced with sanctions, fines or penalties in connection with such inquiries or actions, including with respect to the investigations and other matters discussed herein. Even if we were to ultimately prevail, such inquiries and/or actions could have a material adverse effect on us.

### ***Southwest Healthcare System:***

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

We ve received notification from CMS that it intends to effectuate the termination of SWHCS s Medicare provider agreement effective June 1, 2010, which, if it occurs, will likely also result in the termination of SWHCS s Medicaid provider agreement. SWHCS has commenced discussions with officials from CMS regarding an agreement that will potentially rescind the provider agreement termination action. Should we be unable to reach an agreement with CMS, we intend to file an administrative appeal with the Department of Health and Human Services and/or pursue other such remedies that may be available to us.

We ve also received notification from the California Department of Public Health ( CDPH ) indicating that they plan to initiate a process to revoke SWHCS s hospital license. We plan to appeal CDPH s action and SWHCS will remain operational pending the appeal. In that notice CDPH has indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements.

Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009, after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% of our income from operations after income attributable to non-controlling interest.

### ***General:***

Currently, and from time to time, some of our other facilities are subjected to inquiries and/or actions and receive notices of potential non-compliance of laws and regulations from various federal and state agencies. If one of our facilities is found to have violated these laws and regulations, the facility may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We do not believe that, other than as described above, any such existing action would materially affect our consolidated financial position or results of operations.

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

## **(6) Segment Reporting**

Our reportable operating segments consist of acute care hospital services and behavioral health care services. The Other segment column below includes centralized services including information services, purchasing, reimbursement, accounting, taxation, legal,



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advertising, design and construction and patient accounting as well as the operating results for our other operating entities including outpatient surgery and radiation centers. The chief operating decision making group for our acute care hospital services and behavioral health care services is comprised of the Chief Executive Officer, the President and the Presidents of each operating segment. The Presidents of each operating segment also manage the profitability of each respective segment's various facilities. The operating segments are managed separately because each operating segment represents a business unit that offers different types of healthcare services or operates in different healthcare environments. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2009.

	Three months ended March 31, 2010			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 2,783,431	\$ 544,781		\$ 3,328,212
Gross outpatient revenues	\$ 1,116,925	\$ 77,977	\$ 11,562	\$ 1,206,464
Total net revenues	\$ 989,311	\$ 349,182	\$ 8,660	\$ 1,347,153
Income/(loss) before income taxes	\$ 101,904	\$ 76,857	(\$ 50,590)	\$ 128,171
Total assets as of 3/31/10	\$ 2,788,234	\$ 998,499	\$ 212,578	\$ 3,999,311

	Three months ended March 31, 2009			
	Acute Care Hospital Services	Behavioral Health Services	Other	Total Consolidated
	(Amounts in thousands)			
Gross inpatient revenues	\$ 2,580,139	\$ 503,681		\$ 3,083,820
Gross outpatient revenues	\$ 995,699	\$ 68,128	\$ 15,913	\$ 1,079,740
Total net revenues	\$ 959,849	\$ 322,153	\$ 30,417	\$ 1,312,419
Income/(loss) before income taxes	\$ 113,713	\$ 66,164	(\$ 55,765)	\$ 124,112
Total assets as of 3/31/09	\$ 2,621,050	\$ 993,238	\$ 221,029	\$ 3,835,317

**(7) Earnings Per Share Data ( EPS ) and Stock Based Compensation**

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

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

	Three months ended March 31,	
	2010	2009
Basic and Diluted:		
Net income attributable to UHS	\$ 71,819	\$ 67,541
Less: Net income attributable to unvested restricted share grants	(315)	(314)
Net income attributable to UHS basic and diluted	\$ 71,504	\$ 67,227
Weighted average number of common shares basic	96,539	98,412

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	Three months ended March 31,	
	2010	2009
Net effect of dilutive stock options and grants based on the treasury stock method	911	(a)
Weighted average number of common shares and equivalents diluted	97,450	98,412
Earnings per basic share attributable to UHS:	\$ 0.74	\$ 0.68
Earnings per diluted share attributable to UHS:	\$ 0.73	\$ 0.68

(a) Although there were 8.0 million stock options outstanding as of March 31, 2009, there were no common stock equivalents included during the first quarter of 2009 since the effect was anti-dilutive.

**Stock-Based Compensation:** During the three months ended March 31, 2010 and 2009, compensation cost of \$3.4 million (\$2.1 million after-tax) and \$2.8 million (\$1.7 million after-tax), respectively, was recognized related to outstanding stock options. In addition, during the three months ended March 31, 2010 and 2009, compensation cost of \$697,000 (\$433,000 after-tax) and \$644,000 (\$400,000 after-tax), respectively, was recognized related to restricted stock. As of March 31, 2010 there was \$37.0 million of unrecognized compensation cost related to unvested options and restricted stock which is expected to be recognized over the remaining weighted average vesting period of 3.0 years. There were 94,000 stock options granted during the first three months of 2010 with a weighted-average grant date fair value of \$7.84 per share. There were 49,472 restricted stock shares granted during the first three months of 2010, with a weighted-average grant date fair value of \$30.32 per share.

**(8) Comprehensive Income**

Comprehensive income (loss) is comprised of net income, changes in unrealized gains or losses on derivative financial instruments and foreign currency translation adjustments.

(amounts in thousands)	Three months ended March 31,	
	2010	2009
Net income	\$ 71,819	\$ 67,541
Other comprehensive income (loss):		
Amortization of terminated hedge, net of taxes	(54)	(54)
Unrealized derivative losses on cash flow hedges, net of taxes	78	(314)
Comprehensive income	\$ 71,843	\$ 67,173

During the three month period ended March 31, 2010 and 2009, none of the components of other comprehensive income related to noncontrolling interests.

**(9) Dispositions and acquisitions of assets and businesses and assets held for sale*****Three-month period ended March 31, 2010:***

During the first quarter of 2010, we acquired substantially all of the assets of an outpatient surgery center located in Florida in which we previously held a 20% minority ownership interest. The purchase price consideration in connection with this transaction consisted of acquisition of the net assets less the assumption of the outstanding liabilities and third-party debt.

During the first quarter of 2010, we sold our minority ownership interest in a healthcare technology company for cash proceeds of \$2.9 million. This transaction resulted in a \$1.8 million pre-tax gain which is included in our financial results for the three-month period ended March 31,

2010.

***Three-month period ended March 31, 2009:***

There were no acquisitions or divestitures during the first quarter of 2009.

***Assets held for Sale:***

In August 2005, our Methodist Hospital and Lakeland Medical Pavilion, each located in New Orleans, Louisiana, and our Chalmette Medical Center and Virtue Street Pavilion, each located in Chalmette, Louisiana, were severely damaged and closed from Hurricane Katrina. Since that time, all facilities have remained closed and non-operational. The Chalmette Medical Center building has been razed as a result of the substantial hurricane damaged sustained. During 2008, we commenced divestiture considerations for the real property of these facilities which are included as assets held for sale in the accompanying Consolidated Balance Sheets.

**(10) Dividends**

We declared and paid dividends of \$4.8 million, or \$.05 per share, during the first quarter of 2010 and \$4.0 million, or \$.04 per share, during the first quarter of 2009.

**Table of Contents****(11) Pension Plan**

The following table shows the components of net periodic pension cost for our defined benefit pension plan as of March 31, 2010 and 2009 (amounts in thousands):

	Three months ended March 31,	
	2010	2009
Service cost	\$ 416	\$ 298
Interest cost	1,810	1,209
Expected return on assets	(1,881)	(982)
Recognized actuarial loss	927	1,169
<b>Net periodic pension cost</b>	<b>\$ 1,272</b>	<b>\$ 1,694</b>

During the three months ended March 31, 2010, we made contributions totaling \$6,315 to our pension plan.

**(12) Income Taxes**

We adopted the provisions of Accounting for Uncertainty in Income Taxes effective January 1, 2007. As of January 1, 2010, our unrecognized tax benefits were approximately \$6 million. The amount, if recognized, that would affect the effective tax rate is approximately \$4 million. During the quarter ended March 31, 2010, changes to the estimated liabilities for uncertain tax positions (including accrued interest) relating to tax positions taken during prior and current periods did not have a material impact on our financial statements.

We recognize accrued interest and penalties associated with uncertain tax positions as part of the tax provision. As of March 31, 2010, we have approximately \$1 million of accrued interest and penalties. The U.S. federal statute of limitations remains open for the 2006 and subsequent years. Foreign and U.S. state and local jurisdictions have statutes of limitations generally ranging from 3 to 4 years. The statute of limitations on certain jurisdictions could expire within the next twelve months.

We operate in multiple jurisdictions with varying tax laws. We are subject to audits by any of these taxing authorities. Our tax returns have been examined by the Internal Revenue Service ( IRS ) through the year ended December 31, 2002. The IRS has commenced an audit for the tax year ended December 31, 2006. We believe that adequate accruals have been provided for federal, foreign and state taxes.

**(13) Recent Accounting Standards**

**Accounting Standards Codification:** In June 2009, the FASB issued the FASB Accounting Standards Codification ( Codification ). The Codification has become the single source for all authoritative GAAP recognized by the FASB to be applied for financial statements issued for periods ending after September 15, 2009. The Codification does not change GAAP and did not affect our results of operations or financial position.

**Transfers of Financial Assets:** In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers of financial assets. This amendment requires greater transparency and additional disclosures for transfers of financial assets and the entity's continuing involvement with them and changes the requirements for derecognizing financial assets. In addition, this amendment eliminates the concept of a qualifying special-purpose entity ( QSPE ). This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

**Consolidation of Variable Interest Entities:** In June 2009, the FASB also issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities ( VIE s). The elimination of the concept of a QSPE, as discussed above, removes the exception from applying the consolidation guidance within this amendment. This amendment requires an enterprise to perform a qualitative analysis when determining whether or not it must consolidate a VIE. The amendment also requires an enterprise to continuously reassess whether it must consolidate a VIE. Additionally, the amendment requires enhanced disclosures about an enterprise's involvement with VIEs and any significant change in risk exposure due to that involvement, as well as how its involvement with VIEs impacts the enterprise's financial statements. Finally,

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an enterprise will be required to disclose significant judgments and assumptions used to determine whether or not to consolidate a VIE. This amendment became effective for us on January 1, 2010. This amendment did not have a material impact on our consolidated financial position or results of operations.

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**Postretirement Benefit Plan Assets:** In December 2008, the FASB issued guidance on employers' disclosures about postretirement benefit plan assets. This guidance is intended to ensure that an employer meets the objectives of the disclosures about plan assets in an employer's defined benefit pension or other postretirement plan to provide users of financial statements with an understanding of the following: how investment allocation decisions are made; the major categories of plan assets; the inputs and valuation techniques used to measure the fair value of plan assets; the effect of fair value measurements using significant unobservable inputs on changes in plan assets; and significant concentrations of risk within plan assets. This guidance became effective for us on December 31, 2009. Since the guidance only requires enhanced disclosures, its adoption did not have an impact on our results of operations.

**(14) Stockholders' Equity**

The following schedule presents the reconciliation of the carrying amount of total equity, equity attributable to UHS Common Stockholders and equity attributable to the noncontrolling interests for the three-month period ended March 31, 2010 (in thousands):

	Universal Health Services, Inc. Common Stockholders' Equity									
	Classes of Common Stock				Cumulative Dividends	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	UHS Common Stockholders' Equity	Noncontrolling Interest	Total Equity
	A	B	C	D						
Balance, January 1, 2010	\$ 67	\$ 896	\$ 7		(\$108,627)	\$ 1,879,981	(\$21,253)	\$ 1,751,071	\$ 238,475	\$ 1,989,546
Common Stock (a)										
Issued/(converted) including tax benefits from exercise of stock options		2				1,448		1,450		1,450
Repurchased		(1)				(2,156)		(2,157)		(2,157)
Restricted share-based compensation expense						877		877		877
Dividends paid					(4,834)			(4,834)		(4,834)
Stock option expense						3,505		3,505		3,505
Profit distributions to noncontrolling interests									(4,619)	(4,619)
Comprehensive income:										
Net income						71,819		71,819	10,943	82,762
Amortization of terminated hedge (net of income tax effect of \$30)							(54)	(54)		(54)
Unrealized derivative losses on cash flow hedges (net of income tax effect of \$47)							78	78		78
Subtotal - comprehensive income							24	71,843	10,943	82,786
Balance, March 31, 2010	\$ 67	\$ 897	\$ 7		(\$113,461)	\$ 1,955,474	(\$21,229)	\$ 1,821,755	\$ 244,799	\$ 2,066,554

(a) Authorized shares of Universal Health Services, Inc. consist of 12,000,000 shares of Class A Common Stock, 150,000,000 shares of Class B Common Stock, 1,200,000 shares of Class C Common Stock and 5,000,000 shares of Class D Common Stock.



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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Overview**

Our principal business is owning and operating, through our subsidiaries, acute care hospitals, behavioral health centers, surgical hospitals, ambulatory surgery centers and radiation oncology centers. As of March 31, 2010, we owned and/or operated or had under construction, 25 acute care hospitals (excluding 1 new replacement facility currently being constructed) and 102 behavioral health centers located in 32 states, Washington, D.C. and Puerto Rico. As part of our ambulatory treatment centers division, we manage and/or own outright or in partnerships with physicians, 7 surgical hospitals and surgery and radiation oncology centers located in 5 states and Puerto Rico.

Net revenues from our acute care hospitals, surgical hospitals, surgery centers and radiation oncology centers accounted for 74% of our consolidated net revenues during each of the three-month periods ended March 31, 2010 and 2009. Net revenues from our behavioral health care facilities accounted for 26% and 25% of our consolidated net revenues during the three-month periods ended March 31, 2010 and 2009, respectively. Approximately 1% of our consolidated net revenues during the three-month period ended March 31, 2009 were recorded in connection with a construction management contract pursuant to the terms of which we built a newly constructed acute care hospital for an unrelated party that was completed during the fourth quarter of 2009.

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

#### **Forward-Looking Statements and Risk Factors**

This Annual Report contains forward-looking statements that reflect our current estimates, expectations and projections about our future results, performance, prospects and opportunities. Forward-looking statements include, among other things, the information concerning our possible future results of operations, business and growth strategies, financing plans, expectations that regulatory developments or other matters will not have a material adverse effect on our business or financial condition, our competitive position and the effects of competition, the projected growth of the industry in which we operate, and the benefits and synergies to be obtained from our completed and any future acquisitions, and statements of our goals and objectives, and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, and similar expressions, as well as statements in future tense, identify forward-looking statements.

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

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

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

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

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

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

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

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

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

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

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

demographic changes;

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

a significant portion of our revenues is produced by facilities located in Nevada, Texas and California making us particularly sensitive to regulatory, economic, environmental and competitive changes in those states;

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

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

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

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

changes in our business strategies or development plans;

fluctuations in the value of our common stock, and;

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

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

We ve received notification from CMS that it intends to effectuate the termination of SWHCS s Medicare provider agreement effective June 1, 2010, which, if it occurs, will likely also result in the termination of SWHCS s Medicaid provider agreement. SWHCS has commenced discussions with officials from CMS regarding an agreement that will potentially rescind the provider agreement termination action. Should we be unable to reach an agreement with CMS, we intend to file an administrative appeal with the Department of Health and Human Services and/or pursue other such remedies that may be available to us.

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We've also received notification from the California Department of Public Health ( CDPH ) indicating that they plan to initiate a process to revoke SWHCS's hospital license. We plan to appeal CDPH's action and SWHCS will remain operational pending the appeal. In that notice CDPH has indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements.

Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009, after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% of our income from operations after income attributable to non-controlling interest.

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

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

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We

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consider our critical accounting policies to be those that require us to make significant judgments and estimates when we prepare our consolidated financial statements. For a summary of our significant accounting policies, please see *Note 1 to the Consolidated Financial Statements* as included in our Form 10-K for the year ended December 31, 2009.

**Revenue recognition:** We record revenues and related receivables for health care services at the time the services are provided. Medicare and Medicaid revenues represented 38% of our net patient revenues during each of the three-month periods ended March 31, 2010 and 2009. Revenues from managed care entities, including health maintenance organizations and managed Medicare and Medicaid programs, accounted for 45% and 46% of our net patient revenues during the three-month periods ended March 31, 2010 and 2009, respectively.

**Provision for Doubtful Accounts:** On a consolidated basis, we monitor our total self-pay receivables to ensure that the total allowance for doubtful accounts provides adequate coverage based on historical collection experience. Our accounts receivable are recorded net of allowance for doubtful accounts of \$171 million at March 31, 2010 and \$169 million at December 31, 2009.

Patients that express an inability to pay are reviewed for write-off as potential charity care. Our accounts receivable are recorded net of established charity care reserves of \$73 million at March 31, 2010 and \$61 million as of December 31, 2009.

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

**Results of Operations**

The following table summarizes our results of operations and is used in the discussion below for the three months ended March 31, 2010 and 2009 (dollar amounts in thousands):

	Three months ended March 31, 2010		Three months ended March 31, 2009	
	Amount	% of Revenues	Amount	% of Revenues
Net revenues	\$ 1,347,153	100.0%	\$ 1,312,419	100.0%
Operating charges:				
Salaries, wages and benefits	578,926	43.0%	541,297	41.2%
Other operating expenses	247,028	18.3%	273,221	20.8%
Supplies expense	183,816	13.6%	173,967	13.3%
Provision for doubtful accounts	125,390	9.3%	118,978	9.1%
Depreciation and amortization	53,511	4.0%	51,134	3.9%
Lease and rental expense	17,934	1.3%	17,072	1.3%
Subtotal operating expenses	1,206,605	89.6%	1,175,669	89.6%
Income from operations	140,548	10.4%	136,750	10.4%
Interest expense, net	12,377	0.9%	12,638	0.9%
Income before income taxes	128,171	9.5%	124,112	9.5%
Provision for income taxes	45,409	3.4%	42,078	3.2%
Net income	82,762	6.1%	82,034	6.3%
Less: Income attributable to noncontrolling interests	10,943	0.8%	14,493	1.2%
Net income attributable to UHS	\$ 71,819	5.3%	\$ 67,541	5.1%

Net revenues increased 3% or \$35 million to \$1.35 billion during the three-month period ended March 31, 2010 as compared to \$1.31 billion during the comparable prior year quarter. This increase was due primarily to a \$51 million or 4% increase in net revenues generated at acute care hospitals and behavioral health care facilities owned during both periods (which we refer to as same facility). Partially offsetting the increase in our same facility revenues was a \$20 million decrease resulting from the revenues earned during the first quarter of 2009 in connection with a

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construction management contract pursuant to the terms of which we built a newly constructed acute care hospital for an unrelated party that was completed during the fourth quarter of 2009.

Income before income taxes (before deduction for income attributable to minority interests) increased \$4 million to \$128 million during the three-month period ended March 31, 2010 as compared to \$124 million during the comparable quarter of the prior year. Included in our income before income taxes during the first quarter of 2010, as compared to the comparable prior year quarter, was the following:

a decrease of \$12 million at our acute care facilities as discussed below in Acute Care Hospital Services;

an increase of \$11 million at our behavioral health care facilities, as discussed below in Behavioral Health Services, and;

an increase of \$5 million from other combined net favorable changes, including a \$2 million gain realized during the first quarter of 2010 on the sale of our minority ownership interest in a healthcare technology company and a \$3 million charge recorded during the first quarter of 2009 in connection with the settlement of the South Texas Health System affiliates investigation.

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Net income attributable to UHS increased \$4 million to \$72 million during the three-month period ended March 31, 2010 as compared to \$68 million during the comparable prior year quarter. The increase in net income attributable to UHS during the first quarter of 2010, as compared to the comparable prior year quarter, consisted of:

the increase of \$4 million in income from operations before income taxes, as discussed above;

an increase of \$3 million resulting from a decrease in income attributable to noncontrolling interests, and;

a decrease of \$3 million resulting from an increase in income tax expense due to the income tax provision on the \$7 million of combined increases in pre-tax income (\$4 million increase in income from operations and \$3 million increase resulting from a decrease in income attributable to noncontrolling interests), as discussed above.

**Acute Care Hospital Services****Same Facility and All Acute Care Basis**

The following table summarizes the results of operations for our acute care facilities, on a same facility and all acute care basis, and is used in the discussion below for the three months ended March 31, 2010 and 2009 (dollar amounts in thousands):

	<b>Three Months Ended March 31,</b>			
	<b>2010</b>	<b>%</b>	<b>2009</b>	<b>%</b>
Net revenues	\$ 989,311	100.0	\$ 959,849	100.0
Salaries, wages and benefits	375,099	37.9	355,817	37.1
Other operating expenses	173,197	17.5	171,082	17.8
Supplies expense	164,124	16.6	154,120	16.1
Provision for doubtful accounts	117,182	11.8	110,165	11.5
Depreciation and amortization	43,478	4.4	41,347	4.3
Lease and rental	13,493	1.4	12,570	1.3
Subtotal operating expenses	886,573	89.6	845,101	88.0
Income from operations	102,738	10.4	114,748	12.0
Interest expense, net	834	0.1	1,035	0.2
Income before income taxes	\$ 101,904	10.3	\$ 113,713	11.8

During the three-month period ended March 31, 2010, as compared to the comparable prior year quarter, net revenues at our acute care hospitals increased \$29 million or 3%. Our income before income taxes (and before income attributable to noncontrolling interests) decreased \$12 million or 10% to \$102 million or 10.3% of net revenues during the first quarter of 2010 as compared to \$114 million or 11.8% of net revenues during the comparable prior year quarter. The decrease in income from operations at our acute care hospitals during the first quarter of 2010, as compared to the comparable quarter of the prior year, was due primarily to Medicaid revenue reductions experienced by our Texas hospitals, increases in uncompensated care expenses and salaries, wages and benefits expense and supplies expense which increased beyond the rate of increase in our acute care revenues.

Inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our acute care facilities increased 0.6% and 1.8%, respectively, during the three-month period ended March 31, 2010 as compared to the comparable period of the prior year. Patient days and adjusted patient days decreased 0.5% and increased 0.6%, respectively, during the three-month period ended March 31, 2010 as compared to the comparable prior year period. The average length of inpatient stay at these facilities was 4.5 days during each of the three-month periods ended March 31, 2010 and 2009. The occupancy rate, based on the average available beds at these facilities, was 63% and 67% during the three-month periods ended March 31, 2010 and 2009, respectively. During the three-month period ended March 31, 2010, net revenue per adjusted admission

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increased 1.3% and net revenue per adjusted patient day increased 2.5%, as compared to the comparable quarter of the prior year.

We continue to experience an increase in uninsured patients throughout our portfolio of acute care hospitals which, in part, has resulted from an increase in the number of patients who are employed but do not have health insurance. We provide care to patients



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who meet certain financial or economic criteria without charge or at amounts substantially less than our established rates. Because we do not pursue collection of amounts that qualify as charity care, they are not reported in net revenues or in accounts receivable, net. Our acute care hospitals provided charity care and uninsured discounts, based on charges at established rates, amounting to \$176 million and \$158 million during three-month periods ended March 31, 2010 and 2009, respectively. A continued increase in the level of uninsured patients to our facilities and the resulting adverse trends in the provision for doubtful accounts and charity care provided, could have a material unfavorable impact on our future operating results.

There were no differences between Same Facility and All Acute Care Basis during the three month periods ended March 31, 2010 and 2009 as there were no acute care hospitals acquired or opened during the period of January 1, 2009 through March 31, 2010.

**Behavioral Health Services**

The following table summarizes the results of operations for our behavioral health care facilities, on a same facility basis, and is used in the discussion below for the three-month periods ended March 31, 2010 and 2009 (dollar amounts in thousands):

**Same Facility Behavioral Health**

	Three Months Ended			
	2010		2009	
		%		%
Net revenues	\$ 343,615	100.0	\$ 321,922	100.0
Salaries, wages and benefits	166,782	48.5	157,646	49.0
Other operating expenses	61,110	17.8	58,538	18.2
Supplies expense	17,870	5.2	17,919	5.6
Provision for doubtful accounts	8,276	2.4	8,647	2.7
Depreciation and amortization	7,869	2.3	8,029	2.5
Lease and rental	3,708	1.1	3,853	1.2
Subtotal operating expenses	265,615	77.3	254,632	79.1
Income from operations	78,000	22.7	67,290	20.9
Interest expense, net	3	0.0	51	0.0
Income before income taxes	\$ 77,997	22.7	\$ 67,239	20.9

On a same facility basis during the first quarter of 2010, as compared to the first quarter of 2009, net revenues at our behavioral health care facilities increased 7% or \$22 million. Income before income taxes increased \$11 million or 16% to \$78 million or 22.7% of net revenues during the three-month period ended March 31, 2010, as compared to \$67 million or 20.9% of net revenues during the comparable prior year quarter.

On a same facility basis, inpatient admissions and adjusted admissions (adjusted for outpatient activity) to our behavioral health facilities increased 4.0% and 3.8%, respectively, during the three-month period ended March 31, 2010 as compared to the comparable period of the prior year. Patient days and adjusted patient days increased 4.1% and 3.9%, respectively, during the three-month period ended March 31, 2010 as compared to the comparable prior year period. The average length of inpatient stay at these facilities was 15.0 days during each of the three-month periods ended March 31, 2010 and 2009. The occupancy rate, based on the average available beds at these facilities, was 76% and 74% during the three-month periods ended March 31, 2010 and 2009, respectively. During the three-month period ended March 31, 2010, net revenue per adjusted admission increased 2.8% and net revenue per adjusted patient day increased 2.7%, as compared to the comparable quarter of the prior year.

The following table summarizes the results of operations for our behavioral health care facilities for the three-month periods ended March 31, 2010 and 2009, including newly acquired or recently opened facilities:

**All Behavioral Health Care Facilities (dollar amounts in thousands)**

	Three Months Ended			
	2010		March 31,	
		%	2009	%
Net revenues	\$ 349,182	100.0	\$ 322,153	100.0
Salaries, wages and benefits	170,724	48.9	158,137	49.1
Other operating expenses	62,943	18.0	59,218	18.4
Supplies expense	18,324	5.2	17,997	5.6
Provision for doubtful accounts	8,141	2.3	8,649	2.7

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	Three Months Ended March 31,			
	2010	%	2009	%
Depreciation and amortization	8,303	2.4	8,060	2.5
Lease and rental	3,887	1.1	3,877	1.2
<b>Subtotal operating expenses</b>	<b>272,322</b>	<b>78.0</b>	<b>255,938</b>	<b>79.4</b>
Income from operations	76,860	22.0	66,215	20.6
Interest expense, net	3	0.0	51	0.0
Income before income taxes	\$ 76,857	22.0	\$ 66,164	20.5

During the first quarter of 2010, as compared to the comparable prior year quarter, net revenues at our behavioral health care facilities (including newly acquired or recently opened facilities), increased 8% or \$27 million. Income before income taxes increased \$10 million or 15% to \$77 million or 22.0% of net revenues during the first quarter of 2010, as compared to \$67 million or 20.5% of net revenues during the first quarter of 2009.

**Sources of Revenue**

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

Hospital revenues depend upon inpatient occupancy levels, the medical and ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the charges or negotiated payment rates for such services. Charges and reimbursement rates for inpatient routine services vary depending on the type of services provided (e.g., medical/surgical, intensive care or behavioral health) and the geographic location of the hospital. Inpatient occupancy levels fluctuate for various reasons, many of which are beyond our control. The percentage of patient service revenue attributable to outpatient services has generally increased in recent years, primarily as a result of advances in medical technology that allow more services to be provided on an outpatient basis, as well as increased pressure from Medicare, Medicaid and private insurers to reduce hospital stays and provide services, where possible, on a less expensive outpatient basis. We believe that our experience with respect to our increased outpatient levels mirrors the general trend occurring in the health care industry and we are unable to predict the rate of growth and resulting impact on our future revenues.

Patients are generally not responsible for any difference between customary hospital charges and amounts reimbursed for such services under Medicare, Medicaid, some private insurance plans, and managed care plans, but are responsible for services not covered by such plans, exclusions, deductibles or co-insurance features of their coverage. The amount of such exclusions, deductibles and co-insurance has generally been increasing each year. Indications from recent federal and state legislation are that this trend will continue. Collection of amounts due from individuals is typically more difficult than from governmental or business payers and we continue to experience an increase in uninsured and self-pay patients which unfavorably impacts the collectability of our patient accounts thereby increasing our provision for doubtful accounts and charity care provided.

Since a significant portion of our revenues are derived from facilities located in Nevada and Texas, we are particularly sensitive to regulatory, economic, environmental and competition changes in those states. Any material change in the current payment programs or regulatory, economic, environmental or competitive conditions in those states could have a disproportionate effect on our overall business results.

The following table shows the approximate percentages of net patient revenue for the three month period ended March 31, 2010 and 2009 presented on: (i) a combined basis for both our acute care and behavioral health facilities; (ii) for our acute care facilities only, and; (iii) for our behavioral health facilities only:

**Acute Care and Behavioral Health Facilities Combined**

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	Percentage of Net Patient Revenues	
	Three Months Ended March 31,	
	2010	2009
Third Party Payors:		
Medicare	25%	25%
Medicaid	13%	13%
Managed Care (HMO and PPOs)	45%	46%
Other Sources	17%	16%
Total	100%	100%

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Acute Care Facilities	Percentage of Net Patient Revenues Three Months Ended	
	March 31,	
	2010	2009
Third Party Payors:		
Medicare	28%	28%
Medicaid	9%	9%
Managed Care (HMO and PPOs)	46%	47%
Other Sources	17%	16%
Total	100%	100%

  

Behavioral Health Facilities	Percentage of Net Patient Revenues Three Months Ended	
	March 31,	
	2010	2009
Third Party Payors:		
Medicare	17%	16%
Medicaid	25%	27%
Managed Care (HMO and PPOs)	42%	42%
Other Sources	16%	15%
Total	100%	100%

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

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

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

In July, 2009, CMS published the final IPPS 2010 payment rule which provided for a 2.1% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors and annual geographic wage index updates and the documenting and coding adjustments are considered, we estimate our overall increase from the final federal fiscal year 2010 rule will approximate 1.1%.



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In April, 2010, CMS published its proposed IPPS 2011 payment rule which provided for a 2.4% market basket increase to the base Medicare MS-DRG blended rate. When statutorily mandated budget neutrality factors and annual geographic wage index updates and the documenting and coding adjustments are considered, we estimate our overall decrease from the proposed federal fiscal year 2011 rule will approximate 0.9%. In addition, as outlined in the Sources of Revenues and Health Care Reform discussion below, CMS is also required by federal law to reduce the update factor by 0.25% in federal fiscal year 2011.

In September, 2007, the TMA, Abstinence Education, and QI Programs Extension Act of 2007 legislation took effect and scaled back cuts in hospital reimbursement that CMS was set to impose. In federal fiscal years 2010 to 2012, the new law requires CMS to make adjustments to the Medicare standardized amounts in these years to reflect the removal of actual aggregate payment increases or decreases for documentation and coding adjustments that occurred during federal fiscal years 2008 and 2009 as compared to the initial CMS estimates. In federal fiscal year 2010, CMS made its initial statutory mandated adjustment under this legislation and will continue to do so in subsequent fiscal years to ensure the implementation of MS-DRGs was budget neutral among all affected hospitals. In April, 2010, the IPPS 2011 proposed payment rule applied a 2.9% reduction to the 2011 market basket update and indicated another 2.9% reduction would also be applied in 2012 for documenting and coding. In this same rule, CMS indicated a remaining documenting and coding adjustment of 3.9% reduction is still required to be made to future IPPS updates. CMS did not indicate to which future federal fiscal year(s) this reduction would be applied.

On January 1, 2005, CMS implemented a new PPS ( Psych PPS ) for inpatient services furnished by psychiatric hospitals under the Medicare program. This system replaced the cost-based reimbursement guidelines with a per diem Psych PPS with adjustments to account for certain facility and patient characteristics. The Psych PPS also contained provisions for outlier payments and an adjustment to a psychiatric hospital's base payment if it maintains a full-service emergency department. According to the May, 2009 CMS notice, the market basket increase is 2.1% for the period of July 1, 2009 through June 30, 2010. According to the April, 2010 CMS notice, the market basket increase is 2.4% for the period of July 1, 2010 through June 30, 2011.

In October 2009, CMS published its annual final Medicare Outpatient Prospective Payment System ( OPPS ) rule for 2010. The final market basket increase to the OPPS base rate is 2.1%. When other statutorily required adjustments are considered the overall Medicare OPPS payment increase for 2010 is estimated to be 1.9%.

In December 2009, the Department of Health and Human Services ( HHS ) published a proposed regulation and an interim final rule implementing the health information technology ( HIT ) provisions of the American Recovery and Reinvestment Act (referred to as the HITECH Act ). The proposed regulation defines the meaningful use of Electronic Health Records ( EHR ) and establishes the requirements for the Medicare and Medicaid EHR payment incentive programs. The interim final rule established an initial set of standards and certification criteria.

The implementation period for these new Medicare and Medicaid incentive payments starts in federal fiscal year 2011 and can end as late as 2016 for Medicare and 2021 for the state Medicaid programs. State Medicaid program participation in this federally funded incentive program is voluntary and we are unable to predict which states will choose to participate. We estimate that approximately 75% of the projected incentive payments will be paid by Medicare and 25% from state Medicaid programs. Our acute care hospitals may qualify for these EHR incentive payments upon implementation of the EHR application assuming they meet the meaningful use criteria . These Medicare and Medicaid incentive payments are intended to offset a portion of the cost incurred to qualify as a meaningful user of EHR. Our acute care facilities are scheduled to implement an EHR application, on a facility-by-facility basis, beginning in late 2011 and ending in late 2014. However, there can be no assurance that we will ultimately qualify for these incentive payments and, should we qualify, we are unable to quantify the amount of incentive payments we may receive since the amount is dependent upon various factors including the implementation timing at each facility. Should we qualify for incentive payments, there may be timing differences in the recognition of the revenues and expenses recorded in connection with the implementation of the EHR application which may cause material period-to-period changes in our future results of operations. Hospitals that do not qualify as a meaningful user of EHR by 2015 are subject to a reduced market basket update to the IPPS standardized amount in 2015 and each subsequent fiscal year. Although we believe that our acute care hospitals will be in compliance with the EHR standards by 2015, there can be no assurance that all of our facilities will be in compliance and therefore not subject to the penalty provision of the HITECH Act.

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

We receive a large concentration of our Medicaid revenues from Texas and significant amounts from Nevada, Florida, California, Washington, D.C. and Illinois. The majority of these states, as well as most other states in which we operate, have reported significant





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budget deficits that have resulted in the reduction of Medicaid funding for 2009 and 2010. We can provide no assurance that reductions to Medicaid revenues, particularly in the above-mentioned states, will not have a material adverse effect on our future results of operations. Furthermore, many states are currently working to effectuate further significant reductions in the level of Medicaid funding due to significant state budget deficits also projected for 2010, which could adversely affect future levels of Medicaid reimbursement received by our hospitals. Conversely, on February 17, 2009, the American Recovery and Reinvestment Act of 2009 was signed into law and contained various Medicaid provisions that will impact our hospitals including the following: (i) temporary increases to Medicaid funding through enhanced federal matching assistance percentages ( FMAPs ) for a 27 month period retroactive to October 1, 2008 through December 31, 2010 with all states receiving a FMAP increase of 6.2% and also receiving a bonus FMAP increase contingent on the increased level of a state's unemployment rate; (ii) a temporary increase of 2.5% in the federal Medicaid disproportionate share hospital allotment for both federal fiscal years 2009 and 2010, and; (iii) states will be required to maintain effort on Medicaid eligibility consistent with requirements prior to passage of this law. Due to the indirect nature of the enhanced Medicaid federal funding contained within the American Recovery and Reinvestment Act of 2009, we are unable to determine the impact of these Medicaid changes on our future results of operations.

Certain of our acute care hospitals located in various counties of Texas (Hidalgo, Maverick, Potter and Webb) participate in CMS-approved private Medicaid supplemental payment ( UPL ) programs. These hospitals also have affiliation agreements with third-party hospitals to provide free hospital and physician care to qualifying indigent residents of these counties. Our hospitals receive both UPL payments from the Medicaid program and indigent care payments from third-party, affiliated hospitals. The UPL payments are contingent on the county or hospital district making an Inter-Governmental Transfer ( IGT ) to the state Medicaid program while the indigent care payment is contingent on a transfer of funds from the applicable affiliated hospitals. We received \$10 million and \$8 million during the three-month periods ended March 31, 2010 and 2009, respectively, of aggregate, net UPL and affiliated hospital indigent care payments. If during the remainder of 2010 the hospital district makes IGTs consistent with 2009, we believe we would be entitled to additional aggregate, net UPL and affiliated hospital indigent care payment revenues of approximately \$30 million during the remaining nine months of 2010.

In July 2009, the Texas Health and Human Services Commission ( THHSC ) issued a final rule and will rebase during state fiscal year ( SFY ) 2010, on a statewide budget neutral basis, all acute care hospital inpatient Standard Dollar Amount ( SDA ) rates. In addition, the THHSC will also rebase all MS-DRG relative weights concurrent with this SDA rate change. The THHSC will use SFY2008 cost report cost data for the SDA and relative weight rebasing and will only make changes on a prospective basis regardless of when the rebased SDA rates and relative weights are implemented. We expect this rebasing to be implemented by THHSC sometime in 2010 or later. While we are unable to estimate the reimbursement impact, this change could have a material adverse effect on our future results of operations.

In addition, we were notified on May 6, 2009 by the THHSC that the statewide new hospital rate for our hospitals located in South Texas will be reduced. Although the definitive hospital rate has not yet been finalized, at this time, we estimate that our Texas Medicaid reimbursement will be reduced by \$12 million annually, which was applied retroactively to September 1, 2009. This rate change will be superseded by THHSC during SFY 2011 by the rebased SDA rates required by the July, 2009 proposed rule.

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

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

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

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



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

Upon meeting certain conditions and serving a disproportionately high share of Texas and South Carolina s low income patients, five of our facilities located in Texas and one facility located in South Carolina received additional reimbursement from each state s DSH fund. The Texas and South Carolina programs have been renewed for each state s 2010 fiscal years (covering the period of October 1, 2009 through September 30, 2010 for each state). Included in our financial results was an aggregate of \$14 million and \$12 million during the three-month periods ended March 31, 2010 and 2009, respectively, recorded in connection with these DSH programs. Failure to renew these DSH programs beyond their scheduled termination dates, failure of our hospitals that currently receive DSH payments to qualify for future DSH funds under these programs, or reductions in reimbursements, could have a material adverse effect on our future results of operations. Assuming that the Texas and South Carolina programs are renewed for each state s 2011 fiscal years at amounts similar to the 2010 fiscal year amounts, we estimate our aggregate reimbursements pursuant to these programs to be approximately \$40 million during the remaining nine months of 2010.

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

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

***Immediate Medicare Reductions:***

The Reconciliation Act reduces the market basket update for inpatient and outpatient hospitals and inpatient behavioral health facilities in 2010 and 2011 by 0.25% with the noted effective dates as follows:

Outpatient acute care	Retroactive to January 1, 2010
Inpatient acute care	April 1, 2010
Inpatient behavioral health	July 1, 2010

***Future Medicare Reductions:***

Future changes to the Medicare program include:

- Market basket update reductions and productivity adjustments (effective 2011 and forward)
- Reforms to Medicare Advantage payments (effective 2011 and forward)
- Implement a hospital readmissions reduction program (effective 2012)

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Implement a national pilot program on payment bundling (effective 2013)

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

### **Medicaid Revisions:**

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

Reduction to Medicaid DSH (effective 2014)

### **Health Insurance Revisions:**

Large employer insurance reforms (effective 2014)

Individual insurance mandate and related federal subsidies (effective 2014)

Federally mandated insurance coverage reforms (2010 and forward)

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Although we do not believe the above-mentioned Medicare market basket reductions scheduled to be implemented in 2010 will have a material impact on our 2010 or 2011 results of operations, we are unable to estimate the future impact of the other legislative changes as outlined above.

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

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

**Other Operating Results**

Combined net revenues from our surgical hospitals, ambulatory surgery centers and radiation oncology centers were \$4 million and \$7 million during the three-month periods ended March 31, 2010 and 2009, respectively. In connection with construction management contracts pursuant to the terms of which we built a newly constructed acute care hospital for an unrelated third party which was completed during the fourth quarter of 2009, we earned revenues of \$20 million during the first quarter of 2009. Combined income before income taxes earned in connection with the revenues mentioned above was not material to our results of operations during each of the three-month periods ended March 31, 2010 and 2009.

Interest expense was \$12 million and \$13 million during the three-month periods ended March 31, 2010 and 2009, respectively. Below is a schedule of our interest expense for the three month periods ended March 31, 2010 and 2009 (amounts in thousands):

	<b>Three Months Ended March 31, 2010</b>	<b>Three Months Ended March 31, 2009</b>
Revolving credit & demand notes	\$ 750	\$ 1,365
\$200 million, 6.75% Senior Notes due 2011	3,378	3,378
7.125% Senior Notes due 2016	7,124	7,124
Accounts receivable securitization program	152	310
Other combined, including interest rate swap expense, net	2,652	2,414
Capitalized interest on major construction projects	(1,462)	(1,818)
Interest income	(217)	(135)
Interest expense, net	\$ 12,377	\$ 12,638

The effective tax rate, as calculated by dividing the provision for income taxes by income before income taxes, was 35.4% and 33.9% during the three-month periods ended March 31, 2010 and 2009, respectively. The effective tax rate, as calculated by dividing the provision for income taxes by the difference in income before income taxes minus income attributable to noncontrolling interests, was 38.7% and 38.4% during the three-month periods ended March 31, 2010 and 2009, respectively.

**Liquidity****Net cash provided by operating activities**

Net cash provided by operating activities was \$136 million during the three-month period ended March 31, 2010 and \$152 million during the comparable quarter of the prior year. The net decrease of \$17 million was primarily attributable to \$17 million of construction management receivables collected during the first quarter of 2009 related to a new acute care facility built for a third-party that was completed during the fourth quarter of 2009.

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Our days sales outstanding ( DSO ) are calculated by dividing our net revenue by the number of days in the three-month period. The result is divided into the accounts receivable balance at March 31<sup>st</sup> each year to obtain the DSO. Our DSO were 43 days at March 31, 2010 and 45 days at March 31, 2009.

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### **Net cash used in investing activities**

During the three-month period ended March 31, 2010 we used \$60 million of net cash in investing activities as compared to \$78 million of net cash used in investing activities during the three months ended March 31, 2009.

During the first quarter of 2010, we used \$60 million of net cash in investing activities as follows:

spent \$63 million to finance capital expenditures related to the following: (i) construction costs related to the newly constructed Palmdale Regional Medical Center, a 171-bed acute care hospital in Palmdale, California that is scheduled to be completed and opened during the third quarter of 2010; (ii) construction costs related to multiple projects in process to add capacity to our busiest behavioral health facilities, and; (iii) capital expenditures for equipment, renovations and new projects at various existing facilities, and;

received \$3 million in connection with the divestiture of our minority ownership interest in a healthcare technology company.

During the first three months of 2009, we used \$78 million of net cash in investing activities to finance capital expenditures, including capital costs related to the following: (i) construction costs related to the newly constructed Palmdale Regional Medical Center; (ii) construction costs related to a major expansion of the emergency, imaging and women's services at our Southwest Healthcare System hospitals located in Riverside County, California; (iii) construction costs related to a newly constructed 220-bed replacement acute care hospital in Denison, Texas that opened in late December, 2009; (iv) construction costs related to multiple projects in process to add capacity to our busiest behavioral health facilities, and; (v) capital expenditures for equipment, renovations and new projects at various existing facilities.

### **Net cash used in financing activities**

During the three-month period ended March 31, 2010, we used \$78 million of net cash in financing activities as compared to \$70 million of net cash used in financing activities during the comparable three-month period of 2009.

During the first three months of 2010, we used \$78 million of net cash provided by financing activities as follows:

spent \$68 million on net repayments of debt due primarily to repayments pursuant to our \$800 million revolving credit facility partially offset by increased borrowings pursuant to our \$200 million accounts receivable securitization program;

spent \$5 million to pay profit distributions related to noncontrolling interests in majority owned businesses;

spent \$2 million to repurchase 66,000 shares of our Class B Common Stock;

spent \$5 million to pay quarterly cash dividends of \$.05 per share, and;

generated \$2 million from the issuance of shares of our Class B Common Stock pursuant to the terms of employee stock purchase plans.

During the first three months of 2009, we used \$70 million of net cash provided by financing activities as follows:

spent \$52 million on net of repayments of debt primarily due to repayments pursuant to our \$800 million revolving credit facility;

spent \$15 million to repurchase 437,000 shares of our Class B Common Stock;

spent \$4 million to pay quarterly cash dividends of \$.08 per share, and;

generated \$1 million from the issuance of shares of our Class B Common Stock pursuant to the terms of employee stock purchase plans.

***2010 Expected Capital Expenditures:***

During the remaining nine months of 2010, we expect to spend approximately \$250 million to \$290 million on capital expenditures. We believe that our capital expenditure program is adequate to expand, improve and equip our existing hospitals. We expect to finance all capital expenditures and acquisitions with internally generated funds and/or additional funds, as discussed below.

**Capital Resources**

**Credit Facilities and Outstanding Debt Securities**

We have an \$800 million, unsecured non-amortizing revolving credit agreement, as amended ( *Credit Agreement* ) which is scheduled to expire in July, 2011. The *Credit Agreement* includes a \$100 million sub-limit for letters of credit. The interest rate on the borrowings is determined, at our option, as either: (i) the one, two, three or six month London Inter-Bank Offer Rate ( *LIBOR* ) plus a spread of 0.33% to 0.575%; (ii) at the higher of the Agent's prime rate or the federal funds rate plus 0.50%, or; (iii) a competitive bid rate. A facility fee ranging from 0.07% to 0.175% is required on the total commitment. The applicable margins over *LIBOR* and the facility fee are based upon our credit ratings from Standard & Poor's Ratings Services and Moody's Investors Service, Inc. At March 31, 2010,



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the applicable margin over the LIBOR rate was 0.50% and the facility fee was 0.125%. There are no compensating balance requirements. As of March 31, 2010, we had \$155 million of borrowings outstanding under our revolving credit agreement and \$580 million of available borrowing capacity, net of \$65 million of outstanding letters of credit.

In August, 2007, we entered into a \$200 million accounts receivable securitization program ( *Securitization* ) with a group of conduit lenders and liquidity banks. The patient-related accounts receivable ( *Receivables* ) for substantially all of our acute care hospitals serve as collateral for the outstanding borrowings. The interest rate on the borrowings is based on the commercial paper rate plus a spread of .35%. The initial term of this *Securitization* was 364 days and the term can be extended for incremental 364 day periods upon mutual agreement of the parties. The facility was extended for a third 364-day term in August, 2009 and will mature in August, 2010. We have accounted for this *Securitization* as borrowings. We maintain effective control over the *Receivables* since, pursuant to the terms of the *Securitization*, the *Receivables* are sold from certain of our subsidiaries to special purpose entities that are wholly-owned by us. The wholly-owned special purpose entities use the *Receivables* to collateralize the loans obtained from the group of third-party conduit lenders and liquidity banks. The group of third-party conduit lenders and liquidity banks do not have recourse to us beyond the assets of the wholly-owned special purpose entities that securitize the loans. As of March 31, 2010, we had \$120 million of borrowings outstanding pursuant to this program and \$80 million of available borrowing capacity. The outstanding borrowings pursuant to the *Securitization* program are classified as long-term on our balance sheet since they can be refinanced through available borrowings under the terms of our Credit Agreement.

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

During 2001, we issued \$200 million of senior notes which have a 6.75% coupon rate and which mature on November 15, 2011. The interest on the senior notes is paid semiannually in arrears on May 15 and November 15 of each year. The senior notes can be redeemed in whole at any time and in part from time to time.

The carrying amount and fair value of our long-term debt was \$892 million and \$951 million at March 31, 2010, respectively. The fair value of our debt was computed based upon quotes received from financial institutions.

Our revolving credit agreement includes a material adverse change clause that must be represented at each draw. The facility also requires compliance with maximum debt to capitalization and minimum fixed charge coverage ratios. We are in compliance with all required covenants as of March 31, 2010. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

Our \$800 million Credit Agreement, under which we had \$155 million of outstanding borrowings at March 31, 2010, matures on July 28, 2011. We also have \$200 million of 6.75% senior notes which are scheduled to mature November 15, 2011. Our refinancing plans for these two debt facilities have not yet been determined. Under current economic conditions and based on our historical and projected financial performance, as well as our current investment grade ratings, we believe we will have sufficient access to the various capital markets to enable us to adequately replace the borrowing capacity scheduled to mature in 2011. It is likely that should current economic conditions remain the same at the time of such refinancing, the terms and costs of such financing will be less favorable than exist currently. There can be no assurance that we will be able to refinance these loans at the time we choose to access the markets or the terms upon which we will be able to do so.

We expect to finance all capital expenditures and acquisitions, pay dividends and potentially repurchase shares of our common stock utilizing internally generated and additional funds. Additional funds may be obtained through: (i) the issuance of equity; (ii) borrowings under our existing revolving credit facility or through refinancing the existing revolving credit agreement, and/or; (iii) the issuance of other long-term debt. There can be no assurance that such additional funds will be available in the preferred amounts or from the preferred sources.

## **Off-Balance Sheet Arrangements**

During the three months ended March 31, 2010, there have been no material changes in the off-balance sheet arrangements consisting of operating leases and standby letters of credit and surety bonds. Reference is made to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Contractual Obligations and Off-Balance Sheet Arrangements, in our Annual Report on Form 10-K for the year ended December 31, 2009.

We have various obligations under operating leases or master leases for real property and under operating leases for equipment. The real property master leases are leases for buildings on or near hospital property for which we guarantee a certain level of rental income. We sublease space in these buildings and any amounts received from these subleases are offset against the expense. In addition, we lease four hospital

facilities from the Trust with terms scheduled to expire in 2011 and 2014. These leases contain up to four, 5-year renewal options.

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As of March 31, 2010 we were party to certain off balance sheet arrangements consisting of standby letters of credit and surety bonds. Our outstanding letters of credit and surety bonds as of March 31, 2010 totaled \$81 million consisting of: (i) \$64 million related to our self-insurance programs; (ii) \$14 million related primarily to pending appeals of legal judgments (including judgments related to professional and generally liability claims), and; (iii) \$3 million of other debt guarantees related to public utilities and entities in which we own a minority interest.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no material changes in the quantitative and qualitative disclosures during the three months ended March 31, 2010. Reference is made to Item 7A. Quantitative and Qualitative Disclosures about Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Item 4. Controls and Procedures**

As of March 31, 2010, under the supervision and with the participation of our management, including our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), we performed an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the 1934 Act ). Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management on a timely basis in order to comply with our disclosure obligations under the 1934 Act and the SEC rules thereunder.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting or in other factors during the first quarter of 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

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

*Litigation and Administrative Appeal of CMS's Attempt to Terminate Medicare Participation of Two Rivers Psychiatric Hospital:*

Two Rivers Psychiatric Hospital ( Two Rivers ), a behavioral health facility operated by one of our subsidiaries, received a notice of termination of its Medicare/Medicaid Certification as a result of Two Rivers' alleged failure to correct certain deficiencies which make it ineligible for Medicare program participation. We attempted to resolve these issues amicably with the Centers for Medicare and Medicaid Services ( CMS ) in an effort to prevent the termination from going into effect. In the interim, Two Rivers filed an administrative appeal with the U.S. Department of Health and Human Services, Departmental Appeals Board, Civil Remedies Division, seeking review of that decision. In order to prevent CMS from terminating the facility from the program prior to a hearing in the administrative appeal, Two Rivers also filed a complaint in the U.S. District Court for the Western District of Missouri seeking a temporary restraining order and preliminary injunction against CMS' proceeding with the termination. By agreement, the court issued a temporary restraining order preventing CMS from terminating Two Rivers from the Medicare/Medicaid program until such time that a settlement could be reached with CMS or a preliminary injunction could be ruled upon by the court. On April 7, 2010, Two Rivers received a letter from CMS advising that, as a result of a resurvey conducted by CMS surveyors in March, the termination notice was being rescinded and the facility was found to be in compliance with all conditions of participation.

*False Claims Act Case Against Virginia Behavioral Health Facilities:*

In late 2007 and again on July 3, 2008 and January 27, 2009, the Office of Inspector General for the Department of Health and Human Services ( OIG ) issued subpoenas to two of our facilities, Marion Youth Center and Mountain Youth Academy, seeking documents related to the treatment of Medicaid beneficiaries at the facilities. It was our understanding at that time that the OIG was investigating whether claims for reimbursement submitted by those facilities to the Virginia Medicaid program were supported by adequate documentation of the services

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provided which could be considered to be a basis for a false claims act violation. On August 4, 2008, the Office of the Attorney General for the Commonwealth of Virginia issued a subpoena to Keystone Newport News, another of our facilities. It was our understanding at that time that the Office of Attorney General was investigating whether Keystone Newport News complied with various Virginia laws and regulations, including documentation requirements.

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In response to these subpoenas, we produced the requested documents on a rolling basis and we cooperated with the investigations in all respects. We also met with representatives of the OIG, the Virginia Attorney General, the United States Attorney for the Western District of Virginia, and the United States Department of Justice Civil Division on several occasions to discuss a possible resolution of this matter. However, the parties were not able to reach a resolution.

Consequently, on November 4, 2009, the United States Department of Justice and the Virginia Attorney General intervened in a qui tam case that had been filed under seal in 2007 against Universal Health Services, Inc. ( UHS ), and Keystone Marion, LLC and Keystone Education and Youth Center ( Keystone ). The Department of Justice and the Commonwealth of Virginia filed and served their complaint which, at present, relates solely to the Marion Youth Center. The complaint alleges causes of action pursuant to the federal and state false claims acts, Virginia fraud, and unjust enrichment. The former employees filed a separate amended complaint, alleging employment and retaliation claims as well as false claim act violations. On April 30, 2010, UHS and Keystone filed separate motions to dismiss the government s claims in their entirety. Keystone intends to file a separate motion to dismiss the relator s employment claims. We have established a reserve in connection with this matter which did not have a material impact on our financial statements. We will continue to defend ourselves vigorously against the government s and former employees allegations. There can be no assurance that we will prevail in the litigation or that the case will be limited to the Marion Youth Center.

*Ethridge v. Universal Health Services et. al:*

In June, 2008, we and one of our acute care facilities, Lancaster Community Hospital, were named as defendants in a wage and hour lawsuit in Los Angeles County Superior Court. This is a purported class action lawsuit alleging that the hospital failed to provide sufficient meal and break periods to certain employees. We have denied liability and are defending the case vigorously which has not yet been certified as a class action by the court. We are still uncertain as to the legal viability and extent of the claims, and, as such, are unable to determine the extent of potential financial exposure at this time.

***Other Matters***

The healthcare industry is subject to numerous laws and regulations which include, among other things, matters such as government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government action has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Providers that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We monitor all aspects of our business and have developed a comprehensive ethics and compliance program that is designed to meet or exceed applicable federal guidelines and industry standards. Because the law in this area is complex and constantly evolving, governmental investigation or litigation may result in interpretations that are inconsistent with industry practices, including ours. Although we believe our policies, procedures and practices comply with governmental regulations, there is no assurance that we will not be faced with sanctions, fines or penalties in connection with such inquiries or actions, including with respect to the investigations and other matters discussed herein. Even if we were to ultimately prevail, such inquiries and/or actions could have a material adverse effect on us.

***Southwest Healthcare System:***

During the third quarter of 2009, Southwest Healthcare System ( SWHCS ), which operates Rancho Springs Medical Center and Inland Valley Regional Medical Center in Riverside County, California, entered into an agreement with the Center for Medicare and Medicaid Services ( CMS ). The agreement required SWHCS to engage an independent quality monitor to assist SWHCS in meeting all CMS conditions of participation. Further, the agreement provided that, during the last 60 days of the agreement, CMS would conduct a full Medicare certification survey. That survey took place the week of January 11, 2010.

We ve received notification from CMS that it intends to effectuate the termination of SWHCS s Medicare provider agreement effective June 1, 2010, which, if it occurs, will likely also result in the termination of SWHCS s Medicaid provider agreement. SWHCS has commenced discussions with officials from CMS regarding an agreement that will potentially rescind the provider agreement termination action. Should we be unable to reach an agreement with CMS, we intend to file an administrative appeal with the Department of Health and Human Services and/or pursue other such remedies that may be available to us.

We ve also received notification from the California Department of Public Health ( CDPH ) indicating that they plan to initiate a process to revoke SWHCS s hospital license. We plan to appeal CDPH s action and SWHCS will remain operational pending the appeal. In that notice CDPH has indicated its willingness to rescind this revocation should SWHCS demonstrate its ability to meet all state licensing requirements.

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Rancho Springs Medical Center and Inland Valley Medical Center remain fully committed to providing high-quality healthcare to their patients and the communities they serve. We therefore intend to work expeditiously and collaboratively with both CMS and CDPH in an effort to resolve these matters although there can be no assurance we will be able to do so. Failure to resolve these matters could have a material adverse effect on us. For the year ended December 31, 2009, after deducting an allocation for corporate overhead expense, SWHCS generated approximately 4% of our income from operations after income attributable to non-controlling interest.

### ***General:***

Currently, and from time to time, some of our other facilities are subjected to inquiries and/or actions and receive notices of potential non-compliance of laws and regulations from various federal and state agencies. If one of our facilities is found to have violated these laws and regulations, the facility may be excluded from participating in government healthcare programs, subjected to potential licensure revocation, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. We do not believe that, other than as described above, any such existing action would materially affect our consolidated financial position or results of operations.

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

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### **Item 1A. Risk Factors**

Other than developments related to our Southwest Healthcare System, as disclosed in Note 5 to the Financial Statements included in Part 1 of this Report and incorporated herein by reference, and the healthcare reform legislation update as provided below, there have been no material changes in our risk factors from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2009.

#### ***We are subject to uncertainties regarding healthcare reform.***

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (the "PPACA"). The Health Care and Education Reconciliation Act of 2010 (the "Reconciliation Act"), which contains a number of amendments to the PPACA, was signed into law on March 30, 2010. The goal of the PPACA, combined with the Reconciliation Act (collectively referred to as the "Legislation"), is to provide for increased access to coverage for healthcare while reducing healthcare-related expenses.

Although it is expected that as a result of the Legislation there may be a reduction in uninsured patients, which should reduce our expense from uncollectible accounts receivable, the Legislation makes a number of other changes to Medicare and Medicaid which we believe may have an adverse impact on us. The Legislation revises reimbursement under the Medicare and Medicaid programs to emphasize the efficient delivery of high quality care, and contains a number of incentives and penalties under these programs to achieve these goals. The Legislation provides for decreases in the annual market basket update for federal fiscal years 2010 through 2019, a productivity offset to the market basket update beginning October 1, 2011 and a reduction to disproportionate share payments that could adversely impact the reimbursement received under these programs. The Legislation implements a value-based purchasing program, which will reward the delivery of efficient care. Conversely, certain facilities will receive reduced reimbursement for failing to meet quality parameters; such hospitals may include those with excessive readmission or hospital-acquired condition rates.

The various provisions in the Legislation that directly or indirectly affect reimbursement are scheduled to take effect over a number of years. Legislation provisions are likely to be affected by implementing regulations. Further Legislation provisions, such as those creating the Independent Payment Advisory Board, create certain flexibilities in how healthcare may be reimbursed by federal programs in the future. Thus, we cannot predict the impact of the Legislation on our future reimbursement at this time.

The Legislation also contains provisions aimed at reducing fraud and abuse in healthcare. The Legislation amends several existing laws, including the federal Anti-Kickback Statute and the False Claims Act, making it easier for government agencies and private plaintiffs to prevail in lawsuits brought against healthcare providers. These amendments also make it easier for severe fines and penalties to be imposed on healthcare providers that violate applicable laws and regulations.

We have partnered with local physicians in the ownership of certain of our facilities. These investments have been permitted under an exception to the physician self-referral law. The Legislation permits existing physician investments in a hospital to continue under a "grandfather" clause if the arrangement satisfies certain requirements and restrictions, but physicians are prohibited, effective immediately, from increasing the aggregate percentage of their ownership in the hospital. The Legislation also restricts the ability of existing physician-owned hospitals to expand the capacity of their facilities.

The impact of the Legislation on each of our hospitals may vary. Because Legislation provisions are effective at various times over the next several years, we anticipate that many of the provisions in the Legislation may be subject to further revision. We cannot predict the impact the Legislation may have on our business, results of operations, cash flow, capital resources and liquidity, or whether we will be able to successfully adapt to the changes required by the Legislation.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During 2007, our Board of Directors authorized us to repurchase additional shares on the open market under our stock repurchase programs. Pursuant to the terms of our program, we purchased 65,514 shares at an average price of \$32.92 per share or approximately \$2.2 million in the aggregate during the first quarter of 2010. As of March 31, 2010, the number of shares available for purchase was 2,086,825 shares. There is no expiration date for our stock repurchase program.

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2010 period	Total number of shares purchased	Average price paid per share for forfeited restricted shares	Total number of shares purchased as part of publicly announced programs	Average price paid per share for shares purchased as part of publicly announced program	Aggregate purchase price paid	Maximum number of shares that may yet be purchased under the program
January, 2010	5,905	N/A	5,905	\$ 32.15	\$ 189,833	2,146,434
February, 2010	18,418	N/A	18,418	31.79	585,453	2,128,016
March, 2010	48,191	\$ 0.01	41,191	33.54	1,381,550	2,086,825
Total January through March	72,514(a.)	\$ 0.01	65,514	\$ 32.92	\$ 2,156,836	2,086,825

(a) Includes 7,000 shares forfeited pursuant to the terms of the restricted stock purchase plan during the first quarter of 2010.

**Dividends**

During the quarter ended March 31, 2010, we declared and paid dividends of \$.05 per share.

**Item 6. Exhibits**

(a) Exhibits:

- 11. Statement re computation of per share earnings is set forth in Note 7 of the Notes to Condensed Consolidated Financial Statements.
- 31.1 Certification of the Company's Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
- 31.2 Certification of the Company's Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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**UNIVERSAL HEALTH SERVICES, INC. AND SUBSIDIARIES**

**Signatures**

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

Date: May 7, 2010

Universal Health Services, Inc.  
(Registrant)

/s/ Alan B. Miller  
Alan B. Miller, Chairman of the Board  
and Chief Executive Officer  
(Principal Executive Officer)

/s/ Steve Filton  
Steve Filton, Senior Vice President,  
Chief Financial Officer  
(Principal Financial Officer)

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**EXHIBIT INDEX**

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